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Day 4: India Financials Conference 2020 - Key takeaways

To provide a great ending to a multi-day conference, we reserved Day-4 of ICICI Securities India Financials Conference 2020 for insights and thoughts from industry leaders across the gamut of financial services sub-segments, be it banking, ARC, AMC or insurance. They shared the perspective on how they are redefining and reorienting themselves to not only cope with the near-term issues, but also emerge stronger, leaner and better. Most corporates we hosted today including banking leaders (Axis, Kotak, SBI) have aligned their strategies to our conference theme of 'Survive, Revive, Thrive'. We hosted today niche players (AU and CUBK) as well as diversified players (JM, Magma). Besides, one of the largest AMCs (Nippon Life India AMC), largest ARCs (Edelweiss), leading health insurer (Star Health) and largest custodian (CAMS) shared how their redefined business models are evolving. To get insights on the evolving Insurance sector we hosted two experts – PolicyBazaar and Mr. Mahesh Nadgaudi, health & insurance expert.

Mr. Rajkumar Bansal, MD & CEO, Edelweiss ARC, had an interesting observation: Stressed asset recovery rate has improved to 43% (from 26% pre-IBC) and resolution time has reduced to 1-2 years from >four years In addition, stressed asset recovery is a sizeable opportunity in India and Edelweiss ARC expects industry wide GNPLs to rise to 12.5% by FY21. Also, with respect to the business model, it would closely evaluate stress assets in retail and MSME segments and, in terms of structure, it will find an ideal mix of ARC and AIF for optimal return on capital.

We also hosted Mr. Aseem Dhru, CEO, SBFC Finance, who drew an interesting anecdote that it is important to get the cost of credit, cost of funds and cost of operations right across cycles as businesses gain scale to be successful. He highlighted how SBFC Finance is focused on building a differentiated micro enterprise lending entity with pan India presence. His views are contradictory to leading financiers in the sense that ground reality suggests much more stress than perceived and, after a couple of quarters, asset quality pain will become more visible.

We hosted Dr. Prakash Subbarayan, MD, Star Health & Allied Insurance, who indicated that the company has witnessed enhanced business during this period, but the claims have also seen a significant increase. Unpredictable quantum of outgo, no standard cost structures across hospitals and no standard protocol issued by the governments, are the challenges faced in processing Covid claims.

With improving trend in collections and pick-up in demand during the festive season, we note that discussions are relatively more centred on disbursements / growth vs collections a month back. Select corporates highlighted that it is too early to extrapolate current trends to the future and also reminded investors of the fear of a second wave of Covid. Further, recovery in the SME segment is better than expected. It appears that lenders are opting for restructuring judiciously and lending only to entities giving comfort on cashflow revival. On RBI's IWG report, most participants reserved comments and will await final guidelines. However, large and well run NBFCs would evaluate the recommendations at Board level and incumbent banks suggested that conditionality of tax neutrality will extend the implementation framework.

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Disclaimer: I-Sec doesn't cover companies for Research which are categorised as “Unrated/Unlisted”. For the experts, summary is purely based on the discussions held in the conference with respective industry experts, and is only for your ready reference.

Expert Access – Mr. Rajkumar Bansal, MD & CEO, Edelweiss ARC

We hosted Mr. Rajkumar Bansal, MD & CEO, Edelweiss ARC

Key Takeaways

<u>Stressed assets opportunity</u>

- The opportunity of stressed assets market in India is sizeable as GNPLs of banks in FY21 are estimated to be at 12.5% or ~USD150bn. Besides this, NPAs in wholesale lending done by NBFCs is also expected to go upto 4% (from 1%).
- Majority of NPAs traditionally have been in corporate segment - 70%, MSME at 15%, AGRI at 10% and Retail at 5%.
- Stress pool is concentrated in specific sector namely infrastructure, power, metals, textile, engineering, construction etc. Major stress is observed in power sector with 15-16 incomplete power plants and 16-17 plants with one or more completed units without PPAs. The other sectors having these NPAs are mid-sized steel companies and in textiles where many of the old units which have lost their viability, not finding any buyers.

<u>What led to the current stressed assets?</u>

- **Policy hurdles:** delay in payments like delay by NHAI, telecom etc.
- **Commodity super cycle leading to overcapacity**: prices got too high for steel, oil, etc.
- **Over optimistic growth expectations of companies leading to** overleveraged balance sheets.

With the introduction of IBC norms, all regulatory guidelines pertaining to restructuring loans under different schemes of the central bank such as CDR, JLF, SDR, S4A are withdrawn.

Sec-29A in IBC was introduced: Changed lot of things, where existing promoters need to exit the company.

<u>Why was the code required and how does it help</u>

Time taken to resolve bankruptcy is 7 years in India – much higher when compared globally. Delay was causing damage to the image of ease of doing business. Cost of resolution gets high and recovery is low.

- **What does IBC bring to the table?**
  - Consolidation of existing laws
  - Creditor in possession model
  - Defined distribution waterfall
  - Insolvency professional (IP) plays a key role
  - Existing promoters are barred from participation
  - Defined time period of 330 days

- **Pre IBC:** Recovery rate was 26%, that has now gone upto 43% now and resolution time also has reduced to 1-2 years from more than 4 years.

Status of resolution under IBC

- Success: out of roughly 4k cases admitted, 598 closed cases, resolution plan approved for 250 cases.
- Out of liquidation orders, actually only 60-70% companies got liquidated as there are not many investors bidding for the assets. Currently, there are 7k-8k cases waiting to get admitted into NCLT and some of them could not get admitted due to infrastructure constraint.

