"Ujjivan Financial Services Q3 FY18 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Ujjivan Financial Services Q3 FY18 Earnings Conference Call hosted by Axis Capital 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 '*' then '0' on your touchtone phone. I would now like to hand the conference over to Mr. Vikas Mundra from Axis Capital Limited. Thank you and over to you, sir.

Vikash Mundhra: Thanks Stanford. Good afternoon, everybody and welcome to the quarter 3 Earnings call of Ujjivan Financial Services. We have with us representing Ujjivan Financial Services Ms. Sudha Suresh - MD and CEO and representing Ujjivan Small Finance Bank, Mr. Samit Ghosh - MD and CEO, Ittira Davis - Chief Operating Officer, Rajat Singh – (Head) Strategy and Planning, Sneh Thakur – (Head) Credit and Collections of the MFI business.

Firstly, I would like to apologize for the little delay which we had to start the call. I would like to congratulate the entire Ujjivan team for the improvement shown in the quality of results in quarter 3. Now, I would request Mr. Samit Ghosh, to take us through the key highlights of the quarter post which we will have the question and answer session. Over to you, sir.

Samit Ghosh: Thank you Vikas. Good afternoon, welcome to our third Quarterly Earnings Call and thank you all for joining us. First, to start with the brief update about the industry then carry on and tell you a little about our business update which will be followed by discussion on our financials.

The microfinance industry is recovering well from the impact of demonetization. There are visible improvements in asset quality across all the regions except Vidarbha region in Maharashtra and some districts in Madhya Pradesh. Ujjivan is not directly impacted in these two areas. The average monthly disbursement in the MFI sector now has reached normal levels implying steady growth. The collection efficiency on the loans which were disbursed in the last calendar year, it is closer to the pre-demonetization level. Several MFIs reported 98% plus collection efficiency for loans disbursed after January 2017. The 7 new small finance banks launched this year and the two in the previous year has embarked on their journey. The new banks would be looking beyond traditional micro finance or the loan businesses they had and will work towards providing full range of banking services. Most SFBs have invested in latest technology and have potential to grow and become formidable banks serving the unserved and underserved population in the coming years.

This quarter marks the return to profitability for Ujjivan in the trajectory we have set ourselves at the beginning of the year. Our business is back to normal level with nominal increase in portfolio this quarter while our disbursement steadily increased with the 28% growth year-on-year and 9% quarter-to quarter growth. We have made significant changes in the MSE and affordable housing businesses and brought in new leadership. They recorded robust growth in disbursement as well in this quarter in line with our plan for diversifying into these segments. Further the collection efficiency continues impressively at 99.7% for all new businesses from January 2017 till December. As a result, fresh delinquency has been arrested and with sustained collection efforts, our PAR has shown a steady decline from 6.7% in September to 5.4% in December. The dedicated collection team which has been set up to focus on the 90 days plus bucket of overdue loans have shown an increase in traction of 34% this quarter.

Our GNPA has come down from 4.24% in December as compared to 4.99% in September. Since majority of the provision and write-off has been done in first 2 quarters, this quarter we went ahead to clear the remaining small portion of the portfolio with 34 crores of write-off. We also recovered a significant amount of 31 crores from the NPA bucket this quarter. As a result, our NNPA has been reduced from 1.38% in the second quarter to 1.04%. We are progressing well as per our plan on small finance bank branches roll out. We now have 121 branches operational across 20 states in the country. We have launched banking services in Assam, Bihar, Odisha, Rajasthan and Tripura during this quarter. The plan is to roll out 67 branches in fourth quarter taking the count of SFB branches to 188 by year end. Further by opening 39 unbanked rural branches by January end, we are also spreading our reach to the unserved and underserved people in the rural area.

We have observed good interest for both existing MFI customers and open market customers in terms of deposit generation. Our deposits are growing and the total deposit base stands at 2,437 crores which includes CDs of 1,379 crores. Initial focus is to mobilize low cost deposit base through institutional deposits and CDs**,** while scaling up our retail deposits business as more and more banking outlets are rolled out over the period of next few quarters. As a bank we have invested heavily in technology and design tech-based solutions as per our customer needs to make banking paperless, fast and available within easy access. So, we are providing a whole lot of benefits to the customers such as doorstep banking using handheld devices, mobile and internet banking, phone banking, access to ATM through biometric devices, Aadhaar enabled debit cards among others. At each of our branches we will have dedicated staff which who will go to customers to teach basics like using phone and mobile banking, miss call banking and using and biometric ATM.

