"Cholamandalam Finance Q3 FY12 Earnings Conference Call"

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Moderator Ladies and gentlemen, good day and welcome to the Q3 FY12 Earnings Conference Call of Cholamandalam Finance hosted by UBS Securities India Private Limited. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Gautam Chhaochharia from UBS Securities India Private Limited. Thank you and over to you sir.

Gautam Chhaochharia Good afternoon everyone. We have the pleasure of hosting Cholamandalam third quarter results conference call. We have with us Mr. Vellayan, Managing Director, Mr. Kaushik Banerjee, President Asset Finance and Mr. Arul Selvan, CFO. I would like to hand over the call to the management to give opening remarks for the quarter number and then there will be Q&A.

Vellayan Subbiah Yeah thanks Gautam, thanks a lot. Welcome to the call. Overall we had a fairly good quarter. Disbursements and vehicle finance will continue to be strong for us and VF as you know 70% of our book. Vehicle finance grew 65% compared to the same period last year if we look quarter on quarter. Home equity loans grew by 17% and then in terms of other business we also launched the gold loan business.

We basically only launched three branches in the quarter. As of now we have opened up about 17 branches. It is a bit too early to talk about that business. The company disbursed 1915 crores, for the first time we crossed 700 crore disbursement by mark in vehicle finance in the month of December and that is compared to 1158 crores in Q3 of 2010-11. Home equity disbursed 368 crores versus 315 in the same comparable quarter last year. Overall basically the company did about 2283 crores for this quarter, which is a growth of 55% at the same comparable quarter last year. The portfolio performance continues to be quite good. Basically if we take our GNPA at 1.62% of total assets for Q3, net NPA for Q3 is 0.31% of total assets. I think that the industry overall has very low NPAs. That in combination with the efforts we put in continues to keep our numbers very low. I do not think that that is basically going to stay at these really low levels throughout the cycles. So we think may be slightly higher, we look across the entire cycle.

The growth income from operations basically was 457 crores compared to 281 for the same quarter last year. That is a growth of 62% and one more thing we did this quarter is we sold 700 crores of vehicle finance, priority sector assets to banks because we got fairly favorable rates from it. So from a securitization perspective, that's the first securitization transaction we have done this year. Also just to be clear in that, we would be recognizing gains over the tenure of the transaction as against recognizing profits upfront.

The PBT for a company is 68.6 crores as against last year which was 10, but last year was also an aberration of the downside because of the standard assets provisioning. So if you take a like to like comparison it is a 144% growth and if you take PAT for the company this quarter we have been at about. 41.1 crores is the PAT for the company this quarter. Also if you take the year to date numbers of PAT is 118 crores with obviously one more quarter to go for that.

So as the overall business continues to be fairly strong and I think what might be most useful, one more thing we want to talk about was raising of equity. We just have a preferential issue of equity shares and obviously it used to go through shareholder approval, but otherwise we are basically raising 212 crores at Rs. 160 per share from two private equity investors, Multiples and Creador**.** One final point I will end with is that ICRA has also upgraded with the long term credit rating for the company from AA- to AA / Stable. So let me stop with that and then we turn it over Gautam back to you or to -

Moderator Thank you. We will now begin the question and answer session. At this time if you would like to ask a question please press * then 1 on their touchtone phone. Participants are requested to use only handsets while asking a question. Participants who wish to ask a question may press * and 1 on their touchtone phone. The first question is from Kaitav Shah from Anand Rathi, please go ahead.

Kaitav Shah Good afternoon sir, congratulations on a good set of numbers. I wanted to understand on an absolute level what would be the gross NPA?

Vellayan Subbiah The GNPA numbers we have reported as well as part of the press release, 1.62%.

Kaitav Shah Sir, the absolute number?

Vellayan Subbiah We will calculate the number and we will give it to you.

Kaitav Shah And on a firm level basis what would be the margins you have reported for portfolio levels. On the entire book what would be the margin, the NIM?

Vellayan Subbiah On the total book it is 6.7% and absolute number for GNPA is 220 crores which includes personal loans of 130 crores which is been fully provided. So if you look at the non-personal loans it would be around 90 crores.

