"MAS Financial Services Limited Q1 FY-20 Results Conference Call"

August 1, 2019

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MODERATOR: **MR. ALPESH MEHTA – MOTILAL OSWAL FINANCIAL LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to MAS Financial Services Limited Q1 FY20 Results Conference Calls, hosted by Motilal Oswal Financial Services 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. Alpesh Mehta from Motilal Oswal Financial Services. Thank you and over to you sir.

Alpesh Mehta: Thanks Lizann and good evening everyone and welcome to this 1Q FY20 Results Conference Call of our MAS Financial. Today we have with us Mr. Kamlesh Gandhi – Chairman & Managing Director and Mr. Mukesh Gandhi – Director & CFO, Ms. Darshana Pandya – Executive Director and COO and Mr. Ankit Jain – Vice President (Finance) from the management to discuss the results.

Post the initial comments by the management, we will open up for Q&A session. Thank you and over to you sir.

Kamlesh Gandhi: Thank you Alpesh. And good evening, everybody. I am very happy to connect to all of you once again. I think we already published our results and all of you must have got an opportunity to go through that. As we all know and would not like to discuss the same thing again that the sector is going through a tough time and this is the time where the fundamentals count a lot.

So, coming back to the results:

If I share with you the results for Q1 we grew our asset under management by 29.22% as compared to last quarter, that is Q1 19 on Y-O-Y basis. Total income increased by 33%, that to 159.23 crore from 119.63 crore making taking the profit before tax to 62.66 from 46.84 and profit after tax a rise of 33.70% at 40.73 crore. So, this is in line with our endeavors and what we always try to do that grow anywhere between 25 to 30% keeping the fundamentals intact and if we talk about gross stage three assets as percentage to AUM is 1.39% as compared to 1.24% last year and after the provisioning it is 1.14 as compared to 1.1% last year.

I will share details on the product wise:

As you know that we are focused on four primary products that is micro enterprise loans, small and medium enterprise loans, two-wheeler loans and commercial vehicle loans. But if you see that our main focus on micro enterprise loans and SME loans continues when you are registered a 30.60 and 34.13% growth respectively with the assets under management at 3595 and 1375 respectively, and two-wheeler at 455 crore and commercial vehicle at 152 crore which registers a growth of 16% and 3.48% respectively. This includes the underlying assets we work through our large partners of various NBFCs.

I am not going to the IGAAP numbers IGAAP numbers are just given for better understanding. I will now take you through the performance of our subsidiary that is, Mas Rural Housing and Mortgage Finance Limited. As you know that housing finance business has witnessed and unprecedented pressure on various fronts be it the market be it the liability and various other things. But withstanding that even on a small base, we could grew at around 30% this year, whereas asset under management from 210 crore to 271 crores and they are translating into income growth of 37% and a profit after tax growth of 23.53%. And once again the focus on quality 0.40 and 0.29 is a net gross stage three asset as percentage to AUM and net stage three assets as percentage to AUM which is more or less in lines with what we were operating last year.

So, this is about the performance of the company and let me share with you that the performance is a function of the strong fundamentals what we have been telling all the investors right, since I got an opportunity to talk to all of you and various analysts since our IPO that we believe in a steady and a very calibrated growth, our priority always has been quality profitability and then the growth and as you see we are well capitalized at around close to 28% in capitalization.

So, despite of that we have never endeavor to grow at an exponential rate and financing being a leveraged business, we always understood that we are responsible to create quality growth and not just the growth and that is what we call it as an all-round development. So, this is in nut shell the performance of the company in terms of how we work towards this quarter is, we have concentrated as I have shared with you on these four products, we increased 15 new branches mainly in Gujarat, we have further deepened our penetration in the state of Gujarat.

We continue to work with well managed and NBFCs and smaller NBFCs that we share with you know have no ALM issues, maybe the growth will be little muted this year but if I share with you the NBFCs with whom we work with in this quarter also could raise close to 5500 to 6000 crores in that.

So, that is also a positive sign this quarter that they are in a position to mobilize funds may be somewhat at a higher rate and maybe something less than what they would have expected. But they could mobilize that and our focus on working with them comprehensively, not only from creating assets, but being the friend philosopher guide on how we can create quality assets. And being very indulgent with them continues and we are have said as you all know, we are we have been dealing in this since 2009-10 and this is almost 10 years now.

So, this is from me, this is the overall working for the quarter, I request Mukesh to very briefly share with you the most important thing for this quarter that has been liability.