Our customers can open an account at their doorsteps through the hand-held devices that our field staff carry. It is self-service and assisted service. We launch senior citizen account variant on the liability side and tax saver deposit this quarter to meet the customized needs of specific target segment of our customers. In conclusion, we can say we are on track. We are well in control of the portfolio quality problems, post demonetization and have made adequate provision and write-off in our books. Business volume of micro finance is growing steadily. We have revamped MSE and affordable housing businesses and expect their contribution to grow significantly in the overall loan book as planned. We will put in much greater focus on building our deposit base both retail and institution going forward.

With this, I would like to hand over to Sudha, who will take you through further details on our financial performance.

Sudha Suresh: Thank you, sir. So, to continue with our business performance, we have recorded a disbursement of Rs. 2,134 crores which is an impressive 28% year-on-year growth and a 9% growth on the previous quarter. With that the gross loan book now stands at about 7,095 crores which is a growth of 6.39% over the previous quarter. Our on-book portfolio has been scaled to 6,927 crores with a growth rate of 8.83% over the last quarter. Also during this quarter, we have added a record 1.88 lakhs new customers. The quarter also saw the share of MSE and the affordable housing business increasing to 5.5% of the portfolio from 4.3% in the previous quarter on the back of healthy growth in their disbursements. We also expect the trend to continue in the coming quarters as well.

Moving on to the financials of Ujjivan, the net interest income for the quarter was Rs. 217.33 crores which is an increase of about 11.33% over the previous quarter. Consequently, the net interest margin for the bank increased to 11.08% in Q3 from 10.02% in Q2. This is due to nominal growth in the revenue as well as reduction in our finance cost. Our funding cost has further shown a reduction this quarter as we have repaid our high cost legacy loan and replace them with deposits at lower cost. In fact, we have repaid more than half of our legacy loan of around 2,255 crores and also done additional prepayments of about 950 crores in this fiscal year. So, our average cost of fund has reduced to 9.3% as of Q3 as compared to 10.4% as of March FY17. Our cost-to-income ratio stands at 69.05% in Q3 as against 68.82% in Q2 FY18.

Coming on to the credit cost, we see the credit cost are trending down quarter-on-quarter as the demonetization impact has been largely taken care off in the first two quarters of this financial year. We have a provision coverage ratio of 76.3% after a write-off of Rs. 132 crores in this fiscal year. Our credit cost has been curtailed by 60 crores in this quarter and all these facts have resulted in a profit after tax of Rs. 29 crores. For the quarter, our ROA was 1.35% and the ROE stood at 6.99%. Moving on to the cap adequacy ratio that stands at about 22.05% there is a revision in terms of its computation as we have indicated, and this is as per the RBI directive date in November 08, 2017, which is provided for an exemption to all the SFBs in terms of not inclusion or non-inclusion of any capital charge on the market and operational risk weighted assets.

On to the liability business as indicated by sir, we have a good interest from the institutional deposits post scheduled bank status in August. In fact, we have raised significant amount of institutional deposits including certificate of deposits as per our strategy for the first year of our banking operations. Of the deposit base, which stands at about 2,437 crores as on 31st

December we have CDs of about 1,379 crores, 799 crores of institutional deposits and the rest include retail and CASA. We are also witnessing good traction from the retail deposit in the form of FDs and RDs as our rates are quite attractive in the market. We do expect that the retail deposit base will increase further with the conversion of many of our existing branches into full-fledged bank branches in the forthcoming quarters and extensive mobilization of deposits through existing customer base. Our branch conversion has also been successfully implemented as per our strategic plan. Our deposits cover 36% of advances in Q3 as against 22% in Q2. The average cost of deposit is trending at 7%. Overall, we have seen a good quarter and all the parameters have shown a good traction. We do expect the trend of growing disbursements and overall growth to continue in the forthcoming quarters.

With this, I would like to hand over the session back to the moderator to start the Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. We take the first question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal: I have question on the overall collection efficiency trend. On a 78% portfolio which is January to December 2017, we have collection efficiency 99.7%. Could you tell us the 18% of that book which is old vintage book, what kind of collection efficiency we have?

Samit Ghosh: We can get back to him on that

Sudha Suresh: So, we will get back to you on this data point.

Manish Ostwal: Secondly, in terms of branch expansion during this quarter we have added around 29 branches, right and now we are adding again 67 branches in quarter 4. So, do you see our yearly guidance of 650 crores of OpEx any material upside to that number on the full year basis or quarter 4?

Samit Ghosh: No, so that number will more or less be the same in the same range.

Manish Ostwal: And NIM expansion during this quarter what are the factors which contributed to that kind of main expansion?

Sudha Suresh: So largely we had the funding cost which trended down and as I just indicated, you saw the average cost of funds also coming down to 9.3% and that was at about 9.5% in the last quarter. That has significantly contributed to this.

Manish Ostwal: And sir, in initial remarks you shared that the micro finance business is recovering except two geography, Vidarbha and MP. So, any other geography where we, in absolute terms our portfolio is going down or not of that, what is that situation?