Kaitav Shah Okay. Sir just on the direction, I mean obviously in the numbers the growth has panned out on your CV book but incrementally do you see this as sustainable?

Vellayan Subbiah Yeah, this year we do see a sustainable for the next few quarters.

Kaitav Shah Whereas I see that the used CV share has gone up to 29% of your book. So we are doing increment, I mean we are focusing incrementally there, right?

Vellayan Subbiah Definitely, one of the things we did gather is that we got the business into vehicle finance broken down into three verticals now. One vertical is only focused on used so we are definitely doing used CV more.

Kaitav Shah Okay, so where do you see this over the next couple of years, the share of used CV?

Kaushik Banerjee There is a fundamental difference between new and used. One is that your ticket size in new in terms of value is significantly higher than your ticket size in terms ofused. In terms of unit growth the used will grow at a faster rate than the new because the ticket size in new is about 3.5 lakhs, the ticked size is used is about 4.5 to 5 lakhs. So what we have seen over the last one year is that the growth in units has been higher and this trend will continue. Moreover in terms of value, on disbursement the contribution in terms of growth used to be slightly lower than the unit growth. Does that answer your question?

Kaitav Shah Yeah, yeah fine. One final question from my end is on the capital adequacy, we are at roughly around 10% at the end of this quarter and with the capital infusion we might be somewhere around 11.5%.

Vellayan Subbiah You are talking Tier-1.

Kaitav Shah Yes sir, Tier-1. So I mean over a period of one year would be still be below that 12% mark, I mean how comfortable, where would be our comfortableness in terms of the Tier-1, at what levels?

Vellayan Subbiah Tier-1 basically, obviously we have to wait for the Usha Thorat's reports to come out. If Usha Thorat gives guidance then we will have to basically fall in line with that. But even they say that even if that comes out it will give us three years in a move to that structure. So the requirement is only 7.5%, so we feel comfortable with where we are at.

Kaitav Shah Okay fine, thanks a lot sir.

Moderator Thank you. The next question is from Aditya Singhania from Enam Holdings, please go ahead.

Aditya Singhania Thank you. Just wanted to follow up on your comment on quality. We have heard similar comments from other players in the industry saying that current NPL trends are probably not sustainable although they are very-very good. So one, are you seeing any signs of that changing especially in the vehicle finance business and what should we watch out for to predict any change that might happen?

Vellayan Subbiah Aditya it is a good question. And there are no signs of it changing yet. It is not driven by data, that comment is not driven by data. It is driven by kind of instate that generally the industry I mean kind of has never kind of performed so well over the sustained period of time. What kinds of early warning indicators can we look at? We always look at our whole set of things in terms of you know if this kind of plays any over supply utilizations,. Now we look at kind of macro indicators like that, and those are still these early warning indicators to look at for the business but right now there is not any alarm in any of the early warning indicators either, so the only question if the supplies kind of suddenly increases too much then it can start giving utilization problems. We haven't seen it yet.

Aditya Singhania So if I may sort of flip that around despite such a sort of apparently weak economy, why have we not in this cycle seen a weakness in the CV side which has been the normal case in this?

Vellayan Subbiah It is a good question. Basically it is saying kind of why hasn't gone bad, right. So I think it is interesting because it is probably driven, if we take sectoral exposures, perhaps a couple of areas, I mean the ones that we see as most hit up basically mining, big infra power, right. Mining, luckily for us we did not have that much exposure too. Now big infra and power basically do not consume CVs as much. So for example if there was a risk slowdown in consumption, if there is a drop in consumption for example, straight away that tends to reflect because a lot of the mini-LCVs are kind of last mile consumption kind of driven by nature. So it is basically I think kind of what is causing the overall kind of slowdown is very sector specific and those do not seem to be sectors that are consuming commercial vehicles in terms of from a demand side. So that is why we do not think it is being affected by that.

