mahindra FINANCE

"Mahindra & Mahindra Financial Services Limited
Q4 FY24 Earnings Conference Call"

May 06, 2024

mahindra FINANCE

B&K SECURITIES
WE UNDERSTAND MONEY

CHORUS CALL®

Management:

Mr. Raul Rebello: **Managing Director & CEO**

Mr. Vivek Karve: **Chief Financial Officer**

Mr. Sandeep Mandrekar: **Chief Business Officer**

Host: **Mr. Jigar Jani - Batlivala & Karani Securities India Private Limited**

Moderator: Good evening, ladies and gentlemen. Please note this call is not for Media Representatives. All such individuals are requested to disconnect now, and the replay of this call will not be available to the media.

Good day and welcome to the Mahindra & Mahindra Financial Services Limited Q4 FY24 Earnings Conference Call. This call will be recorded, and the recording will be made public by the Company pursuant to its regulatory obligations. Certain personal information, such as your name and organization may be asked during the call. If you do not wish to be disclosed, please immediately disconnect this call.

As a reminder, all participants' line 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.

Before proceeding, I will read out the safe harbor statement:

Please note that certain statement made in this meeting with regard to our future growth prospect, our forward-looking statements which involve a number of risks and uncertainties that could cause actual results to differ materially for those in such forward-looking statements.

I now hand the call over to Mr. Jigar Jani. Please go ahead.

Jigar Jani: Good evening, everyone. This is Jigar Jani from Batlivala & Karani Securities India Private Limited. Thank you very much for joining us for the Mahindra Finance Call to discuss the Quarter 4 FY24 Earnings.

To discuss the earnings, I am pleased to welcome Mr. Raul Rebello - Managing Director and CEO; Mr. Vivek Karve - Chief Financial Officer and Mr. Sandeep Mandrekar - Chief Business Officer.

Thank you very much for the opportunity to host you, sir. I now invite Mr. Rebello for his opening remarks. With that over to you, sir.

Raul Rebello: Thank you, Jigar and good evening, everyone.

Jigar, just another announcement again because we can see some folks in the list who are not from the investor or analyst community would request as a moderator and control of the console, if you could please keep this call limited to only the Investor and Analyst Community.

Anyway, good evening, everyone and again, welcome to our Q4 Call, I am pleased to have as mentioned our CFO – Mr. Vivek Karve and Chief Business Officer of Wheels – Sandeep Mandrekar alongside me.

I will open this commentary with the recently detected one Northeast branch, which is the Aizawl branch fraud, which was the reason, because of which we deferred our Q4 Financial Results that were scheduled on the 23rd of April, but then held 11 days later on the 4th of this month. This fraud was detected during a management review in the second-half of March 24. And we then put our best internal teams while equipping them with external firms also who engaged with the local law enforcement agencies to dive deep into this matter. What unfolded thereafter in the course of the investigations was a case of extreme collusion, and I repeat, *"Extreme Collusion"*, because this involved (+20) of our employees, 5 vehicle dealerships with their staff and even some bank employees. Till date, 11 arrests have been made and we do expect this number to grow.

The extent of this collusion, we believe, is extreme and unique because employees belonging to various job families, in our banking and finance parlance, we refer to them as maker checkers and some of them in the checker plus roles. All of them connived along with reputed OEM dealerships and their staff to take the disbursement proceeds into dealership bank accounts and thereafter also connived with bank staffs to open fake bank accounts. And it was in this manner that this racket kept going.

As you would be aware, vehicle loans disbursements are never made into borrower accounts, but into the account of dealers. And in these case too all the proceeds of disbursements went into dealer accounts. We have thereafter done an exhaustive analysis of the portfolio and as management it was a prerogative to ensure that the worst-case scenario is factored before we closed our books of accounts. Accordingly, 2887 accounts, which required Rs. 136 crores of provisions have been made and in our estimate, this is the worst-case scenario. We of course do expect recoveries as completion of actions by the law enforcement agencies have now started and are drawing closer, and we must also complement the Mizoram police who are continuing to do a great job on this. We do believe what happened in the Aizawl branch is an isolated event. However, Management was keen to double check in light of this incident and run a series of stress tests across our 1300 branches, Pan India and post completion of these checks, we have concluded that there is no such evidence of a similar fraud in any of our other branches.

The details of this stress test for the Pan India branches have been duly reviewed by the Stat. Auditors and the Audit Committee, which was recently held. So, in conclusion of this section of the fraud reporting, let me say we maintain that this is an isolated event and our business model, which has its inherent strengths, which is, with existing control design on systems and processes with stakeholder responsibilities have the inherent ability to solve for mitigating these fraud risks. However, definitely there are lessons from this incident mainly on how do we foolproof the system even for such extreme frauds. And in that direction, we are in the course of implementing a very heightened due diligence around customer onboarding, including centralized processes and these additional safeguards have been scheduled on priority and accelerated in terms of its timelines for delivery.

I now move on to the Quarter 4 and Full Year Financial Updates and may I request you to keep the Analyst Report which we have circulated earlier in the day:

If you refer to Page #13, #14, #15, #24 and #25, I will in the course of my commentary be referring to these pages.

So, in the progress of Quarter 4, we did cross a significant milestone. As a Company, we have crossed the Rs. 1,00,000 crores mark of assets under management. We closed the quarter at Rs. 1,02,597 crores of book which was a 24% Y-o-Y growth. For Quarter 4 Y-o-Y, the disbursements grew at 11%, which is at Rs. 15,292 crores and for the full year by 13% at Rs. 56,208 crores. If you refer to Page 13, you will see that segment wise, the growth that we have delivered is quite secular across categories, including passenger, vehicle, CV business, the used vehicle business and the three-wheeler business. All these businesses have seen a healthy growth in the course of the year. We have also gained market share across these categories.

