IndusInd Bank

"IndusInd Bank Limited Q3 FY18 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the IndusInd Bank Limited Q3 FY '18 Earnings Conference Call. As a reminder, 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. Romesh Sobti from IndusInd Bank. Thank you, and over to you, Mr. Sobti.

Romesh Sobti: Thank you. Good afternoon and thank you for joining us. This call is for Q3 results which we declared a while ago. And this has been uploaded on the site, so you should be having the detailed investor presentation also with you all. So before we get into the numbers and then the Q&A, just a brief macro update. And I think, the big headline is that the GDP growth seems to have bottomed out and there are indications of acceleration going forward. We have seen some lead indicators. One of the big ones is the Purchasing Managers' Index. And of course, we have a lead indicator within our loan book which is growth in our Vehicle Finance business. Both are showing very robust upward trending. So it looks like there is an implied growth of almost 7% for the second half of the year, which would take us to full year growth at around 6.5%. And after the initial hiccups associated with the rollout of the GST and demon, I think, things seem to be coming back on track.

The other big headline, of course, is a very strong hardening of the G-sec yields. In the last 3 months, they've hardened by almost 40-50 basis points, and in last 12 months by almost 100 basis points. And of course, the attribution of this hardening of yields is to, I think, the mop up of the excess liquidity that was there in the market by the RBI. There are some concerns on fiscal slippage and, of course, rising commodity prices led by oil. This hardening of yields of course has a big impact and you will see some of that impact in the books of banks in the current quarter and maybe going forward in the fourth quarter as well, as a consequence of the mark-to-market gains having been wiped out. The other headline that we saw during the quarter was really credit growth coming back to double digits at 10.6%. One, of course, we are talking about a favorable base effect, but also there is a retail growth of almost 17%, so there is a good traction there. And certainly, we are seeing working capital growth recovery. And additionally, I think some reversal of the bonds into bank credit because of the hardening of yields. So some shift of the credit surrogates into real credit. Recapitalization of PSBs, so we see how that first lot of Rs. 80,000 crores is going to be given out. And I think the small print to be watched here is whether these bonds would qualify for SLR. If they do, they will put more pressure on bond yields going forward into quarter 4 as well. So that is a very quick sort of update of the macros.

As far as our quarter is concerned, we had a steady quarter. Growth for bottom line came up at 25% and that was supported by a good growth of 22% in the core fee income. Trading income was lower and that's why you see total fee income sub 20%. But core fee income was still up

22% and net interest income grew by 20% as well. So the balance sheet crossed Rs. 200,000 crores for the first time, the footage. And in spite of that growth, we are seeing an increase in our return on assets which went up from 1.90% to 1.96%. More importantly, the vector that we have kept for ourselves, budgeted for ourselves, the return on risk-weighted assets, which is now nudging 2.4%, which is our target for March 2020. The other feature, of course, is that for the last 12 months, if you see year-on-year, risk-weighted assets are almost flat, although the balance sheet has grown by 25%. I think this reflects the steadily improving risk profile especially of our corporate loan book. And the credit rating profile definitely improved and that is visible in one of the slides that we disclose every quarter. I won't go into detailed analysis of what went up and what went down. But as far as margins are concerned, the margin was steady. This margin was steady around the 4% benchmark, I already talked about ROA, and there is definitely improvement in ROE. Also, I think the Earnings Per Share went up in accordance with the growth in the bottom line.

