Q4 FY22 Earnings Conference Call

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Management

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Indian Numbering System Legend

INR 10 Lakhs	= INR 1Mn
INR 1 Crore	= INR 10Mn
INR Rs100 Crores	= INR 1Bn
INR 1 Lakh Crore	= INR 1Tn

Moderator: Ladies and gentlemen, good day and welcome to Capri Global Capital Limited Q4 FY22 Earnings Conference Call hosted by Go India Advisors As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*'then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ravikant Bhat from Capri Global Capital Limited. Thank you and over to you, Sir!

Ravikant Bhat: Good afternoon everyone. Welcome to the Capri Global's Q4 FY22 Results Call. Before we begin with the opening comments by the MD, Mr. Rajesh Sharma, I will read out a brief disclaimer. 'Certain statements in the call would contain words or phrases that are forward-looking statements and all these forward-looking statements are subject to risks, uncertainties and assumptions that could actual results to defer materially from those contemplated by the forward looking statement. Any opinion, estimate or projection herein constitutes the judgment as of the date of this call and therefore there can be no assurance that future results or events will be consistent with any such opinion, estimate or projection. The full disclaimer can be accessed on the slide of our Q4 FY22 investor deck.' With that I now hand over the call to our MD, Mr. Rajesh Sharma to present his opening comments.

Rajesh Sharma: Good afternoon friends and hearty welcome to Capri Global's Q4 FY22 Earnings Call. It is a pleasure to once again discuss our quarterly earnings performance with you all. We announced our audited consolidated results for Q4 and FY22 on Saturday May 22, 2022. I hope you had an opportunity to go through our investor deck. In my opening comments, I shall focus on three aspects: a) business and earning performance, b) asset quality and credit cost, and c) our growth guidance.

During Q4 FY22 the operating environment was largely smooth with hardly any disruption during the short lived third COVID-19 wave. On business side, we delivered a 37% year-on-year growth in AUM including the Rs1.2 billion we booked under co-lending mechanism, which is a new initiative for us. This compares with our 20% year-on-year target we thought we would deliver in FY22 while maintaining a 22% to 27% medium term CAGR target. Clearly the performance has been much above our guided path. Performance across all verticals was strong including in construction finance where we consciously peg growth to the retail AUM performance to keep its share under 20% of consolidated AUM. The co-lending mechanism was activated for MSME. We achieved Rs1.15 billion AUM under this mechanism, the first full quarter of operations. Although we are not sharing an explicit target yet for this AUM it will be fair to consider Rs1 billion to Rs1.5 billion as base quarterly momentum for the MSME product under core lending. Core lending for affordable housing has been activated in Q1 FY23 for which we tied up with the State Bank of India in March 2022. We are gearing up for the formal launch of 20 gold loan branches in June. I had shared in the Q3 FY22 earnings call we have some ambitious plan here with AUM target of Rs80 billion and an exclusive network of 1,500 branches in the five years to 2028. We aim to open 100 gold loan branches in H1 FY23. The top and middle rank leadership has already been on boarded. The lower level recruitments are on fast track.

Though the disbursals growth for Q4 FY22 appears a bit tepid at 12% year-on-year, it should be noted that Q4 FY21 disbursals were also an outcome of pent-up demand following normalization post second lock down. In fact, we did 68% of FY21 disbursals in Q4 FY21 alone. Hence a better comparison would be the full year disbursal performance which was Rs28.4 billion over Rs15 billion in FY21. This signifies a 90% year-on-year growth.

Our car loan distribution business had the first full year of operation. The vertical originated Rs17.4 billion in new car loan origination for our partner banks. The business performance progressively improved during the year peaking at Rs7.8 billion on Q4 FY22. We are confident of doing upwards of Rs30 billion in car loan origination in FY23. The vertical contributed Rs467 million in gross fee income. It has been profitable since Q3 FY22.

I shall now briefly comment on earnings. Our spreads and NIMs after showing resilience and expansion in nine months FY22 exhibited weakness in Q4 FY22. This is after adjusting for some one-off effect. The chart on Slide 14 is self-explanatory. We had held back rate increases. But after the emphatic RBI rate action earlier this month and quick general acceptance of a tighter rate scenario, we are in the process of resetting yields on all the loans where such resets are due or overdue. This is a meaningful portfolio that can be repriced in both Affordable Housing and MSME segment. We expect to stabilize and effect trend reversal on NIMs going ahead. We have already made the beginning in affordable housing loan where incremental yields were better in Q4 FY22. Please refer to Slide 13 in this regard. Our expansion both people and network is reflected in the inflated operating cost as well as the bumped up cost ratios as illustrated in Slide 15. We have had the strongest expansion since FY19, some of it front loaded.