The segments which we witnessed degrowth was in the Tractor Segment. Of course, the Tractor Segment this year saw industry-wide contraction, but needless to say that our market share across the quarters has remained stable. You would see that the SME degrowth which has happened on a Y-o-Y basis is nothing to do with our core smaller ticket SME growth. The overall degrowth is in line with the larger ticket SME growth, which was pertaining to hitherto medium enterprises. That segment we have vacated now because the intense competition with banks as well as pricing was more or less in line with our thinking that this segment will not be in our sweet spot of pricing efficiency.

Moving to revenue growth, which you can check on Page #24 and #25, what you will notice both in Q4 and the whole year basis, we have had a strong revenue growth 22% on a quarterly Y-o-Y basis and 23% on a full year basis. We are actively working on the revenue levers, which are mainly on the product mix driven by the used vehicle increase, fee income increases and overall pricing efficiency. On cost of fund, we have seen an overall increase both for the quarter and the full year. The reasons largely for cost of fund increase, you are aware that the rate environment has remained elevated. Besides that, our leverage ratios also have been increasing. We have a two-pronged strategy now on cost of fund. One is to of course optimize for overall cost of fund attractiveness in terms of instruments. But we are also diversifying our liability mix to get much more granular in terms of our liability mix. The cost of funds for the quarter Y-o-Y grew by 30% and on a full year basis by 40%. On NIMs since the last quarter saw cost of fund decline, we were able to take some of the NII growth from that relief into Q-o-Q NII growth of 16% and a full year growth of 10%.

Moving to OPEX:

You would have noticed that an overall OPEX decrease has happened in terms of the OPEX to average assets. On standalone OPEX growth, it has been a very reasonable 2% increase for the quarter and 8% for the full year. This is largely driven by a very rationale headcount increase, which is for the full year being under 2%. At a PPOP level, the growth in quarter Y-o-Y growth has been quite decent at 24% and 11% on the full year basis.

Moving from PPOP to now:

The credit cost and asset quality lines first, I will cover the GS3 numbers, which is coming at a very healthy decrease from Q3, which was at 4% fallen to now 3.4% in Q4. If you noticed, last year we had closed at 4.5%, so this is 110% reduction from last year's GS3 levels. Our net GS3 numbers also now stand at 1.3%. Another important asset quality metrics is the GS2 number, which has slid from 6% in Q3 of the fiscal to 5% at the end of Q4. So, the way to look at it is as GS2 plus GS3 which was last year close to 10.4% as this year closed at 8.4%, which is a 200-bps reduction in the GS2 and GS3 levels at a combined level.

Moving now to credit cost:

Q4 was at 1.2 and the full year at 1.7 and by the way this includes the Rs. 136 crores of the Mizoram fraud. You will recollect at the end of Q2, we had guided for a 1.5% to 1.7% credit cost, and we closed at 1.7%. If the Mizoram fraud was not included, this would stand at 1.6%. You would acknowledge the credit cost as a function of provision plus write off, the way we are looking at controllable variables and looking at a trend the last 5 years trend in provision number has been a little jumpy with sometimes rapid increase and then thereafter decrease. So, taking a 5-year average period between 19 and 23, the provision cost average has been at 30 bps and the write off for the same period has been 2.6%. However, as we have very controllable measures taken in terms of the GS3 numbers as well as on time collection, the write off component in credit cost has slid from 2.6% to 1.6% which is a good 100 bps decrease and we see this structurally shifting with our continued focus on due date collections, performing books mix and the performing books, which is Stage-1 plus Stage-2 now being at 96.6%.

Moving to PAT:

The details of PAT is on the Page #6, #24 and #25. While PAT has degrown Y-o-Y on a quarter basis at 10% and 11% on a full year basis, one can explain this decrease with the swing that has happened in provision between last Q4 and this Q4 of Rs. 341 crores and swing for the whole year of Rs. 1,322 crores. One should take comfort with the PPOP growth, which is basically a metric which is worthwhile noticing, which has steadily increased. From P&L, I move to balance sheet comments. The capital adequacy of the Company continues to be well capitalized. The Tier-1 capital is at 16.4 and Tier-2 at 2.5. Our coverage ratios are prudent. We carry a 63.2% cover on Stage-3 assets. If you combine the entire provision which we maintain across Stage-1, Stage-2, Stage-3 and look at it as a cover on Stage-3, we are at a very high level of 97.5. Our liquidity buffer is also at a comfortable level at 8.3 of our outstanding borrowing.

I now move to Mission 25:

Since at the end of ‘22 we gave Mission 25 a kind of guidance. You can refer that in Page #16.

- The first one is on asset quality at 3.4. We are on a good note here. The levers we continue to be sharply focused on are for ensuring that GS3 at a sustainable basis is maintained is:
  1. Sourcing business on customer segments which are within the risk guardrails.

  2. strengthening our underwriting capabilities.
  3. Ensuring that we have best in class collection practices.

