"Magma Fincorp Limited Update on the Recent NPA Sale Conference Call"

April 5, 2017

ANALYST: **MR. UMANG SHAH - EMKAY GLOBAL FINANCIAL SERVICES**

MANAGEMENT: **MR. SANJAY CHAMRIA - VICE CHAIRMAN & MANAGING DIRECTOR - MAGMA FINCORP LIMITED**
MR. KAILASH BAHETI - CFO - MAGMA FINCORP LIMITED
MR. KAUSHIK BANERJEE - PRESIDENT AND CEO, ABF BUSINESS - MAGMA FINCORP LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Conference Call of Magma Fincorp hosted by Emkay Global Financial Services. We have with us today Mr. Sanjay Chamria - Vice Chairman & Managing Director, Mr. Kailash Baheti - CFO, and Mr. Kaushik Banerjee - President and CEO, ABF Business. 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. Please note that this conference is being recorded. I now hand the conference over to Mr. Umang Shah from Emkay Global. Thank you and over to you!

Umang Shah: Thank you Stanford. Good morning everyone. I would like to welcome the management and thank them for giving us this opportunity to host the call. I would now hand over the call to Mr. Sanjay Chamria and request him to give us an update on the recent NPA sale that the company has done. Just a request to all participants that the call is mainly pertaining to give an update on the transaction, so kindly restrict your questions to the transaction and not to the Q4 performance. Over to you Sir!

Sanjay Chamria: Thank you Umang and good morning everyone and wish you all the best at the beginning of the new financial year. Thank you every one for taking time-out to attend this call. As Umang mentioned, this call is to explain our rational for the NPA sale of Rs.679 Crores at a consolidated level. As most of the people in the call might be aware that we were having significantly higher NPA levels in our books and our GNPA and the NNPA ratios without RBI dispensation as on December 31, 2016 were 10.5% and 8.1% respectively. Further, these NPAs were spread across various buckets from the early to the medium and hard to very hard buckets. To improve the overall focus in resolving our NPA issue, we have taken the decision to dispose off almost the entire hard bucket NPAs that is the NPAs which are greater than two years old in the asset backed financing business. In mortgage, we have gone a step further and sold almost all the NPAs which were greater than six months in the housing business. Post this sale, our GNPA and NNPA ratios will improve by 3.6% and 2.1% respectively. We are now focused on the balance NPA in our books, which would be just about an average of eight months into the NPA bucket. Consequent to the sale of NPAs, the NPA management team would be very sharply focused on recoveries in the early buckets and we expect to improve the resolution of the balance NPAs now remaining in our books, and thereby reduce the overall NPA during the current year. The overall impact of the NPA sale on FY2017 P&L would be around Rs.140 Crores at a PAT level. This would also mean that we would not have the overhang of the old NPAs in the coming quarters. Our decision was also driven by the following factors: (1) As per past trend, NPAs peak roughly in about two years from the date of origination. This means that the NPAs in the book originated up to March 2015 has peaked. (2) We have launched our new branch structure in December 2015 and we have experienced significant improvement in the portfolio quality in the new book. (3) Our new portfolio originated post December 2015 would be close to 45% as on March 2017 AUM and we expect a contribution of the new book to be around 80% by the end of March 2018. With the combined effect of the above three factors, we are confident that our NPAs have either already peaked or are very near peaked and we should see gradually improving NPA ratios in FY2018.

In the recent past, we have taken a few important initiatives as well to ensure that from now on the NPAs would not grow, but rather come down and with increase in the AUM the ratios will look even healthier. (1) We have launched branch and dealer grading effective April 2017 based on the overall sales and collection performance and varying degrees of focus on the stressed versus normal branches. (2) The quality of stress underwriting is expected to get further boost with the introduction of credit scoring model, which will strengthen credit decisioning by the branches. The introduction of the risk management framework and adoption of triggers, and branch and product levels to combat any earlier sign of portfolio stress will also bring about the improvement. (3) Investment in the NPA management team through creation of especially specific focus groups on high-ticket cases, reposition of assets, early disposal of repo assets, which should all lead to faster generation and high realization in the NPA accounts. (4) Introduction of the business CEOs for each vertical who are now responsible for the profits of the respective business like ABF mortgage and SME, and thereby greater degree of ownership and accountability with razor sharp focus on asset quality. We are sure that these initiatives would bring substantial improvement further in the portfolio quality. With the sale of NPAs behind us we have entered the new fiscal with much healthier balance sheet. We will witness reduction in the credit cost and hence better financials going forward.

