Aavas Financiers Limited
Q2 FY19 Earnings Conference Call

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MANAGEMENT:	**MR. SUSHIL KUMAR AGARWAL – WHOLE-TIME DIRECTOR AND CEO – AAVAS FINANCIERS LIMITED**
	MR. GHANSHYAM RAWAT – CFO, AAVAS FINANCIERS LIMITED
	MR. S. RAM NARESH – CHIEF BUSINESS OFFICER, AAVAS FINANCIERS LIMITED
	MR. ASHUTOSH ATRE – CHIEF RISK OFFICER, AAVAS FINANCIERS LIMITED

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Aavas Financiers Limited Q2 FY'19 Earnings Conference Call. This conference call may contain forward-looking statements about the Company, which are based on the belief, opinions, and expectation of the Company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. 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 '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Sushil Kumar Agarwal, Whole-Time Director and CEO. Thank you and over to you, Mr. Agarwal.

Sushil Kumar Agarwal: Good Evening everybody and I have with me Mr. Ghanshyam Rawat – CFO, Mr. S. Ram Naresh – Chief Business Officer, Mr. Ashutosh Atre – Chief Risk Officer and other senior team members.

First of all, I welcome you all to our first investor call after the IPO. Company got listed on the NSE and BSE on October 8, 2018, and we declared the first result post IPO on October 26, 2018. Before I take you all to H1FY19 performance highlights, I would like to thank everyone for their support during the IPO of the Company. The total size of the IPO was 1,640.3 crores of which primary was Rs. 360 crores. The infusion of the equity in the Company will allow us to meet our future capital requirement arising out of the growth in our business, expand branch network, and grow our retail loan book in a healthy fashion. As this is the first call, there are few people on the call with whom we will be interacting for the first time. I would therefore like to give a brief description about the Company before we move on to performance of H1FY19 performance highlights.

Aavas Financiers Limited (formerly known as Au Housing Finance Limited) started operations in 2011 in Jaipur, Rajasthan. The Company was promoted by Au Small Finance Bank until 2016. Currently, it is being run by a professional management team backed by marquee Private Equity investors Kedaara Capital and Partners Group holding approx. 34% and 24% respectively. Aavas Financiers has its registered office in Jaipur and is registered as a housing finance Company with National Housing Bank (NHB). The Company is a retail affordable housing finance Company primarily serving low and middle income salaried, self-employed customers in semi-urban and rural areas of India. A majority of these borrowers have limited access to formal banking credit, but have the ability to serve loans. Our product offering consists home loan for purchase, loan for construction of residential properties and loan for extension and repair of existing housing units. The Company has 186 branches, and is spread across 108 districts in 8 states as on September 30, 2018.

On the business side, we largely focus on single unit houses providing credit to underserved, unreached customer segment, and our distribution is built on semi-urban and rural distribution framework. Our product mix consists of home loan which accounts for 75% of our portfolio with an average ticket size of Rs. 8.7 lakhs and other mortgage loans which accounts for 25% of our portfolio with average ticket size of Rs. 7.8 lakhs. Our portfolio does not consist of any developer loans. Of our total loan book, retail book constitutes 99.3%. 65% of our customer are self-employed and the balance 35% are salaried customer. Our strategy of focusing on extending credit for purchase and construction of single unit dwelling of small average ticket size for self-occupation is playing out well. Our endeavor is to continue servicing the customer in this segment with an average ticket size of less than 10 lakhs. Our loans are sanctioned based on square feet and the construction area. The loan is capped in the construction category around Rs. 1,000 per square feet and our average LTV on the portfolio is around 50%.

Business model wise, the Company has made a choice to focus on in-house sourcing and today we have 100% in-house sourcing starting from lead generation, to risk management, and collections. Company has made deep investments in technology and data analytics. Every possible process across the chain is being shifted to digital or tech platform for reducing TAT, increasing productivity, enhancing customer experience. Robust and comprehensive credit assessment, risk management, collection framework has helped us deliver strong AUM growth of 78% CAGR since March '14 while maintaining asset quality and NPAs at less than 1%, with consistent ROA maintaining above sub-3% level and in-house sourcing business model has also resulted into reduction in turnaround time from 21 days to 13 days in FY18. We have maintained a strong control of loan takeover by other institutions. Due to high collection efficiency, our 1+ DPD has reduced from 7.3% from this time last year to 4.07% currently.