ARC model to involve as a combination of AIFs

- ARC model, since it requires 15% equity is gradually transitioning towards the fund model. RBI has recently come up with the guidelines where FPIs, FIIs can directly pay for the assignment of debt. Since they don't have to pay the stamp duty, it helps companies to avoid tax, write offs.
- In the shortcomings, AIFs are not allowed to buy debt directly and cannot take SARFAESI action. Hence evolution of business model will be combination of ARCs and AIFS together.

Effectiveness of SWAMIH Investment Fund

- SWAMIH Investment Fund is restricted to only small ticket affordable housing segment. Constraints like 60% should be complete and each flat should not go more than Rs15mn in Delhi, Rs20mn in Mumbai further restricts the size of the fund. SWAMIH is not able to do justice to all the projects. May be there is a need to increase the size of the fund.

How does it expect resolution of stress relating to various sectors

- **Coal based power projects**: The projects that are operational but facing liquidity issues as discoms are not paying regularly can be resolved through normal resolutions. Power plants without PPAs should take a haircut and go for restructuring. Incomplete or initial stage under-construction plants will likely go for liquidation.
- Resolution for EPC projects will be possible by collaborating with EPC customers. There is nothing much to liquidate in EPCs.
- Resolution of Bhushan Power should hopefully happen before march.

Expert Access – Mr. Aseem Dhru, CEO, SBFC Finance

We hosted Mr. Aseem Dhru, CEO, SBFC Finance

Key Takeaways

Opening remarks

- Niche NBFC have created value, while general purpose NBFCs may have created size but not value.
- Small lending business especially is notoriously difficult business – many have tried but only 3 have been able to build scalable business. Challenge is to survive and keep building business. For a business to successfully scale up - cost of funds, cost of credit and cost of operations – get all 3 needs to be right across cycle – not many have been successful.
- NBFCs have been doing well due to less aggression shown by PSU banks.
- In the business lending, market is more focused towards unsecured lending and concentrated only in few regions.

About SBFC business model

- SBFC began its journey 3 years back SBFC with a focused and differentiated approach - into secured micro enterprise and with pan India orientation - 110 branches in 100 towns spread across 17 states.
- It is trying to build a business around strong unit economics and profitability focused.
- Loan book currently stands at US$0.5bn (expected to increase to US$1.5-2bn) - 75% of the lending is against property and 15% is against gold.
- It has gold loan book of Rs4.5bn and average AUM of Rs45mn per branch (comparable to market leaders). In loan against gold, experimental services of home delivery loan is undertaken wherein customer doesn't need to come to centre to deposit gold and avail loan. This can help in expanding the geographical presence.
- SBFC focusses on small value lending - Rs1.0-1.2mn.
- Second line of business is loan management service – it has signed up for 1.5bn dollars of assets under management

Ground reality suggests higher stress; cheque bounces an area of concern

- Industry troubled accounts which were getting managed over past few month have started to see stress. Covid affected segments have taken pretty long than anticipated.
- Cheque bounce rate in the system is alarmingly high at 40%. This is putting pressure on collection systems/infrastructure – system is not geared for 40% cheque bounce on a consistent basis. Elevated cheque bounce will eventually increase delinquency and NPLs.

- On their own loan book, they have seen higher bounce rate for high EMIs (more than Rs25k) loans compared to low-EMI loan portfolio.
- Clients with below 750 CIBIL scores have seen large bounce rate.

Expected restructuring to be 4-10%

- Currently, economy is not in an expansion mode and what everyone is talking about is normalization.
- Somewhere between 4-10% is a weak book. Players with 1.5% GNPLs should eventually see 4.5% NPLs. Banks and NBFCs are well capitalized with superior margin margins and hence can take the pressure.
- 50% of ECLGS will topple over

On RBI IWG report

- NBFCs will be better off doing what they are doing currently and will lose competitive edge on several aspects if they convert to bank.
- When NBFC converts into a bank, initial cost of funds will be very high till they achieve scale. Along with higher cost of funds there are many operating cost which are required to be incurred for being a banking organisation. This will keep profitability level under stress for a longer period of time.

Expert Access - Dr Prakash Subbarayan, MD, Star Health & Allied Insurance

We hosted Dr Prakash Subbarayan, MD, Star Health & Allied Insurance

Key Takeaways

Opening remarks

- SHI has 29.5% of total market share in retail health insurance, which is the highest. SHI's market share in new business during FY21 has been 54%. As such, there was a gain in market share in FY20.
- Focus remains on acquiring larger share of retail pie since it is less loss making.
- In the past five years, the industry has grown from Rs200bn to Rs520bn. Of this, the share of retail has increased slightly to 41% at Rs210bn now compared to Rs80bn five years ago. Still, the coverage is only 6% of the total population of the country. Hence, there is a large scope to expand. Medical inflation has been ~12% p.a., so industry growth continues to be healthy.

