"Cholamandalam Investment and Finance Company Limited

Q2 FY '25 Earnings Conference Call"

October 28, 2024

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MODERATOR: **MR. NISCHINT – KOTAK SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day, and welcome to the Cholamandalam Investment and Finance Company Limited Q2 FY '25 Earnings Conference Call hosted by Kotak Securities 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 after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Nischint from Kotak Securities. Thank you, and over to you, sir.

Nischint Chawathe: Thank you. Good morning, everyone. Welcome to the earnings conference call of Cholamandalam Investment and Finance Company Limited to discuss the 2Q FY '25 performance of Chola and share industry and business updates. We have with us the management of the company represented by Mr. Vellayan Subbiah, Chairman and Non-Executive Director; Mr. Ravindra Kundu, Managing Director; and Mr. Arul Selvan, President and Chief Financial Officer.

I would now like to hand over the call to Vellayan for his opening comments, after which, we'll take the Q&A.

Vellayan Subbiah: Thank you, Nischint, and good morning, everybody. We'll go through our financial results and performance for the quarter and the first half of the year. Our disbursements were at INR24,314 crores per quarter, which is up by 13% and INR48,646 crores for the half, that's up by 17%. The total AUM stands at 1,77,426 crores, which is up by 33% year-on-year.

The net income for the quarter is at INR3,238 crores, which is up 37% year-on-year and INR6,271 crores for the half year, which is up by 40% year-on-year. PAT is at INR963 crores for the quarter, which is up 26% year-on-year and INR1,905 crores for the half, which is up 28% year-on-year.

The Board met and approved the unaudited results for the quarter, half-year ended 30th September 2024. Vehicle finance disbursements were at INR12,336 crores in the quarter as against INR11,731 crores, which is a growth of 5%. And disbursements in H1 FY '25 were at INR25,102 crores as against INR23,032 crores, which is a growth of 9%.

LAP. the loan against property business disbursed INR4,295 crores in Q2 as against INR3,192 crores, which is a growth of 35%. And for the half, they were at INR8,170 crores as against INR5,872, which is a growth of 39%.

Home loans disbursed INR1,823 crores in the quarter as against INR1,575 crores, which is growth of 16% and for the half, disbursements were INR3,601 crores as against INR3,029 crores in the previous year, which is a growth of 19% year-on-year.

The SME business disbursed INR1,959 crores in the quarter as against INR1,945 crores, which is a growth of 1% and disbursement for the half were at INR4,119 crores which is a growth of 3%.

The CSEL, Consumer and Small Enterprise Loans, disbursed INR3,588 crores for the quarter as against INR2,853 crores, which is a growth of 26%. And for the half, they were at INR7,075 crores, which is a growth of 36%.

Secured business and personal loans disbursed INR312 crores in the quarter as against INR246 crores in the same quarter last year, which is a growth of 27% and the disbursements for the half were at INR580 crores, which is a growth of 36% over the first half last year.

AUM stood at INR1,77,426 crores as compared to INR1,33,775 crores, which is a growth of 33%. PBT growth in Q2 was at 27% and for the half, it was at 29% and PBT ROA for Q2 was at 3%, and for the half year, it was 3.1%. ROE for the quarter was at 18.24% and for the half was 18.55%.

The company continues to hold a strong liquidity position with INR13,864 crores as the cash balance at the end of September, including INR2,563 crores embedded in G-secs and INR2,106 crores invested in T-bills and INR624 crores invested in Strips shown under investments, with a total liquidity position of INR14,404 crores, including undrawn sanctioned lines. The ALM is comfortable with no negative cumulative mismatches across all-time buckets as per regulatory norms.

Consolidated PBT for the quarter was at INR1,304 crores as against INR1,065 crores in Q2 FY '24, which is a growth of 22%. And for the half, it was at INR2,579 crores as against INR2021 crores, which is a growth of 28%.

In terms of asset qualities, Stage 3 levels increased to 2.83% as of September '24 from 2.62% as of the end of June '24. GNPA as per RBI norms increased to 3.78% as of September '24 as against 3.62% as of June '24. NNPA, as per RBI norms, also increased to 2.48% as of September '24, as against, 2.37% on June '24. NNPA is below the threshold of 6% prescribed by RBI as a threshold for PCA.

The capital adequacy of the company as of September 30, 2024, was at 19.5% as against the regulatory requirement of 15%. Tier 1 capital was at 15.04%. Common equity at Tier 1 at 14.20% as against the regulatory minimum of 9% and Tier 2 was at 4.46%.

So with that, I'll stop with the commentary, and we'll be happy to turn it over to you for the Q&A.

Moderator: The first question is from the line of Dhaval from DSP. Please go ahead.

Dhaval: Thanks for the opportunity. Just a couple of questions. First is on the asset quality for VF and CSEL. Could you talk a little bit around both these segments, where the Stage 3 in CSEL is, especially the NCL is also relatively higher in the first half compared to last year. Just how things are progressing, in line or better than what you think?

The second question relates to the growth. Just with the RBI sort of cautioning companies on growth? How is the company looking at, just where we are and our growth trajectory? And if you could give some perspective around regulatory interactions around this aspect, that would be useful.

Vellayan Subbiah: Yes. Dhaval, so I'll answer the growth bit and then kind of Ravi will talk a bit about asset quality. As you can see, we've moderated disbursements a fair bit. The disbursement growth is upside only by 13% for the quarter. And so you can see that growth moderation that basically we will be talking.