There are two star features of the quarter 3 performance. One, of course, is the continued robustness in growth in the savings bank balances. We added 300,000 new to bank savings and current account customers during the quarter, and that made up part of the 500,000 new customers that we actually acquired during this quarter. SA growth came in at 68% year-on-year and that is why CASA is nudging 43% now. The other feature is the growth in our vehicle finance book, which had become evident even in the last quarter, but that has now sustained in a very robust manner. Our disbursements on Vehicle Finance as a whole went up by 34% year-on-year in quarter 3. Just Commercial Vehicles in disbursements grew 39% actually. So the growth is now firmly in the 20s for the loan book as a whole. And I think the interesting feature is, on Vehicle Financing, that it is not just Commercial Vehicles, the heavy vehicle stuff, we are already seeing a good, handsome growth in utility vehicles, cars, 3-wheelers, 2-wheelers, construction equipment, especially tractors. Tractors grew almost 58%. So that is a good sign for us and that helped us to slowly sort of rebalance the book. So the target, the ratio between Corporate and Retail has been stagnating at 60-40, whereas we have said that we grow to 50-50. So we see a 1% improvement in the profile of the Retail versus the Corporate Bank.

Other than that, the digital sourcing part of our businesses also showed very good traction. 25% of the newly acquired savings bank customers during the quarter were acquired through Tab banking. Almost 14% of our credit card businesses were acquired online. Almost 64% of our personal loan businesses are what they call pre-approved as well. We are seeing a very good traction on our mobile banking. We were a little late, as you would recall, coming up. Mobile banking now has grown 3x over the year. And we have 1.5 million sort of transactions now being done every month. So that part is also built up nicely.

We can go through briefly the loan book. If we open the slide on the loan book, so the loan book profile, as I said, only moves 1% in favor of Retail. But I wanted to talk more about the diversified split of Corporate book. There you would see a slight movement upward on power generation and that is caused by one account which has international bank guarantees for it.

Other than that, I think the dispersal is almost the same as we saw last quarter. So we don't see too much of a movement there.

Loan book quality is the other part. If you talk about our gross NPAs, moved up by 8 basis points. Slippages have actually fallen from 1.7% to 1.32%. And credit cost actually came down from 18 basis points to 15 basis points while the gross NPAs went up by 8 basis points. The Provision Coverage Ratio was kept at 60%; we retained that. The restructured book is now down to 0.15%. It's a very small book. And the SR book, which is sales to the ARC, is about Rs. 440 crores, the total amount. So I think there is steadiness around the loan book quality. We also give you individual product-wise gross NPAs, and we don't see a movement. The big one is an improvement in the commercial vehicle side where gross NPA has actually fallen by about 9 basis points overall.

Other than that Capital adequacy, the CRAR actually went up by almost 20 basis points in spite of the balance sheet growing by 20%. The loan book actually grew by 25%, and that is because of the drop in the risk weightages. So I think it is a fair indication of what I said earlier on the way the trending of our loan book quality. If you see all this together with the fact that our SMA-2 data is well below 1% of our book, I think that is a fair indication of where this book is actually headed. So that's on the CRAR.

I think the cost to income I have already talked about. Fee income, we have discussed that the core fee income has grown 22%. And if you see the breakup of the core fee income, then all the vectors show a pretty decent growth, except for Investment Banking. Investment Banking is a lumpy business, so you can't expect uniformity in terms of its growth profile quarter-on-quarter.

So that's it in terms of quarter 3 results, and we are open to questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. We take the first question from the line of Kunal Shah from Edelweiss Securities.

Kunal Shah: So in terms of the RBI's divergence report, have we already received it? And it has not been material enough in order to maybe disclose anywhere. Is that the case?

Romesh Sobti: No. The RBI report is still awaited. So they completed the audit only towards the end of December, and they have not yet given us even the preliminary findings, the preliminary risk assessment report. So all that is still going to happen in quarter 4.

Kunal Shah: Okay. So that is going to come in Q4 if there is any divergence?

Romesh Sobti: Yes.

Kunal Shah: Okay. And secondly, in terms of this power generation, so whatever is the movement in the ratings which are there, is it largely on that account?

Romesh Sobti: No. That is a guaranteed sort of exposure. We have international bank guarantees to do that. I just wanted to explain that there is one account which actually moved the percentage of exposure to power generation as a percentage of our total loan book.

Kunal Shah: Yes. But in terms of rating, it is not impacting because there is some...?