Sudha Suresh: I think largely our portfolio across these affected states has also been improving month-on-month. There is a good collection team as sir had mentioned and which is having a good traction in terms of collection of over dues. So, we do see this position improving month-on-month and this will continue for the next few quarters also.

Moderator: Thank you. We take the next question from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: Over last 5 quarters we have either provided or written-off close to 340 cores. So, my question is one, is there any more provisioning or write-off needed because there is still a 40 crores-45 crores gap between the PAR portfolio and the provisioning. So, is that portfolio going to need some extra provisions or write-offs? And my second question is from whatever we have written-off provided, do we expect any kind of write-backs because of the improving trend we are seeing in microfinance? Thank you.

Sudha Suresh: I will answer this question partially afterwards Sneh will take over. So as we have indicated provisions are made based on the positions that is identified in terms of the repayment and once the provisions are made the write-off is basically only a technical process. So to that extent once the provision is made it has already hit our P&L and the write-off is subject to a lot of process which includes sign off from those branches and all the details. **Sneh Thakur:** In terms of provisioning as you can see the NNPA number is that 1% which roughly translates into 70 crores of the book which will incur some additional provisioning during this quarter and the next quarter as well. So, it really depends on the bucket movement of these accounts and how much collection we are able to get.

Digant Haria: Sorry, if I just can ask the number in terms of let say, if you are not able to collect anything then this entire 70 crores will, Ma'am, so just my question was that if in case the recoveries are not there at max there could be 70 crores of provisioning from today right on this old demon related microfinance portfolio.

Sudha Suresh: That is an extreme case, we are expecting one third of recoveries to come in on the NPA buckets and estimated incremental provisions for this quarter would approximately be 20 crores to 24 crores.

Digant Haria: And any write-back which we could expect, or it is too much of time which has passed and so write-backs from whatever 300 crores we have, 330 crores we have provided. It is not a rational expectation to have.

Sudha Suresh: While we do expect write-backs, it is too early to say what percentage that could be.

Moderator: Thank you. We take the next question from the line of Vishal Rampuria from HDFC Securities. Please go ahead.

Vishal Rampuria: So on Page #10, you have mentioned that on the hard buckets there has been some collection, right of 34%. Can you explain what exactly has been the number, can you explain the amount of collection?

Sudha Suresh: So these are the collections that have been done by our dedicated collection team and from the allocated pool to this team we are seeing a traction of 34% during the quarter.

Vishal Rampuria: Which means that balance customers are not paying us? Is that the way to understand this?

Sneh Thakur: We have clients over 90 days and largely over the 8^{th} bucket and we have seen collections to the tune of 26 crores during Q3.

Vishal Rampuria: Non-interest income for the quarter, can you give me the breakup?

Rajat Singh: So we do not have that breakup readily available to be share it.

Vishal Rampuria: Thirdly will be OpEx guidance for the next year, given that side we have rolled out so many branches now.

Sudha Suresh: See, overall on the branch expansion plan we are looking at completing the conversion of all our branches into full-fledged bank branches and beyond that again on the disbursement as we are given guidance earlier on our portfolio growth. A 25%-30% growth is what we can expect and give guidance for.

Rajat Singh: On the other income, bulk of that income is coming from processing fee which is close to 15 crores-20 crores. 20 crores – 22 crores of income is coming on the investment and remaining 8 crores is largely miscellaneous income like securitization and some third party.

Vishal Rampuria: Can you repeat the numbers again?

Rajat Singh: So, 18 crores is processing fee and 22 crores treasury income largely on investments and remaining …

Vishal Rampuria: 8 crores?

Rajat Singh: 22 crores and remaining 8 crores is miscellaneous income like securitization income, third party income, some kind of recovery like that. So, 22 combined is 28 crores.

Moderator: Thank you. We take the next question from the line of Gautam Jain from JCJ Financial. Please go ahead.

Gautam Jain: Ma'am, we have reached to 34% of deposit to our total loans. So can you just brief us your strategy about deposit going forward?

Sudha Suresh: So, in line with our strategy for the first year of our banking operations, we had planned out that we will be raising largely our deposit through whole sale deposits and that is what you are saying in terms of our presentation also. As we indicated our deposit base of 2,437 crores is made up of CDs which is about 1,379 crores and the other institutional deposits of 799 crores. We would also look at the next quarter we are predominantly we expect whole sale deposit to add to the chunk and increase the percentage as a basis of our advances. However, in the next financial year and going forward we will slowly see the retail deposit including the CASA's to build up and that could substantially increase over the next 2 financial years and that could bring down the percentage that the wholesale deposit contributes to the total deposit.