We obviously kind of, this is a matter that we discussed at the Board as well. And so you can basically see that disbursement growth is moderated to 13%. Why you see a slightly higher number for AUM is because oof base, from last year. But that will moderate kind of as we go into the rest of the year as well

Dhaval: So Vellayan, you were just highlighting that you had discussed at the Board and the disbursement growth is around 13%, and that's when we lost, yes.

Vellayan Subbiah: Yes. So basically, that was just to give you an indication that we have moderated.. And as kind of some of the base effect wears off, I think, we'll kind of drop to numbers that are slightly lower than the numbers that you are seeing in terms of AUM growth. Ravi, if you want to add? Asset quality.

Ravindra Kundu: So Dhaval, asset quality in vehicle finance, we've seen that due to the heatwave in the first quarter, the second quarter was actually the extended rains and all, slightly it has gone up by 30 basis points in Stage 2 and then 30 basis points in Stage 3. I think, this quarter, it will be at the same level and then next quarter, it will come down. As usual, the fourth quarter is always better for the vehicle finance as well as the company.

As far as the CSEL is concerned, they are also in the range-bound hovering between 4.25% to 5%. And we have also started Samsung partnership mobile funding. So there are 3 businesses: One is traditional; second is the partnership for the digital lending and digital lending in-house; and then, the Samsung. So CSEL is continuously expanding their product line, so you will see that this will be hovering between 4.25% to 5.5%.

Dhaval: Got it. And just -one follow-up on the growth bit. So the book is sort of shifting towards longer duration product, so which is why there is a gap between AUM and disbursement. So what we should monitor is disbursement growth? Or at the Board level, the focus is on disbursement growth or AUM growth? Because just trying to link the medium-term guidance of 25% plus AUM growth, that's the reason I'm asking.

Vellayan Subbiah: Yes, so our sense is that what you saw was a 33% number. That number will come a bit off. So that's why I'm saying that the guidance of 25% is kind of a useful guidance to use on the AUM side.

Moderator: The next question is from the line of Raghav Garg from Ambit Capital.

Raghav Garg: My first question is on the asset quality again. Your slippages this quarter were around INR930 crores. How much of this would have come from the vehicle finance and the CSEL product specifically? If you can give these 2 numbers separately. And how much would these numbers be up on a Y-o-Y basis?

Arul Selvan: It's given in Page 29 of the investor presentation, even individual product-wise details have given on the Stage 3 numbers. So there's a slippage of around INR600 crores -- less than INR600 crores, of which around INR300-odd crores has come from vehicle finance and the rest has marginally increased.

Raghav Garg: Sir, I think your write-offs have also been elevated, right? So I am assuming here that some of the flows that you would have seen in either last quarter or even in this quarter would have been written off. In that backdrop, the absolute amount on gross slippages, which seems to be about INR900 crores would -- a breakup of that would be useful.

Arul Selvan: So it is at the same level as last quarter.

Vellayan Subbiah: Write-offs are the same level. Write-off, there's no difference in the comparable quarter.

Raghav Garg: Understood. Fair enough. The second thing is that in the last call, you had mentioned about 1.2%, 1.3% credit cost for vehicle finance this year, right? We're already averaging about 1.8%, 1.9% in the first half. I think that in the first quarter call, you had mentioned it would come down. Just wanted to understand what has changed between then and now that the credit cost has not come down, still elevated? And what gives you the confidence that it will come down in the second half?

Ravindra Kundu: For company level, we said that 1.2% to 1.3%. So 1.2% to 1.3%a and if you take a little conservative approach, it will be at 1.4% at our company level. Vehicle finance is actually at 1.8% for Q2FY25.

Arul Selvan: Both at the company level and even at vehicle finance level, if you see, compared to Q1 it is coming down, and this is the same similar trend you saw in the last year, that what used to be like a larger number, ends in the year with a smaller number because second half will always be better, especially more so in vehicle finance because they are more skewed towards collection during the festival period and post-harvest.

Raghav Garg: No, sir, I completely understand. Q4 is generally very good in terms of recoveries and collections, but it's just that whatever guidance you had, the ask on second half just goes way too high. So I wanted to get some confidence on that. But yes, you partly...

Arul Selvan: It will be at 1.3% NCL is what we are seeing now.

Raghav Garg: Understood. And sir, in vehicle finance, can you, apart from the numbers that are already there in the presentation, whatever is there in the quarterly numbers, what is actually happening on the ground in vehicle finance in terms of truck utilization, in terms of the freight rates, or if you give some granular sense? Are operators getting enough load to carry, all that sort of stuff, just to help us gauge how the trends could be going forward?

Ravindra Kundu: Yes. So Ravi here. Trucks, we are actually having a lower mix in terms of our commercial vehicle business. But small commercial vehicle business, we do more. So we saw that the rural economy is slightly not being that better. And demand side also, we have seen that small commercial vehicle has come down. So delinquency related to the last mile transportation is there.

So among all products within vehicle finance, if you segregate CV and passenger vehicle, tractor, 2-wheeler, 3-wheeler, I see that small commercial vehicles especially sub-1 ton last mile transportation got impacted, both from the demand side as well as the delinquency side. And therefore, the overall delinquency is at a higher side, but it is also related to seasonality.