On the asset liability management, since inception, the Company knew that it did not have the parentage, so we made a conservative choice on that side. Today, the Company has positive asset liability with surplus of asset over liabilities across tenors. Because of this comfortable position we are well placed to navigate an increasing interest rate environment. Our average tenor of the borrowing stands at 136 months, which is 11+ years. For Q2FY19, incremental borrowing tenor was c. 154 months. The company has comfortable liquidity position with debt sanctioned by multiple institutions. With the current equity infusion of Rs. 360 crores, it has further strengthened not only our liability position, but we will also have financial flexibility to accelerate the growth. We have leveraged only 2.2 times of equity at this point of time.

On the borrowing side, the Company has access to a diversified and cost effective long-term finance with c. 36 lenders on-board. 87% of our borrowing are from term loans, assignments, NHB refinance, and cash credit limits. Only 13% of our borrowings are from the market with no borrowing by way of commercial papers. We have well-balanced mix of floating and fixed assets and liabilities. Our credit rating has been upgraded in the past by all the major rating agencies. Our long-term rating has been upgraded from BBB+/Stable to A +/ Stable by CRISIL. From A/ Stable to A+ / Positive by ICRA and from A+/Stable to A + /Positive by CARE. Our short-term borrowing ratings were also reaffirmed by both ICRA and CARE to A1+.

Company has been operating at a healthy and consistent spread in the range of 5% to 5.5% over the years. The OPEX cost has seen an upward trend due to increased investments in technology, management team, and branch expansion. Our operating expense is higher than the industry because of fully in-house sourcing model; however, most of these costs are fixed in nature; so with better and higher utilization of manpower and increase in business from each branch, operating efficiencies will start playing out. We will also leverage our technology and data analytics to support growth and improve margins and profitability. Our return on total assets (ROTA) has been consistently operating at a healthy range of 2.5% to 3%, across last 16 quarters and we see an uptrend as margins increases further.

On the branch expansion side, as mentioned earlier, one of the reasons for increase in the operating cost in last two years is the number of branches added in last two years. Before that, we have had adequate touch points through Au SFB branches. Post divestment, we have been continuously investing in branch expansion, in order to increase our penetration levels. We have added 75 branches during last 12 months.

Coming to financial performance, there has been a lot of changes in the accounting method due to transition to Ind-AS. We have explained them in detail in our investor deck on Slide #31 and #32. Also IGAAP to Ind-AS reconciliation has been explained in detail for PAT, ECL provisions and Net Worth on Slide #37, 38, 39. On key business parameters, as on September 30, 2018, Aavas Financiers has cumulatively financed housing units around 75,407. Total number of live accounts stands at 63,098. Cumulative disbursements till date is Rs. 6,287 crores. We have presence in 108 districts across 8 states. Total number of branches as on September 30, 2018, is 186 and 21 new branches were opened during the first half of FY19. Asset Under Management stands at Rs. 4,759 crores as on September 30, 2018, a growth of 49% year-on-year.

Segment wise breakup – home loan constitutes 75% of AUM, LAP constitutes 16% of the AUM, and balance 9% is other mortgage loans. Our LAP portfolio has average ticket size similar to home loans.

Customer wise breakup – salaried customer constitutes 35% of AUM and the balance 65% is from self-employed category. Fresh sanctions for the first half of the year were 13,952, an increase of 52% year-on-year growth. Disbursements increased by 37% year-on-year to Rs.1088.8 crores for the H1 FY ‘19. Total income was Rs. 311 crores for H1 FY ‘19 a growth of 41% year-on-year. Net interest income increased by 54% year-on-year to Rs. 173.9 crores. NIMs for H1 FY ‘19 stands at 8.87%. PAT stands at Rs. 65.5 crores for H1 FY ‘19, year-on-year growth of 38% as per Ind-AS accounting. Our average cost of borrowing for H1 FY ‘19 was 8.6% against an average yield of 13.9%. We were able to maintain our spreads above 5%, which was at 5.3% for the first half of FY ‘19.

Asset quality: On the asset quality side, our gross NPA stood at 0.57% as on September 30, 2018 (improved of 24 basis points) and net NPA stood at 0.48% (improved by 20 basis points) on the outstanding loan book as on 30th September 2018. Segment wise GNPA – home loan was 0.67% for 30th September 2018 as against 0.98% same period last year. Other mortgage loan was 0.28% as on 30th September 2018 (same compared to the last year). As mentioned earlier, we have no exposure to developer loan. On the return ratio, we maintained our ROA at around 3% level (3.06% as on September 30, 2018). Our ROE is at 10.2%, which has been lower due to continued equity infusion over that period. We expect to improve the returns going ahead with a high growth in our business and operating leverage to play out. Our book value per share stands at Rs. 186 before equity infusion of Rs. 360 crores. Including the recent equity infusion, our book value per share would have been Rs. 222. With this, I conclude update on the results, and now we can open the floor for question and answers.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. We will take the first question from the line of Nilang Mehta from HSBC Global Asset Management. Please go ahead.