Gautam Jain: So, what is the cost of fund on certificate of deposit right now?

Sudha Suresh: Yes, so the cost of funds on certificate deposits has been very comfortable at about 6-6.8 till January and we need to wait and watch as to how the cost of fund behaves during the current few months.

Gautam Jain: At the beginning of the year we have mentioned that we will be accruing around 150 bps fall in cost of fund and benefit to NIM. So, have we reach that level or some benefit yet accruing before Q1?

Sudha Suresh: So we have reached about 101 basis point of the 150 basis point that we are expecting. We have already touch 101 basis point as of Q3.

Gautam Jain: So, 50 basis points more improvement can be seen in Q4-Q1 onwards.

Sudha Suresh: could be depending on the rate, we could see that can be manage by this quarter end.

Gautam Jain: So in this quarter is there any reversal of interest income added in the topline?

Rajat Singh: It was very marginal. So, compared to other quarters the number was negligible.

Gautam Jain: Can we get the number, sir?

Rajat Singh: It is close to 1 crores.

Gautam Jain: So, this year our loan growth guidance is around 20%-25% is that intact?

Sudha Suresh: So, current year we may close anywhere between 18% to 20%. But the guidance for next financial year could be definitely in the range of around 25%.

Gautam Jain: And by end of next year we will be converting all the branches into SFB?

Sudha Suresh: Yes, that is the plan.

Gautam Jain: And anything on the cost-to-income ratio side from 70% of FY18 to 19?

Rajat Singh: See, we are right now in our planning phase. So, those numbers will be made available in next couple of months and we have broad ideas of our asset growth, branch conversion but cost, etc. will be only coming in next couple of months. So, maybe in next concall we will be able to tell you more accurate.

Gautam Jain: Final question on the credit cost side, in this quarter we have around 40 bps of credit cost. So for next year, is safe to assume we will be below 1.5 or 150 bps?

Sudha Suresh: So, as you seen that the current book has an excellent collection efficiency of 99.7% and with this being the trend we expect next financial year credit cost to be approximately around 1% or even sub 1%.

Moderator: Thank you. We take the next question from the line of Aseem Pant from HSBC. Please go ahead.

Aseem Pant: Just a couple of questions. In terms of MSME sir mentioned that you revamped the process in, if I am not mistaken in the MSME and in the affordable housing space if you could elaborate on that and also how do you view the opportunities arising from GST and what is the on ground experience and secondly how do you view this whole PSU bank recap and kind of emphasis based placed on trying to lend to MSME from a competitive stand point that would be my first question and I will come to the second in a bit.

Samit Ghosh: So on the MSME and housing, we actually had it under one business earlier. So, we have split the business into two now and we first, we also got in people from the industry with experience both on the MSME side and housing. And we are on the MSME side earlier all our products and services we are largely as a finance company. But now that we have become a bank, we are in the process off introducing products like overdraft and things like that which can be offered jointly with the loan products to our customers in the MSME side. We frankly do not see too much competition from the public-sector banks in this area because we operate at a level which is where public sector banks are not very active because our loan sizes are much smaller then what they deal with.

Aseem Pant: And secondly sir, if you could share any insights or any lessons we might have learned from this whole microfinance crisis now as you look back and in terms of what the normalize credit cost maybe or specially you mentioned that some players in microfinance are reporting 98% collection efficiencies even post January 2017 disbursements. So, are we at a new normal now or how do you look at that?

Samit Ghosh: So, our repayment rates are actually 99.7 for the new loan. I think there are obviously lessons learned from the demonetization exercise. Largely this was an event which was a black swan event. But underlying there were lot of issues which has played one of the things obviously in states where we saw lot of political intervention, the states like Maharashtra which still continues the portfolio quality has not improved. And there might be an overlap in these areas of excessive competition among microfinance institutions. But it is not as bad as the situation was during the Andhra crisis because we have the credit bureau reports and we have the disciplines which we put in after the Andhra crises. But definitely I think in pockets were there was excessive competition we have saw also levels of political intervention. So, those are some other things we have to learn from this whole exercise but in general I think given the fact that microfinance now in on the new portfolio has came back to what it used to be, the demand is there, the customers are as good as they were before, the only issue really was external intervention and political intervention. As long as we can avoid that and may be concentration in terms of lending in excessive number of players in one in small pocket, I think we will be fine.

Aseem Pant: So, are you seeing competitive intensity reduce significantly or given your own growth outlook is probably a little lower than we had earlier kind of guided for?

Samit Ghosh: No, I think the competitive intensity has definitely declined. Some of the major players are no longer active. But on the other hand, institutions like Bandhan, etc., are aggressive and they are doing very well. Whereas some of the players who were very aggressive have disappeared from the market. So in those markets we do not have that much of a problem but again where we are competing with institutions like Bandhan we have stiff competition.