Aditya Singhania Thanks and just if I may ask you know the gross NPL that you report currently are on 180 days so assuming that the Usha Thorat recommendation go through again, on 90 days how would your sort of NPLs look and would that trigger any change in your provisioning policies or are you sort of comfortable the way you are right now?

Arul Selvan 70% of our portfolio is VF book, 180 days levels is at about 0.41%, which is a 35 crore of the exposure, it is gross NPA 180 days.

Aditya Singhania This is just for CVs?

Arul Selvan This is for the vehicle finance. On a same portfolio on 90 day is at around 61 crores, which is 0.7% on a gross NPA percentage. So if you look at it, it is like 25 crores would be additional NPA that will get accrued if we have to go for a 90 DPD sort of evaluation of gross NPA that is Usha Thorat's committee recommendation. On 25 crores if you take a 15% provisioning it is what is the requirement that is hardly enough – this will be our impact.

Aditya Singhania And sir if I may just ask you know sort of previous cycles what have you seen CV delinquencies at the same 180 or 90 day levels that you mentioned?

Vellayan Subbiah I can tell you March we had almost similar levels. 180 days was around 50 bps and 90 days was around 70 bps.

Kaushik Banerjee Now were in inflated cycle is a question as one is as higher – 1.2% for 180 days.

Aditya Singhania Okay thank you.

Moderator Thank you. The next question is from Sanjay Shah from KSA Shares & Securities, please go ahead.

Sanjay Shah Good evening sir. First I take this opportunity to congratulate for fantastic investor presentation as always, which are self explanatory and replies majority of our questions. My question is regarding I would like to know your vision regarding the future, especially next year how do you see your verticals growing? And which verticals do you see most challenging for your company?

Vellayan Subbiah Thanks for the question and we are always glad that our presentation is kind of good, it answers a lot of question. If we take the overall business that I mean obviously, if we take the next year goal will be basically to see the growth it will take percentage wise, because we will be expanding that business from virtually zero. So I think from a challenge perspective also then that is a vertical to kind of stay most focused on as it grows. It is a different thing once vehicle finance for example is stable that has been established over time and so it is much more kind of how we scale out on an existing model versus goal which is defining the model for ourselves. So off the three I would definitely see gold therefore being the vertical that kind of would take the most time and be the most challenging to build out. Now given that obviously growth wise we will see the most disbursement growth coming from the vehicle financial vertical. We will continue to be very strong and there we have always consciously expand market share over time and so that is a conscious effort to increase market share both through increased reach will continue to add more branches there and as a matter of fact I think will add about 115 branches over the next 4 to 5 months. And then we will be also very focused in basically optimizing our product mix over there, because that kind of defined with the overall margins in the business. I mean there was an earlier question of course more of a shift we used, that shift will also continue to happen over time.

Sanjay Shah Right sir, thank you very much.

Moderator Thank you.

Gautam Chhaochharia Couple of questions from me. One is that in terms of cost to income ratio that has gone up in the third quarter, how do you use that trend depending on the future?

Vellayan Subbiah It has gone up from 30.5 to 31.8 is what you are referring, right.

Gautam Chhaochharia Yeah.

Vellayan Subbiah See one is we have a brought in some technical teams to increase the productivity levels there is some cost increase on account of that. There is like more like a one-time cost. So this has added some amount of cost to the current quarter and also the origination cost during this period has been high because we have done high the disbursement, I mean it has been a considerable scale up in the disbursement during this quarter and as you know that the absorbed the entire disbursement cost upfront**Gautam Chhaochharia** Where do you see this stabilizing once we see a ramp up of the branch network and

Vellayan Subbiah It is not necessarily due to branch network. It is more to do the origination cost being absorbed on incurrence without having the benefit of the book yielding, increased book yielding towards that.

Gautam Chhaochharia But would not the fee income capture that, cover up for the -

Vellayan Subbiah Not fully, that will be some amount of gap will be hinted to the extent of around 0.2% to 0.3% gap.

Gautam Chhaochharia Currently what is the marginal cost of borrowing and the current yields on the different books?