Nilang Mehta: Sir, my question was more related to asset quality. While the presentation gives numbers on year-on-year basis since March, could you tell how they have moved from last quarter, because while year-on-year there is a dip, there has been a slight increase on gross NPAs and net NPAs when we compare to the March numbers, would you be able to also give numbers from June quarter?

Sushil Kumar Agarwal: We give two parameters for asset quality in our book. One is 1+ DPD, so our Q1 1+ DPD was 4.9% and Q2 1+ DPD is 4.1%. We have improved our position by 80 basis points on this. On the 90 + DPD, Ghanshyam Ji will brief you.

Ghanshyam Rawat: Our 90+ DPD as on June was 0.51%, roughly the same level for September.

Nilang Mehta: Could you give color on how do you expect the net interest margin to move? What is the range in which you would like to maintain considering the change in environment where liquidity has tightened significantly on the funding side. While we understand that your sources of funding is not completely market-oriented, but nevertheless is there a change in thought process? How do you think the spread will move from here on?

Sushil Kumar Agarwal: We work on spreads which is around 5% plus and current yield on the book is 13.9% which you can see from last two quarters it is almost same. On the borrowing cost side as on March 31st also, we were around 8.6% and today also we are 8.6%, but going forward given the current scenario, there will be increase in cost of borrowing. We are in a position to pass on that increase in cost of borrowing to our customer in the lending rates going forward. In this year, we have increased our lending rates two times, first around 25 basis points and recently (as of yesterday), we have also increased our lending rate PLR by 35 basis points (effective 1-Nov-2018).

Ghanshyam Rawat: As Sushil mentioned, we already have around Rs. 800 crores cash on the balance sheet, which we will be using. Some part of that money has been borrowed till September and some part has been raised in the form of equity also. So the money raised is at a lower rate of say ~8.60%. Recently we also got a sanction from few private sector public sector banks and few assignment deals are in our hand, which are in the range of 9%, or so of the fresh borrowings. Recently, we got one more Rs. 200cr sanction from CDC as a masala bond, which is for 7 years, which we will draw in the Q4 is also in the range of 9% to 9.10%, we even have cash liquid. With these fresh borrowings, we feel we will be able to raise fresh money in the range of 9%. Recently, we have increased our base rate by 35 basis point. We are seeing more opportunity at ground level where certain players are restricted in terms of sanctions and disbursements at this moment, so we feel we will be able to pass on the increase in cost of borrowings, majority of it to our customers. We will be able to maintain our spread somewhere in the range of 5%to 5.5%.

Moderator: Thank you. The next question is from the line of Karthik Chellappa from Buena Vista Fund Management. Please go ahead.

Karthik Chellappa: Sir, my first question is on our home loan, if we look at the share of home loans that is actually steadily being coming down in the last three years and even in the first half of this year, it is now down to about 75% and on a disbursement run rate basis, it is around 66%, why is this growing much slower than the overall portfolio and what is the medium-term growth that we can look for in this home loan segment?

Sushil Kumar Agarwal: As Company we take refinance from NHB and as per that we need to have 75% home loan portfolio and 25% mortgage portfolio. If you see 25% mortgage portfolio, it has three portions, one is the fee and insurance part which is around 3% to 4% on the home loans which is a part of home loan, but we consider this as a non-home loan, otherwise, in most of the other balance sheet it is shown as a home loan portion, so if we combine that then housing will be somewhere around more than 77% to 78%. Then 3% to 4% cases are where the customer has 18 to 24 months vintage with us without a single day delay. There we give them top up loans for the requirement other than home loans and around 16% portfolio is mortgage. In all these three categories, average ticket size is again same 8 to 9 lakhs and asset quality is better. You are seeing these numbers increasing because we started this mortgage loan portfolio only after the demon-period, which is somewhere around June '17, Since it is recently started that proportion is looking low, but going forward as a Company we will keep it 75%-25% on the home loan side and non-home loan portion.

Karthik Chellappa: My question is the 25% other mortgage loans which we classify, it could include home improvement loans and all other loans other than a loan taken to buy a first house, am I understanding it right?

