"Srei Infrastructure Limited Q2FY19 Earnings Conference Call"

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MODERATOR: **MR. ASITAVSAHOO -MAYBANK KIM ENG SECURITIES PVT LTD.**

Moderator: Ladies and gentlemen, goodday and welcome to the Srei Infrastructure Finance Limited Q2 FY19 Earnings Conference Call hosted by Maybank Kim Eng Securities India Private Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the 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. AsitavSahoofrom Maybank Kim Eng Securities. Thank you and over to you sir.

AsitavSahoo: Thank you. Good afternoon everyone and welcome to this Conference Call to discuss H1 FY19 numbers. From the Management Team we have Mr. Hemant Kanoria – CMD, Srei Infrastructure Finance, Mr. Devendra Kumar Vyas – CEO, Srei Equipment Finance, Mr. Sanjeev Sancheti – the Chief Strategy Officer, Mr. Sandeep Kumar Sultania – the CFO and Mr. Amit Agarwal – Vice President - IR. So we will begin with a brief management commentary and then we can open it up for Q&A. I would hand over the proceedings to Mr. Hemant Kanoria to begin the call. Over to you, sir.

Hemant Kanoria: Thank you. Good morning and good afternoon everyone. I would like to first of all make a brief introduction on the situation of the NBFC sector at this particular juncture vis-à-vis where Srei stand as we had the last conference call which was there on the 6th of September.That time the situation for the NBFCs was very different and the entire environment for the NBFCs was very conducive for their growth, there was no setbacks which anyone had and people were all quite optimistic that NBFC and the sector itself and all the companies specifically would continue to show very good performance both from the perspective of growth and their profitability. But however the situation changed on the 21st of September when we had the debacleof ILFS and subsequent to that everything around that just changed and there seems to be a topsy-turvy in the infra space.Many of the companies,even the large companies and very well established companies, were caught unaware because they had a short term liability and long term asset so in the short term, there were mismatches in the asset liability maturity tenure and everyone was caught by surprise and many of the companies who were there on the growth trajectory also found that liquidity had become a big issue so therefore there has been many setbacks in the NBFC sector and people has been seeing that for the last one and a half months now almost two months that this particular ILFS problem we keep on reading in the papers, we keep on seeing from time to time how things are changing. However, for Srei fortunately we have not been affected in any manner what so ever. Because for the last 30 years we have been in this business and have very well formalized and fundamental principles which has been institutionalized so therefore we have been able to stick to that. We never believed in an asset liability maturity mismatch so therefore when this situation of mutual fund money being utilized for lending medium to long term arose we were not caught unaware because we had no such situation where we had mutual fund money which was used for lending purposes. So we have no asset liability maturity mismatch from that particular perspective. We had very small mutual fund exposure through CPs which was there in Srei Infra and Srei Equipment and both have been fully paid off. So at this juncture, and it was very small amount in Srei Infra it was almost negligible about 50-100 crore and in Srei Equipment also 300-400 crore which was all paid off. So, therefore we have no outstanding mutual fund money because we used to use the mutual fund and I would like to invite the attention of everyone that for the last so many years we have been mentioning this continuously that the mutual fund money which we had been borrowing under CPs was only used for interest arbitrage and not for the lending purposes. So, therefore this situation of ILFS has not caught us unaware and therefore we have not had any surprise from this particular debacle which is taking place. So for us, business is as usual. In the Infra financing our strategy remains the same, there is no change in the peer end which isSrei Infrastructure finance, we reiterate that our strategy was to generate business, down sell and improve the ROE through velocity of the business that we are doing and churning because with the skillset that we have developed as a team for management, first of all understanding risks and mitigating them and executing transactions. So we continue to do that, there is no change in our strategy or the business model. In the Srei Equipment finance our business model was to finance equipment's we continue to do that, there is a robust growth in the construction mining equipment, healthcare, IT which we had also diversified. So business remains as usual for us where the equipment financing is also concerned. Nevertheless, what has been the setback it is not that anything which happens in the market does not have some negative effect. So the negative effect would be only to a certain extent and very marginally would be that funding from banks would now be a little slow to come because we used to rely on the bank funding also but over a period of time - last two years we have renewed that many of the banks we are reaching our exposure norms so therefore GAAP and that is a reason why we had shifted to ECBs and now we have shifted to ECAs also in a big way. Last week the RBI has also relaxed the average maturity tenure for ECA loans which used to be three years so therefore that will be also acting as a positive for us while we are doing business. So we would be looking at the funding source for us that would remain to be in three, four manner one is the ECB, second is the ECA lines again international, NCD issuance which is there and the forth would be through securitization and we have also now gradually started developing a market for Co-lending. RBI again about a month and a half back they have come out with a very clear guideline on co-lending which the NBFCs can do along with the bank. So therefore, co-lending is another product that we have been developing. Again in the last one, one and half years since the GST has been allowed and we have mentioned in our previous calls also that we would be doing leasing again as we used to do about 10-20 years back. Since the multiplicity of taxes was introduced leasing had become an extinct product which has been revived after the introduction of GST. So from the asset acquisition side our business remains to be strong, from the borrowing side again because of the various types of borrowing that we were engaged in we'll continue to do that. So therefore, I do not see that there is a major setback. So what has definitely affected the market and our company to a certain extent would be the negative sentiment. But when we go and explain to people that this is our business model so therefore we have seen in the last one and half month since the ILFS collapse also that our bankers they have stood beside us becausethey have seen the kind of quality of our portfolio and the business model that they had. So the banks and the lenders are aligning themselves to support those companies who have their fundamental business model in place. So therefore for us from the business perspective both in Srei Infra and the Srei Equipment the business is normal, life remains for us as it was earlier before the pre-ILFS scenario and also from the fundamental principles plus the policies, strategy that we have it remains the same. So there will be no change. This was a brief background that I wanted to just present to all of you before we get into the financials. I will now request my colleagues DK Vyas to present the financials.