On Covid claims

- During Q1FY21, the claims were mostly coming from public hospitals, so it was comfortable with lower loss ratios. But from July onwards, claims ratio saw an unprecedented increase, with average payout increasing 3-4 fold. In FY20, during the same period, the average payout was between Rs35-40,000, which increased to Rs110-115,000 during Q2-Q3.
- Total pending claims for the industry is estimated at ~Rs80bn.
- Challenges related to Covid-19 claims:
  - Outgo quantum is unpredictable.
  - No standard cost structures across hospitals.
  - No standard protocol issued by the government. Also, policies/ advisories/ protocols change frequently.
- Company has witnessed enhanced business during this period. But the claims have also seen a significant increase.
- A second surge, as is currently being witnessed in Delhi, may impact the company's health portfolio and make the balance negative for the year, even though revenues might be higher. Even though there has been a plateauing of cases and claims post Dussehra, the company is geared up for the second surge, if it may arise.
- There has been a higher interest from youth, with higher inquiries and policy purchases, at higher sum assured.
- There has been an increase in the number of inquiries on OPD coverage.
- Dr Prakash highlighted that of the total infected populace, only 15% require hospitalisation. Of this, only 30-40% require intensive care. Thus, telemedicine

needs to be the preferred choice for majority of patients, starting with homecare and shifting to the same hospital providing telemedicine facility, if required.

On pricing front

- Even though the regulator has allowed an increase of 5% on premiums, the company has decided not to increase its premiums at the moment since it is more focused on the larger objective of increasing health insurance penetration currently. Only a few companies have utilised the 5% increase allowance.

Other highlights

- ***SHI's average sum insured has almost doubled in the past five years from Rs368,000 to Rs603,000 (ex-Covid related policies). This is majorly due to higher sum being insured by fresh policy buyers (>Rs0.6mn/person), while in case of the existing customers, the average increase in sum insured is ~10%.***
- Company has over 400 doctors associated with it to help it validate the policy pricing structure, medical undertakings, claim settlements, investigating the requirement of the surgery/procedure done and ensuring that hospitals and patients follow ethical practices.
- Dr Prakash noted that healthcare spending by the government is currently only 1.3% of the GDP and it is the need of the hour to increase it to over 2.5% of GDP. Still the necessary transformation required in India's healthcare infrastructure can majorly be done through the means of health insurance only.
- FY20 average payout per claim was Rs40,890. In Q1 it increased to >Rs60,000, while in Q2 it increased further to >Rs63,000. Currently, it stands at ~Rs56,000. Around 20% of the total claims have ticket size over Rs100,000.
- RoE in FY20 was ~20%. But it is estimated to be lower this year as loss ratio is over 60%.
- Priority of the company is to work through its agent in order to increase the retail market share. The company has banca partners but it does not prefer to scale up this route of customer acquisition. It also does not prefer the broker route which is also loss making.

Expert Access – Mr. Sarbvir Singh, CEO, Policy Bazaar

We hosted Mr. Sarbvir Singh, CEO, Policy Bazaar

Key Takeaways

Opening remarks

- PolicyBazaar is the largest distributor of policies both online and offline
- Protection products constitute a large portion of its business
- Does not deal with endowment products.
- PolicyBazaar has 90% market share in digital distribution of products.
- It has seen growth in last two years due to: 1) growing penetration of term products, 2) consumer preference for digital platforms for making purchases.
- Less than 5% of middle income class have term insurance or retail health insurance, which leaves significant headroom to grow.
- 90% of sales come directly to PolicyBazaar. Nothing is paid to intermediaries (like Google) to bring customers to website.
- Works with 46 insurance companies and has more than 400 products online.
- Data is collected from customers regarding their declaration made by them on the website. Additionally, PolicyBazaar also captures whether the information was submitted at one go or a number of changes were made before submission. Data and risk management systems, which have been developed, allow the company to offer much better business to insurance partners, which in turn helps them lower the loss ratios or improve mortality experience.
- Going ahead, profitability will be driven by the annuity business, which comprises renewals.

Others

- In early phase of the pandemic, Apr-May'20, there was lot of interest towards term products. Jun-Aug'20 health business gained traction. But, as of now, consumers are realising that everything is back to normal, hence the conversion rate is not as high as it was during earlier phase of pandemic.
- Affordability is creating a challenge. In term plans, there are physical (and) medical (tests) necessary in certain plans, which are holding back the consumer currently.
- Concentration is currently not a risk.
- All employees are on the roll and there is a robust system for incentives.
- Lower loss ratios and better mortality rates for policies issued from the PolicyBazaar platform is appreciated by the insurance partners.
- In last 12 months, 7.5mn transactions were done by 5.5mn customers, which is 1.3 transactions per customer. This is an improvement from the less than 1.2x in the prior 12 months.

Kotak Mahindra Bank (BUY, CMP: Rs1,925)

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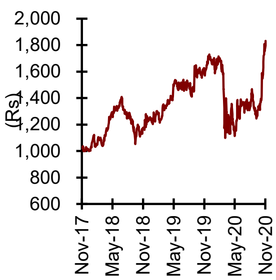
Price chart



We hosted Mr Jaimin Bhatt, Chief Financial Officer and Mr. Abhiram Bhattacharjee - Senior EVP & Head - IR

Key Takeaways

On assets and advances

- Bank being going slow on growth during H1FY21 given the tough and uncertain environment.
- However, bank has now started moving the ship and is looking at growth in retail into home loans & secured asset and working capital towards high quality corporates.
- The focus going forward will be on secured consumer and rural areas. They have launched new mortgage rates for secured consumer loans by taking advantage of low cost of funds.
- Bank's primary focus is to make risk adjusted returns. Despite there is de-growth in loan book on YoY basis in Q2FY21, balance sheet has grown 18% YoY over the same period.
- Kotak is largely into secured lending. Currently, it is still cautious on the unsecured retail lending piece and it is not much into lending towards capex projects.
- On the credit card and unsecured personal loans – a very large portion would be to salaried customers