- The second metric on Mission 25 was on margins. We closed the year at 6.8 against the initial 7.5 goal. We are recasting this goal, and we believe if we close at 7% for FY25 would be a decent spike from the current levels. The metrics that we are working on, the levers we are working on are on product mix, fee and cost of funds.
- The third metric on book growth, you would see that the last three year's CAGR on book growth has been in the 17% range. If the tailwinds in FY25 are supportive, we would be able to continue the same trajectory. And if we do so, then our book goal, which we slated in FY22 to reach close to 1,20,000 should be a possibility.
- Our fourth metric on OPEX, this is a metric which you would notice is sequentially come down and we are at 2.8%. Now we will continue to keep the spends on for tech, for digital properties as well as for beefing up our manpower which are in the functions of underwriting, in the functions of fraud control and the functions of SME. The benefits that we have started seeing in terms of the investments made in tech and digital will also start bearing fruit meaningfully going forward. So, we are not immediately giving guidance that our OPEX ratio from 2.8 will climb down very sharply because we will invest in distribution, we will invest in branches, but we will also see benefits, as I mentioned in the investments we have made in tech and efficiencies for the frontline staff.
- Fifth, on new businesses, here we did guide for a 15% mix from the new businesses. That is quite behind. The SME business and leasing business though they are growing well, the pace of vehicle business is far outpacing them and hence it will take some time for us to get to that 15%, but we are in a medium term still committed to get the new businesses to contribute to 15% of the overall mix.
- Lastly, on the ROA, we had guided for a 2.5% at the end of FY25. We closed the year at 1.7. We do think that striving for a 2.2 post tax ROA can be a reasonable goal. For taking the 1.7 up to 2.2 would mean 50 bps increase, but that is at post tax level, which means that we will have to at least factor for a 65-bps increase at a pre-tax level. Roughly, we are anticipating 25 bps lift in NII, 10 bps lift in OPEX and a 25-bps lift again in credit cost. These are of course don't take this as guidance, Take this as more internal goals that we have for ourselves to move from the 1.7 to 2.2 ROA.

We have added a new page. If you look at Page #18 on subsidiaries, the subsidiary, the three ones which we have showcased here, MIBL has had a good year crossing the Rs. 100 crore pack. MIBL also is playing a much more horizontal role, not just with covering vehicles, they are also into now multiple lines of businesses, including commercial lines and also including opening up stores and increasing the life and health insurance. Mahindra Manulife has crossed the 20,000 AUM and climbed the rank in terms of AMCs in the country and our HFC, which was focused last year on asset quality correction, has covered a decent level in Q4. Now, they are close to 9% in the GS3 reduction, a long way to go here again.

So, now, before I go into Q&A, I just want to make three quick points:

1. We want to give you confidence that this is a business model which has its inherent strengths.
2. We do acknowledge that the model requires augmentation. The model requires new capabilities for it to flourish to full potential.
3. We are on this path of strengthening, the business model. We are all committed here as senior management and as every one of the 40,000 employees to make this turn around and transform the business in an impactful and sustainable manner.

I want to give some data points of the journey we had covered in the last year. You know this business has historically by design being a model which was fully decentralized. We will continue to retain the decentralized mold to give us the ability to be agile, but we have also stitched in a central nervous system for extra oversight. In the last six months, 50% of our branches have gone from a fully decentralized check to now also having a second level centralized check on docs and pre-disbursement formalities. The CPC has gone live for 50% of our branches. The next 50% have been prioritized and will go live in the next few months.

The second data point is on capabilities on data and tech. We have got new capabilities and we have actually onboarded quite a few new members. Close to 18 new members have been onboarded in the last few months, data scientists, business analysts, data engineers and AI experts who are now beginning to skin out very powerful and sharpened risk insights as well as upgraded our underwriting models. We have in the last year recruited 144 number of underwriting staff and we are all set to add another 161 underwriting staff which are budgeted for this year. These staff will be completely having no conflict of interest in businesses and make sure that our underwriting practices are further streamlined. In the last year, we have also onboarded a fraud control unit head and he has augmented the team. Recently, 61 employees have joined the Fraud Control Unit. We have onboarded 23 agencies, FCU agencies have been onboarded to further strengthen our underwriting and our onboarding of customers. The risk and compliance teams have also been strengthened. We have recently added another 40 employees in the risk and compliance teams.

We are soon going to go live with our new org structure to give you a little bit of color of a new org structure. We are bringing back a branch head lead org structure with heavy emphasis on the branch head on delivery on ops and risk controls, and accountability for every branch being a microcosm of having the highest amount of safeguards in place.

On the talent front, we have seen leaders in the BFSI segment join us recently in functions of underwriting, collections, data analytics and we will continue to augment the organization with these talents that are required.

So, in summary, before I hand it over to Q&A, I want to mention that with all the investments that we have put in place and we will continue to put in place, I have cited some of our commitments on this path for strengthened operations. We do see our franchise increasing its meaningfulness to the sector and adding value as well as creating value as you go ahead.

I pause here now and invite you for question and answers. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Marque from Nuvama Wealth Management. Please go ahead.

Mahrukh Adajania: I have three questions. My first question is just on the core credit cost, not the fraud related provision, but the core credit cost seems to be slightly higher than the usual seasonality, right? So, last quarter also we had the COVID related rollover, but the provisions in the 4th Quarter were much lower. So, what drove that? Is it possibly because of the activist movement that is going on in some states? So, that is the first question, right, because the write backs to Stage-3 even excluding the fraud provision are on the lower side compared to last year's 4th Quarter? So, that is the first question. And then the second question is on other income. There has been a very good growth in other income. So, what drove it and how do you see it sustaining in the next few quarters, right, because other income would include fees as well? And my third question relates to the fraud incident that you said that it was caught in a management, there was wide collusion across companies and that it was detected in a management review, so how frequently are the management reviews done like say once a quarter or when or was it detected because the management review is very intense in March given year end results? So, these are my 3 questions?

Raul Rebello: I will take them one by one. On your first observation of overall Q4, not the whole year as we have mentioned that the overall write-off and settlements which we called as end losses has been Rs. 500 crores lesser than last year on a whole year basis. Your observations are right on a Q4 versus Q4, it is slightly muted compared to last year. And the reason there is if you break it up and we usually don't give this level of granularity, but just for the overall clarification, the bad debt write-off continues at the same pace as in because the bad debts because the Stage-3 numbers are reducing, we will constantly see bad debts coming off lower. In Q4 this year versus last year of Q4, we did resort to slightly higher amount of settlements because when we repossess vehicles and we find a good time to sell them instead of keeping them in our yards, we would prefer to do that at a good price discovery. But of course, there are overall losses that emanate from doing that. So, in Q4, usually we would like to clean up our yards and make sure that the settlement, the whole disposal of vehicles increases and that is why compared to last year, you would see a slight bump in settlement. But overall, we are quite confident that our end losses will structurally start seeing a decline from quarter to quarter going forward too.