Moderator: Thank you. We take the next question from the line of Sandeep Dudhawat from Purnartha Investments. Please go ahead.

Sandeep Dudhawat: So, I just couple of questions, one was regarding can you give us the current disbursement run rate currently and how much can we expect for the quarter and are we lending through all the branches or are there still some branches we are not lending like last quarter the sub-95 PAR branches where we were lending?

Samit Ghosh: So I mean, Rajat will give you the details in terms of the growth rate of our disbursement but the branches where our PAR is more than 5%, it is not that we are not disbursing. We are disbursing but we are not acquiring new customers. We are only disbursing to our existing customers. So, we are disbursing in all the branches. But our disbursement rate obviously in the branches with PAR of more than 5% is lower because no new customers are being acquired in these branches. So they now account for about 149 of our branches.

Sandeep Dudhawat: So, 149 branches we are lending only to the existing customers?

Samit Ghosh: Yes, in that 149 branches we are only lending to our existing good customers.

Rajat Singh: In Q3, we have disbursed close to 2,100 crores which is almost 9% growth over Q2. In Q4 we are looking to similar kind of growth on disbursement 9% to 10%.

Sandeep Dudhawat: Similar 9% to 10% over this Q3?

Rajat Singh: Yes.

Sandeep Dudhawat: And one was regarding the cost of funds as last year it was given 150 basis points decline. So how much can we expect to go down from FY18 to FY19? Would it stabilize around some number?

Sudha Suresh: So, definitely from last year which saw at us about 10.4, we have already reduced 101 basis points and we had given a sort of guidance of around 150 basis points reduction for this financial year. We will see based on this quarter's acquisition of funds, we have also seen the interest rate trending up. So, we will see whether we can make it to the 150 basis points which we do expect. But going forward the momentum in terms of the decline in terms of absolute percentage will definitely taper down and if the interest cost do harden up, probably there is scope for reduction in finance cost or average cost of funds will be lower. But definitely around that 150 basis points that is achievable.

Sandeep Dudhawat: That would stabilize around lower by 150 basis. So any number on the NIM, how would our interest yields be affected as such there would be change in mix of our overall portfolio?

Sudha Suresh: So, we will also be looking at the lending rates for the next year and as we close on the budgets and other things we will have a fair picture of the same. Because we will have to factor in the possibilities of the rising interest cost and we will see that incorporated in our budget.

Sandeep Dudhawat: So, any rough number can be expected for NIM or so?

Sudha Suresh: I think it will be ideal if we can answer this in the next quarter.

Moderator: Thank you. Next question is from the line of Abhijeet S from Kotak Securities. Please go ahead.

Abhijeet S: Just trying to understand the NPL movement quarter-on-quarter, what was the slippage for the quarter and what was the recovery number?

Sneh Thakur: So, the opening balance for the quarter was Rs. 323 crores and we had a slippage of Rs. 35 crores and the collection of Rs. 31 crores and we have also written-off Rs. 33.5 crores and we close it Rs. 294 crores.

Abhijeet S: And in terms of overall NPLs, what would be the break up between MFI and non-MFI Sneh Thakur**:** It is majorly MFI.

Abhijeet S: While we are on MFI, just looking at the geographical break up of your book it seems that you are seeing pretty good growth in already penetrated markets like Tamil Nadu. Would it be fair to say that you are probably gaining market share or what explains this growth rate?

Samit Ghosh: See Tamil Nadu is well-penetrated but on the other hand major microfinance institutions are also cutting down on their microfinance business in that state. So, that also gives us an opportunity actually to grow our microfinance portfolio in that state.

Abhijeet S: But as of now you are not really worried about the state level issues on …

Samit Ghosh: Not in Tamil Nadu, definitely not.

Abhijeet S: Any other states that you would like to highlight where you are seeing some level of stress or some issues, political or otherwise?

Samit Ghosh: No, I think the residual impact of demonetization in Maharashtra is the only place where we have continued concern. Otherwise we do not have any concern.

Abhijeet S: While we are seeing that your share of relatively less penetrated states has been going up over last let’s say one year or so. Your average ticket sizes have also gone up quite a bit. I think the year-on-year growth on the microfinance ticket size is close to 20%. So, just trying to understand what explains that?

Rajat Singh: One of the reason for that higher skew is in this financial year number of fresh loan which we are given is lower due to this demonetization and more proposition of more repeat loan has push the ticket size up. So, in real life ticket sizes have not gone up by 20% it might have gone up by 10%-12%. But due to the mix of fresh and repeat number is looking at higher levels.

Abhijeet S: And the final question is on the liability side what would be the duration of CDs that you would have booked?