On home loan

- Typically, a home loans stays with the bank for 6-7 years as against its original tenure of 10-20 years. Similarly, for a car loan, it stays for 18-24 months as against is tenure of 3-5 years

On SME and ECLGS scheme

- MSME and ECLGS scheme has been a great success by giving MSME sector to fight through crisis.
- Under ECLGS, Kotak's share in ECLGS was reasonably higher than Kotak's share in overall SME lending. Overall banking sector share in advances is around 2.6%, while under ECLGS its market share is over 6%.
- Bank also saw various instances, wherein they availed benefit under ECLGS scheme and on the contrary, reduced their usage on OD/CC.

On deposit profile & cost

- While loan growth was slower, bank continued to build upon its deposit base
- SA rates have been cut twice in FY21, once in April and then in May
- Overall, cost of SA has come down sharply from the levels seen a year ago.

On the housing portfolio

- Of the total mortgage book, 55% is towards home loans while rest is towards LAP. Home loan - Mumbai would be by far the largest in terms of value
- Idea is to try and have a meaningful presence in the selected areas rather than having pan India presence
- Kotak Bank's average ticket size is higher than peers

On real estate

- Bank is seeing signs of revival in residential real estate
- However, commercial real estate is not picking up. This is because there is no increase in demand for commercial office space as of now.

On subsidiaries

- Kotak MF has been doing well on the debt as well as equity side. Profitability of AMC will improve due to operating leverage as the proportion of equity improves like it has in the recent past
- Kotak securities - Focus on cash segment continues and company might also see attractive plans being launched in the coming months in the F&O front as well
- On insurance, VNB margin is amongst the highest among peers, due to the AUM mix for Kotak

On the RBI guidelines related to NOFHC structure

- ***On the RBI report, would want to reserve the comments as it's a discussion paper as of now and will await final guidelines.***
- NOFHC for existing banks is conditioned on tax neutrality. Moreover, even after the tax neutrality is introduced, the entity will be given another 5 years. Hence, it has a long way to go.

Other highlights

- Growth has to be a part of bigger strategy and superior focus on execution – customer acquisition, engagement and cross-sell.
- Biggest focus is customer acquisition and engagement – will leverage the engagement framework organically. Modes of customer acquisition could be physical, digital and acquiring someone else customers.

State Bank of India (BUY, CMP: Rs244)

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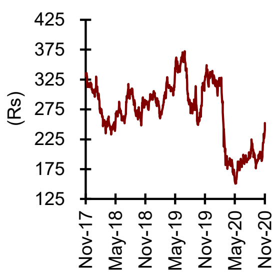

We hosted Mr Swaminathan Janakiraman, Dy. Managing Director and Mr. Misal Singh, VP – Investor Relations

Key Takeaways

On RoA trajectory & performance

- NII story is playing out well as NIMs further gained traction benefitting from incremental higher growth in retail credit (corporate book actually shrunk QoQ), lower NPL drag (interest on pro forma slippages not reversed) and sharp cut in deposit rates. Interest expenses grew by only ~2-3% despite deposit growing by 14-15%. NIMs are more likely to settle at current levels over medium term - going forward, deployment of surplus liquidity and resolutions may offset any downward pressure on NIMs.
- During the past three years as performance was impacted by corporate stress cycle, RoA was relatively subdued compared to its historical long term RoA average of 0.8-1.0%.
- Inferring from the operating metrics trend, the bank seems to be gradually moving towards the long term RoA range in the immediate and surpass its long term average RoA in near to medium term.

On dichotomy between ground reality and collection efficiency

- ***Given that a large part of SME business is unorganised and has no access to formal credit lines, the perceived pressure in the SME segment is not reflected in industry-wide banks collection efficiency number.***
- With respect to SME at the industry level, 50% SME businesses are self-financed, 35% finances from unorganised sources or through microfinance route while only ~15% of SME financing is done via banks.

On YONO capability and analytics

- ***YONO is not just a digital bank, but a financial superstore.*** Combined with analytics team and with capability of YONO, bank is able to offer both upsell (top up on existing loan, balance transfer on home loans) as well as cross-sell.
- ***Product per customer is 2x on an average.*** This is because bank has customer base in excess of 450mn and hence, product per customer on an average comes out to be very low. Today, the bank is using a lot of manpower to reach customers in tier-2/3/4 cities. With digitisation, banks should be able to reduce costs and attain financial inclusion at a larger scale.
- ***On digital partnership, bank is open to either partner or collaborate with fintech. It sees fintech as a partner rather than a competition.***
- On digitisation, the share of digital transactions stands at 93% and is still improving. The power of digitisation is immense. ***For example: During the past 6-***

7 months, it sourced US$1bn worth of personal loans digitally, which could have otherwise taken long to be sourced via branches.

- YONO will gain in scale and capacity over the next 2-3 years and then at an appropriate stage and time will engage with investors for value discovery.