Quarter 1 and quarter 2 have been always higher. And this time, it was election in the first quarter and then heat wave. Second quarter, we have extended rain as well as the post-election transition also not completed fully on ground. And therefore, there is some utilization-related problem. Then the festival also moved to October, both the festivals. So pre-festival activity also has not been good in the quarter 2.

So all put together, last mile transportation, capacity utilization during the quarter 2 for the commercial vehicle has been down. So among all products, we have seen that CV delinquency were higher. It is likely to go down in the quarter 3; and then quarter 4, it will improve further.

Raghav Garg: Do I have room for another question?

Ravindra Kundu: Go ahead.

Raghav Garg: Sure. Okay. Sir, just on the employee side, right, there has been a substantial jump quarter-on-quarter. We've almost added about 7,000 employees this time, which all products have we added? And in which functions have we added these employees? That's my last question.

Ravindra Kundu: So all the divisions is actually, if you see that the LAP is working on micro LAP. SME business is working on equipment finance, medical equipment finance, industrial equipment finance and micro term loan. HL is expanding into non-South market. Vehicle finance is also adding small branches as well as manpower for collection. CSEL is also expanding, so manpower increase is there across the businesses.

Moderator: Mr. Garg, does that answer your question?

Raghav Garg: Yes, yes. I am good. My questions have been answered.

Moderator: The next question is from the line of Avinash Singh from Emkay Global.

Avinash Singh: So questions, I mean, related to this employee addition. I mean, that has also led to sort of the expansion in the opex ratios. Now if you can help, I mean, that how has been this breakup of employee addition towards the sales and collections? And also if, I mean, this is what sort of led to kind of jump in opex?

Now how do you see the ROE trajectory improving? Because I mean in terms of credit cost, yes, I mean, we are expecting some bit of improvement in the second half, but I mean for the full year, it is somewhere toward the upper end of guidance. Now OpEx going towards slightly higher end. And also, I mean, you're borrowing just because of function of your growth will be higher, so how do you see that ROE playing out?

Ravindra Kundu: So the operating expenses are actually flat if you see the quarter 1 and quarter 2, it is at 3% level. And it is going to be in that same level for this financial year because we are adding manpower for expansion of the product line as well as the geography. The productivity is down because the market was down.

So quarter 3 onwards, the individual productivity by sales executive doing more number of loans will go up from October month. We have seen that in this month the disbursements are higher than last month. So the productivity increase is going to be seen, but the opex will remain as it is.

Avinash Singh: Yes. And if you can just help that, okay, how much of this kind of 7,000 employee addition you have done towards collection side?

Ravindra Kundu: More or less, balanced actually. We're adding manpower equally in sales and collection, not only sales and collection, we are also adding for supporting businesses.

Arul Selvan: Yes, it is, in vehicle finance, it's a little bit more in collection, but LAP and the other businesses, it is more on the sales. So I think the breakups will be more getting into more data, which is not available in public domain, so just leave it at a very broad level, but this is the broader range.

Vellayan Subbiah: General bias is that, like Arul said.

Moderator: The next question is from the line of Abhijit Tibrewal from Motilal Oswal.

Abhijit Tibrewal: I had 2 questions. First thing, please, I mean, if you could comment a little bit on our view on the auto cycle. Sir, if you look at the last 4 quarters, vehicle finance disbursements have been in a tight range to INR12,500 crores to INR13,000 crores. And given that we are already talking about some slowdown that is being seen in PVs. How should we look at the auto cycle going ahead? This is something I want that Ravi sir to comment on.

And the other thing is, maybe a related question here is, I mean, while you said October disbursements are looking better than September. If you could also comment a little bit on the festive season demand because from what we are able to gather, I mean, festive season is not very good this time around. And sir, the second question that I had is Ravi sir, said, that in the month -- in the last quarter, we saw that CV delinquencies were higher, small CVs last month transportation has got impacted, both on the demand side as well as the delinquency side. So just wanted to understand, I mean, if you can throw some nuance around new and used CVs. Is there a significant difference in behavior that you are seeing between new and used CVs. Those are the 2 questions I have.

Ravindra Kundu: Yes. So maybe the demand is determined by the wholesale number of the manufacturers. I'm not sure how much wholesale number will come in the quarter 3. As of now, in the quarter 2, CV numbers are down by 11% and PV is down by 2%. But retail is going to go up because whatever supply they have made it to the dealership, dealership is going to sell and to the extent that the disbursement will go up.

As you mentioned that we have been doing INR12,000 crores of disbursement in a quarter. So obviously, from there, from Q3 onwards, it will go up. And that's how we have also budgeted internally.

What Mr. Vellayan was talking about that even after doing the disbursements, say, 10% to 12% or 14% is in the vehicle finance, the asset growth, which is at, say, 22% will come down to 18% to 20%. And at the overall level, it's a similar story, we are at 17% growth in terms of H1 and if little bit disbursement goes up also, the asset growth will come down to 25% to 28%. Now coming to delinquency, which you want segregation between used and new we don't do small commercial vehicle used. We do light and heavy. So as far as the small commercial vehicle, which is related to last mile transportation, it is pertaining to new small commercial vehicles, especially sub 1-ton. But if you club all CV new versus all CV used, the delinquency levels are in the same level. So increase in the delinquency are the same irrespective of new and used.