Coming to your second question on other income, you have heard from us over the last 2-3 quarters that we are putting in place a lot of investments in skinning the opportunity to get other income. We have traditionally been a Company which was heavy on only interest income. There were capabilities for us to skin the organization on various fee based incomes and some of them are starting to bear fruit. Yes, Q4 was also some of the income that we have seen whether it is in the subvention mode or in the mode of some of the insurance incomes are slightly higher, but this is also going to be, I would say you would actually see the management focus on skinning the organization for other income.

Coming to your third question on management reviews, yes, we maintained that this was not any external agency which highlighted the fraud that occurred. We have institutionalized what we call as our other support functions and our control functions. We have a portfolio quality group which is housed under the risk and underwriting functions which every month and the CFO, the CRO, me, we all of us, huddled toward, we huddle every month on these alert mechanisms. Aizawl was a little bit of an outlier as a branch because this was artificially kept low from a risk standpoint. Nothing came up. There was huge collusion in terms of operating metrics, which all came down, but nevertheless, we have now besides the alerts which come to us beyond delinquency or beyond the operating metrics we also look at market insights. Just to give you a heads up, the growth in Aizawl branch versus any other branch in the country was not an outlier in FY22 or FY23. It was only in FY24 that the growth in this branch was slightly an outlier. And it is a triangulation of risk-based alerts, triangulation of operation-based alerts and market insights which led us to find out that this was an outlier and that is how we got the outlierish nature of this fraud.

Mahrukh Adajania: So, it is not necessarily a strict yearend review right? It is like a usual review that happens?

Raul Rebello: Yes, reviews happen throughout the year.

Moderator: Thank you. The next question is from the line of Avinash Singh from Emkay Global. Please go ahead.

Avinash Singh: Few questions. First one on your FY25 targets, now looking back and of course you have explained, I mean only pieces, but looking back now if you see that 2.5% ROA as an outcome where did sort of, what inputs or where you missed that, I mean this target now has to sort of a revised 2 or 2.2% odd and I am asking particularly because even when in the past, you were reiterating this sort of a target, the analyst investor were sort of pointing out that, things are not adding up, the way the NIM was playing out or the OPEX eventually it was not looking. So, at this just if you can help us where sort of or when you sort of had chosen this 2.5% target and where you are today, what has sort of came in at for expectations watching over this last 2-3 years? That is one? Second, again, you have provided a lot of details and clarification around this fraud, so only thing of course with the hindsight sort of, I would say information intelligence in place. Considering that it is the Northeast place like Aizawl and the extent of Rs. 136 odd crores, a couple of things, if this was the sort of extent particularly Rs. 136 crores amount as such would be a really big amount for even your larger branches and that too particularly the small place, this big amount that I mean entirety of fraud even I mean over this course of fraud loans being booked, your probably the market share in the vehicle loan in that particular set you would have been going up and why did it take so long for you to sort of detect almost like a 3000 close accounts to Rs. 135 odd crores kind of amount that to in a small place, where all sort of a things went wrong that it took so long to detect, because I mean sort of I am aware of certain sort of this kind of a nature of some frauds happening even with some public sector banks in certain branches, but generally even for the banks, and that to be the bigger branch level balance see, typically it gets detected at an early stage in Rs. 15-20 crores, but here is Rs. 135 crores for

MMFS and that too in Aizawl. So, what sort of lapses did you sort of find that okay this went to such a scale?

Raul Rebello: I will take both your questions. First is, you are right at the end of Financial Year '22, we did set out a goal of 2.5% ROA. And we have been giving everyone feedback across the journey on how we are trending against this. If you ask us in reflection, why is this 2.5 being probably reset at 2.2, I think the major variable over there, which is something probably I don't think in Financial Year '22 anyone would have looked at the cost of funds moving in the direction in which it moved, right. I think that is one single variable, even if you looked at it six months back, I think everyone was giving guidance that end of Q3 of the last fiscal, you would see some softening in the rates and I don't need to labor on that point. We all know that there is really no relief on that number and that number is a meaning number in terms of the NII deviation that we have as of now. So, if you draw the ROA tree and you look at various attributes of the ROA tree which was supposed to deliver the 2.5, the biggest deviation there is the NII. Can we not solve it and look at other alternatives? I think you have seen part of that in the last quarter, Q4 or Q3, whether we are skinning the other income, whether we are looking at still growing the NII line with passing on pricing, all of that is happening and our NII has been sequentially moving up. But clearly the gap in terms of the original cost of funds factored in for this 2.5% ROA and where we are today, that is probably the biggest mess.

The other kind of variables, levers that we have are in credit cost and in OPEX and I would think in credit cost, you can't fault us for the way in which we have come down. I think we have been quite reasonable in terms of the guidance we have given and the way we have progressed on that and even on OPEX compared to the rest of the pack, I think our OPEX today in category sequentially come down better than most of the other lenders. I am not kind of indicating this 2.2 is exact guidance, I think this 2.2 is something which is reasonable for us to aspire. It is in my mind our base case. If things progress well, we might be able to give some upsides from there, but reasonable to save the cost of fund in that whole pack of 2.5 was the most bumpy variable.