Slide 29 shows our head count increase which is up by 1.7 times year-on-year basis. We also added 32 branches during the year. Our business model places network and people in the centre of growth plan and is essential for our business. To that extent we shall stay course on expansion. We are confident some of the course correction our earnings that I discussed earlier shall eventually nudge our cost ratios lower.

On asset quality I would say we are satisfied overall although the quarter may be somewhat forgettable, showing elevated credit costs. In absolute terms, our Stage-3 assets have shown a decline. Collection efficiency especially in MSME, which was lagging, has caught up strongly to touch 100%. Other parameters like CBR are exhibiting improvement and our closer to pre pandemic level. Qualitatively we can say we are more optimistic about asset quality turning out better than the year before. The write-off too has been higher than in any year after FY16. In other words, elevated write-offs are that much rare for us. Cumulatively. we wrote off Rs413 million in FY22, of which, 25% was in Construction Finance. It was purely technical in nature and shall be fully recovered. The rest in retail portfolio had a sticky element and has been but prudently written off. Despite the spreads and cost moving adversely, we have delivered a good performance at operating profit level which increased 84% year-on-year in Q4 FY22 and 20% year-on-year in FY22. Our net profit registered a 54% year-on-year growth in Q4 FY22 and healthy 16% year-on-year growth in FY23.

Finally on the outlook, I would consider optimism on the growth a given. We have much going for us - a strong retail sales team that can deliver both on and off-balance growth and healthy appetite on wholesale lending. We consider 25% year-on-year AUM growth achievable in FY23. On earnings, we expect to report a much better performance when compared to Q4 FY22. In other words, Q4 FY22 could be a considered a bottoming out level for our earnings. Certain line items like credit cost for were one-offs, so there was no sustained trend over there. Such items will simply reverse to a better level going ahead. Fee contribution from the car loan distribution business is yet to achieve maturity and hence shall be a growth contributor to the net income. So overall, our earnings should exhibit a healthy growth trend. With that, I conclude my opening remarks. We shall now take questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. Our first question is from the line of Ashwin Agrawal from Akash Ganga Investments Private Limited. Please go ahead.

Ashwin Agrawal: Sir first of all, congratulations for a good set of results. So, my question was that due to rising interest rates how do you see the borrowing cost moving forward as the interest rates are going to rise further and how should the same be passed on to the borrowers?

Rajesh Sharma: So a majority of the portfolio under MSME and Affordable Housing is semi-fixed level and there, it is possible to pass on the hike to the customers. Our customers are from low-income proof category - the smaller customers - they care more for the availability of funds than the cost of funds. So passing on 30 to 40 basis points to the customer will not be difficult. So, I think that cost of fund - whatever the increases - we are going to have our ALCO meeting during the month end. By this time we will be able to consider the effect of all the banks and determine our hike* and on the basis of formula which has been given by the RBI, will pass on the entire cost to the customers.

*(*increase in CGCL's Cost of Funds)*

Ashwin Agrawal: So the spreads would be largely be maintained in 6.3% to 6.5% kind of range only?

Rajesh Sharma: Yes.

Ashwin Agrawal: Okay so that range?

Rajesh Sharma: We will be able to maintain the spreads.

Ashwin Agrawal: And my next question was that when we see our growth targets, our major contributors are going to come from the gold and MSMEs. How do you see the MSME sector like shaping up in terms of growth?

Rajesh Sharma: So MSME segment is going to be a key contributor for us. I think going forward on a consolidated basis, MSME segment will continue to remain the biggest contributor. Currently the AUM is about 50% and with the gold loan inclusive it may come down to about 35%, but still, it is going to be the majority of it.

Ashwin Agrawal: Thank you Sir.

Moderator: Thank you. Our next question is from the line of Naman Bhansali from Perpetuity Ventures LLP. Please go ahead.

Naman Bhansali: Thank you for the opportunity. My first question is on the cost-to-income ratio which has been slightly inching upwards. Is it attributed majorly to branch expansion and what sort of guidance do we have here for FY23 given that we will continue to add new branches?