Abhijit Tibrewal: Got it, sir. And sir, just one more question that I wanted to squeeze in here. In addition to, I mean, this festive season demand, how is the festive period panning out? Sir, I think, I mean, somewhere you said that manpower increase is there across businesses and will continue in the foreseeable future. I just wanted to understand for how long do you expect this to continue? And at what point we will start focusing on improvements in productivity?

Ravindra Kundu: Yes. So CV has not picked up in this festival. For the month of October, we are seeing other than CV, all the other products are doing well relatively. And this will get continued, maybe post harvesting when the crop will come to the market and farmer will start getting money and then construction activity will pick up, then CV will start picking up. Till such time, I don't think CV is going to pick up the way we want it.

As far as the productivity is concerned, in vehicle finance, we mentioned that we have recruited more collection than sales. So obviously, we are focusing on the productivity on sales side with the existing manpower and increasing the collection intensity to manage the collection.

Other product line, they are adding manpower. Obviously, they are working on the productivity. Now you take the example of home loan. Home loan is like they are 50% focus in South and non-South is like 50%. Obviously, they have a lot of room to basically expand rest of the market.

So obviously, they will continue to hire manpower, continue to open branches. And similarly, LAP, CSEL, SBPL, those are operating from 1/3 or say, maybe half of the vehicle finance branches. So obviously, if they open up more branches, they have to recruit more manpower for sales and collection. Initially, every business will open up, recruit more manpower in sales and then they recruit collection.

Moderator: The next question is from the line of Ishan Shrimali from Tara Capital.

Ishan Shrimali: I just wanted a little clarification on the credit cost. Was it 1.3% on the NCL? Or what was it? Is it 1.4% or 1.3%?

Ravindra Kundu: 1.3%, 1.4%, NCL.

Vellayan Subbiah: 1.4% for the quarter and 1.5% for the half, right, for last year's NCL.

Ishan Shrimali: Yes, NCL. I was talking about the NCL. It was 1.3%. It's 1.4% for this quarter and for the next of the year, it was?

Ravindra Kundu: 1.4% for this quarter, it has come and what we said that it will be 1.3% for the full year.

Ishan Shrimali: Okay, 1.3% for the full year.

Moderator: The next question is from the line of Piran Engineer from CLSA.

Piran Engineer: Congrats on a good quarter. My question is really on the home loan business. Firstly, can you just talk a bit about competition. And secondly, when repo rates are cut, what happens to our yields? What percentage of our home loan book is linked to the repo rate?

Prashanth Kumar: So as far as home loan is concerned, right now we are expanding geos and our major focus is in self-construction business. So as of now we are maintaining the yield. We'll not allow the yields to drop because we are going towards the new geographies where the delinquencies will turn off over a period of time.

So as far as the yields are concerned, we are trying to maintain that. Of course, going forward, if the rate of interest goes down, there will be a stiff competition. And as we all are aware, this is the affordable segment, there are many new entrants. But over a period of time, it will be those guys who can maintain the delinquency levels at the expected and who can have the team for assessment credit.

Vellayan Subbiah: Are you there?

Piran Engineer: Yes, I am there.

Ravindra Kundu: Okay. Fine.

Piran Engineer: So but my question is really like are our internal benchmarks indirectly pegged to the repo rate or not? Like if the repo rate is cut 50 bps, will our yield on the back book also decline by 50 bps. How should we think about that? That was my question.

Ravindra Kundu: Yes. Going forward, definitely, the pass on will be to the customers, but there are 3 aspects to that. Of course, the cost of fund is one of the variance. There is also the cost of operations and the profitability part. So we'll see, over a period of time, how it pans down in terms of the rate reversals to the customers.

Piran Engineer: Understood. Understood. And just one clarification on what Kundu sir mentioned, the lower capacity utilization, is that only for LCV or across LCV, HCV, both?

Ravindra Kundu: Yes. Across all product lines, we see that including the first quarter and second quarter that is because of the election, heat-wave, extended rains and also transition has not been completed. The capacity utilization of the commercial vehicle is down as well as last-mile transportation also got impacted because of the poor demand in economy as well as the consumption in the rural market is down.

Moderator: The next question is from the line of Kunal Shah from Citigroup.

Kunal Shah: So first is on the borrowing side. So when we look at it, still the skew is more towards the bank borrowing compared to that of the debt market. But the rate cuts would be following relatively later compared to the benefit, which we are seeing on the debt market side.

Would we be tweaking the proportion looking at the opportunities, which are available? Or we obviously expect the overall mix to continue? And within bank borrowings, how much is linked to MCLR and how much is linked to EBLR within that, in terms of just to gauge the repricing benefit?

Arul Selvan: Yes. See, we will continue with the skew more towards bank borrowings, primarily because of 2 reasons. You are right, like more than 50% to 60% of the borrowings are connected to EBLR, and we are already seeing some amount of benefit coming into that. And the other point is because of the bank borrowings, in bank borrowings, we take advantage of the PSL as well to get the rates lower than the market rate. So it continues to be skewed towards bank borrowing.

Kunal Shah: Okay. And within bank borrowing, you said 50% is linked to EBLR?

Arul Selvan: Yes, yes. And 50% in EBLR, around 10% is fixed and the rest are MCLR.