I would now give some of the numbers in greater detail. The NPAs sold comprised of asset finance business, which we call as ABF, which compromise the commercial vehicles, passenger vehicles, tractors, used assets, construction equipment to the tune of about Rs.577 Crores and the mortgage NPAs of Rs.101 Crores. Out of the asset-backed finance, which is ABF NPAs of Rs.577 Crores, 73%, which is Rs.423 Crores of NPAs have been sold on a cash payment basis and only 27% that is Rs.155 Crores have been sold under the SR structure. Similarly out of the mortgage NPAs of Rs.101 Crores, we have sold Rs.92 Crores under the SR structure and Rs.9 Crores on a cash basis. Our total cash receipt is Rs.74 Crores and the investment in the SR is Rs.86 Crores. The logic of selling most of the mortgage NPA on the

SR basis is the underlying security for the mortgage NPAs does not lose value with the passage of time and the expected recoveries are a lot higher. Having shared with you all these, Kaushik, Kailash, and myself are ready to take any questions that you all may have. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone. If you wish to remove yourself from the question queue, you may press "*" and "2". Participants are requested to use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. We take the first question from the line of Amit Gupta from Everstone Capital. Please go ahead.

Amit Gupta: Good morning Sanjay Sir. In the new initiative, you have mentioned that four to five factors that have been taken by the Magma in which the quality of underwriting investment in NPA management team, introduction of business CEOs, and the first one you said that you have made some launches at a branch level?

Sanjay Chamria: Kaushik who is the CEO for the ABF business, which is 70% of our AUM is also on the call and he will explain that is the initiative he has introduced effective April.

Kaushik Banerjee: If you could be slightly more specific about what you like to know, I would be able to give you an appropriate response.

Amit Gupta: Sir basically I would like to understand what are all the changes or the initiatives we have introduced at a branch level.

Kaushik Banerjee: In Magma, we have some very sophisticated tools for protecting portfolio behavior, which kind of allows us to calculate terminal loss on any asset at any branch, so what we have done and this is called as CPMI index. We have 300 branches and we have 8 product lines, so we have actually graded all 300 branches and all the 8 products at each branch under the RAG, which is red, amber, green classifications based on the actual portfolio of the branches and we have linked right from the feet on speed up to senior dealership position, we have aligned their KRAs and KPIs to the branch grading. So, just to give an example, if a branch is graded an A then the branch manager quote KRAs as sales linked with a higher weightage on sales and lower weightage on collections. Whereas if a branch is graded as D then the KRA of the branch manager there is significantly cued towards collections with the lowest cue on the sales side.

Amit Gupta: Are we saying that we have categorized these branches basically based on the CPMI index and the products that these branches are handling, so the management has decided that these branches should focus mainly on sales and these branches have more stressed assets so they should focus only on the collection?

Kaushik Banerjee: You are absolutely right, so the entire thing is aligned, so even the credit eligibility norms, etc., are all linked to the grading of the branch. We have also graded the dealers for each product.

Amit Gupta: Dealers of the products?

Kaushik Banerjee: Including the dealers, yes, even they have grading, so even our empathy in terms of doing business with dealers is linked to the grading of the particular dealer of that particular asset category.

Amit Gupta: And this has been done on a PAN India basis?

Kaushik Banerjee: This has been done on a PAN India basis, yes.

Amit Gupta: Okay. Sir this CPMI index, which you are saying what does this stand for?

Kaushik Banerjee: It is continuous portfolio monitoring index.

Amit Gupta: Continuous portfolio monitoring index.

Sanjay Chamria: I think, you know, Amit in simplistic terms what we call is early warning indicators and this basically measures the quality of the portfolio originated in the last 15 to 18 months and measured by the number of contracts which are more than two installments due. Therefore, there is specific tolerance that we would have and the branch manager and the team would be responsible to ensure that the quality of new portfolio originated should be within that tolerance and therefore the branches are graded accordingly. Now as Kaushik mentioned there are several products, it could be that some products would bring the triggers, some products are within the triggers, so therefore the product in which the branch would bring the trigger there the focus would be more on collection, whereas the products in which the branch is well within the trigger the focus would continue to remain on sales. This will also then bring in a self-control at each of the branches because you cannot guide and control everything from head office.

Amit Gupta: Agreed Sir, one little connected question if I may ask?

Kaushik Banerjee: Go ahead.