On credit profile

- Retail segment has been a key loan growth driver over the past two years and will continue to drive the overall credit growth. Credit profile in retail segment too is comforting – 94% of Xpress credit customers are government/defence employees whose salary levels have not been hit due to the pandemic. Also, in home loan segment, 50% customers are government employees, 20% are from well-rated corporates and 30% are self-employed customers with high creditworthiness.
- ***As of now, approvals and credit enquiries are above pre-Covid levels on the retail front.*** SBI is approaching salary-backed loans in a focused but a risk-mitigated manner. **It expects overall loan growth to remain around 8% with some upside risk.**
- ***Retail loan origination via YONO in H1FY21 was 38%.***
- Bank would like to get back very strongly in agriculture and MSME.

On asset quality

- Collection efficiency – of Q2FY21 – 97% - payment received over EMI dues.
- Estimated slippages of Rs200bn for H2FY21 – provision coverage in corporate (legacy) book is 88% against historical LGD of 55%. In corporate book has done very granular analysis at RM level – so its bottoms up.
- Should have lower burden on credit cost provisioning in H2FY21 – more a factor of how economy evolves.

On capital

- Management said capital is sufficient to manage near-term growth as plough-back of profits further shore up capital adequacy. It raised Rs199bn in tier-2 (Rs160bn) and AT1 (Rs40bn) capital at best-in-class rates during the quarter. By FY21-end, tier-2 capital is expected to reduce to ~2% (from 2.8% currently) on account of redemption and exercise of call options.

On ECGLS

- About 25% MSME customers didn't opt for support from ECLGS, 25% opted partial disbursements towards ECLGS, while 50% opted ECLGS.

Axis Bank (BUY, CMP: Rs620)

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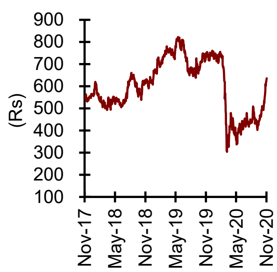

We hosted Mr Puneet Sharma, Chief Financial Officer and Mr Abhijeet Majumder, Head Investor Relations

Key Takeaways

On collection efficiency & disbursements

- Overall collections at 94-95% level in Sep'20 and at 97% in Oct'20
- Secured disbursement is now back to pre-Covid level and unsecured loans at 50% of pre-Covid level. Overall proportion of secured disbursement in overall retail credit is at 90% vs 80% in pre-Covid times.
- Disbursement market share has tilted in favour of private sector players and so has incremental deposit share. This trend is likely to continue going forward

On credit profile and growth

- Pandemic and economic cycles always helps positioning of well capitalized bank.
- In terms of growth, will be selective but at the same time has taken up opportunities that come up in a risk calibrated manner.
- The company has grown 500-600bps higher than industry in recent times and is likely to maintain this trend.
- Growth in retail will be driven by secured loans. Seeing some sequential growth in SME in which had downsized some exposure during Covid.
- The focus on wholesale has been strong with new and improved product and service offerings

On asset quality

- They expect slippages in Q3FY21 and Q4FY21 to be higher than seen in Q1 and Q2 led by retail as moratorium has ended.
- The company won't do any adhoc provisions and reversal and reversal, if ay will largely depend upon how slippages stack up in the coming quarters
- They have capital adequacy of 19.4% and hence there is no need of incremental capital as of now.

On fee income

- Will continue to build granularity in fee income and will give away large bulky underwriting corporate fee.
- Two fee income streams seeing traction including transaction banking and forex flows – reached 1.2x pre-Covid levels.
- Greater than 1x fee income on TSD fee – new team, investing in systems, understand the product from manufacturing to distribution etc.

On liquidity

- Bank doesn't see liquidity easing off soon from the balance sheet
- Hence, margins are likely to normalize only in FY22, atleast from the liquidity side
- On full year basis, headwinds in terms of excess liquidity will go away only when bank starts deploying this excess funds into credit assets rather than repo window or excess SLR

On the RBI guidelines related to NOFHC structure

- Given that this is a working paper and the timeline is January, it is would await final guidelines.
- Also there is a condition of tax neutrality which will be a subject of revenue department rather than regulatory and it is unlikely that it will be a part of the forthcoming budget recommendations.

On digitization

- 70%+ of account openings come from digital platforms while around 50% of mutual funds and new credit cards come from digital
- Have very strong presence in digital - 20% market share in UPI vs. 4-5% overall market share

Other highlights

- Net promoter score – it tracks it very closely and can say with reasonable amount of certainty that its improving period over period.
- It were cautious about grant under ECGLS scheme and approach remains the same under ECLGS 2.0.
- Enabling board resolution for Rs150bn for period of 12 months till July next year – has raised Rs100bn via QIP.
- With respect Max deal – it has come to a structure where shareholding has changed but governance and protection rights have been maintained. Transaction will be consummated subject to regulatory approvals – positively looking forward to it.

AU Small Finance Bank (BUY, CMP: Rs874)

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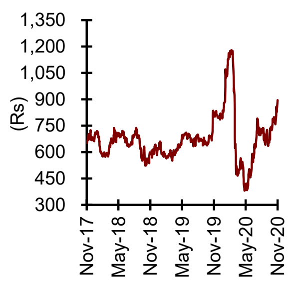

We hosted Mr. Prince Tiwari (Chief of Investor Relations) and Mr. Aseem Pant (VP, Investor Relations and M&A)

Key Takeaways

Collection efficiencies in Sep'20 was already at pre-Covid level.

Customer activation at 78% (full payments) with collections in Wheels (72%), SME (78%) and Gold loan (72%) remaining lower.