Kunal Shah: 10% fixed rate and balance MCLR. Okay. Got it. And when we look at it in terms of the commentary, normally, Q3 sequential uptick in the disbursements, particularly on the vehicle is quite good. So does it suggest that maybe at least in terms of the momentum this quarter, Q3 could be relatively low, maybe at least in terms of the increase from where Q2 was, would it be relatively lower compared to what we have been seeing in the past 2, 3 years because you are highlighting maybe things are still not on track and it might take some time?

Ravindra Kundu: Q2 to Q3 disbursement is going to go up. That is for sure. There is no problem.

Kunal Shah: No. The only thing is in terms of like the quantum, which generally happens, that's quite huge, but the commentary still suggests that it's going to take some time. So would it be fair to assume...

Vellayan Subbiah: Are you talking about disbursements? Or are you talking about collections on that?

Kunal Shah: Yes, disbursements. Disbursements.

Ravindra Kundu: Disbursements are about the same range only. I don't think disbursements saw a very jump from Q2 to Q3.

Vellayan Subbiah: Disbursements, we don't see that. I think, the question, as Ravi's commentary was more on the collections and the portfolio normalizing.

Kunal Shah: And collections also Q3, you said like at least in terms of the GS2, GS3, it would be at a similar level to Q2 and the improvement would be from Q4 onwards. So that's right?

Ravindra Kundu: That's correct.

Moderator: The next question is from the line of Shubhranshu Mishra from Phillip Capital.

Shubhranshu Mishra: Three questions. The first one is around the fee income, a chunky piece is now coming from our insurance premium. How do we model for the insurance premiums going forward in the fee income?

The second question is around the assignment that we used to do in vehicle finance. It's come off drastically versus, say, 6, 7 quarters ago. How do we look at that in terms of assignment going forward in vehicle finance business? And third, if you can split the collections team or collection employees into various businesses?

Arul Selvan: Insurance. Yes, insurance, we were earlier getting through the subsidiaries and which we're taking through dividends, it is now coming in Chola. We are already at a fairly decent pace on the insurance. I don't see too much of an upswing from here. It will go in line with the disbursement trends. On the assignment, actually, we're not doing assignments. We're doing more of only securitization so far. So...

Vellayan Subbiah: So I think his question was, we doing a lot of assignment...

Arul Selvan: Long time...

Vellayan Subbiah: That was a long time ago.

Arul Selvan: Very long time. More than 5 years back. Actually, most of the assigned book we have in VF, has already run down. We have a few INR1,200 crores or so on the LAP and HL book, which we have done long time back, which is still as well as the whole residual...

Vellayan Subbiah: Manpower, obviously, I mean, we're not going to give guidance around...

Arul Selvan: We have not given separately guidance on collections team, et cetera, but...

Vellayan Subbiah: But the majority -- more or less in line with kind of the size of the each of the businesses.

Shubhranshu Mishra: But how many people do we deploy in collections?

Vellayan Subbiah: Oh, question is overall in collections.

Arul Selvan: That will differ, again, product to product. Maybe vehicle finance is the largest, or most like 20,000 people will be in VF.

Vellayan Subbiah: So I think a quarter of our total workforce should be collections.

Shubhranshu Mishra: Say that number again?

Vellayan Subbiah: So it will be between 25% and 30% of our total workforce is collections.

Shubhranshu Mishra: And what portion would be in vehicle finance and LAP?

Vellayan Subbiah: That's what we just told you no. We won't give any specific guidance and you can just assume that it's in ratio of the size of the business.

Moderator: The next question is from the line of Viral Shah from IIFL Securities.

Viral Shah: Let me ask the question. So I wanted to check on the new businesses, since last 3 quarters now we are seeing broadly flattish kind of disbursements, so what is the outlook over there? Or is it more of a conscious call? And also, if you can share the percentage of the CSEL book now being sourced through fintech partnerships?

Balraj Menon: **In** CSEL book 10% is partnership.

Balraj Menon: The overall CSEL book is INR14,000 crores. Out of that fintech partnership is only INR2,000 crores. The ratio has actually come down.

Vellayan Subbiah: So it's about 12% through fintech partnership of the book. And to your question, kind of I think what we've always indicated is that the totally unsecured book will cap out as a percentage of our overall portfolio. So the CSEL business is about 8% to 9% of the overall portfolio right now. So we don't see it kind of growing into double digits.

So I think we'll cap out at 10% max. So to your question on whether that's conscious? Obviously, it's moderated, yes, by the size of the overall business. So quick answer is, yes.

Viral Shah: Okay. And when you say you'll cap it at, say, at max 10%, is it like say more 6 months, 12-month kind of thing? Or more from, say, a medium-term perspective, say, 3 years out also it will be like...

Vellayan Subbiah: Yes, yes, medium term also. Three years out also.

Viral Shah: And secondly, I wanted to check if there would be, say, any impact of the RBI's directive on doing it with the foreclosure charges on the floating rate MSME book, which would be a LAP book in our case. Do you foresee any impact not just from, say the, fees perspective or, I would say, more from a competitive perspective as well as the exit barrier kind of goes ahead?

Arul Selvan: The directive is more for foreclosures out of own funds and for personal purposes taken. What we do is all business loans and where it is from own funds, we don't charge, but where it is a balance transfer, etc, we will charge.

Viral Shah: Okay. So you are saying only the non-BT portion will be impacted on the LAP book?