Sudha Suresh: So, we have done CDs which are largely for three months but there are some CDs also for 6 months.

Abhijeet S: And the marginal increase in the marginal cost of funds for the quarter is this because of higher share of CDs?

Sudha Suresh: No, I think this quarter the increase came because of our term loan from one of the financial institution and that was the cause

Abhijeet S: Ma'am, sorry just to understand this better the increase, is this because of …

Sudha Suresh: This you saw was not because of the CDs because we were able to acquire CDs at very low rates of interest but it was a term loan from a financial institution which has been the main cause of our marginal increase in the borrowings.

Moderator: Thank you. We take the next question from the line of Rishabh Parekh from Sunidhi Securities. Please go ahead.

Rishabh Parekh: Just wanted to ask some questions on regarding the NIM. So what I understood last quarter call was that the NIM expansion would be 150 basis points over last year. If I look at the 9-month FY17 NIM it was 13.42% versus 9 months this year was 10.39%. That is actually de-growth of about 300 basis points. So, could you just give a guidance on this years and next year's NIM, if possible please?

Rajat Singh: So, if we look at the (SFB) small finance banks NIM, I mean our guidance was kind of directed towards the SFB NIM and we started the year at close to, sub-9 NIM to begin with and we already said that we will have 150 basis point uptick on that NIM, which will finally closer to 10point something. So, NBFC NIM always will be slightly on the higher side which is the consolidated number, we should look at only SFB NIMs.

Rishabh Parekh: And could you provide some color on the consolidated NIM for this year and the next year possible because there is lot of change in terms of our liability, franchise as our asset base also. So, just wanted to understand how this NIMs will trend over the next couple of years?

Sudha Suresh: Yes, I think we can throw more light on it probably in the next quarter because we would have also finalized our budget for the next financial year.

Moderator: Thank you. Next question is from the line of Rakhi Prasad from Alder Capital. Please go ahead.

Rakhi Prasad: Just wanted to understand in terms of your disbursements where in the group loans, the micro individual loans has reduced the amount versus last year the same quarter, is this because you were saying more pain in the individual segment versus in group?

Rajat Singh: Yes, so for unsecured individual loan due to the demonetization we saw slightly higher NPLs. So, we had taken a pause to understand the reasons and also, I mean after doing on the checks and balances we are going back to growth but that has kind of slowdown our business in last quarter for individual loans.

Rakhi Prasad: Can you give a break up in terms of what is the NPA for the micro individual loan?

Rajat Singh: Generally, that couple of percentage higher.

Rakhi Prasad: It is 2%, that is quarter 3 of FY18?

Sneh Thakur: So, the GNPA is 7.5% on the IL portfolio.

Rakhi Prasad: 7.5% on the …

Sneh Thakur: Individual lending.

Rakhi Prasad: For Q3 of FY18?

Sneh Thakur: Yes.

Rakhi Prasad: And what was that in FY17, quarter 3?

Rajat Singh: So, see that number may not be comparable because there was no demonetization. So, it was less than 0.1%-0.2%.

Rakhi Prasad: Your group loan NPA would be much lower than in quarter 3 FY18?

Sneh Thakur: Our GNPA for group loans is at 4%.

Moderator: Thank you. We take the next question from the line of Anand Dama from B&K Securities. Please go ahead.

Anand Dama: Just wanted to ask that in the beginning of the call you mentioned something about the capital charge exemption that the RBI has extended. So, what is that about?

Sudha Suresh: Yes, So, in the denominator earlier there was a particular amount which was included as capital charge on market and operative risk-weighted assets and that exemption has come through an RBI circular dated November 08. So, because of that what is happened is the denominator has shrunk now. Because the denominator has shrunk you see the CAR percentage has gone higher. So, like if you saw in the earlier quarter something like 19 and odd right now you are seeing a percentage which is 22.02 or something like that. So, the reason basically is because the denominator has been changed.

Anand Dama: But any specific reason why this exemption has given?

Sudha Suresh: This is a circular coming from the RBI and this is an exemption available for all SFBs.

Anand Dama: All SFB?

Sudha Suresh: Yes, if you would again therefore back track and calculate your previous quarters based on this new RBI formula you would see that our CAR in the first two quarters also was in the range of 21.81% in Q1, 22.2% in Q2 and as of now as we indicated 22.05%.

Samit Ghosh: So, there is a very little leeway given to SFBs by the Reserve Bank but our minimum capital adequacy requirement is 15% and regular commercial banks have somewhere about 8%-9%, so this is the leeway given till the calculations given for SFBs that you do not include the operational and market risks allocation of capital.

Anand Dama: But does that mean that SFBs really do not have the operational in the market risk at all?