Amit Gupta: Sir as Sanjay Sir has explained that now we have adopted a policy that for each and every business they have identified a CEO who will be responsible for driving that business, their profitability, their asset quality, ownership responsibility and everything, but I guess that all these businesses are coming through the branches wherein one particular branch may handle three or four different products, so how are these reporting structures for the branches or let us say for the branch manager, how are they placed and how do they report to the CEO?

Sanjay Chamria: Yes, this question I will take. What we are doing is, branches as distribution centres, wherein in fact not three, in fact four businesses are operating out of, which is the asset finance, SME housing and even our insurance. Therefore we have evolved a support function infrastructure wherein we have operations and IT and admin as one, HR is another, and finance is third, so there is arm's length distribution of the cost incurred at the branches between the four businesses and depending upon which branch is using what kind of an infrastructure accordingly the loading will happen to that business and we have also in the last six months introduced a lot of new leadership in the company. For example, Chirag has joined as a Chief Operating Officer at a group level and he was earlier a COO of life insurance company and he is responsible for IT, operations, admin, and customer services. Similarly, Kailash has assumed role in the last six months as a CFO so he is overseeing the entire finance function and then Debraj has joined us from a Max Life Group as the Chief People Officer heading the HR function at a group level. Therefore, the branches are the frontend which are to be leveraged by each of the four businesses for the purpose of reaching out to the agents and the customers, and the overall cost incurred at a branch level is split across businesses on a pre-agreed formula so that each CEO would know as to what is the loading that is happening to his business. In terms of the reporting structure, the people who are pertaining to the respective business vertical would report through the four-tier approach, which is the branch, region, zone and a national level right up to the CEO. Whereas the support function infrastructure would report to their support functional heads.

Amit Gupta: It is branch, region, zone, then national level. Okay Sir. That answers my query very well. Thank you so much.

Moderator: Thank you. We take the next question from the line of Deepak Poddhar from Sapphire Capital. Please go ahead.

Deepak Poddhar: Thank you very much Sir for the opportunity. My first question revolves around your ROA and credit cost. Now that we are through with our asset sale, for FY2018 we were discussing a target of 1.5% for both ROA and credit cost, so do you envisage any kind of improvement over that kind of target or how we stick to that?

Sanjay Chamria: Deepak, as Umang mentioned in the opening comments that this particular call we would rather restrict to the sale of the NPA and the questions related to that and not on the Q4 performance and not in terms of guidance for FY2018, which is something that I will do after our 11th May board meeting and this time we are proposing to even have an interaction in Mumbai, we will meet with all of you and at that time we will have face-to-face interaction.

Deepak Poddhar: Sure, no problem. Now my second question pertains to your provision coverage. As I see post this asset sale, your coverage would be around 14% to 15% right?

Kailash Baheti: Yes, you are right. It will be slightly higher than 15%.

Deepak Poddhar: So what is the thought process on that, because would we want to increase that provision coverage ratio that we have, any thoughts on that would be helpful?

Kailash Baheti: The provision coverage ratio is a function of what kind of assets you have on your book and when all the NPAs, for example, the NPAs related to mortgage is now only between 90 and 180 or 120 and 180 depending on whether it is housing finance or Magma Fincorp, that is the very initial bucket. You cannot have very high provisioning there and the second is also as we said the overall NPAs will be just in two NPA buckets for eight months only. The average age just about 358-360 days, so when you have such young NPA obviously the provisioning will be lower. Whether we would like to increase the provisioning or not I think going forward as we time passes obviously the provisioning coverage will increase.

Deepak Poddhar: Okay. So is there any sort of raised that we are looking at this what we are comfortable with in general 20% to 25% kind of range, I understand that it depends upon your age but generally as a policy.

Kailash Baheti: If you see next year, this year itself FY'18 RBI guidelines also requires the entire industry to move to 90 plus. Also the next higher bucket for higher provisioning would also advance from 540 DPD to 455 DPD, which is from 18 months to 15 months and therefore by virtue of this itself the PCR will increase to more than 20% and even we would look to increase our PCR as a guidance over the succeeding quarter.

Deepak Poddhar: Okay, I understood that. I think that is it from my side. Thanks.

Moderator: Thank you. We will take the next question from the line of Ashwin Balasubramaniam from HSBC Asset Management. Please go ahead.

A. Balasubramaniam: I just had a couple of questions First is what is the NPA sale on cash basis or on security reserve basis and if SR basis what would be the proportion of cash. Secondly, assuming that NPA sale had not happened what would have been the kind of provisioning which you would have required for these accounts?