Romesh Sobti: No, not at all. The rating profile actually shows an improvement.

Suhail Chander: That's why we say that because there are guarantees it is showing an improvement.

Roopa Satish: That is one of the contributors. It is not the only contributor.

Romesh Sobti: That is only one, but a lot of it is because some lending has happened to the PSUs. And also, PSUs have a higher rating, so that also you can see it in the slide where we give the rating profile of the banks.

Kunal Shah: Yes, that is true. So if we just look at the rating profile, there is some inch up away from, say, AA and AA- towards A- and A- exposure. So anything to read into that? Or maybe it's more like financial statements would have come in and that is that where we would have reviewed the entire rating and nothing much to worry about in terms of this kind of shift which has been there, so the rating downgrade which has been there, 2% to 3%?

Romesh Sobti: Yes, I think there is a little bit to celebrate there rather than worry because the rating profile has actually improved. So the rating profile of the whole portfolio, actually now we are around to around A.

Kunal Shah: Yes. It's more towards A-. Initially, it was more towards AA and AA-...

Romesh Sobti: No. Overall, we are talking about the whole portfolio.

Sanjay Mallik: The average portfolio, Kunal, is A.

Kunal Shah: A, okay. Okay, so you are saying quarter-on-quarter, there is no deterioration as such?

Sanjay Mallik: There is a marginal improvement.

Kunal Shah: Okay. And thirdly, in terms of this commercial vehicle, so a much stronger traction. So how much do we see it structurally and just maybe we would tend to believe that the cycle has just begun. And how much of it would be, say, on account of some kind of a preponement of the demand which would have been there in, say, Q3. So is it more kind of a structural and we should see it continuing for a while?

SV Parthasarathy : Actually, there is no reason for preponement. It's not a year-end kind of situation. Therefore, I suppose it's a bit structural, but we will have to wait for a couple of quarters to see whether it is a trend.

Moderator: Thank you. We will take the next question from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question on the loan book growth during this quarter and thereafter, your comment during the press conference that now you are seeing a firm growth in the corporate side also. So how do you see the growth in that context because the industry was growing 4%-5%, we were growing 25%. If the environment is good, we can reach to 30% kind of growth again?

Romesh Sobti: So if you look at our record for 10 years, you see that whether things are going up or going down, we are steady at 25%. So the fact that we grew 25% three quarters ago and now things are looking up, I don't think we are going to press the pedal and push the loan growth to 30%. What we will do certainly is that to rebalance the book, and that book rebalancing means that hopefully the retail part will grow faster than the corporate part. And we go back to that target of achieving a 50-50 balance between, let's say, in the next 2 years.

Manish Ostwal: Sure, sir. The second question, on the operating expenses growth last many quarters, the growth rate is trending down, and now it is 15% Y-o-Y growth. And maybe it is a function of some digital initiatives that is also paying off in terms of lower cost of acquisition and servicing of those clients. So how do you see the operating expenses growth given these digital acquisition trajectories and the second is the overall efficiency in the bank?

Sumant Kathpalia: So our FTE (Full Time Employee) per branch and which is the good indicator which we take to measure has gone down by 20% per branch over the last 12 months. If you have to see the data that FTE per branch is down, and it will continue to go down as more and more digital and as we grow our business, I think, and as we get into digital more and more, I think this will continue to go down. Romesh has already informed you that 25% of our savings account, 65% of our PL and 15% of our credit cards are now acquired digitally.

Manish Ostwal: That is it. Last question, on the microfinance book. We now crossed Rs. 3,000 crores of microfinance book. So how is the asset quality in that book, whether the things are improving from the quarter 2 or is it stable? How is that trend in collection efficiency terms?

Sanjeev Anand: Yes. The asset quality is very good, actually. So in fact, all our loans which have been booked after January 1st 2017, the repayment rate remains at 99.8% and in fact, we have been seeing some recoveries also now for the earlier provided NPAs.