Devendra Kumar Vyas: Hi, good afternoon everyone. We have had very good quarter,profit has grown overall by 29% this quarter and for the six months compared to corresponding period the growth has been 66%. On the Equipment Finance business, profit for the six months has grown by 86% and for the quarter it is 46% growth. Our assets under management has crossed Rs. 50,000 crore so broadly there has been a growth of over 14% in assets under management (AUM)consolidated. And in the Equipment finance, as Mr. Hemant said seems to be a focusing on growth of equipment finance, the equipment finance AUM has grown by over 27% because the growth in the equipment segment is continuing. The equipment market has been growing very good quarter on quarter and we being the leader there our portfolio also is growing there. Our return on equity overall has improved to 12.8% from 8.4% last year. And for equipment finance business return on equity has crossed 15% in this quarter. RoA return on asset has also improved it has gone up to 1.1% from 0.8% and in equipment finance it has crossed 1.5%. Our asset quality has been improving quarter on quarter that is what we have been saying even the asset quality, cost of risk or credit cost has been coming down, our credit cost of this quarter in equipment finance business is just 1% which is now coming back to normal. It has reduced compared to last year September quarter from 2% it has come down to 1% and for the six months it has gone to 1.3% and as far as in Srei Infra Finance also the asset quality has been good so there also the cost of risk has come down substantially. Our cost to income ratio has also improved, our cost to income on equipment finance has come down to 30% now, though on absolute terms you may see a little bit of increase in the cost, particularly on the employee benefit, because of continued good performance for last two years, this year we had announced good performance incentive for employees which was disbursed in this quarter July to September quarter due to which the cost has gone up a bit and in other administrative expenses the cost has increased due to onetime expenses for some recovery expenses and professional fee, etc but overall cost to income ratio has reduced to 30% on equipment and finance business, it has improved. Our asset quality as I said has been improving so our gross NPA for equipment finance business has further improved. Ithas reduced from 3.3% to 3.2% in this quarter and net NPA also has been reduced marginally it has come down in both the business, both infrastructure finance and say equipment finance. Our provision coverage ratio has also improved for project finance it has gone up to 47% and the equipment finance it has gone up to 40%. So broadly overall it has been a good quarter in terms of improvement in asset quality the continuing growth improvement in profitability, improvement in NPA scenario, etc. So there has been a good quarter from all perspective and, just to share with you beyond and apart from that in equipment finance business our repossession stock also has be coming down quarter on quarter. So this quarter there has been reduction in repo stock further so that also speaks about the good realization of the repossessed asset as well as the good growth in the overall business. So this broadly about the financials about both the organization.We are now open to question and answer.

Sanjeev Sancheti: So this was the brief background of the financial. Now we are open for the Q&A.

Moderator: Sure, thank you very much. We will now begin 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 questions. Ladies and gentlemen we will wait for moment while the question queue assembles. We have the first question from the line ofAnita Rangan from HSBC. Please go ahead.

Anita Rangan: Just wanted to know what is the status on the IPO of Srei Equipment at this juncture. And if let say IPOs like postponed or delayed what is the prospective for capital raising in this entity so on that note what kind of growth assumptions are you making for the next couple of months or couple of quarters down the line that was my first question and secondly, can you throw some color also on the absolute amount of Gross NPA, Net NPA and how much is the repo assets and so on.