Samit Ghosh: I do not know about the operational risk side, but I think definitely operational risks is there to a certain extent, but it is more than adequately covered by our capital requirement of 15%. Market risk I think would be much more limited because we are not active in treasury and other things and we do not have also the exotic products which normally which are subject to market risk.

Anand Dama: Ma'am second question on this portfolio at risk which we have about 384 odd crores of an on book. So, how this portfolio is going to run down in next 12 months either through NPA or through write-off?

Sudha Suresh: So, write-off we will just come from the provisioning that we have already made on the identified loss assets and in terms of recoveries we are expecting recoveries in the range of 25% to 30% over a period of time.

Anand Dama: So, we have already recognized I believe 294 odd crores of NPA from these portfolio at risk book, right?

Sudha Suresh: Yes.

Anand Dama: So the remaining portion is that how do you tend to recognize that basically through the NPAs first and then you write it off?

Sudha Suresh: Yes, absolutely. They will get recognize as NPAs first, once we fully provide for these assets they will be taken up for write-off.

Anand Dama: So, what is that is actually holding back for us to basically recognize these accounts as NPAs proactively? Is there any payment which is coming into these accounts?

Sudha Suresh: Yes, absolutely. If they do not have a 100% provision today, it means that we are receiving recoveries on these accounts. It could be part, or it could be full EMIs but they continue to be delinquent with the lag in repayment.

Anand Dama: And lastly, we had this Karnataka election coming in this year, so any thoughts that again some kind of political risk or some kind of talks which are already going around which possibly could hurt the portfolio that we have particularly in the Karnataka region?

Samit Ghosh: See, we have been worried about elections in many states whether it is Bihar, West Bengal, whatever. Very frankly election do not impact this portfolio, it is only interventions of loan wavers and that comes about which came post-demonetization, etc., post Andhra crisis those are what created problems. Elections, we have generally seen do not impact the microfinance portfolio.

Anand Dama: And I hope so it does not this time around in the Karnataka.

Moderator: Thank you. The next question is from the line of Savi Jain from 2Point2 Capital. Please go ahead.

Savi Jain: I had a question as you convert your branches into your bank branches, do you retain all the staff that you have in those branches?

Rajat Singh: Yes. So, our branches actually are combination of microfinance, existing asset business as well as liability business. So, all our staffs are retained there who are currently focused on different asset class and also some of the administrative work like customer relationship, management and tellers job. So, they all are retrained because some of them also focus on building liability from existing customers.

Savi Jain: So, but the branch manager do you hire a different person or is it someone from inside the team?

Rajat Singh: So, in case of branch manager we trying to hire somebody with banking experience who can handle everything including operations, floor management and other business. So, we hire from outside as well.

Savi Jain: All these peoples that you hire from outside from prior banking experience they will be at a markedly higher salary as compared to your field staff that are present in your non-converted branches where typically the lowest level person would be getting around Rs. 15,000. So, how do you take care of these two different sets of compensation and how do you assimilate the culture between these two different sets of people?

Samit Ghosh: So, when we converted to the bank the people who worked in our microfinance business also got significant increases. So, there is no sort of dissonance from that perspective and people realize that someone is coming with a skill set of a branch manager where we run multiple businesses whether it is microfinance or deposit, or we also run housing, MSE businesses this person has a like an oversight over all these businesses and they make sure that the whole team works as a team. So, there is no dissonance within the organization because the microfinance staff are pretty happy that they got a healthy increase when we became a small finance bank.

Savi Jain: So, the benefit that you got on the cost of funds …

Samit Ghosh: Unlike other there are some, they are all part of the same branch. They are not like treated separately or anything like that. They form just one team of the branch.

Savi Jain: So, then it would have led to a significant increase in the salaries of these people who do collections at doorstep, etc. earlier they were maybe using a cycle to travel to these areas. So, there has been a change in the entire culture of the organization and the low-cost operation that was there that no longer remains?

Samit Ghosh: Well, first of all, we did had bicycles many years ago for our staff but most of them now use motor cycles and there has been an increase and that is reflected also in the operating cost but this staff which was doing microfinance is not only responsible for microfinance but is also responsible for raising deposits from these very customers. So, the relationship is now not just loans but also deposits from the microfinance customers. So, their role is also changed, and each branch raises at least 30% of their liabilities comes from the microfinance customers and these are largely in CASA, savings account and recurring deposits which actually lowers the cost of fund for that branch. So, they are adding value to the whole process. It is not as so they are just getting the money just because we have become a bank.

Savi Jain: So, just to continue on this line, earlier if I am right these people used to sleep in that branch itself and they used to have …

Samit Ghosh: No, we never did all that.

Savi Jain: You never did that but most of the …

Samit Ghosh: There are some institutions which do that. they are sleeping in the branch, etc., we never followed that.

Savi Jain: Even when you are a NBFC you were not in that?