Manish Ostwal: Okay. And last point, sir. What is the update on Bharat Financial merger, sir? Where we are right now in terms of stage?

Sanjay Mallik: Yes. So we made a disclosure to the stock exchange that we have received the approval of the Competition Commission. That happened very quickly. We are still awaiting approval from the Reserve Bank. After which, we can move towards the next stage of approval which is the stock exchange approval and finally the NCLT approval. So it's moving through the motions in Reserve Bank.

Moderator: Thank you. The next question is from the line of Ashish Sharma from ENAM Asset Management.

Ashish Sharma: Just on this interest income growth where we have seen some bit of disappointment, 16%. And if I just see your yield for both corporate and consumer finance, we are seeing some bit of pressure there. Just some color on, is it more to do with the private and public sector banks being a little too aggressive in the corporate space? Do you see further tightening there? Just some color on that, sir.

Sanjay Mallik: Yes. So I think the number you quoted is not exactly right. The net interest income growth was not 16%.

Ashish Sharma: No sir, interest income, not net interest income, only interest income. If I were to compare it with...

Sanjay Mallik: Right. Okay. And the second part, of course, you talked about the, I think, the yield reduction.

Ashish Sharma: Yes.

Sanjay Mallik: Yes. So there is a yield reduction, but simultaneous with that is also a cost of fund reduction. So net-net, margin movement has been almost negligible. It's been about 1 basis point. But specifically, I think there are some pockets in consumer finance where I think the spreads have become, in some segments, slightly more competitive, notably in products like LAP and I think in one segment in the vehicle business as well.

Ashish Sharma: Okay. The other point was that given this cut throat competition more on the corporate side where even the yields have gone below 9%, so do we see that risk adjusted there is still a segment where we can focus because in this quarter, the loan book growth was faster in the corporate book rather than in the retail book. So...?

Romesh Sobti: Absolutely. I mean, just don't look at interest income. Look at the non-interest income that flows along with it. When you look at corporate relationships, you don't just see the interest earned out of it. You also see the return on your exposure, return on assets. And that is there because fee income has a lower risk weightage and, therefore returns go up. So certainly that is an area that we would like to grow because the fee pools are much larger in corporate banks.

Ashish Sharma: Okay. So risk adjusted, including the fee part, this looks perfect.

Sanjay Mallik: Not just the fee part, but also the opex in the corporate bank is much lower than the retail bank. So from a bottom line perspective, returns are pretty attractive.

Moderator: Thank you. The next question is from the line of Dhaval Gala from Birla Sun Life Asset Management. Please go ahead.

Dhaval Gala: A couple of questions. First question, on your yields. Could you tell us what will be incremental or marginal yields both in corporate banking business and the consumer banking business? And how is the trend like on the incremental versus the average yields which we report?

Sanjay Mallik: We don't disclose individual items, Dhaval, in terms of the product yields. But I think the takeaway really is what's happening to funding cost and what is happening to yields. And I think the net result of that is your NIMs. So that's how you run the business.

Dhaval Gala: Just to ask you maybe the recent move in the interest rates, more in market rates especially, will that have a considerable impact in times to come, looking at our portfolio yields reducing right now much faster than the book yields on basically the average yields?

Sanjay Mallik: No. So the margin is also a function of your mix. And I think it was mentioned earlier that the retail businesses are starting to grow faster. And if you look at the differential yield is almost 5% between Retail and Wholesale. So that is certainly going to give you a little bit of a cushion.

Romesh Sobti: At the end of the day, your Consumer Finance, the retail part is yielding 14%, right, which is clear over 5% spread over the Corporate side. And the more you do on the retail side, you take care of the competitive pressures that are coming on the corporate side. There are some, as Sanjay mentioned, some competitive pressures in the retail side also, but the high-yielding assets are still holding up nicely. It's just the area of commercial vehicle etc., where a few players have sort of come in. They are opportunistic, and they will last for a maximum of 6 months.