Hemant Kanoria: So basically answering your first question on the IPO, as you would appreciate that at present the market is not conducive for receiving any IPO from the NBFC sector because it is not specifically that we have any issues but there is general feeling that the NBFC would be having certain problems so we would wait for sometime before we are going to launch our IPO because we have to see the market, we want to see the market stabilize and that is what our investment bankers have also suggested. It is a too early to decide for an IPO now because of the present market situation due to ILFS. And also on the alternate side we will look at many of the private equity guys are interested so we would start the discussions from them because we are just waiting to see what happens with the ILFS one, it had just happened, it has just been one and a half month that the ILFS issue has occur so we will just wait and within the next 15 days to a month we will take a decision that which way to go. But that would not deter us from continuing with our growth because there are various opportunities on the growth side of it. So we will continue our growth and which is also being happening in the last one, one and a half month so we have not slowed down our growth. Whenever there is a good opportunity definitely we will be cautious about the quality of the assets and the financing that we do because we have always kept in mind that whenever we are doing financing we have to get the money back so it is not for growth sake itself so therefore we are going to do an intelligent growth we will continue on that path. On the specifics of the NPA and the repossession and all.

Devendra Kumar Vyas: Yes, for repossession stock for Srei Equipment finance the repossess stock has come down from Rs658 crores in last year September 17 to Rs332 crores and there has been a continuous decrease in that if you see quarter on quarter repossession stock has been improving and the realization is improving on that. As regards to NPA for Equipment finance the gross NPA is Rs 901 crore which is around 3.2% and net NPA is Rs.534 crore for say equipment finance which is around 1.99% just close to 2% and for Srei infrastructure finance the gross NPA is around Rs1814 crore and the net NPA is Rs957 crore so there is a provision coverage of 47% for Srei Infrastructure finance and the provision coverage is 40% for Srei Equipment finance and since this year the IndAS has been implemented from 1st April so our provision coverage which used to be around 30% has gone up, we have improved that and now it is on 40%.

Sanjeev Sancheti: Overall 45%

Devendra Kumar Vyas: Yes, overall 45%.

Anita Rangan: Thank you, just one more question. Your capital adequacy ratio in Srei Equipment was very close to 15% so I am just trying to understand in that sense will your growth be a little bit of a challenge at this point and what will be your capital adequacy at this juncture can you share that number?

Hemant Kanoria: Basically we will maintain our capital adequacy which will be as per the requirement of RBI so it will be in consonance with the RBI requirement. Yes, it will be a fine balancing that we have to do but we will continue to do that balancing but we will not sacrifice the growth because of the capital adequacy. Similarly we will not compromise on the capital adequacy because of the growth so it will be a fine balance which we will maintain.

Moderator: Thank you. The next question is from the line ofSameer Dalal from Natwarlal& Sons. Please go ahead.

Sameer Dalal: So the first question is to do with your gross stage NPA question that was already done but your gross stage has gone from Q1 to Q2 from 9% to 9.7%. If you can just explain why there has been an increase after you have already, after the ECL was implemented, you have taken all the possible losses that would come why such a big jump has happened in Q2.

Sanjeev Sancheti: No, there isn't any significant jump here. So if you look at it, it has gone up from Rs1769 crores to Rs1814 crores. That is just about Rs50 crores.

Sameer Dalal: You said it'sRs1840 crores right, your gross NPA.

Sanjeev Sancheti: Rs1814 crores.

Sameer Dalal: Okay. But what is the particular reason why after even taking the probable losses that could occur why a further increase in the gross stage three that means the probable losses are also going further up so, where is the problem in the lending space that has happened which is causing this problem on your books.

Sanjeev Sancheti: These are not probable losses sometimes these are technical NPAs when you touch a particular number of days of OD. I do not think that we are talking about losses increasing really speaking, Rs30-40 crores plus minus in such a big book can always happen in any point of time. In fact the credit cost has come down so we are not seeing situations where our losses are going to increase. We have sufficiently covered by significantly high coverage ratio.

Hemant Kanoria: And also under IndAS what had happened was that we had taken certain standards so therefore any letter suppose it is delay by one day also we have to do, it does not mean that the money is not going to come back or the money is not but there is no such discipline also with borrowers that it will be paid on exactly the same day, there can a slip of one day here and there but because of provisioning we have to do the provisioning and it comes back next month. So 50 crores plus, minus I think this is only 50 crore, 50 crore plus minus will keep on happening that way.