Arul Selvan See the marginal borrowing this quarter this has been high for two reasons. It had the full impact for the full quarter coming under after the base rate increased in the two quarters. Also we did around 250 crores of Tier-2, which has come at a considerably higher cost both considering it is at around 10.88% during this quarter.

Gautam Chhaochharia And the yields on the different books right now, the marginal yield?

Vellayan Subbiah It is around 15.74% for the vehicle finance and home equity would be at around 14%.

Gautam Chhaochharia Okay, thank you.

Moderator Thank you. The next question is from Kanchan Diwan from UBS, please go ahead.

Kanchan Diwan Congrats on good set of results. I had two questions, firstly if you could give us some update on a tractor financing business and secondly in terms of the outlook for the remaining year.

Kaushik Banerjee We started the tractor business in June 2011 and as of end December we have done about approximately 1% market share Even though we have 345 branches PAN India for the vehicle finance business and the tractor business is co-located with the VF business so that is the operation of about 345 branches. I think in the earlier discussion we indicated that we would not be ramping up this business aggressively till we have the first couple of cycles of payment. So the book at it stands today is behaving at acceptable levels and we have now touched about 38 crores of business in a month. Plans going forward are we would probably grow to about 50 crores of the disbursement by April 2012 and then as Mr. Vellayan also said that we would be adding another 150 branch, vehicle finance network and we will have more 460 branches by April-May. The opportunity to leverage the branch network to generate business appears to be quite high. So we feel that the opportunity to actually ramp up the volumes and tractors over the current year is very strong.

Kanchan Diwan Sir would you still go ahead with your initial estimate of 3 billion book size for tractor financing for this year?

Kaushik Banerjee Yeah, normally we thought we would be slightly short of that in the current year which is something okay. We will probably be closing to about 270 crores mark into 300 crores mark. And we actually disbursed 107 crores in Q3. So we will probably be lower by about 20-25 crores of the 300 crore plan that we actually planned into the next financial year.

Kanchan Diwan And sir how is the gold financing business plans for the remaining quarter of this year because we are initially given an estimate of around 2 billion book size for this year, so how is that coming up?

Vellayan Subbiah We would be doing anywhere around 50 crores we might maximum this year.

Vellayan Subbiah We are slightly delayed in our plans so we are going to end with the smaller numbers than we had planned.

Kanchan Diwan Okay, thanks.

Moderator Thank you. The next question is from Vinit S from DSP Blackrock, please go ahead.

Vinit S I just wanted to understand the outlook in NIMs going forward. I think for this quarter you mentioned it is 6.5% if I got it right but what is the outlook going at this quarter and even next year?

Vellayan Subbiah Yeah, I think it is going to depend a lot on cost of funds next year but the cost of funds stay at a current level they are. We just expect NIMs to stay in line. We go into a down cycle we can some NIM expansion.

Arul Selvan The CRR cut for RBI is yet to translate as any rate reduction or even the market papers are coming with the prices are not significantly changed. We are waiting for that to happen to commit anything on that.

Arul Selvan And as a matter of fact in May if the banks do not transmit as effectively even the rate go downward.

Vinit S And secondly I have actually not gone through the presentation but if you can help me with the ROEs or ROA which you might have reported for the quarter and what is the outlook for FY12 and FY13?

Vellayan Subbiah As per the ROA, the post tax ROA is 1.47% for the quarter. And ROE is 14.04%. Just the kind of the intent is to push those two numbers up over time. It is our annualized number.. I think basically as we look at we will try and push it by about 0.4% up year by year, that is a little general kind of number for ROA.

Vinit S And on the earlier question you mentioned about your strategy of gaining market share and that is the way to grow going forward. If you can help us also understand what probably, what will be your market share today and what is it that you may be looking at one or two years down the line?

Kaushik Banerjee In the CV segment there are three categories, one is heavy commercial vehicles and you have light commercial vehicles, and you have small commercial vehicles. Within this our market share in heavy commercial vehicles is 3%. Market share in light commercial vehicles is 14%

and the market share in small commercial vehicles is 11% so the overall market share that we enjoy is 9%, which is up 1% over last year. So that is how the market share has moved. I am talking about as of December.