I would like to sum that up in one word that we have the simplest format of working and a very robust way of managing your liability. And this has not emerged from the current crisis, but it has been at least since long and that is why we have not only well capitalized but we have raised debt as in when we have thought to raise it. Obviously, the rates have little tightened but we could register the growth in AUM only because that we could raise the liability and I am thankful to all the lenders who have put tremendous faith in us.

With this background, I will hand over to Mukesh to take you through some detailing on that. Over to you Mukseh.

Mukesh Gandhi: Good evening everybody. Just to give you the note that liability is a very important as Kamlesh told that it's a very important component so far as the NBFC is concerned and currently, we don't have any issue of ALM and that was since beginning we work in such a way that we never have a ALM issue of our liability are as per the matching of the assets and if I take the borrowing composition the 47% of our borrowing comes from assignment and that because of the assignment we have a door to door maturity. 34% comes from tax credit limit, 18% comes from term loan and we have a 1% that is sub-debt however, total liability composition works.

If you look at the cost of borrowing, now the current cost of borrowing has gone up and it is currently 9.26% if you compare with year-on-year last year for the same period it was 8.84%. So, there is a rise of 44 bps and if you compare from March then there is a rise of 34 bps and that is because of the overall tightness in liquidity, we hope that in coming one or two quarters because of the various measures taken by Reserve Bank of India when government the rate of interest will be route that is what we are expecting to that.

Now, if you look at our CAR then it is 28.09% and/or debt equity ratio is very-very low and that is 3.11x debt-equity ratio. And that is because of our assignment transactions 37% of our AUM that is off the balance sheet. So, on balance, the leverage is 3.11 and interest coverage is 1.97%. So, this is how we have arranged our liability aspects. And that is very much in line with our growth and we have been fortunate enough to get the support from our lenders because of our vast track record of more than two decades and we have sufficient assignment interactions with the banks and the term loan as interactions so for our entire years growth we are hopeful of raising the liability as we want. So, with that I end here.

Kamlesh Gandhi: Thank you Mukesh. So, that was from Mukesh on liability side. I will brief you on how we create assets the business model I think most of you know that we are focused on the MSME segment. And going further, taking it further for the year we would like to give the same guidance that we like to grow anywhere between 20 to 25% depending upon the market dynamics and once again, the priority will remain quality profitability and growth. So, we that we are open for any questions if anybody has any queries or anything to ask.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave: Sir, I had three questions. One is on your liquidity lines, any undrawn bank lines, cash on books, all that amount put together how much liquidity. How much access to liquidity do you have?

Kamlesh Gandhi: That will be close to 1800 crore

Agastya Dave: 1800 crore. So, this excludes any repayment and prepayment money which comes back to through your AUM right?

Kamlesh Gandhi: Yes, this is net new lines which we can draw whenever we want to draw.

Agastya Dave: Perfect sir. Sir, in all your geographical areas where you are operating or all the product segments that you operating in, are you seeing any sign of stress anywhere where you would like to go slow going forward?

Kamlesh Gandhi: We don't see trend as such and the basics for that is not because everything is fine everywhere. But that is because of the policy what we follow since years of extending credit where it is due. And even because of this policy, we are not seeing any trend that may be Gujarat is like this or Maharashtra is like this. Right now the beginning we work in such a manner that depending upon the demographic the credit visa design, and the operation is done accordingly.

Agastya Dave: Excellent. And sir the final question is in terms of competition that you were facing, let's say last year before ILFS and what you are facing now, do you think a lot of competition has grown up? Is it like visible on the ground in terms of competition you are facing?

Kamlesh Gandhi: Let me take you through our fundamentals on asset creation, you always focused on what we can do and how we can extend the credit. In terms of financing it is not about selling it is about credit buying, the markets were there they were huge, they are still there, they are huge. There are many players who have come, many players who have exited. So, parse for us a very intense competition or a vacuum does not change the way we work. So, we don't evaluate much from that point of view. Having said that, it is a well-known fact that many of the players have reduced the disbursement will create more opportunities in the market. But having said that, that does not make much difference to us.

Agastya Dave: Great sir. So, you will not unnecessarily overextend yourself right to gain market?

Kamlesh Gandhi: No, exactly.

Moderator: Thank you. The next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: So, first is we didn't have four product segments, I think there has been a continued slowdown in the CG as well as the two-wheeler vehicle market. So, given our small size I felt that we could have done a bit better. But if you can throw some more color on the same that would be useful?