Now coming to your observations on fraud, I do not differ with your view that Rs. 136 crores is a big amount for one branch, a branch which is close to Rs. 400 crores in AUM. And I just want to lay down a few clarification points. This Rs. 136 crores is worst case scenario. We have looked at all the accounts here and factored even for the worst case scenario. So, that is the number, 136 are the worst case. Why wouldn't this fault be detected earlier? If you heard my earlier commentary, Avinash, what we have mentioned is there are systems and controls to, and we are a Company in the last 30 years never seen something like this before. You usually put systems and controls with stakeholders, maker checker, architecture to protect for these kind of anomalies. I don't think what is Phantom is such large-scale collusion wherein you have stakeholders within your organization from three families, maker checker, checker Plus and I repeated there are external entities here, dealerships where money has gone to dealership accounts and they have also connived. And here we are talking about connivance with even bank employees. Bank employees have been fired over the last week. So, this is not a normal scenario. And mind you, this Rs. 136 cores in our scheme of things were these all not even Stage-3, these all Stage-1 accounts. So, this was a well thought of, I am not saying that we should not have even been able to bust this earlier. We are, as I said increasingly making more and more investments to make sure that the liability of even such large-scale collusions are brought under or detected earlier. But I am trying to labor on the point that this was a quite outlierish fraud with many stakeholders coming together to hoodwink the system.

Moderator: Thank you. The next question is from the line of Abhijit Tibrewal from Motilal Oswal. Please go ahead.

Abhijit Tibrewal: First, because we were kind of just discussing the fraud, I just wanted clarification, this Rs. 136 crores, has it been classified under GS3 now given that you just said that they were Stage-1 loans, have they been classified under GS3 and 100% provided for?

Raul Rebello: Yes, Abhijit, your understanding is exactly right. They have been moved to GS3 and full provision has been made.

Abhijit Tibrewal: And sir again, just a clarification, while you explained that there was, like you said, extreme collusion that happened between multiple stakeholders, do you think in hindsight this collusion could even have been avoided had there been centralized kind of a check in terms of someone verifying the KYC documents of customers, vehicles and registration documents of vehicles, someone in a more centralized setup, could this have been avoided?

Raul Rebello: See in hindsight, Abhijit, many things can be thought of. I just want to leave some data points here for everyone. Northeast especially, Mizoram, the penetration of Aadhar, see we do, we do centralized checks on Pan and NSDL, but the penetration of Aadhar, the penetration, this state is by the way exempt of IT. So, a lot of it requires decentralized approvals. And some of it are geography related constraints, which as I did mention in my opening commentary, we are solving for by making sure we have a centralized outfit now even to check some of these localized practices, So, two comments there. One is there are inherent challenges with this location which we are now put in place a special team over there to overcome these geography level kind of hindrances. But you are right, even speed tracking. I did mention 50% of our branches today mandatory are now on the local plus centralized check and in a couple of months all branches will go through the centralized check to even catch these outliers.

Abhijit Tibrewal: And my last question again I am referring to slide 15 of your presentation, where you have given your ROA tree and also just kind of just trying to understand in terms of your internal targets you spoke about 25 basis points decline in credit costs to get to the 2.2% ROA target and the base case, just kind of trying to understand last two years, right? FY23, there was a provision of almost 1.4% and then again in FY24, I think the provisions were just 10 basis points. Given where we are now today in terms of Stage-2 and Stage-3 when you I mean think of this 25 basis point decline in credit costs, are we still factoring in releasing, ECL either from the ECL model refresh that you did in the third quarter or decline in the provision cover on Stage-3 and standard loans and maybe a related question on the ROA itself, how are we kind of thinking about cost of borrowings from here? How are we expecting it to trend? So, that we can kind of derive some comfort on the margin trajectory. So, I think the 15 basis points or the 25 basis points NIM plus income improvement that you have spoken?

Raul Rebello: So, on the credit cost, what you would have seen Abhijit is, we have a sharp 100 bps reduction in the write offs, right? So, 2.6 will become 1.6. We don't expect any change in provision now, I think going forward the provision numbers are going to stay the same. What we do believe will give us some relief is further improvement in our write offs which will further come down to that 25 bps and you are right, the ECL model which Vivek had mentioned last time which not the change in the ECL model, but the fact that the coverage, 63% coverage that we are sitting on because it is a 46-month moving average which had periods of the COVID. As we now move forward, it is a moving block. As we move forward, we do see that 63% coverage ease off and that will also provide some amount of relief to the 25 bps that I talked about in credit cost.

Coming to your second question on cost of funds, I think I mentioned that there are two objectives here, one is diversifying the liability mix at the same time getting some cost of fund benefit, but I will invite Vivek here to give you commentary on that.

Vivek Karve: As we speak today, there are no immediate signs of easing off that are evident. So, you would know that in the 4th Quarter, our average cost of incremental borrowing was in and around 8%. So, at least in the short run of the next couple of quarters, we believe it will range in that bucket only. However, at some stage the rates may start falling when both the Fed and RBI in India start getting some comfort on the inflation parameter. If that were to happen in H2, maybe we can expect some relief. But from where we are today, where the cost of borrowing was closer to 8, I am afraid to say that there are no immediate signs of easing off and we would not like to make a promise, what we can't see what then we can't promise. But as Raul said, we are trying to exploit all avenues including PSL borrowing, including doing short-term borrowings well within the ALM framework and the prudential limits framework, which would help us to keep a tight leash on the overall cost of funds.

Raul Rebello: Abhijit, just to conclude on your how the 25 bps again, this is internal goals, the 25 bps NII increase while cost of funds might be flattish, as Vivek expected, and we will optimize for what we can do on cost of funds, but the other levers on the NII plus fee, we are making a shift towards used vehicles. So, that shift in used vehicles, you would have seen in our Q4 also the share of incremental used vehicle is going up and that is a concerted effort we are making and the fee-based income which is also starting to play out will give us some data on the NII, right.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from Phillip Capital. Please go ahead.

Shubhranshu Mishra: Sir, two questions. The first one is, what have changed in the collections, are we increased the incentives, are the collections bucket wise as well as business wise, so how do we look at collections and what would this be as a proportion of total manpower or total OPEX? What is the cost of collections either of the numbers can be spelled out? And second is, is there guidance as to whether we can reduce our M&M dependence to say 10% or 15% of our AUM, today it is ballpark 45%, so we are more or less look that like a captive financier. Are we willing to take that leap of faith and let go of this tag of captive financier and give guidance towards lowering this number with some kind of time frame?