Sudha Suresh: All our processes around the HR be it right from training to working hours all that was completely regulated and probably we were one of the finest institutions which in still the kind of code of conduct not only for our customers but I would say the entire protocol for how our employees are treated and I think you will see that reflection in the great place to work award that we have been year-after-year.

Samit Ghosh: So, we never follow that because there are, these practices were actually borrowed from Bangladesh. Some institution like Asha and all that they had that practice of having the staff live in the branches, etc., whereas Gramin Bank and other do not have that kind of practice. So, we followed largely what Gramin Bank follow in terms of microfinance.

Savi Jain: And second question is this, these existing branches that are already operational are you predominantly doing liabilities out of that or it is, you also lending from there?

Samit Ghosh: No, we do both. We do lending microfinance lending, we do lending of housing, MSE and also raising liability. These are not dedicated liability branches. These branches provide full set of services, which we offer.

Moderator: Thank you. We take next question from the line of Vaibhav Agarwal, an Individual Investor. Please go ahead.

Vaibhav Agarwal: I have a very broad level question like in a steady state environment without considering the impact of demon or something like that, what do you see the kind of growth rates in the loan book like you said around 25% in the next year. So, that would be a conservative estimate or it would be normal scenario like what is your take on it, is there is any scope of improvement?

Sudha Suresh: So, I think based on what we have seen in the past we would say that around the 25% is a reasonable estimate and definitely may be on the conservative side but looking at the years ahead we could even forecast a growth which could be in the range of 25% to 30%.

Vaibhav Agarwal: And what be the kind return ratios in terms of ROA and ROE, like broad figures like, right now it is from 5%-6%, so what kind of ROEs and what kind of ROAs can we expect?

Rajat Singh: So, long run we are targeting to two and a half percent of ROA and 16% to 18% of ROE.

Moderator: Thank you. We take next question from the line of Mayur Parkeria from Wealth Managers. Please go ahead.

Mayur Parkeria: Since we would have built our investment side of the SFB in the last 12 months or so, will it be fair to say that there would be now some mark-to-market losses on that portfolio given the hardening of yields which we have seen in the last 3 months?

Samit Ghosh: No we didn't had any mark-to-market losses this quarter. See, we were very careful about how we allocate our securities in investment. We had a small loss in the previous quarter, we learned our lesson and we re-allocated so that we do not have any losses this quarter.

Mayur Parkeria: So, what would be the average duration of this portfolio and what would be the yield at which we may be sitting?

Rajat Singh: Yield is closer to 6.4% to 6.5%, average duration I will have to come back. With most of them are under HTM category but I will have to come back right number.

Mayur Parkeria: But will it be fair that we will be around 7 years or is it so in that range?

Rajat Singh: We can get back to you on that.

Samit Ghosh: We can check with treasury and get back to you?

Mayur Parkeria: Because across the yield curve the rates have hardened significantly, so because it is HTM category I think we would have not …

Sudha Suresh: Yes, that is why we have not incurred any mark-to-market losses

Rajat Singh: And it is in all under HTM category, we have not such anything under ASF.

Mayur Parkeria: And can you help us with the customer profile for this CD and institutional deposits please?

Sudha Suresh: So, they have been fair amount of mutual funds as well as a few banks who have invested in our CD.

Mayur Parkeria: And if I understand this correctly just a clarification, so you are saying this marginal cost for the borowing is also 7% and our cost of deposit is also around in the region in 7%?

Sudha Suresh: Average cost, yes.

Mayur Parkeria: So, for the total liability side right now we are running at around 7% on the marginal cost?

Sudha Suresh: Yes, more or less. But we have been able to obtain deposits and the CDs at much lower cost also. So, we obtained CDs starting from 6.3-6.8 and so.

Mayur Parkeria: So, in that case given the rising base of deposits you mentioned in your initial answers you were saying that the tapering down of the cost of funds would come down but the pace would be very low but given the differential between current average cost and the marginal cost should not be that the average cost would continue to fall?

Sudha Suresh: Average cost will continue to fall but it could not be as drastic like we see that in this financial year we expect to have overall a 150 basis point. You cannot expect again a 150 basis point to come next year. That is what we were trying to say.

Mayur Parkeria: So, you still feel that it can come down around to less than 9%, it is possible?

Sudha Suresh: That possibility is there.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments.

Sudha Suresh: I think, we just had one question which Sneh Thakur would like to answer.

Sneh Thakur: So, this was the very first question on the collection efficiency, while 78% of the portfolio has the collection efficiency of 99.7% the balance 22% has an efficiency of 91.6%.

Sudha Suresh: So, with that we would like to thank all our participants for their interest in Ujjivan and the moderator. Thank you very much.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Axis Capital Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.