Kamlesh Gandhi: I really don't get what better means, but 16% growth in two-wheeler where overall two-wheeler has shown a down trend shows that we have the advantage of a smaller size and with this been portfolio of the 14,000 or 15,000 crore the chances of that would not have grown at this percentage because of the market dynamics and as I shared with you once again, we focus on how to create quality and how to extend credit where it is to you, so within that parameters, we give our maximum and we give the best and then the growth is the resultant figure, growth is never the targeted figure and that is why if you see this organization. We are close to 25 years and still talking to you of around close to a 6000 crore AUM having said that we should understand that my first balance sheet size was just 2 crore, my translate into a 35% CAGR. So, the fundamental approach to asset creation is such that it's all about extending credits where it is due and irrespective of what my size is or irrespective about what the market dynamics are. So, if I say that we are internally fine with the 16% growth in two-wheeler and commercial vehicle we all know that it is not the time and there were no opportunities there in the market to grow that.

Sarvesh Gupta: Understood sir. And sir on your if I see the classification of your AUM as per DPD, I think there was a big jump on the greater than 120 days DPD by almost 30 basis point. So, how should we read that sir?

Kamlesh Gandhi: It is always range bound, if you see those DPDs remains within a range bond, so we are not unduly worried about all that 120 DPD, if you see the net NPAs of the stage three, we have been in position to manage that. So, it's a range bond performance from quarter to quarter it will vary because we cannot have very straight line on performance it will be varying from quarter-to-quarter. But suffice to say that we don't see any sort of undue pressure ultimately coming on loss given default or that in our stage three or net NPA's increasing.

Sarvesh Gupta: Understood sir. And sir on our borrowing cost I think from 1Q to 4Q of last year despite tightening of liquidity we were able to reduce our borrowing costs, but this quarter there has been a substantial jump from 4Q to 1Q. So, any reasons behind this steep price?

Kamlesh Gandhi: From Q4 to Q1 the trend, the increase from Q4 to Q1 as Mukesh shared is because of the market situation that in order to have certain liquidity on hand, we need to pay more and that is what it was done and for formally we could manage because the situation was not that bad, as it was perceived this year and we would have some on drawn credit line insured as a certain rate which were lower and as I told you that the respect what we demand from our lenders is that they will not increase the rates to give once they have sanctioned it. So, maybe the new sanctions might have come at a higher rate, whereas at the last time the sanctions we might be having sanctions at a lower rate and that we had drawn. So, when anything continues for a longer period that advantage goes away of having sanctions at a lower rate because that are for a specific period of time. If it still remains for another three, six months like this then I will have to draw from a new sanctions only. The way we work is that we are always two to three quarters ahead in terms of getting the sanctions.

Sarvesh Gupta: So, what is the marginal cost of borrowing right now and what was the same end of March?

Kamlesh Gandhi: I think the marginal cost of borrowing ranges from 9.5% to 10 that will be range bond 9.5% average 9.5 to 10, I might borrow at 9 and at some place I might be boring at 10.25, so average must be ranging from 9.5 to 10% and must be around 20-25 bps less last quarter.

Sarvesh Gupta: Okay, sir. So, because of this quarter I think we have also seen some reduction in our net interest income percentage wise. So, I guess that is because of the steep increase in the borrowing cost and maybe you will try to pass it on to your borrowers in the coming quarters?

Mukesh Gandhi: The reduction in NIM is as you told is because of the increase in the rates and our asset the way we disburse money to and the client's to whom we work with, we are in the position to pass it on to them maximum possible in a shortest possible manner.

Moderator: Thank you. The next question is from the line of **Yog Rajani from Sejwan.** Please go ahead.

Yog Rajani: I just have two questions. Who do you see as your biggest competition in the Gujarat and Maharashtra region and what competitive advantage you think you have over there?

Kamlesh Gandhi: As I told you once again, we are not more focused on the competition landscape given the size of the market we work in and given our size. So, whether it is Gujarat, Maharashtra or Rajasthan that has never been an issue with us as far as the competitive landscape is concerned. So, we continue as I shared with one of the persons earlier is that, that we continue to focus on our business that we are credit buyers and we are not credit sellers and that is what differentiates us from all the other lenders. And that has been our fundamentals followed right from last 20-25 years. So, we personally believe that there's a huge market to be served, the problem is not the market size. The problem is how you decide your growth rates, how you decide the markets where you can add value, how you think that we need to create good entrepreneurs and not just borrowers. So, with all these fundamentals, we see that the market says what we have the problem, there is no problem for growth the way we want to grow. So, from this you might make out that our competitive advantage is the understanding of the segments where we are working.

Moderator: Thank you. The next question is from the line of Raj Kapoor from Water Bridge Capital. Please go ahead.