Rajesh Sharma: So, I would like to say that our cost-to-income ratio also comprises the cost of car loans segment where we have almost 400 employees. In the current context, Cost/Average AUM would be a more robust way of tracking our cost efficiency. Please note our employee and non-employee operating expenses now include the opex incurred on our Car Loan Distribution team, which is almost 1/6th of our headcount and on our payrolls. The AUM this team creates is a one-time fee generating AUM and not a spread generating AUM that sits on our balance sheet. While looking at the quarterly Cost / Average AUM ratio, one should include the car loan AUM in denominator. This would deflate the Cost / Average AUM ratio by 50 to 60 basis points. So, if you look at our Opex / Average AUM ratio, it will decline by 50 to 60 basis points that way. I think while we have given a 40% cost to income ratio guidance in FY22, I think we should be able to keep our cost to income ratio in the range of about 40%.

Naman Bhansali: Okay and my second question is that could you please talk a bit on the housing finance business like have the things improved and how have they increased and anything on how we see that on the business environment front?

Rajesh Sharma: If you look at our housing business AUM, it has grown almost 51% during this year. We have already increased about 32 branches during the year. Our expansion is continuing and funds in the housing finance company are available from NHB. It is about 4%. So, there is a big cushion available in the margins because of the low cost fund availability from the NHB. And demand is there. We see on the ground the business is growing well. Next year also we will continue with the case of 30% plus onwards in this segment. So, because of low cost funds, because of the demand, and because of increase in the branch, I think growth will be there and margins will be better.

Naman Bhansali: That helps. Thank you.

Moderator: Thank you. Our next question is from the line of Amrish Kumar from Geosphere Capital. Please go ahead.

Amrish Kumar: Sir thank you for the opportunity. I wanted to ask you something on your gold loan business. In the past you have explained that this is a very good opportunity and this is a very good business. You get high single digits to double digits margins, then there is hardly any cost of delinquency. So, this is indeed a good business. But in the past, can you can explain why there have been such only few players in this business? I will give you another observation of mine. The State Bank of India which increased its gold loan business by about 5x in the last two to three years has also gone slow. The last two to three quarters, I am not seeing its AUM growing that fast. So can you explain what is stopping everyone else to come into this? Just your observation?

Rajesh Sharma: So gold loan business requires a deep penetration and large number of branches. It is a very high operating cost business in the segment where NBFCs operate. The customers of the banks are different and NBFC customers are entirely different. Banks would lend at about 9% rate of interest whereas the NBFCs do lend in the range of about 15% to 20%. So, there is a distinctly different customer segment. To operate in the gold loan segment is a high opex business as I said, and it requires a large branch network. If you see our plan, we are also planning to open 1,500 branches. You have to deeply penetrate, your branches have to be at the ground floor level where the rentals are high, you have to put up the strong room, take the insurance, keep a well-trained gold valuer, and then do the business. So, it is a business which requires a particular size. Without that this business will not be able to be profitable. Hence any NBFC will either plan for a deep branch network – 1,000 plus or it will not turn out to be profitable and this could be one deterrent. Barring that, I think there is a good appetite more in the North and West. South is already well covered by Muthoot, Manappuram and other players but North and West still has a lot of scope. If you see other competition in the gold loan, 80% of their newer expansion is happening in the North and West. We had engaged the Boston Consulting Group and a couple of credit bureaus to get the data and I think this business still has a lot of scope. And what we are talking is only creating a book in the next five years of Rs8,000 Crores which in the Indian context and looking at the overall size of Rs3 Lakh Crores, is still very small. So, while in the overall context it is doable, it is going to be profitable for us and it will give us a cross sell opportunity. Now our customer segment is the same. The kind of customer we deal in MSME are same, housing finance is the same and the same customer will be in the gold loan. So, this is also going to help in the cross-sell as well.

Amrish Kumar: So, my question on this will be if banks are giving gold loan at 9% to 10% and NBFC like you giving gold loan at 15% to 16% and I understand that banks have higher cost of operations and all. So, do you think that 10% them giving their ROA in this business or ROE in this business would be similar to us?

Rajesh Sharma: I have not tracked what the bank ROAs are in this business. But I would say the banks deal with customers who are their existing customers, whose data is available with them whereas we have to just see the value of their gold, take their KYC, and give the money. The same is finished in 10 minutes whereas the banks take much longer time. So, the customer segment is different. Now what will be the banks' ROAs on this, I have not really tracked.

Amrish Kumar: Sir the second question is on your asset quality. In the last quarter did it vary from what you had expected at the beginning of the quarter or was it in-line with your expectations and what do you expect now for the next quarter or two where your asset quality would be in terms of new stress formation?