Ravindra Kundu: No, there are 2 type of foreclosures. If someone is actually paying from his own pocket, then we are not charging. And someone is basically taking loan from the market, then it is being charged.

Viral Shah: Okay. And that does not change with this kind of directive, to your understanding?

Ravindra Kundu: Difference is coming, I think.

Suresh Kumar: It will come, so we will have to assess it. At the portfolio level, we will see and there could be some impact if the full circular is implemented.

Viral Shah: Okay. Got it. Thank you. And do I have a chance for 1 more question?

Ravindra Kundu: Go ahead.

Viral Shah: With respect to the NIMs, if you can see, let us know how it will trend in the second half? And more importantly, also in this quarter, was there any effect of averaging or timing impact because we saw 10 bps increase in cost of funds, right? Did it have anything to do with the ECBs that we raised?

Arul Selvan: So we did Tier 2 INR3,000 crores. There's a marginal impact, but it is more case of some of the old loans, old borrowings, which were at lower rate also running off. The same reverse story of what we talk about in vehicle finance, but we were able to manage it there, and we hope to keep it.

Moderator: The next question is from the line of Pranuj from JPMorgan.

Pranuj: Two questions. One is on your fee income, it is sustaining at a pretty decent level of INR400 crores plus. Your insurance income has not increased that much quarter-on-quarter. So what actually led to the strength over here? And second is your OpEx should sustain at that 3%, 3.1% level even if you see that incremental disbursement growth coming off from this year and next year?

Ravindra Kundu: Fee income.

Vellayan Subbiah: Yes. So I think the OpEx will be at the 3% level. We don't see kind of that opex going up even if disbursement grow. As opex is basically measured off of the AUM base, and we'll see the AUM base like we've guided. Kind of will be lower than the 33%, but the OpEx, we don't see an issue.

Arul Selvan: Fee income. Fee income will remain at similar level. It has improved a bit, but it will remain at similar levels.

Vellayan Subbiah: As a percentage of...

Arul Selvan: As a percentage of average assets because it is amortized on the book under Ind AS.

Pranuj: Understood. Just to clarify, OpEx, you said 3% to 3.1% should sustain going forward also, right?

Vellayan Subbiah: Right. Yes. 3%.

Moderator: The next question is from the line of Hardik Shah from Goldman Sachs.

Hardik Shah: I had 2 questions. One is specifically on yields, what will be your incremental yields versus outstanding? And if you have taken any interest rate hikes across portfolios?

Vellayan Subbiah: In which -- you're talking about overall?

Hardik Shah: Overall.

Arul Selvan: In this scenario, we will not be taking interest rate hike from the floating rate book, which has already been hiked, which is the LAP, HL and SME. In the rest of the books, where it's a fixed rate, we have progressively been increasing marginal yield, 2 components to it. One is the increase as well as the mix.

Most of this is giving an impact on the yield. So you'll see that more in vehicle finance and CSEL. And CSEL, you won't see much because it's already a high rate book, so you may not see that much impact. But in vehicle finance, you will see progressive increase over the next 2 quarters.

Hardik Shah: So what would be the broad delta on incremental yield versus...

Arul Selvan: We can't discuss those delta because it is a combination of 2 factors, as I said. One is the increase we are doing as well as the mix of the portfolio. So mix of the portfolio will be determined by market demand, etc, so we cannot really give you a number, and it's going to nitty-gritty into that.

Hardik Shah: Okay. Got it. And sir, second question is broadly on the customer overlap with MFI. If you could share some color, especially for our 2-wheeler and affordable housing business, if you're seeing any impact on those portfolios from the stress that we are seeing in MFI?

Ravindra Kundu: No, there is no overlap actually.

Hardik Shah: Zero?

Arul Selvan: Across all business...

Vellayan Subbiah: We can't say zero. It is minimal.

Moderator: The next question is from the line of Nidhesh Jain from Investec.

Nidhesh Jain: Two questions. Firstly, are there any growth and asset quality divergence between new CV and used CV? And secondly, in the SME book, there is almost a 30 basis point sequential increase in GNPA GS3, and the book is also growing at a healthy pace. So that looks a bit high increase on the GS3, so any comment or color on that?

Ravindra Kundu: As we mentioned always, we are more focused on the CV used. And in the case of CV new, whenever heavy commercial vehicle is growing faster, our growth looks lower than the market. But now CV new is also growing lower pace, so our growth rates in the CV New and CV used, both are same.

Nidhesh Jain: And sir, on the asset quality trends, the GS3 increase that we have seen, is it uniform across used and new or there are divergences?

Ravindra Kundu: Yes, yes, same only. I mentioned that in the previous analyst question also.

Nidhesh Jain: Sure.

Pankaj Murpani: As far as SME book is concerned, quarter-on-quarter the book has almost stabilized on the same number. And as far as GNPA is concerned, basically, book is maturing and we are seeing that some cases will come. But with the legal course and all, things will come down with SARFAESI. It's all covered under SARFAESI. So it is now maturing, and we'll take actions to bring it down. And H1 was anyways a little bit tougher. The market was like that, but in H2, we are confident that it will come down

Moderator: The next question is from the line of Ajit Kumar from Nomura.

Ajit Kumar: Just one question. In your credit cost guidance for FY '25, are you factoring in further reduction in ECL provision in Stage 1, 2, 3 assets in second half? This quarter as well we have seen reduction in ECL provision. That is why I wanted to check on trajectory of ECL provision going forward?