Raj Kapoor: I would just like to know what would be your guidance on the NII growth for FY20 and 21 both given that we are placing some pressure on margins?

Kamlesh Gandhi: As you could right now it can be anywhere between 7% to 7.5%. NII growth you are telling, the NII will be 7% to 7.5% and see when we grow at around 20% to 25% ideally NII should make that growth, so it will be anywhere around 20%.

Raj Kapoor: Okay. And sir regarding the auto and two-wheeler sales so do you expect the demand or the business to pick up in the second half of FY20 given the festival season would come and so all your focus is on that?

Mukesh Gandhi: I would rather tell that I, we have lot of the market dynamics are such that I would really cannot predict. What aspect I will put it I wish that this festival season improves as far as the demand is concerned, this festival season can be a trigger for the demand ideally it should be like that, but given the market dynamics it's difficult to tell anything.

Raj Kapoor: Okay. And sir what would be your branch expansion plan over the next two, three years?

Kamlesh Gandhi: Within next few years we see ourselves close to anywhere between 130 to 150 branches current 93 branches only.

Raj Kapoor: Okay. And sir one last question. Sir, we see that our SME, in the SME lending our ticket size has reduced from 80 lakhs a few quarters back to something around 37 lakhs as of now, so any reason anything to read around it?

Kamlesh Gandhi: It depends on the business we source on a quarter to quarter basis, because if say in SME we are anywhere between the Rs.10 lakh machinery to even to the size of around 2 crore more. So, it depends upon the type of business we source at a particular quarter. So, the ticket size will depend on that, once again it is a function of where we find the credit be good and credit to be extended and accordingly we will built up our assets and that will be reflected in the ticket size.

Raj Kapoor: Okay, and sir this ticket size is on the loans or on the disbursements?

Darshana Pandya: On the disbursements.

Moderator: Thank you. The next question is from the line of Madhuchanda Dey from MCA Research. Please go ahead.

Madhuchanda Dey: I have two questions. The first is, in light of the quite a bit increase in the cost of funding. Do you think that you will be able to pass this on entirely to your borrowers? And how do you see the NIM trajectory going forward, especially in light of the expectation that the overall macro interest rates are headed down.

Kamlesh Gandhi: See in terms of passing on the interest rate as I shared with one of the caller, that as the people whom we lend to we have the opportunity and we have the facility to increase the rates that we have to because of our higher borrowing and within us, and that to the turnaround time is not much more in that. So, whatever increase is there with us on us we will be in a position to pass on that increase that is what we have done. And we think that we should be in a position to do it, maybe there will be some time lag and that might reflect on the NIMs. In terms of, if the interest rate decreases, the way the intention is that interest rate should decrease and if we get it at a lesser rate we will be in a position to pass it on that rates to the customers once again, keeping our news in fact we always work and we always guided on a ROA of anywhere between 2.5 to 3%. That once again will be range bond and for that we need a NIM anywhere between 7 to 8%. So, going forward we think that given our business model, even the opportunities in the market, the class of customers whom we serve to and our immaculate track record on liability raising will be in a position to maintain our ROAs anywhere between 2.5% to 3%. And for that the NIMs will be maintain between 7 to 8%.

Madhuchanda Dey: So, as per your calculation, what was the NIM at the end of June quarter?

Kamlesh Gandhi: Right now, our NIM is 7.7%.

Madhuchanda Dey: And what was it as per your calculation at the end of March?

Kamlesh Gandhi: It was it was an 8%.

Madhuchanda Dey: Okay, so there was a 30-bps kind of a drop. And you hope to recoup this by the end of September quarter. Is that a realistic assumption because of the lead lack?

Kamlesh Gandhi: Maybe this much gap because 7.7% and our March it was 8.08%. It might not be recouped 100%, but maybe close to it.

Madhuchanda Dey: Okay. I have a second question which is the asset growth has been quite healthy on the micro enterprise as well as SME in the June quarter. But of course the slowdown is kind of getting aggravated by the day, given the scenario are you kind of going a little slow in this current quarter, or the outlook in your end market hasn't changed much?

Kamlesh Gandhi: The market in which we are working, there's a lot of requirement of credit. The only thing is that how we conduct ourselves on credit delivery and what are the distribution channels we decide and how we really redistribute the credit and extend credit where it is due. So, given the market size, and given our size, at the rate, what we contemplate to grow anywhere between 20 to 25%, I personally believe should not be a problem and given our distribution of direct distribution of close to 3500 centers and working with more than 120 NBFCs around. The growth in MSME in SME at around 20%-25% should not be a problem irrespective of the macro headwinds.