Vinit S And your strategy is there some kind of a target in mind as to you know

Kaushik Banerjee We will be making every attempt to retake and increase the market share as time goes by, the industry too has become fairly competitive. So as long as you know we do not have to kind of without our effort would to kind of increase our market share without compromising on NIM or on the portfolio quality, so is it increased market share by about a percentage point and this category, I mean we would be equally satisfied with that particular effort. As I said subject to NIM and portfolio quality being maintained and protected. So another way we are going to do this is by enhancing our branch network.

Vinit S Okay, that is it from side. Thank you.

Moderator Thank you. The next question is from Abhinav Yadav from CRISIL, please go ahead.

Abhinav Yadav Yeah congratulations sir on the good set of numbers. Now we have seen a good growth in the LCV segment for the past 4-5 quarters, and my question is how sustainable do you think this growth is going to be and does it really mean that we will have to pull up our socks in the HCV segment which we have been a bit reluctant to go full HCV segment.

Kaushik Banerjee Let me just take this question in two parts, one is the LCV and one is the non-commercial vehicles. We have to acknowledge the fact that the industry itself has grown quite robustly in the LCV segment. The good news is that Cholamandalam has grown at faster than the market rate. So that is something we have all being doing over the last several years and something try and ensure that we continue to do**.** And as I said that if we can ensure that we continue to expand our branch network to address markets which are peripheral markets are not addressed today, that will support our growth in terms of LCVs and also if we keep trying for deeper penetration in the existing markets through the basically with the manufactures and dealers and the core strength of the team itself. We are fairly confident that we should be able to retain the market share that we have in LCV. Incidentally, as of December starting, 16% is in light commercial vehicle, 10% in small commercial vehicles, and 3% in heavy. Now in heavy commercial vehicles the reason that we have a 3% market share is an internal decision. It is not related to the market. There are two reasons for that. One is that the lowest yields at product in the commercial segments actually generates in the heavy commercial vehicle segment. So from deploy the funds your LCV and your small commercial vehicles are on higher yields than heavy commercial vehicles, that is one. Two is that, this is a pretty large segment with heavy commercial vehicles to a strategic borrowers and that is typically a segment that we did not kind of aggressively chased as a market class. We have focused on the retail segment of heavy. Finally to answer your question, to kind reinforce the comment which Mr. Vellayan made small commercial vehicles and your light commercial vehicles are consumption driven products, whereas your heavy is a production driven product. So in terms of vulnerability to macro other changes the heavy commercial vehicles are more vulnerable. So these are the two reasons why we prefer to maintain a more profile in heavy even though we have actually grown quite aggressively in their products where market share has gone up 2 to 3%. In unit terms it has gone up by about 60% over last year. So spreads is allowing, we would be positioned to increase our volumes in heavy. So it is more of a financial decision in terms of the participation in the heavy commercial vehicle segment other than the ability and the opportunity to participate in that segment. We can easily increase volume of the segment, but we chose not to.

Abhinav Yadav Okay, I got it thanks a lot.

Moderator Thank you. The next question is from Kaitav Shah from Anand Rathi, please go ahead.

Kaitav Shah I just wanted to know sir basically in light of the increased competition as you yourself stated that competition has increased. One, how do we calculate if you can divulge that and two, the areas that we are growing in, basically those areas have no competition, low competition, how is it that we source our new branching?