Arul Selvan: So the reduction would be driven by the reduction in Stage 2 and Stage 3 assets. It's not a reduction, if you are indicating that it's a reduction by changing the methodology.

Moderator: The next question is from the line of Bhaskar Basu from Jefferies.

Bhaskar N. Basu: I just had 1 question on the credit cost side. So you seem to be indicating that GS3, the asset quality would broadly be stable sequentially, while the ask on the credit cost for the second half to meet your full year guidance is still fairly high. So do you expect credit cost to go down next quarter onwards like we have seen in the past or it's going to be largely back-ended?

Ravindra Kundu: Next quarter will be flat. The fourth quarter will be lower, and that's how we will achieve. As of now, we are at 1.5%, if you see that. And as we have said that it will come down to, say, 1.3%.

Bhaskar N. Basu: Right. So the entire improvement is likely to be in the fourth quarter is what you are indicating?

Ravindra Kundu: Yes, that happens actually, normally. Last year, quarter 3 also was good, but since it is the October month, last day is the Diwali. So October month will not be that great. And then November and December, we need to cover it up. And also, the entire harvesting also got extended.

Bhaskar N. Basu: Okay. Okay. And when you're talking about reduction in GS3, it's going to be across the board or specifically on the vehicle finance side where you see a correction from where you are?

Ravindra Kundu: Some of the portfolio like LAP and HL are already at the rock bottom level. Even in vehicle finance, if you see that we are much lower than the pre-COVID level. And that is also one reason that it is going up. When you have reduced it so bottom, it has to go up a little bit in a month. But we are expecting that vehicle finance, CSEL, SME, they will be reducing their Stage 3.

Moderator: The next question is from the line of Ankush Agrawal from Surge Capital.

Ankush Agrawal: Firstly, sir, our capital adequacy has increased sequentially, so can you explain why did that happen?

Ravindra Kundu: CAR has gone up.

Arul Selvan: CAR has gone up because I told know we did the Tier 2 and Tier 1. Perpetual debt goes into Tier 1 so that has improved.

Ankush Agrawal: Sorry, can you repeat, what goes into Tier 1?

Arul Selvan: Perpetual debt. We did INR1,000 crores of perpetual debt, which goes into Tier 1 and INR2,000 crores, which went into Tier 2, both have helped improve the CAR.

Ankush Agrawal: The second question was about growth. I mean in quarter 1 con call, we made this comment that the Q1 growth and disbursement were much higher than what we had expected because of election. And that in Q2 onwards, we expect it to increase further, but obviously, we have not seen that happen. So what changed between these 2 periods that the overall growth outlook is now much lower than what was there in Q1?

Ravindra Kundu: Q1 growth was 21%. Now it is at 17%. We said that in Q2 because of the rain it had an impact, and then from Q3 onwards it will pick up.

Arul Selvan: We've always maintained 20% to 21%.

Vellayan Subbiah: Yes, and broadly, the guidance we've always given, like Arul said, has been 25% AUM growth, right? There was also the question based on kind of RBI input and all of that. So broadly, what we're saying is that we've shown 33% in the first half. And we will likely kind of drop to a lower number. But still we maintain that 25% guidance. So we're not changing the full year guidance of 25% AUM growth..

Moderator: The next question is from the line of Renish from ICICI Securities.

Renish: Just one question on the credit cost front, once again. So if you can just throw some light maybe qualitatively that since we expect a sizable recovery in Q4 from all our product line, which product you expect will drive this improvement, including since our exposure to some of the unsecured product is relatively higher. Maybe NCL, unsecured business loan, et cetera. So which segment you expect to drive this recovery in Q4? And do you foresee any risk to that recovery as of now?

Ravindra Kundu: So first of all, you have to accept that it is actually from quarter 1, which has come down from 1.5% to 1.4%, okay? And with 1.4%, we are saying that it will go down to 1.3% at the company level. Now if you see that our LAP, which was actually doing the reversal till last year, they were reversing 15 basis points. This year, they have given 15 basis points above NCL. So that is a 30 basis point swing.

So now they do not have that much reversal capacity. They will do 15 basis points. In steady state, they can go up to even 30 basis points, but they're doing better than their expectation. Vehicle finance actually from 1.9%, it has come down to 1.8%, and it is going to go down further. So the major difference is only 10 basis points, 1.4% to 1.3%. So 1.4% to 1.3%, everybody will have to contribute, but those who are already lower like HL and LAP, they are already lower, they cannot contribute anymore.

Vellayan Subbiah: Yes, so HL and LAP have had a strong performance. That will continue. And obviously, some of the other segments will now start contributing a bit more.

Renish: Okay. And do you -- I mean, you don't foresee any risk of unsecured business loans or maybe unsecured portfolio sort of resulting in higher credit cost in second half, given the current environment is...

Vellayan Subbiah: There is no concern on unsecured business.

Moderator: The next question is from the line of from Kaitav Shah from Anand Rathi.

Kaitav Shah: Sir, just one question was on the improvement in the ROTA. So with the growth perhaps slightly slowing down, does that change the ROA trajectory for you? I mean, ROTA trajectory, in a medium-term perspective? I mean, does it postpone the ROA improvement? Or it's still on track, do you think, over the medium term?

Vellayan Subbiah: No, no. I think that is still on track. We don't see any challenges.