Dhaval Gala: Alright. Sir, the other question, more on your corporate asset quality as such. Could one expect no more challenges from here on because if we look at our portfolio mix in terms of diversity of sectors and most of the NCLTs and the divergences, et cetera, for the other corporate banks largely done with, you would not have material things left. So should one expect lower slippage ratios for you on your corporate exposures in the coming years?

Romesh Sobti: See, on the BAU basis, if you look at the steady improvement in the rating profile of our Corporate loan book for the last 3-4 quarters, if you look at the fact that we have a high provision coverage ratio of almost 60%, we have a floating provision of Rs. 70 crores, we have got SMA-2 at well below 1% as I mentioned. So there is no reason why the BAU credit cost should not actually remain either stable or move downwards. The other element is only the divergence element. If there is divergence, if you see finally from the RBI report, the divergence again only be of a technical nature and not really credit-related because our SMA-2 data reflects that. SMA-2 data is well below Rs. 1,000 crores, right? So there is no reason for us to believe otherwise, that the loan book quality has improved and, therefore, there should be a steady improvement in the, what do you call it, the credit cost profile.

Moderator: Thank you. We will take the next question from the line of Shivakumar from Unifi Capital. Please go ahead.

Shivakumar: Sir, my question is regarding the Bharat Financial merger. You had given a list of approvals that are yet to be sought from the regulatory authorities. I just wanted to know the broad time lines which you have in mind. Will you be able to complete this before the Q2 of next fiscal?

Sanjay Mallik: Yes, that is the plan.

Shivakumar: Okay. Or it can be even much before that, sir? So when do you believe RBI will be able to approve the merger?

Sanjay Mallik: It is possible, but I think I can't second guess how soon RBI can approve it. So I think that would be a bit of guessing.

Shivakumar: Okay. But you're confident that by Q2, you will be able to get all approvals, right?

Sanjay Mallik: It looks like that.

Romesh Sobti: We are hoping for that, yes.

Moderator: Thank you. The next question is from the line of Anusha Raheja from LKP Securities. Please go ahead.

Anusha Raheja: Yes. So on the margin side, how do you see margins shaping up for the next fiscal? You mentioned that you are moving more towards the retail book. So once the mix improves more towards retail, like 50-50, where the yields are better, how the margins will shape up?

Romesh Sobti: Yes. So our sensing is that margins are going to remain stable because we are seeing yield pressure on the corporate side of the business. And even while the mix changes, I think this will sort of neutralize it. The other big kicker that can come in to improve margins is the CASA. CASA is almost 43% now. Our target is to take it to 45%. And if that happens, then I think certainly there is an upside possible, provided there is rational pricing in the market.

Anusha Raheja: Okay. And sir, one thing on the NPLs that has come on the consumer lending side, it was Rs. 213 crores in Q2FY18, and now it's around Rs. 266 odd crores. So anything more to read into it, like there is a rising trend there?

Romesh Sobti: Well, I think on the next slide, we have given you a breakup.

Sanjay Mallik: Consumer NPLs have fallen quarter-on-quarter. They were 1.19% in quarter 2. And at an aggregate level they are 1.1% in quarter 3. And in the products there are some movements. CV has slightly come down. LAP has slightly gone up. But they are all within sort of comfort zone.

Moderator: Thank you. We will take the next question from the line of Monica Agarwal from Bernstein.

Monica Agarwal: Sir you just mentioned about CASA ratio that we are aiming at 45%. By when is this are we planning to achieve this particular target?

Romesh Sobti: This is the target, if you recall, when we presented our plan, we had said that we will cross 40%. Now that we have crossed 40%, it's on the table on whether we should be upgrading our target. So we are saying that we should be aiming at least to have the ambition to achieve 45%.

Monica Agarwal: So 45% by FY20, right?

Romesh Sobti: Yes, it's an ambition.