Kaushik Banerjee There is no simple answer to that particular question. If there was a formula to handling competition, it adds to a lot of **effort and monty** to catch that particular formula but unfortunately there is not. So I think the ability to kind of grow and build a retail market share is a combination of several factors. It is a function of how long has the company been in the industry. What is the comfort level that the manufacturers or the channels have with that particular company? What are the credibility of that company has built up over time in specific segments, like you know we have a fairly strong position at the bottom of the pyramid in terms of the first time borrowers and in terms of agri borrowers, etc., asset borrowers. So obviously one way to sustain growth and manage competition is to keep enhancing reach. The second is to ensure that our ability to turn around a case quickly remains superior to those of competitors. And I think the good news is that today Cholamandalam has a base of about 275000 live customers in VF. We also have a dormant based people who gave the Cholamandalam at a given point of time more 500,000 odd customers. So competitors who enter the industry today would not have the advantage of having so many customers who are a part of Cholamandalam, who have been a part of Cholamandalam. So referral business actually plays a very significant role in our ability to actually sustained growth. Today, about 25% of the disbursals that we do come from existing customers that is one leverage that we definitely have. The second is because we built a very large base of customers with certain segments, typically you know our name comes up as a potential vendor. And the second thing is that we have been kind of building our branch network steadily. So we would add around 124 branches and we grew to 345 branches and by the end of June it will be at about 406 branches. Though there are several markets today that are virtually untapped by Cholamandalam, so penetration into those markets also allows us to grow our volumes on the total addressable market. Finally as Mr. Vellayan said earlier, we have three verticals here, retail vertical, we have a direct vertical. These are created specially with the purpose of ensuring that there is a focused effort on each product segments that we address. We have the vertical focus in the new commercial vehicle segment. And we have a dedicated team who addresses that segment. We are also parallely using and we are developing and including a lot of technology initiatives, which should result in better customer delight as well as different operations. So as Vellayan Sir said earlier we are also engaging with the consultants in terms of enhancement of productivity….. It will serve in bringing down the actual sourcing cost. So, the combination of all these factors we will allow us to retain and grow market share while also improving our efficiency parameters. And tractors will also give us a picker in terms of incremental business at fairly attractive yields.

Kaitav Shah Okay. Thanks a lot sir.

Moderator Thank you. The next question is from Aditya Singhania from Enam Holdings, please go ahead.

Aditya Singhania Just had a question on this business finance segment, I am just comparing the first half and the 9-month slide that you gave in your presentation. Just wanted to understand what is this 10 crores provision towards standard assets that you have made this quarter in sense is for regulatory reasons or something else? And there seems to be a loss on this segment, is this purely driven by in this segment in this quarter. So is this purely driven by this provision or is there something else to it?

Vellayan Subbiah The loss is driven by the provision and surely because of that, what we did is basically it is a third quarter, right in terms of the stock market. It has basically kind of a judgment call and how we decided to provisioning kind of **precausionary measure while** I think the norms are clear. Basically what this includes is that we made a 10 crore kind of provisioning towards standard assets

Arul Selvan See frankly what we expect is because of the high volatility some of the shares are in lowest brackets, so though the asset cover is there we are just not being conservative in order to ensure that the losses that could creep in due to this sales. They are no major fallen due nor there has been any default and asset cover available. We have taken the provisioning as standard as standard asset provisioning.

Aditya Singhania And is the expense ratio that you report inclusive of this provision? Why has that gone up?

Vellayan Subbiah Particularly, what is happening is they were growing in that book anymore. So the way we are looking at it is that we will shrink that business down overtime and like RBI is not in favor of that business. Again Usha Thorat's report is going to bea concern is if we have a big book there and then basically get hit through the 150% risk weightage. So we are actually working that business down in terms of the book size and therefore the expenses ratio is going a bit up.

Aditya Singhania So just to confirm, your voice actually broke up in the middle, the 10 crore provision is purely sort of as a precautionary measure. There is no NPL or expected loss there.

Vellayan Subbiah No, we did not have any crystallized losses or anything like that but basically there is asset cover and the stocks that we had a security hit lowest circuit in trading. So we wanted to take a more cautious kind of view given that that happened.

Aditya Singhania But you still have to cover and I am presuming you will ask for more cover and manage the risk.

Vellayan Subbiah In one situation we are in negotiation with the guys for additional cover.

Aditya Singhania Okay thanks a lot.

Moderator Thank you. There are no further questions at this time.

Gautam Chhaochharia I think we can close the call here. Thanks very much. Congratulations again and look forward to fourth quarter now.

Vellayan Subbiah Okay thanks Gautam, thanks a lot.

Moderator Thank you on behalf of UBS Securities India Private Limited. That concludes this conference. Thank you for joining us and you may now disconnect your line.