Sameer Dalal: Okay. On the second side, equipment financing yes there is a lot of collateral in the form of equipment that is there so you probably provided a bit lower but on the infrastructure side the provisioning is near about 50-55%. Now in these large infra projects usually the asset that is there collateral sometimes we need not quantify anything as we have seen in the past where you have to take huge right offs. So can you give us some sense on what kind of right offs we could expect going forward from the infrastructure book given that the net NPAs are still around Rs950 crores.

Hemant Kanoria: Here in the infrastructure sector you see there is an advantage also, there is a big advantage because in the infrastructure project the infrastructure has been created. So if the infrastructure has been created the cause of certain gaps in the government policies there may be some time which take to resolve those government issue but from our perspective under IndAS we had taken certain policies. So as per that policy we do the provisioning but that does not mean that the asset is written off, because in infrastructure there is a solid asset for example there is a power plant or also we have certain exposures to SR and all. So, as soon as we have made a provision, but as soon as the money comes back which we are expecting should be happening within this particular quarter, so there will be a huge write back because of that. So, similarly because the asset quality is good but the cash flow has not happened that is the reason why the provision has to be made but as soon as the things get resolved with the government or where any kind of laws and all which have been implemented and set right, then we start getting the money.

Sameer Dalal: So can you break up three things, can you tell us what is SRs exposure that you have as of today, what is the exposure to various road projects which are now in the NPA category power projects can you break up what are the sectors and SR especially.

Hemant Kanoria: Yes, sure so what we will do is that we will just, so you require three things and all the three we will send it to you because we do not have it in front of us exactly so all the three will take out the specifics and send it over to you.

Sameer Dalal: Okay, fine great that will be good. Going forward now coming back on the strategy side earlier also there was a question asked on 15% capital adequacy has almost been reached in the Equipment financing book and you said that there would be some amount of sell down of loan asset that you do so that you can grow the equipment finance book going forward. Just to understand when you sell down the finance loan that you have, can you explain how much of the income or profit that you retain and how much you pass on and how that could affect us, I am trying to work out if you were to grow by 10, 15, 20% and need to sell off that particular amount what could be the increase in spreads or NIMS that would have been going forward.

Hemant Kanoria: Basically if we look at it, all these particular securitization that we do is just a way of funding for us.

Sameer Dalal: I understand that, but when you sell it down how much do you retain and how much do you pass on to the person who you sell the securitize asset.

Devendra Kumar Vyas: So basically when we sell down we are talking about assignment and securitization. So assignment or transaction which are bilateral with the banks and mutual fund when we do, the difference which comes is around say 2 to 3% range whatever it comes from the pool to pool and that is been taken as intoso when we implement IndAS that time it has gone through the transition period so now we unwind that or whenever new we are doing we take that upfront earlier it was getting amortize as IGAAP now the difference comes upfront as per the IndAS accounting norm. And the previous one is getting un-winded so it is a normal practice the pool to pool varies somewhere pool which has got a high yield and we are able to get a better pricing for that pool. The difference could go to 3 to 4% or it could be, so 2 to 4% the range for various pools.

Sameer Dalal: And you are saying that you will take that entire income upfront even if it's a two year loan that is probably outstanding**.**

Devendra Kumar Vyas: But that is now accounting rule till March it was getting amortize so now the IndAS say that you have to take it up front.

Sameer Dalal: Okay, fine. And last question on the book value, your book value from Q1 to Q2 again has been lower from 81 to 77 please explain why the book value has further fallen.

Sanjeev Sancheti: Two reasons one that, during the transition there was this, the transition losses which were taken to the reserve there was a deferred tax asset to be created this year conservatively we have removed the deferred tax asset because deferred tax asset which you have taken that we have removed so we have taken the full loss into the reserve so that has curtained about Rs110 to 120 crores of , and then we have divided payout which has happened this quarter which has also resulted in reduction in the Rs30 crores PAT. So these two reasons are the main reason for the reduction, this is one time.

Sameer Dalal: Okay. And last question provisioning it has seen a good decline, now going forward given that if you are saying that you won't need to provide too much further and if you get SR sold off and getting money coming through what kind of provisions can we expect in H2 for the current financial year.

Devendra Kumar Vyas: So in Sreitoday you see 47% coverage is there once we start, as Mr. Hemant said once we start seeing recovery we will keep reviewing I think the provisioning policy we are not going to change, the amount may change depending on the customers and contracts and exposure but we are not going to reverse the policy that we will be trying to be as conservative as we have been in terms of provisioning.

Sameer Dalal: Any kind of guidance how, what numbers we can expect in second half anyway some sort of, I understand you are giving a policy but some kind of expectation that we could work with.