Madhuchanda Dey: But have you seen any change in the borer behavior in absolute recent times?

Kamlesh Gandhi: This is a time where borrowers to be honest, in to the classroom we are serving they always need money and rather they need more money now, because their working cycles have been extended and the inventory levels have increased. So, they need more money, but the question is can we really lend to them the way they want? And the irony is that when they need more money is the time where we have to be very circumspect and see to that, that we can really lend them the to that extent, because will they be in a position to serve the interest, will they be in a position to repay. So, that is a paradox that they need more money, but might be they are not that eligible from the credit perspective. So, that is where our discretion on credit and our understanding on the segment plays a very important role.

Madhuchanda Dey: So, you are a kind of internally tightening your underwriting standards is that a correct understanding?

Kamlesh Gandhi: It automatically happens because we have certain parameters that this should be the sales, this should be the profitability, this should be the inventory turnover and various parameters like that, due to such time that parameters get distorted as far as the borrowers are concerned. And as a result of which they will not be then eligible for the criteria. So, because of the functions what they, because of the financial ratios and the way they work is affected, then there's extending credit to them is also affected. Plus whatever new learning's are there for a particular sector is continuously imbibed in our credit screen. So, it is a new learning plus the working of the enterprises with whom we are working with.

Moderator: Thank you. The next question is from the line of our Amit Mantri from Point to Point Capital. Please go ahead.

Amit Mantri: I wanted to understand lot of the microfinance NBFCs as well as half of SFBs have been talking about overheating in some geographies especially in Eastern India. Since you have a fair bit of exposure towards microfinance, what's your view on overall indebtedness in some of these geographies and if that's a risk that you see brewing going forward?

Kamlesh Gandhi: That's true the new areas which are explored and there are a lot of MFAs and established MFAs who are working in other part of the countries, are trying to work over there. So, there is, so there are more and more people trying to go there and distribute credit. And when and the companies who are not discreet in the credit delivery can face problems. And how we mitigate is that we work with the people who have the good credit models whose growth are calibrated, and we have a ground level understanding of their working and which is authenticated by our team as to how their operations are, so this is how we mitigate it but you are right in a sense that more and more people are finding good opportunities and they see a market which is untapped in those areas and that will automatically increase the indebtedness. So, going forward the companies will have to be very circumspect on selecting their borrowers and in order to maintain their portfolio credit quality.

Moderator: Thank you. The next question is from the line of Piran Engineer from Motilal Oswal Securities. Please go ahead.

Piran Engineer: I just have a couple of questions. Firstly, despite opening 15 branches this quarter our OPEX has been largely stable, so have they been open towards the end of the quarter. How should we think about, modeling operating expenses going forward?

Kamlesh Gandhi: First of all our branches and especially in the VL C and Business category places in Gujarat are absolutely operationally expenses wise very light. So, we really not figure into the operational expenditure in terms of percentage. And secondly, you are right it has been much on the latter part of the quarter, but even they hadn't been in the earlier part of the quarter also would not have made much difference on OPEX cost.

Piran Engineer: Okay, understood. Sir and secondly we have about 120 NBFC sourcing for us. So, if I could just get a sense of maybe the top 5 or top 10 NBFCs how large would they be in terms of doing business for us. And are other banks and NBFCs lending credit to them today, just wanted to get a sense of the concentration from the top NBFCs that source for you?

Kamlesh Gandhi: Our top 10 constitutes around 15%. And as I said in opening remarks the NBFCs whom we are working with during the quarter roughly could mobilize close to 5500 crore in new debt only during the quarter whereas in Q4 they have mobilized around 7500 crores and Q1 usually the lend time for disbursement because people have sufficient liquidity in Q4, then also they could raise around 5500 crores. So, this is the state of the affairs at the ground level.

Piran Engineer: Understood and sir just last question on the RBIs LCR guideline liquidity coverage ratio guidelines where do we stand if you have done some calculations there?

Ankit Jain: So, we are already compiled with it because I you see our asset liability maturity pattern, our asset is 30,000 positive. If you see the first bucket, second bucket or third bucket so I don't think we require an equity, we are already comprised with RBI guidelines.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand over the conference to Mr. Alpesh Mehta for the closing comments.

Alpesh Mehta: Thank you Ivan. And thank you everyone for joining on this call. And all the best for the next quarter.

Kamlesh Gandhi: Thank you Alpesh and thank you everybody.

Moderator: Thank you. Ladies and gentlemen, on behalf of Motilal Oswal Financial Services. That concludes today's conference. Thank you for joining us and you may now disconnect your lines. Thank you.