Raul Rebello: On the first one on collections, see the kind of levers we have on credit cost as I mentioned, is largely on portfolio selection as in the customer segment selection, underwriting and collections. You would recall post COVID we had put in place a very different way of in which we are approaching collections which included lot of analytics to make sure that we are engaging with customers with the right kind of toolkits as well as we have the movement of contracts between different teams. We have soft bucket, hard bucket, etc., we were reducing the noise of the movement of ownership of those contracts. So, in a nutshell, we have improved on our effectiveness of collections and when I say effectiveness, we have not added a single collection manpower over the last 2 years. In fact, moving collection headcount from last year, it has been a reduction of 5% because the toolkits that we are employing for collections and a lot of our customers today don't need us to go and stand in front of the door because in the last 2 years we have also swapped in a very, what we call as a prime segment customers and that is resulting in lower requirement of frontline staff in collection and the whole effectiveness of using, as I said data and using of communication engagement toolkits with customers is improving to give us that delta.

On your second question, frankly, we thought we have shed the tag of being a captive financier, right? As in, M&M for us is not a captive, it is more of a synergistic player. If you look at slide number 14 from FY20 to 46%, we have come down to 44% now and I don't see a reason why we should come down further. M&M is having a great time in terms of the kind of vehicles that are, M&M is buying market share in the passenger vehicle segment, in the commercial vehicle segment, every product they are launching is a superhit, including the one which is now launched. And we have such synergistic. They don't need us, right, we in a manner which is to earn our right in their showrooms to finance their customers. They don't give us any privileged seat on the desk, on the table. We feel that it is a very synergistic business to get more action on the M&M counter and as long as it is synergistic and not captive in nature, we don't see the need to give off any gains that we have over there.

Moderator: Thank you. The next question is from the line of Abhishek Murarka from HSBC Mutual Fund. Please go ahead.

Abhishek Murarka: My question goes back to NII, and the first question is on the cost of funds. You would be expecting further increases in your overall cost of funds, right? So, to get a 25-bps net expansion in NII, the effect of product mix plus yield increase plus fee would have to be much higher. It would probably have to be around 35 bps or so. So, do you see that kind of an expansion happening and just second part to that is what would be the difference in the disbursement yields today versus your book yields, if you could tell us that?

Raul Rebello: I just want to clarify. I don't think Vivek said that he is anticipating an increased cost of funds. He is saying that keeping it stable is more like the guidance and with use of some of the short-term instruments, commercial papers, etc., I think the Treasury team is really working hard to make sure that our incremental cost of funds is not going to come in as you mentioned, 10-15 bps higher. That is clearly not the explanation Vivek gave.

Vivek Karve: Abhishek, what I said is we are not expecting in the short run, the costs to go down, that is what I mentioned.

Abhishek Murarka: Sorry, what I meant is that if you look at your book two years back or something, the cost was roughly 6.5% today it is 8%, so the book matures right and as it matures, a new book gets formed. Automatically, the book cost will keep going up, so you don't see that happening at a portfolio level you think 4Q cost of funds is where it should sustain?

Raul Rebello: Yes, we believe so.

Vivek Karve: Plus, Abhishek, if you know our book is large, we borrow decently floating, but we lend all fixed rates. So, in a declining interest environment, we will stand to gain there from spreads too.

Raul Rebello: Yes, about 45% of the book is floating, Abhishek, so as and when decline commences, we will start getting that benefit obviously with the lag.

Abhishek Murarka: And could you give some sense of the disbursement yield versus book yield? What would be the gap?

Raul Rebello: No, we do not offer so much explanation, Abhishek, you will have to excuse us on that.

Abhishek Murarka: And just a second question on the OPEX part, now can you just share what would be your employee addition, branch addition target for the year and all the staffing, fraud control, strengthening, all of this is relatively high-cost manpower or so does that also impact your OPEX going forward?

Raul Rebello: See at the overall OPEX level, as I said, we are looking at maximum 10-15 bps gain from where we are right now for a large balance sheet that clearly can be absorbed. We are not going to shy away from making investments as I mentioned on the critical themes, whether it is the underwriting team or the fraud control team, etc., these are the heads, and you could say the first level and the second level have already been recruited. Now it is more the third level recruitments which are taking place and we will come up to shore up that specific unit. So, on the OPEX front, we are going to add more branches. We have initially given you guidance that we are looking at close to 150 to 180 branches this year. We are looking at first making sure that the whole branch head structure that we talked about falls in place and you can see more of these branches being opened in the second-half of the fiscal. Having said that, distribution is not in its old sense, only our branches, we are tying up with likeminded ecosystem players. We are doing partnerships with various banks with various other entities. Our co-lending partnership with the SBI is now starting to show some volumes. Our other partnerships even on the SME side are starting to show some decent volumes on a month-to-month basis. So, on distribution, we will spend on augmenting the staff for all these investment led and other departments which are important for a sustainable outfit.

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

Piran Engineer: Firstly, a clarification, when you talk about NIM improvement, are you referring to it on a Y-o-Y basis or from the exit 4th Quarter NIM because our existing anywhere is 25-30 bps better than the FY24 average?

Raul Rebello: All the expectations were from the 1.7 from the year end of 24.

Piran Engineer: 1.7 is actually year average?

Raul Rebello: Yes, for the full year.

Piran Engineer: So, then mathematically, NIM should sustain at 4Q levels, not really improved, I just want to be clear on this because our average NIM for the year is 6.8 and our exit NIM is 7.1?

Raul Rebello: Correct, you are right.

Piran Engineer: So, broadly at 4Q levels, it should sustain, right? My understanding is correct?