Hemant Kanoria: Basically this is something we do not expect it to happen, so we expect the profits to go up, we expect the disbursements to happens, we do not expect that our clients should slip out. So therefore it is very difficult to say that, and presently what we have seen in the last three, four years of financing that we have done it has been good portfolio so therefore the NPA for the new portfolio that we have is almost negligible. So we hope not to see any NPAs happening.

Moderator: Thank you. The next question is from the line of AswinBalasubramanianfrom HSBC Asset Management. Please go ahead.

AswinBalasubramanian: I have couple of questions, like firstly in terms of your exposure ILFS is there any exposure in any SPV or any of the other entities even if it is performing currently that would be the first question.

Hemant Kanoria: Yes, so basically we have because we are in the infrastructure financing so Srei we have exposure in some of the specific SPVs on road where there is full performance and one of the project is annuity**,** toll so therefore we are getting our money and there is cash flow where we have so we have not seen any problem happening anywhere. But we do not have any exposure to ILFS as such or any of the other reason so it is primarily roads that we are in.

AswinBalasubramanian: Would it be possible for you to quantify this amount?

Hemant Kanoria: We will come back to you, we will give you the specifics and we will just come back with exact amount to you.

AswinBalasubramanian: Okay, sure. Secondly, if I just look at your consolidated income statement the finance chargehave gone up quite a bit to a fairly large extent and the equipment finance it is not gone up much. So just wanted to understand because infra book anyway if I am not wrong it is not growing so what explains the increase there to move from 827 to 1100 crores whereas the equipment finance increase in terms of finance cost which is only 480 to 550 crores.

Devendra Kumar Vyas: So if you see the finance for SIFL has increased from 339 to 352 crore only, it is not a major increase I think it is just few amount and in terms of percentage terms also it is not very high.

Hemant Kanoria: 4%

Devendra Kumar Vyas: Yes, 4% increase from 339 to 352. For equipment finance it has gone up from 480 to 550 because the AUM has grown there, the possibility has gone, so NIMs are more or less stable, the interest spread is more or less stable in both the business.

AswinBalasubramanian: Because when I look at your slide 29 the consolidated number has gone from 827 to 1078.

Hemant Kanoria: Yes, so there has been an increase in the Srei consolidated you would see because there is an increase in the Srei equipment Finance. The reason being because of the higher portfolio that we have created over the last two quarters.

Devendra Kumar Vyas: 27% growth & up.

Hemant Kanoria: And also we have announced just last week we have announced the increase in our lending rates also because we see though the market has not yet increased the rates but we think that the rates will go up so therefore in anticipation of that we have also increased our interest rates.

AswinBalasubramanian: And lastly there is a line item called impairment of financial instruments in your Opex line item the one which you filed at the exchanges

Devendra Kumar Vyas: There is a NPA provision as per the new government has come to a new balance sheet and P&L government so this new format where NPA is provisioning on the ECL matter under IndAS expected credit loss methodology**.** Whatever NPA closing is required that has to be disclosed as IndAS impairment to the financial instrument.

Moderator: Thank you. The next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Sir just wanted to understand that any kind of outlook we have for this year AUM and ROA.

Hemant Kanoria: Outlook basically we have as we had also said earlier that we see growth there but it is very difficult to say that what would be the AUM ending of this year as you would have seen that there has been a good growth now it is Rs50,000 crore and we hope that we will be able to continue this growth but at the same time we do not want to make any prediction on the AUM, we can only say that the growth rates are good both on the profit and the disbursements and the AUM will also grow. The only thing we can give you kind of that the equipment market is expected to grow at 20-25% and we being the leader we need to go as per the market at least.

Deepak Poddar: Understood. And sir have you given the figure for ILFS exposure or the SPV exposure connected to ILFS.

Hemant Kanoria: The road project, we have said that we would just take it out and send it whoever wants it we will just take out the specifics and send it because the payment keeps on coming so we will send you the last positioned.

Moderator: Thank you.

Hemant Kanoria: So thank you, if there are no more questions then we will like to thank everyone and thank you for your active participation and just to repeat we are on solid grounds and we do not see any problem with Srei or Srei Equipment finance, Srei Infra or Srei Equipment Finance is concerned in spite of the present environment for adverse environment for where NBFCs are concerned because we have seen, we have almost seen these kinds of ups and down in the market for the last 50 years. So we are sure that we would be in a position to hold our company strong, through our fundamentals. Thank you.

Moderator: Sure. Thank you very much. On behalf of Maybank Kim Eng Securities India Private Limited that concludes this conference. Thank you for joining us ladies and gentlemen and you may now disconnect your lines.