Monica Agarwal: Okay, great. The second question is on the credit cost. So apparently there is a slight upward uptick on the consumer finance portfolio. So where is it exactly coming from? Which particular segment or sub segment that you would highlight that from where is it coming from?

Romesh Sobti: Actually, if you have the slide 23, if you have the investor presentation, you have got the NPA composition of consumer finance. You see there where the gross NPAs are moving. So you see commercial vehicle actually has gone down; utility vehicle has gone down; construction equipment is slightly up; cars has actually gone down; 2-wheelers, slightly up; LAP etc. is up by about 15 or 20 basis points, 19 basis points. So that's the breakup. And the individual values are pretty small.

Monica Agarwal: Okay. So just one last question on the investment side, if you would be able to give me the breakup on the investment portfolio of how much percentage of it do we have on held to maturity, held for trading and available for sale? Do you have some percentage share on these terms?

Sanjay Mallik: No, we don't give those details. You can see it on an annual basis in our balance sheet. But we disclose the trading income every quarter. And that if you see the investor presentation, it has been lower, obviously because yields have hardened this quarter significantly.

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

Jai Mundhra: Sir, just 2 questions. Firstly, you explained a bit about the Bharat Financial merger. Just to understand from our reporting perspective, would it be safe to assume, so let's say next quarter also we would be reporting our number itself only, and once the merger gets the final approval, we would be restating, let's say, at least the fourth quarter number or FY18 number because the approval date is 1st Jan, I believe.

Sanjay Mallik: You're absolutely correct. Yes, that is right.

Jai Mundhra: Sure. And secondly, sir, just one data point. If you can share the security receipt number or is there any change in this quarter for our bank?

Sanjay Mallik: Yes. Rs. 440 crores for the quarter, and we sold Rs. 40 crores.

Jai Mundhra: Sure. And just to reconfirm, there is no SDR, 5:25 and other deferred kind of a stress, right, except this restructuring?

Sanjay Mallik: No, only 0.15% of restructured book.

Moderator: Thank you. We will take the next question from the line of Amit Premchandani from UTI Mutual Fund.

Amit Premchandani: Just wanted to understand what is the management thought process about manufacturing of different financial products like insurance and asset management?

Romesh Sobti: Yes, I think there is an internal debate that we have done well as a distributor of these products and where does the value really reside? Does it reside in the annuities that you earn as a distributor? Or does the value reside in the manufacturer? And certainly, I think the debate is now on. And clearly, there seems to be a strong case that we should also be getting into manufacturing, which means that should we be a life insurer or a nonlife insurer ourselves, should we do asset management ourselves, should we do brokerage ourselves? These things are now on the table. I mean, if you would ask me 1 year ago, they were not on the table. And certainly, there is a discussion now going on. And from those discussions I think some actions will emerge.

Amit Premchandani: And sir, lastly from a thought process point of view, you would like to have organically are growing these books or inorganic?

Romesh Sobti: We will look at both. But where there is long gestation, we would prefer inorganic growth.

Amit Premchandani: Sir, another question, on IFRS. What is your expectation about the timelines of IFRS? And are you reporting fee income in line with IFRS? Or you are following the old or the current prevalent practice?

S. V. Zaregaonkar: On the IFRS, RBI has not given any time lags. As it stands, it is going to be effective from 1st April 2018 that you are all aware about. But there is no revision in the guidelines and all that. So as long as that is not made applicable, we continue to report the earnings on the Indian

GAAP accounting system and we do not find that there will be a big divergence if we converge into the IndAS.

Moderator: Thank you. Ladies and gentlemen, due to time constraint that was the last question. I now hand the conference over to Mr. Romesh Sobti for his closing comments.

Romesh Sobti: Okay. Thank you for joining us. I am sure you have more questions which will be discussed on a one-to-one basis. Good day. Thank you.

Moderator: Thank you. Ladies and gentlemen, on behalf of IndusInd Bank Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.