Non-paying borrowers - Total non-paying borrowers (% of advances) stands at 5.5% as on August'20 of which ~90% were from wheels (50) and SBL (40). Further, 2.5% of borrowers has paid atleast 1 EMI in Sep/Oct'20. Improving trend continues in Nov'20 as well.

Provision buffer. It estimate 2.75% of AuM to remain under stress and asks for close monitoring. However, it believes current buffer of Rs2.8bn (`1% of loans) is sufficient. **No guidance on potential restructuring pool.**

On disbursements – Sep'20 disbursements was at similar level of Sep'19 level and same trend continued in Oct/Nov'20. Disbursements on YoY basis not growing but has reached pre-Covid level, it would like to remain cautious for 1 more quarter before it start pursuing growth aggressively. Disbursements in July was nil, August started selectively and September was the first month of normalized level – initial revival in SBL was mainly driven by ECLGS led but now it is broad based & mainly from entities engaged in essential service, demand revival in Vehicle segment sustained in Oct'20 while HCV/LCV/Commercial PV demand is still tepid.

Liability - Shifting focus from mass sourcing to quality sourcing (RM based approach). To sharpen focus in key markets it formed specialised team and employees KRAs realigned as per revised strategy. Increased focus on customer activation (ZBA down 9% on annualised basis, AMB improved by 51% in 1HFY21 I'm Saving accounts). CASA ratio spiked to 21% from 16% in Q1fy21.

As on Sep'20, 36 branches has more than 5% market share in deposits supported by its strong asset franchise in those markets, having vintage of >10 years. Urban markets – changed hiring strategy – recruiting people with good vintage and good connect in local area which will help AU in on-boarding new customers. >90% of SA accounts were opened digitally. More focused on geography specific strategy and hiring accordingly.

Tourism -Domestic tourism was picking up till Diwali, but subsequently with increasing Covid cases the pace of revival has moderated a bit recently. Large hotels booking on weekends was good but not the segment where AU operates. In the segment where AU operates hotel booking are seeing improvement and tourist taxis are operating at 50-60% utilization.

Product per customer has improved to 1.4x from 1.1x 1.5 years back and it aspire to increase it to 2x over the medium term. Historical asset customers were liability customer hence cross-sell was limited but incremental sourcing in Metro & Urban centers provide scope for cross sells.

Aavas stake sale – Divested ~4.5% stake in Aavas, likely to add 2% to Tier I ratio.

Other highlights

- Bank guarantee of Rs7.5bn comprising of 700-800 customers is largely to contactors banking with AU for long term PWD, Irrigation, NHAI sub-contractors & is FD backed or security backed.
- Customer retention ratio in Retail TD is ~70%, in line with industry average.
- Number of customers doing >4 transaction per month increased by 15% to 2 lakh.
- Total disbursement stands at RS34bn, which is ~72% of pre-Covid level however Sep'20 disbursement is already at 99% of Sep'19 level.
- Few sectors like Education, Travel & Tourism and Hospitality are recovering at slower pace – need extended handholding; Bank remains actively engaged to help impacted customers
- Fine tuning digital strategy from last six months – pivoted around three things: a) customer acquisition, b) deepening the relationship, and c) servicing across liabilities and assets. It rolled out assisted digital lending journey with virtual RM and video banking support to accelerate digital adaption in rural areas. Its end-to-end digital lending is live for Maruti and expected go live for other OEMs in coming months.

Nippon Life India Asset Management (Unrated, CMP: Rs289)

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We hosted Mr. Prateek Jain, CFO, Mr Saugata Chatterjee, Co Chief Business Officer and Mr Abhishek Nalwaya, Head Investor Relations

Key Takeaways

On business performance

- In the past 12 months has established the 'NIMF' brand and activated more than 170 corporates.
- Even in lockdown, full operational efficiency at 100% was maintained
- Had the biggest NFO during lockdown that garnered 80k applications across 370 locations in India.
- The company launched Smallcap 250 Index Fund, IT Index ETF and largest gold ETF during the past few months.

Key highlights

- Retail AUM contributed 26% of NIMF AUM
- NIMF has 6.2 million Unique Investors; 29% market share in the Industry
- Digital contribution to total NIMF business transactions rose to 48%.

On strategy adopted in the past few months

- Company has a high proportion of equity assets and since market corrected sharply in the beginning of 2020, AUM also took a hit.
- Nippon kept on building its SIP book and continued to increase its retail penetration. Net monthly inflow in SIP stands at Rs6.2bn in September and overall SIP AUM is Rs250bn.
- Company adopted three pronged strategy
    - Adopted digitization strategy very aggressively - Digital contribution-to-total NIMF purchase transactions stood at 48%
    - Second strategy was to leverage the first mover advantage and scale up ETF business wherein company scaled banking ETF, smallcap ETF etc.
    - Third strategy was fixed income – industry volumes are expanding in fixed volumes over the past 6-9 months. One of the short term duration fixed income fund launched recently also has now Rs 150bn AUM.
- ***As a result of these strategies, company was able to recover AUM and now it is well above Rs 2tn.***
- ***Fixed Income, ETF will continue to remain as a core strategy at Nippon AMC***

Other highlights

- The biggest USP is that operating leverage plays a big role in ETF business.
- Retail is not participating in a big way in the fixed income space - ~75-80% of fixed income AUM is in HNI & Corporate
- There would be some pressure on yields going forward due to increased competition. However, focus would be on equity and high yielding assets.
- Opex is higher as compared to other large AMCs since they enjoy bancassurance benefit unlike Nippon.