Vivek Karve: No. So, Kiran, you would have Raul also mentioned that for the full year we were at 6.8 and we said that our attempt will be to at least reach 7% for the full year in FY25. So, the other way to say that is what we have achieved in Q4, we will strive hard to maintain that for the full year. You can say the way you want.

Piran Engineer: On this NIM topic, how is pricing across various products because when we just calculate your yield on loans, it hasn't really moved anywhere in the last 5-6 quarters. And initially all were looking at better quality loans, the higher ticket, better quality loans, so the mix change towards that, but even after slowing that down, there has been no improvement in yields?

Vivek Karve: No, I think Piran the way to look at it is if you kind of move to the Page on the mix, right, as in probably, if you look at Page #13, what you would see over there is the real growth is happening in the PV segment that is growing at 28%, CV at 11% and used vehicle at 18%. Now when the mix is increasing towards passenger vehicle, we have in fact after Q3 added another 20-bps pricing in Q4. But the way to look at it is because the passenger vehicle segment, which also has a sizable amount of prime customers, that doesn't give you at an overall level, because that segment comes in at a blended yield, which is lower than or at a overall yield, which is lower. And that is why there is no meaningful bump in the overall income to average assets.

Piran Engineer: And just lastly, how should we think about loan growth for FY25 given that disbursement growth has been slowing down for the past 6-7 months now? And this month also the number was just 4% Y-o-Y?

Raul Rebello: So, the way to look at it is, we know that as I said, 17% is the CAGR for the last 3 years, this year we expect Q1 to be a bit muted. You all are aware there is an election in progress. We also see some of the segments that we serve, which is the agriculture segment because Rabi was a bit muted there is some sentiment drag which we are seeing. So, I don't want to paint a whole full year picture of how growth will look like, but Q1 seems to be going a bit muted. Maybe there is a whole lot of enthusiasm which will come in post elections. We don't want to call anything, but if that picks in and typically there is a sentiment improvement over there, even a 14%-15% disbursement growth coupled with what we hear in terms of monsoons being predicted to be decent, probably 14%-15% disbursement growth will still lead to an 18% to 20% book growth which in our standpoint will be a good outcome for the whole year.

Moderator: Thank you. Next question is from the line of Kunal Shah from Citigroup. Please go ahead.

Kunal Shah: So, a couple of questions. Firstly, with respect to cybersecurity, which is there in the note, in terms of experience some incident out there which took almost like 9 or days to restore, so what is the intensity, what could be the implications of this going forward and how are we taking care about this? So, that is the first question and second is collection efficiency in April again being quite low at 89% even on year-on-year basis. So, if we look at maybe the last 3-4 months, in fact on year-on-year basis, the trends in collection efficiency are not that great. No doubt overall Stage-3 numbers have been coming off with the help of write offs as well, but anything to read into this lower collection efficiency.

Raul Rebello: On the cybersecurity one, I think the factual thing is that we were out for or we were in some way incapacitated for 4 days, not 9 days, you know that we have given most of the disclosures in the Stock Exchange update. It was a very temporary impact for us and because we have 3 levels of backup, we were able to bring back the systems in full control in the next 4 days and there was no material disruption to customers or to any servicing capability, even though this happened in the month of March.

Coming to your second observation on collection efficiency, yes it is below last April, 89 versus 92. I just want to make a few points here. There were a couple of disruptions. There were of course elections in some states, second in the last week of April, compared to the last week of April last fiscal, we did see a bunch of holidays kind of coming up which from a collection universe every day is really going to give you meaningful upside here and there. So, while for us collection efficiency is a very key metric, but I wouldn't look at it as a major outlier what happened in April and hopefully with the way in which we are progressing in May without too much of course there is still disruption with elections, etc., we will hopefully showcase the whole of Q1 being very similar to Q1 of last year.

Kunal Shah: So, election disruption will not have the impact on the entire Q1?

Raul Rebello: No, I am saying that we did see some in April a little bit. I am not kind of giving an overall sweeping statement. We are saying that we are trying to over manage it. We saw some of it in

April minor and we also saw a combination of holidays in April towards the end of the month which disrupted versus April of last year.

Moderator: Thank you. The next question is from the line of Viral Shah from IIFL Securities. Please go ahead.

Viral Shah: So, basically with regards to this fraud, right, so over here, have you actually heard anything from RBI on this perspective? Because given right now the way RBI has hands on approach, is that something that you are anticipating? The second is basically we have seen that couple of other NBFCs or HFCs who have been transitioning to a centralized kind of model where we have seen some instances of frauds that keep coming up essentially some of those practices which used to exist in a decentralized model, that not being possible in this model, so how do we get that confidence that any of these kind of things, not necessarily the similar kind of fraud, but anything different would not be there in other branches? And thirdly, basically from the perspective of growth since last 3 years, we have seen that Mahindra Finance hasn't added any material branches now in this quarter we saw that you added 33 branches. So, how should we read in terms of the sustainable, I would say more from the perspective of disbursement growth for FY25 and more importantly even FY26?

Raul Rebello: I will take all the three questions. First, on RBI, we have very active engagement going with our SSM. Everything that is reported to the external world, whether it is the stock exchanges before that, we have a practice of engaging in a deep manner with the RBI office and of course they being our regulator, would have concerns over the fraud and we have been giving them constant updates on the way in which this has been progressing and all the developments in this matter is kind of made known to RBI on a regular basis. I don't second guess anything on, since you were alluding to actions etc., I do not want to get into speculations on that front. All I can say is that we have a very strong and good engagement going on with our SSM and the CGMs office.

To the second one on the HFC, on Mahindra Rural Housing Finance, see the Mahindra Rural Housing Finance moved into a new loan management system etc., last year and a half back. Of course, now that certain frauds have happened with the decentralized model clearly across the organization, we have got to get our antennas up in all fronts to make sure that these kind of risks are solved for risks of very heavy collusion, risks of decentralized, so clearly as an organization, we are prioritizing safeguarding our designs on systems, controls, etc., any call is a wakeup call and we will use this as a mechanism to make sure that our systems are full proof.