Rajesh Sharma: So, in the last quarter we have seen the collection trend of one particular segment of the customer and based on the feedback by our collection team and their track record, we have chosen to write-off those accounts where we estimated that money is not going to come and it is better to clean up rather than continuing with those accounts. While technically the collection is for reporting to CIBIL and recovery efforts by Section 113, other measures will continue. But as a prudent measure to clean up the balance sheet of such accounts, we have decided to write-off those accounts. And if you see our write-off, which on a consolidated level is about Rs22 Crores* that we have done. Similarly, we have also taken additional provisions that has resulted in a higher PCR and strengthened the balance sheet. Going forward, this is a one-off. This is not going to be repeated and we feel in the coming year, our delinquencies will be lower, our GNPA level will be lower. If you see the delinquencies trend, it is healthy. Our GNPA has come down, Net NPA has come down. GNPA has come down when compared to 2.99% in Q2, it has come down to 2.40% at a consolidated level. If you talk about housing finance company, it has come down to 1.5% and if you talk about CGCL** where the GNPA has come from 3.5% to 2.7%. So there, drastically GNPA has come down. Our collection efficiency as I said is nearly at pre-COVID level and in housing finance segment, it has almost crossed about 99%. So, collection efficiency is good and major write-off has taken place. In the future, we do not see any trend coming up which will give us surprises.

(for Q4FY22, **CGCL Standalone)*

Amrish Kumar: Got it. So I assume that this was your clean up quarter…the last quarter?

Rajesh Sharma: Yes.

Amrish Kumar: My last question would be Sir on the progress of your co-lending business with SBI. I assume this is a very exciting and a very big opportunity for you. So can you just expand a little bit more on this? Where have we reached in the last one quarter and where we are right now and where are you seeing this going forward in the next few quarters? Any guidance or any kind of color would be very good for us.

Rajesh Sharma: Currently co-lending is still happening manually because all PSU banks follow a very strong system of technology and firewall. They have given to some vendor where technology module will be developed where we will put up the file in our system and that through some intervening system will go and sit in their system. They will then approve or decline based on their underwriting parameters and that will happen online. Currently all is happening manually. With that also we were able to achieve in the last quarter Rs1.15 billion in co-lending. And with this pace, we are hopeful to do about Rs6 billion co-lending in the next year minimum. I think this is a very conservative target. Hoping that the latest technology platform will be built in the next three to four months then only this will take off. Here the advantage is 80% money is going to be given by the banks and 20% is by us and that 20% also indirectly we will get funding. So, our ability to leverage will become almost 25 times and this can be a real game changer. Another aspect over here is every year we see about 10% to 12% of foreclosures. And those customers go to lower rate of interest for other NBFCs or preferably with the banks. Those customers are our best or cream portfolio. With co-lending, we will be able to hold those customers with us rather than they leaving us and that will bring a big change in our foreclosure trend. If you look at the last year, almost Rs600 Crores plus amount of customers we lost under foreclosure. Their income has gone for the subsequent years and if you are able to retain even 60% to 70% of that in the co-lending, this is going to make our profitability better. So, under the co-lending arrangement, any customer coming for foreclosure, we can reduce the rate and shift to co-lending. Because in housing finance, our co-lending tie up is at about 6.8% and our MSME co-lending tie up is about 8.5%. So, customer will not be given a loan at 14% because after 12 months record or some other progress some bank or some NBFC or rather bank is willing to give a low rate at 11% or 10.5% or 10%. Under the co-lending we will be to retain him by offering the lower rate of interest and by this a major chunk of the customer and best of the customer who leave us we will be able to retain and it is going to significantly change our income. Those customers we can do cross sell also later. So I think co-lending is going to be a big game changer for us and we are hoping that technology will be built very soon. The banks have already given that mandate through their open tender system and whatever mechanism is and we hope that next three to four months that should be in place. But without that also we on a conservative basis will be able to achieve about Rs600 Crores under the co-lending.

Amrish Kumar: Got it Sir. That is very helpful. Thank you. I will come back in the queue.

Moderator: Thank you. Our next question is from the line of Dr. Ajit Kaushal an investor. Please go ahead.

Ajit Kaushal: This is Dr. Ajit Kaushal. I am a Professor of Law. First of all I would like to congratulate you for a very good result once again and under your leadership the company is doing well. I would like to ask the question which really concerns me as a shareholder. You are already a Managing Director and now you are Chief Financial Officer of the company as well. So, what message would you like to give by making such kind of changes? Do you foresee to a plan hire another CFO in the near future who could work full time in the company?