City Union Bank (HOLD, CMP: Rs185)

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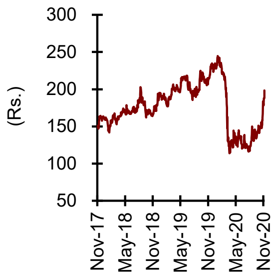
Price chart



We hosted Dr. N Kamakodi, MD & CEO, City Union Bank, in our conference.

Key Takeaways

Collections. ~90% at portfolio level, ~5% non-paying customers and 5% is 1+ DPD as on Sep'20. It extended moratorium to all eligible borrowers during the period from March-August'20. Post the end of moratorium period, ~94.5% CC a/cs & 85.7% of Term loan a/cs, totaling 90.5% of exposure received payments for September demand.

Customer Activation – Total 9.0% of borrowers (in value) (0.65% of CC & 19.12% of Term loan exposure) had not paid even a single payment during moratorium. Out of them total ~5% of borrowers have paid the demand portion of one monthly installment in the month of September 2020, after fully utilizing the moratorium.

Provision buffer. Provided Rs1.1bn for Covid-related uncertainties in Q2FY21 taking total buffer at Rs3.3bn or 89bs of loans.

Restructuring. Currently restructuring request stands at Rs4.3bn and total restructuring to remain around 5%-6% including current pool of 1.35%. The general approach is very clear: entertain only genuine SMEs who were regular pre-Covid and have a viable business model to improve cashflow over next 6-12 moths. Its prudent approach reflects in only 2% slippage from ~10% restructuring pool in 2008

Disbursements. Bulk of the disbursal is towards the ECLG scheme and gold loan. Growth was muted even before pre-COVID.

- Demand for products and services will depend on the stability of economy and better utilisations.
- Will remain conservative in the near term.

Profitability. Had 1.5% ROA in the last fiscal and expect to reach pre-Covid level in H2FY23, could prepone by few months or quarter if current improving trend sustains.

SME exposure

- Anyone who had no payment issues by end of Feb were eligible.
- Those who were defaulting even before COVID are not eligible for ECLG and restructuring.
- Certain businesses are recovery slow like hotels, transport, etc which would break even in few months. Every segment has to be assessed separately.

Other highlights

- **Its exposure to stressed sectors** like Education, Hotels, and Tourism etc stands at 8-10%.
- Recovery rate – In normal times, the recovery rate was ~70%-75%, but with Covid it expects this to drop by a maximum of 5%.
- **Slippage guidance – 3-3.5% in FY21E.**
- **Credit growth** – Currently, credit growth is largely driven by two products Gold loans and disbursements under ECGS. Going ahead, it continues to maintain cautious stance on growing balance sheet. Further, it highlighted that fresh enquiries are mostly for Balance transfers and weak demand for capital investments.
- **Margins** – NIM expansion was mainly driven by two component A) reduction in cost of Deposits and B) optimization of CD ratio. Going ahead, it expects margin to normalize between 3.8%-4.2% from current level of 4.33% (adjusted for interest reversal on SMA loans worth Rs0.25bn) as it sees pressure on asset yields.
- **Cost/Income ratio** – The cost/income ratio is likely to increase to 42-44% in coming quarters from current level of 40% as it expects non-interest income to remain pressure.
- **Update on ECLGS** - Initially, funds availed under the scheme was utilised to kick-start business activity but recently surplus funds are getting utilised to repay high cost borrowing.

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JM Financial (BUY, CMP: Rs78)

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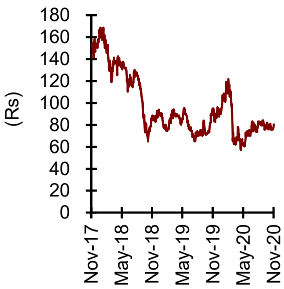
Price chart



We hosted Mr. Shashwat Belapurkar, MD & CEO, JM Financial Credit Solutions and Mr. Anil Bhatia, MD & CEO, JM Financial Asset Reconstruction Company

Key Takeaways

On JM ARC business

- Company had limited focus on fresh acquisition and currently efforts are completely focused on recoveries.
- Concluded major resolution where company was acquired by JSW and it has received Rs5bn of cash – Average IRR on resolved case would be near the average on assets it expects at 28-30%
- Seeing good momentum and hence hoping for some more resolution and recovery over the next six months - One pharma assets and one textile asset are in advanced stage of resolution and expected to come through March 2020.
- Will evaluate the portfolio in February to take a call in provisioning – it is expecting some write back in provisions made.

On real estate business

- Mortgage lending business is a growth business and just waiting for right time and right opportunity. Over the last 2-3 months, there has been an exceptional demand for real estate properties on the residential front.
- JM saw significant amount of pre-payments happening over the past few months.
- Over the past 6 months, there have been some land transactions and takeovers after a lull of almost 18-24 months.
- Escrow collections are almost back to pre-covid levels. Top-rated developers are getting money at 9-10%
- Stamp duty reduction is only in Maharashtra, but demand is visible across India. In management's opinion, people are not negotiating too much for lock and key apartments in the current scenario.
- With respect to demand, homes with value of Rs15mn & below are seeing good traction. For homes with value of Rs30-150mn, there was an initial spurt but it has now gone slow.
- In terms of discounting, flats with value between Rs 20-500mn are being offered discounts in the range of 10-15% (compared to as high as 20-25% 4-6 months ago).
- Not even a single account will go through restructuring – however 18-22% of overall loan portfolio of to go through DCCO. 10% already has been done till today. It gives these accounts 18 month time period. The projects are mostly based out of Mumbai and Pune

Other highlights

- Nothing has changed dramatically in terms of strategy – the business model will remain capital markets and real estate heavy
- RoA of wholelsale lenders were attractive until 2-3 years ago.
- Net debt to equity is currently very low at 1.0x.
- For June & September, there is a huge decline in cash and cash equivalent. This is because of higher utilization levels. Moreover, company has repaid external debt and replaced it with group funding. Hit due to negative carry is Rs1.8bn, which is huge and hence over the next 12 months, company will reduce cash levels significantly and will try to buyback debt.