Kailash Baheti: The cash to SR, as we mentioned from the total sale we realized is Rs.160 Crores. Out of this about Rs.74 Crores is cash and Rs.86 Crores is SR. Within this, there is somewhat deeper detail which you have to notice which is in mortgage we have sold Rs.101 Crores and only Rs.9 Crores is on cash and the rest Rs.92 Crores is on SR, and there we mentioned that since the underlying security is extremely good, we felt that SR structure is going to give us better result. Whereas on ABF, 73% of sale is on cash basis and only a small 27% is on SR structure.

A. Balasubramaniam: What would be kind of provisioning which would have been required for these accounts if the sale had not happened?

Kailash Baheti: That is not really relevant. You have 730 plus bucket. We have taken this decision to reduce our NPA because we had NPA into 730 plus and up to infinite, and RBI provisioning requirement is only 50% until you may have ceased and sold and repossessed and whatever or you have done settlement. Now 730 plus up to infinity, the total average seasoning in our books when we sold was 31 months and what we have left is just about eight months, so there is no comparison.

A. Balasubramaniam: Okay. Thank you.

Moderator: Thank you. We will take the next question from the line of Rahul Ranade from Goldman Sachs Asset Management. Please go ahead.

Rahul Ranade: Thanks for the opportunity I just want to understand this clearly, so on a consolidated basis, we have actually received 160 Crores of proceeds from the sale of NPAs.

Kailash Baheti: That is right.

Rahul Ranade: Okay and out of which 74 Crores is in cash and 86 Crores is in SR?

Sanjay Chamria: That is right.

Rahul Ranade: Okay and you further gave the split of, out of that the mortgage NPA was Rs.101 Crores of which 9 Crores only was in cash and 92 Crores was in SR?

Kailash Baheti: That is right.

Rahul Ranade: Alright, so it is kind of 301 Crores of proceeds received for the mortgage and the remaining 50 Crores odd is received for the ABF is that right understanding?

Kailash Baheti: No. Rs.101 Crores is what we have sold. What we realized is there would be percentage of 101 Crores, it was roughly between 75% and 80%.

Rahul Ranade: In the mortgage?

Kailash Baheti: Yes. So you are right SRs are largely of the mortgage book.

Rahul Ranade: Okay, alright. Thank you.

Moderator: Thank you. We will take the followup question from the line of Amit Gupta from Everstone Capital. Please go ahead.

Amit Gupta: I just wanted to have some clarity. As you mentioned, in December 2016 the GNPA and NNPA numbers were 10.5% and 8.1%.

Kailash Baheti: Yes, that is right without taking the RBI dispensation.

Amit Gupta: Yes, before taking this NPA sell out. So can you guide after this NPA sale out what would have been the numbers?

Kailash Baheti: Actually, the sale has happened in March but if we have to deduct what we have done in March from the December numbers, the number will be 6.9% GNPA and 6% NNPA.

Amit Gupta: Thanks Sir.

Moderator: Thank you. We will take the next question from the line of Rishindra Goswami from Locus Investment. Please go ahead.

Rishindra Goswami: Just a clarification, the total proceeds that you received from the NPA sale if I got that correct is Rs.160 Crores?

Sanjay Chamria: Yes.

Rishindra Goswami: Okay and that is split between mortgage and the asset finance.

Sanjay Chamria: Yes.

Rishindra Goswami: Could you share what was the loss that you booked on the sale?

Sanjay Chamria: We said the impact on PAT basis will be around 140 Crores.

Rishindra Goswami: 140 Crores loss for the full year?

Sanjay Chamria: It is the loss from the sale of NPA assets only from this transaction.

Rishindra Goswami: Okay, that is the PAT impact. This 140 Crores impact is Q4 impact or full year impact?

Kailash Baheti: It is impact of NPA sale only, so whatever profit we had up to December was there, this transaction has resulted in 140 Crores loss at PAT level and whatever profit we will have for Q4 excluding this will also come.

Rishindra Goswami: The GNPA number that you mentioned 6.8 and 6%, this is the current NPA position after the sale?

Kailash Baheti: I said that December NPA if we reduced whatever we have sold then the ratio will be 6.9 and 6.

Rishindra Goswami: Okay, got those are the numbers. What is the coverage now post the NPA sale?

Kailash Baheti: It is at about 15% plus.