Third on growth, you are right that we have not prioritized many branches in the last two years. We were prioritizing a whole lot of other actionable and clearly for an organization like ours, though we have 1300 branches, but in a vehicle lending industry where it is still 94% of our book, the point of action is not just the branch. The point of action is also the dealership. And we work with close at 5000 odd dealership points and every year we keep increasing the coverage of the dealerships and we keep increasing our frontline staff who are manning these dealerships. So, it is not necessary, and we have been talking about improving our tech stack wherein right from the dealerships or from the point of origination all of this moves into the loan origination and the LMS stack so that the whole loan journey gets orchestrated well, which actually in the going forward world unless we are doing very multiple products, we don't need so many branches. At least we see yes, branches solve for reputation, branches solve for comfort of the local geography to see a presence, etc., and we will keep opening branches, but it is not something that we have to grow so prolifically as we grow in the past. Our partnerships, our presence in dealerships and our working with partnerships with other entities are also equal important initiatives for us to look at the distribution front.

Viral Shah: And actually, I had two data keeping questions from Vivek. Vivek, what would be the GNP as per the RBI in this quarter?

Vivek Karve: It will be about a percent more if I am not wrong, but let me just give you the data, Rs. 1,000 crore higher, about Rs. 1,300 crores.

Viral Shah: And Vivek, what would be the incremental cost of funds that we have?

Vivek Karve: No, as I mentioned earlier during the call, we are experiencing the cost of incremental borrowing to be range bound at the same level that we experienced in the 4th Quarter, which was about 8%.

Moderator: Thank you. The last question for today is from the line of Raghav Garg from Ambit Capital. Please go ahead.

Raghav Garg: I have a few questions, so one is on the new branch expansion, I think you mentioned about 150 next year, I just wanted to understand is that going to be the regular annual run rate for FY25-27 or are you going to upfront your branch expansion and then probably slow it down in the subsequent years after FY25? That is my first question. And then 150 branches, what does it mean in terms of OPEX because I think that you just highlighted it might, there is a lever for you to the extent of I think 10-20 basis points in terms of OPEX to assets, but my thought process here is that if you open 150 branches, your OPEX might remain elevated given that you are not targeting about 17%-18% AUM growth. That is my second question. And my last question is even for the 17%-18% growth next year, your leverage would go beyond seven times, would you be looking to come to market to raise the capital given that historically your leverage has been somewhere between 5 and 6 times? Those are three questions?

Raul Rebello: So, on the branches, as we mentioned, we will be not front ending these 150 branches. As I said I don't hold us like this number is not cast in stone. As I mentioned the maneuverability of buying of getting business irrespective of opening a branch versus having more manpower at dealerships, etc., there is capability for us to still meet the growth targets without necessarily having the same run rate of branches. So, our aspiration is to in the potential locations which we call it attractive geographies which we have identified, and we have already opened 33 branches, 33 was last quarter. So, this quarter we may not have a very similar 33 number. The aspiration is 150 for the full year. As I said, the first ambition is to get the whole new branch structure in place and the new branches will be pretty much Q3 or late Q4 objective for us.

Having said that, what it does for OPEX, our branches are not the typical bank type branches, which are very heavy square feet branches. We have also light mode branches which are not very draining on our OPEX. With the new branch mold in place also these branches will have very limited number of people sitting or in the branch staff is much more what do you call as runner boys who are at the site of action, so we do not see these branches actually causing a very steep increase in our overall OPEX to average assets and getting that 10-15 bps release from where we are this year.

Moving to your third question on leverage, you are right. Today, as Vivek pointed out, we are, let us say, 16.5 on Tier-1, 2.5 on Tier-2, so about 19. I think overall Tier-1 plus Tier-2. With the kind of growth that we have for this fiscal, we don't see the need to go to the market to, we won't be definitely in the seven times or 7% debt to equity. We will be still in the 6 point something range which is well below the 15% requirement of Tier-1 plus Tier-2. If at all we need further capital probably will be in the next fiscal and at that point of time we will see what are the options open to us to kind of the routes to raise capital.

Raghav Garg: Sir, just one follow up question. You were alluding to this new branch structure that you are trying to implement, will that lead to higher employees per branch? I believe right now the figure is somewhere around 19 employees per branch. If I just do a simple employees per branch, so, just some thoughts on that please?

Raul Rebello: We have only a couple of job families which you can say are earmarked for the branch. A lot of employees are actually floating as they service multiple branches, multiple dealerships. So, the new branch structure will have just probably about a few as in I said a couple of job families which are earmarked for that branch. The rest are covering multiple branches, multiple dealerships, it is not a heavy structure.

Vivek Karve: And Raghav, coming back to your question on debt to equity, as of March ‘24, our debt-to-equity is 5:1, so I believe you talked about 7:1. So, we are today at 5:1.

Raghav Garg: I was referring to assets by equity, but I get your point.

.

Moderator: Thank you. That will be the last question for the day. I now hand the conference over to the management for closing comments.

Raul Rebello: So, thank you everybody for joining us on this call. I hope you have taken back, most of the queries that you have placed to us, we have tried to cover. We want to give everyone again confidence here that whatever happened in this one branch was an outlier and we did mention that we are making significant investments as management for this turnaround journey that we started about a year back and we are committed to make sure that the organization has the adequate amount of investments in place, to over a period of time really change, we have had a certain amount of setbacks two years back and we do believe that with the kind of investments that we have made, we are in the right path of recovery, and we will demonstrate a consistency in that path. So, thank you everyone and thank you for hosting us, Jigar.

Moderator: On behalf of B&K Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.