CAMS (Unrated, CMP: Rs1,438)

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We hosted Mr Anuj Kumar, CEO and Mr M Somasundaram, CFO, CAMS Ltd

Key Takeaways

Opening remarks

- AUM are back to pre-Covid levels, of which, debt and liquid funds witnessed a sharp increase while equity AUM is 5-6% below peak levels.
- Market share of CAMS stood at 70% in H1FY21.
- Paper transaction, which had reduced sharply during lockdown period, is rising and a part of it is expected to have permanently converted into digital mode.
- Continued to on-board skilled workforce.

Non MF business:

- Major businesses in non-MF business are: 1) Insurance repository, 2) services to AIF and 3) payments (revenue mix of these businesses is 10% of overall revenues).
- From market opportunity prospective, insurance and payments are much larger opportunities.

On Data analytics

- CAMS provides insights and analytics on investor level to mutual funds but does not comment on individual fund level.

Capex

- Capex is estimated to be Rs200-250mn going forward.
- Most of the capex spends will be towards technology and building data storage capabilities.
- Above capex does not include the expenditure of shifting data storage to cloud.
    - However, the company has been experimenting for the past 3 years (CAMSPay).
    - Nobody in capital market has completely moved the data storage to cloud.
    - Hence, the same needs to done in a collaborative way and with regulator's consultation.
- On the capex cost towards moving to cloud, management didn't provide any specific number but guided that moving to cloud will be a better option. Currently, management has a policy to provide tech infrastructure equivalent to 2x of the peak load, but if the same moves to cloud capacity, utilisation levels will be better as there won't be any spare capacity.

Strategy for sustenance of margins and operating leverage

- Strategy for sustenance of margins is by continuing to invest in business to provide better services and value to clients.
- Areas of investments remain hiring highly skilled employees (risk management, data security etc) and investing in new technologies (AI). Investing in this area will ensure value creation for clients and hence, result in positive operating leverage for them.

Maintaining stickiness with clients

- Stickiness with clients is not only due to long relationships, but also due to a number of processes handled by CAMS. Along with the above stated process, CAMS provides a number of value-added services which further strengthen the stickiness with clients

Magma Fincorp (HOLD, CMP: Rs47)

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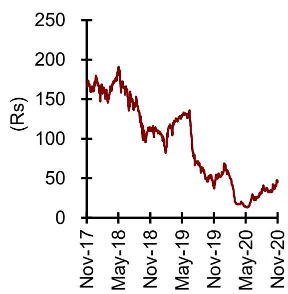
Price chart



We hosted Mr Kailash Baheti, CFO and Mr Jinesh Shah, Investor Relations

Key Takeaways

On collection efficiency and Covid buffer

- Overall Collection Efficiency at 85% in September and 90% in October.
- ***Customers in standard bucket who availed moratorium of at least 1 EMI and have not paid September EMI stood at Rs15bn (9.6% of AUM), and have not paid September and October EMI stands at Rs6bn (3.8% of AUM). During the month of November, this has seen further improvement.***
- ***Company made additional provision of Rs900mn in Q2FY21 for Covid related stress taking cumulative additional provision to Rs2.38bn - 1.5% of AUM***
- ***On bounce rates, it is higher 40% higher than pre-Covid levels***
- Normalized credit loss should be in the range of 2-2.5% (annualized)

On restructuring

- Restructuring only 0.5% of AUM as of now and won't exceed 3% of AUM
- ***One-time restructured portfolio as on 30-Sep: Rs830mn (0.5% of AUM) - unlikely to go beyond 3% of AUM by FY21.***
- For restructuring, there is no change in the rate of interest

On AUM & disbursements

- Vehicle finance business portfolio is being reshaped with ***more than 95% incremental disbursals comprising of focus products, viz., Used Vehicles, Affordable housing finance, SME loans & tractors.***
- ***Risk based pricing is in place across all products***
- On cars which are used for commercial transportation (like Uber, Ola) – there is a load issue and hence they are not able to generate enough cash flows.
- Over the past 2 years, CV sales have fallen every single month. As a result, banks & NBFCs which are completely focused on CV have reduced interest rates significantly. Rates are now at 11.5% from 13% which used to be the rates two years ago. ***Hence, company started to focus on used cars and used assets where it is gaining good returns with higher RoA adjusted for provisions.***
- Company is expecting a substantial improvement in credit demand in Q4.

Other highlights

- Vehicle finance business portfolio is being reshaped ***with more than 95% incremental disbursals comprising of focus products, viz., Used Vehicles***,
- Margins are expected to expand by 70bps in this fiscal on account of lower cost of funds as well as improved yields since the company has shifted to high yielding products
- Since cost of fund has reduced, it is providing enough room to hold excess liquidity.

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