Rishindra Goswami: Okay, thank you. That is all.

Moderator: Thank you. We will take the next question from the line of Shubhankar Ojha from SKS Capital and Research. Please go ahead.

Shubhankar Ojha: Thanks for the opportunity. One question, in terms of the absolute number if you can say post the sale of this NPA, what is the absolute NPA that you have?

Kailash Baheti: Absolute GNPA will be near about 1150 and net NPA will be about 1000 Crores, just short of 1000 Crores. These are the December numbers, so whatever was the December number, we have deducted the amount which we have sold.

Shubhankar Ojha: Can you also give me segment wise breakup of this?

Sanjay Chamria: Sorry, that data is not right now available with me. Only to add that in the previous question whatever I had replied was prior to RBI dispensation. We had also taken RBI dispensation, now the numbers which I have given is 1150 and about 1000 is without RBI dispensation.

Shubhankar Ojha: Okay and including RBI how much would that be?

Sanjay Chamria: If we had taken RBI dispensation this would have been Rs.100 Crores less because RBI dispensation would give you benefit of not treating certain tractor NPAs as NPAs, but we are treating including everything.

Shubhankar Ojha: Understood. Thank you so much Sir.

Moderator: Thank you. We will take the next question from the line of Nishant Shah from Axis Capital. Please go ahead.

Nishant Shah: Thank you for the opportunity Sir. Just one clarification on the numbers, we have about 679 Crores worth of GNPAs which we have sold. Consideration received is about 160 Crores and the expected loss from the transaction that we will book is around 140 Crores, so this balance 379 Crores that we have to assume this was provisioning which was already created earlier and which is just going to get written off from the book, is that correct?

Sanjay Chamria: Yes, whatever was provisioning created this loss of 140 Crores at PAT level is the net of debt provision.

Nishant Shah: Understood, now this new provision coverage ratio of around 15%, does this imply that you are confident of collections from this or is it just because the NPL bucketing is around eight months, therefore right now you just do not need provisions yet, but now like on average eight months crosses over to one year, what is the likely provisioning that we will have to take? I think if it goes from 15 to 25 or 25 to 40 then again we will need to create like large provisions. What message do we take from this new PCR, being confident of recoveries in the remaining 1000 Crores of NNPAs?

Sanjay Chamria: We have made the three or four points. The first was that what we sold was 31 months into NPA bucket, what we have is eight months into NPA. (2) Once these older NPAs are off our books, we will be able to have significantly higher amount of concentration focussed on realizing the rest of the NPAs and we are confident of improving our realization significantly from the rest of the NPAs. Third point was also that for mortgages, the book is only between 90 and 180, we have sold off almost entire at 180 plus itself and therefore the requirements of provisioning are significantly lower and obviously when the NPAs are fresher the possibilities of realization are far, far greater.

Nishant Shah: Okay, thank you so much Sir. Just one small followup question. For Q3 FY17, if I see in ROA tree perspective, we had a top-line of about 15.8% which implies a 15.8% average yield, so this would now include a lot of interest reversals for that quarter right? What is our average incremental yield on all these assets, because from the market perspective these seem to be somewhat slightly risk perspective, so just wanted to understand why our yields are so low? Is it just because of interest reversals which have been occurring up to now and which will reverse going ahead because we have sold off most of the NPAs or is there something more to be said over here?

Sanjay Chamria: I would only reply that when there NPAs, the interest reversal was higher and once NPAs are off, obviously there would some improvement in the NIMs.

Nishant Shah: Incrementally what are our average yields?

Sanjay Chamria: Our average yields are about 16.5%.

Nishant Shah: Okay, thank you so much Sir. That is all from my side.

Moderator: Thank you. We take the next question from the line of Umang Shah from Emkay Global. Please go ahead.

Umang Shah: Thanks for the opportunity. Sir, I just need one small clarification, the 6.9% gross NPA number that we have given post the sale, that does not include any RBI dispensation right?

Sanjay Chamria: Yes, that is right.

Umang Shah: Okay. Got that. So that is already on the higher side, okay. Stanford, do we have any other questions or else we can close the call?

Moderator: We do not have any questions.

Umang Shah: Alright. Thank you so much. We would like to thank the management once again for giving us an opportunity to host the call and we thank all the participants to connect. Thank you and have a good day.

Sanjay Chamria: Thank you.

Moderator: Thank you very much. On behalf of Emkay Global Financial Services that concludes this conference. Thank you for joining us and you may now disconnect your lines.