Arul Selvan: We're still working on the 3.5% ROTA.

Vellayan Subbiah: Yes. So we've always guided that. We have talked about the range and kind of the performance in that range. So I don't think there's any change in medium-term guidance.

Moderator: The next question is from the line of Raghav Garg from Ambit Capital.

Raghav Garg: Thanks, my questions have been answered.

Moderator: Next question is from the line of Sonal from Asian Market Securities.

Sonal: There was a previous question on PBT-ROTA. So in 1H, we are closer to about 3.1%. So how do we reach to 3.5% by the end of the year? Because what I understand there would be 10 bps improvement from credit cost.

Vellayan Subbiah: The specific guidance we've given is 3.5% is the average over the full cycle. And we've said that when we are at weaker points in the cycle, we will drop closer to 3%. So the range we've given is 3% to 4%, and we said we'll average 3.5% over the cycle. So in years like this, we will definitely be lower than 3.5%. So we'll be closer to the 3% end of the year. So what we're saying is it'll move up from 3%, but it will definitely not move up to 3.5%. So we're not saying we'll hit 3.5% this year, to be clear.

Ravindra Kundu: We're at 3.1% level of H1, so it will improve to maybe 3.2% for the full year.

Vellayan Subbiah: Could be 3.3% also. Between 3.2% and 3.3%.

Ravindra Kundu: Yes, for the year.

Sonal: Sure. And just another question on CSEL. So our provision coverage ratio is at 50.5%. Now given that the book is unsecured, any thoughts of increasing this provision coverage ratio?

Vellayan Subbiah: Is your question, whether will we change the CSEL provision coverage ratio?

Ravindra Kundu: No, no, we are not going to change

Sonal: I am talking about CSEL Stage 3.

Arul Selvan: No. CSEL, right now we are adopting a more aggressive policy considering that we don't have the history to do an ECL model on it. Hopefully, by end of next year, we will be having enough data to do the ECL model, but our indications show that the ECL model will throw a lower number than what we are already providing.

Vellayan Subbiah: So broadly, we feel comfortable with the current provisions of it.

Sonal: Okay. So I mean pre-COVID levels, when our book was secured book, we were maintaining about 1.75% of PCR. With unsecured book being closer to about 8%, are we comfortable with 1.83% PCR on the total book?

Arul Selvan: You have to look at it from an overall perspective, CSEL is only 8% of the overall book. So considering that, its not going to swing that much. You are talking the 1.25% is the overall company.

Ravindra Kundu: 1.83% for the entire...

Vellayan Subbiah: 1.83% as a percentage of total...

Ravindra Kundu: Earlier, it was 1.7%, yes.

Sonal: Okay. So we don't see anything to change here over next 4, 5 quarters?

Vellayan Subbiah: No.

Moderator: The next question is from the line of Dhaval from DSP.

Dhaval: Just one sort of question relating to the business model. So like we added these new businesses to reduce cyclicality, and that's what is playing out with VF being lower -- relatively lower growth, but the overall business is sustaining. Any part of the business model that you think as you've added these 3 or 4 segments, anything that can become much more bigger in the next, let's say, 5, 6 years from where we are today? Any of the businesses, just any thoughts around that?

Ravindra Kundu: So one is that at a company level, we have diversified. And within the businesses also, every business is trying to diversify. For example, LAP is actually getting into the micro LAP in order to maintain their yield and ROA can be stable. Similarly, HL is like expanding and we are also having new product other than the self-construction.

CSEL has already got 4 products in their line. SME also started moving to the equipment finance, medical equipment finance, industrial equipment finance. They generated funding and also -- they are also getting into the micro term loan. So I think we are doing both at a company level as well as the division level.

Vellayan Subbiah: The thesis still kind of remains intact. And like Ravi said, HL and LAP are showing good indications of kind of this thing. So I think HL is obviously a much larger base but both of these businesses are showing kind of good indications of taking a larger percentage of the overall book.

Dhaval: And so medium term, should one be thinking that this 50% VF today and maybe eventually 40% to 50%, directionally, it can be far more diversified, may be many years down the line, but it can be a far more diversified business than what it is today, so that should be a broad hypothesis? Or do you think at some point, the VF will still flatten at a particular elevated percent?

Ravindra Kundu: Actually, it will come down.

Vellayan Subbiah: Right, you're seeing that. I mean, like it's at 56%, it will come down -- I mean, if you take the long term, right, I mean, definitely, some of the other businesses also have good growth. So your point is valid.

Moderator: The next question is from the line of Nischint from Kotak Securities Limited.

Nischint: This is just a clarification. When you mentioned credit cost of 1.3% versus 1.4% in the second quarter, is 1.3% for the second half or is 1.3% for the entire year?

Vellayan Subbiah: For the full year.

Nischint: For the full year. So probably second half should be like whatever 1.1%, 1.2% or there. Or maybe fourth quarter should be like whatever, 1.1% or so?

Vellayan Subbiah: Yes, yes. That's correct.

Arul Selvan: Yes, that's what Ravi was saying.

Nischint: Thank you very much. This was the last question for the call. So thank you, everyone, for joining this call. Happy Diwali to all of you, and thank you very much to the management for giving us an opportunity to host the call.

Vellayan Subbiah: Thanks, Nischint. Thank you.

Moderator: Thank you. On behalf of Kotak Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.