Rajesh Sharma: So, CFO is the KMP position which cannot be kept vacant for more than six months and that is the reason to fill that the Board has given the additional charge to me especially as it cannot be kept open for more than six months. While we were looking out for a CFO, we had finalized somebody but because of some reason he could not join us and that has delayed the process. So, the search is on. We hope that in the next two to three months we should be able to onboard the CFO. We have already given that mandate to a large search firm so it should be filled very soon.

Ajit Kaushal: Sir we have a firm belief in your leadership and I am sure that Capri Global is going to set a very good example as far as the corporate governance is concerned. My second question is Sir, Deloitte was our auditor and now in place of Deloitte another auditor has come. Deloitte has very good reputation in the market. May I know as a shareholder what would be the frame of mind and what would be the circumstances under which the key auditors have changed? What may be the reason behind it?

Rajesh Sharma: Last year, the Reserve Bank of India had come out with a circular stating that any auditor who is continuing in any NBFC cannot keep more than eight number of audits. Deloitte was with us in the fourth year and they had to limit that under the circular. So we had to choose another auditor. The current auditor MM Nissim &

Co has been selected very carefully after talking to many. MM Nissim & Co also happened to be the auditor of HDFC Bank, Kotak Prime and many other reputed large corporates. So based on their strength we selected them. And I think they are equally good as compared to Deloitte. It is a very high quality audit firm. Deloitte had to go because of the limitation RBI put on them, not that we asked them to go.

Ajit Kaushal: Thank you so much for your answer. It is really helpful. Thank you so much.

Moderator: Thank you. Our next question is from the line of Vineet Agarwal from Edelweiss Broking Limited. Please go ahead.

Vineet Agarwal: Congratulations on a good set of numbers Just one question - how much of your restructured books are still under moratorium and what is the collection efficiency under the restructured books?

Rajesh Sharma: As far as our NBFC is concerned, we have about 3.3% book still under the restructuring and in NBFC the moratorium period is over. However, in housing finance, it is still continuing. So, moratorium on about Rs13.14 Crores portfolio in housing finance is still continuing.

Vineet Agarwal: And how is the collection efficiency in restructured books?

Rajesh Sharma: Restructured book collection efficiency is slightly lower than the normal pool. It is about 80%. But collection efforts are all going on and all these are secured. So, the moment money does not come they fall in the NPA category and there we are able to initiate this SARFAESI action and start the recoveries. So, anything which goes into SARFAESI, we are able to recover the amount within nine months' time. So I do not think there is any major concern on that side. The amount is also small and the moment it becomes NPA, it entitles us to take over their secured assets under SARFAESI and recover the amount.

Vineet Agarwal: Thank you Sir. That's it from my side.

Moderator: Thank you. As there are no further questions, I would like to hand the conference over to the management for closing remarks.

Rajesh Sharma: Thank you all for joining the call. As I said we will continue to grow in the path of the stated strategy of lending in the secured segment where banks are not catering and serving to those customers be it MSME, be it affordable housing and now be it the gold loan. So same kind of customer in the common geography we will continue to operate and I think it is a business which requires the ground / local understanding, has entry barriers. Having been in these businesses for more than about nine years, we are quite confident to grow about 25% for the next four to five years. As a promoter, we are committed to infuse more money as and when needed by the way of rights issue or any other mode. We are committed to this business and we see there is a golden opportunity because of co-lending where our ROE will be better because once this co-lending takes off, we won't not require much of capital and this can be a complete change in the business. In our new car loan origination business, we do not require any capital but use our banking relationship leverage and our branch network leverage. Next year, we will continue to do about Rs3,000 Crores of average new car loan origination. That means almost Rs75 Crores worth of fee income we will be able to generate and it will be a very good profitability contributor. So collectively, looking at co-lending profit and looking at the profit from the new car loan vertical, it should improve our profitability although on the gold loan branches next year we will be spending money and gold loan branches will take about 15 to 18 months to deliver profit. They will remain under initially the process of setup and removing some of the losses. But from 18th month onwards they will become profitable. But the profit generated from car loan, co-lending, and then the high AUM growth I think should be able to take care of it. So overall we are quite optimistic for the next year with all these positive developments. Thank you. Thank you so much.

Moderator: Thank you. On behalf of Go India Advisors that concludes this conference. Thank you for joining us and you may now disconnect your lines.