Sushil Kumar Agarwal: Home loan portfolio consists of home loan for purchase of the individual houses, for construction of self-independent houses and repairs and renovation, so repairs and renovation will be around 2% to 3%, then your construction cases in terms of number wise higher (around 58%), but in terms of portfolio wise lower because the ticket size is less and purchase portfolio will be around 40% on the basis of numbers; non-home loan portion is I have told you top up, fee, and insurance charges, and LAP.

Karthik Chellappa: Sir, my second question is if we just look at Slide #23 which has our ticket sizes, what we notice is in the mortgage loan ATS, the ticket size on year-on-year basis has fallen almost 22% and the home loan ATS is also down 10%, why is it such a sharp fall in the ATS in the space of, let us say, year or so?

Sushil Kumar Agarwal: It depends the composition of portfolio, we as a company we intend to keep it around Rs. 9 lakhs. In non-home loan portfolio, I have told you it consists of top-up loan also and top-up loan are ranging around 2 to 4 lakhs so that brings down this average ticket size here. Since majority of our housing loan portfolio is coming from Tier-2 to Tier-3, it is mostly construction loans and construction loans are disbursed in 5 tranches, only the part disbursement which is getting disbursed is counted, which reduces your average ticket size, but as a Company, we intend to keep it around Rs. 9 lakhs in both the segments.

Karthik Chellappa: Sir, just two housekeeping issues, this quarter under the revenue for operations we have a line item called net gain on de-recognition of financial instruments which was around I think 24 odd crores last year, but this quarter it is only around like 14 to 15 crores and this line item has been quite volatile, what would this relate to and the next one is the tax rate, what kind of tax rates should we look at on a sustainable basis because the tax rates are also quite volatile during the quarter? Thank you very much.

Sushil Kumar Agarwal: Karthik, can you tell me the slide number?

Karthik Chellappa: Sir, it is actually not on the slide, it is on the results announcement, the one which we file with the stock exchange for eight to nine pages under the NSE format also, under that there is this line item called net gain on de-recognition of financial instrument under amortized cost category, which is 14 crores this quarter and second quarter of last year it was 24 crores and it has been quite volatile, so I am just trying to understand what is this line item?

Ghanshyam Rawat: Let me answer your 2nd question on the tax part. As you are aware this year onwards we need to follow Ind-AS accounting. In Ind-AS, please refer to net worth reconciliation slide for September '18 as well as March '18. Our net worth increased by Rs. 100 crores because of certain accounting change. While we were stating in the past, income on amortized basis, under Ind-AS those income needs to be accounted on the day of conversion. So Rs. 100 crores was an extra future profit which got accounted on March 31, 2018. The tax implication of this change in accounting method has been incorporated in this H1FY19 result. Extra income was generated and added to the reserves, but their taxation implication was accounted in this H1FY19 P&L. Going ahead the taxation rate will be around 33% and 34%, which is standard tax rate. There will be no extra taxation burden on the Company. Let me take your first question on the de-recognition of income. This primarily represents income on assignment. If you see we do lot of assignment and securitization. As on March '18 out of our total AUM or liability composition around 20% to 25% assets are assigned to the banks and institutions. There are many loan partners with us or large PSU banks and private banks. They keep on buying pools to meet their PSL requirements or even retail book requirement. Until now, we were booking income as and when realized basis. Now, under Ind-AS any asset if I do the sale in the quarter, I have to book the profit on the upfront basis. By having a discounting methodology, we have forecasted cash flows to arrive at interest spread, which is then discounted on certain discounting factor. Then whatever income comes, on that day we booked the income, so this income if you see is a little bit changing is because of that, what assignment do in that quarter, accordingly this income will represent.

Moderator: Thank you. The next question is from the line of Trupti Agarwal from White Oak Capital. Please go ahead.

Trupti Agarwal: I actually had a couple of questions, one is in terms of the fixed and floating mix, can you please tell me what is the fixed and floating mix both in borrowings and on the asset side as on September 30th 2018?

Ghanshyam Rawat: If you refer to Slide # 27, where we have given a detailed breakup on assets and liability. We have fixed asset of Rs. 2,200 crores, liability plus some portion of equity put together is around Rs. 2,150 crores, so assets and liabilities fixed to fixed is almost same. Our asset fixed rate book interest yield is 15.7% whereas our cost of borrowing on fixed rate is 8.32%, so we are making 7.5% spread on fixed to fixed book, so it takes care of the interest volatility.

Trupti Agarwal: My second question is can you please tell me who are those NBFCs and banks that you are competing with in your area of operation and also do you compete with Au SFB in the same area?

Sushil Kumar Agarwal: We have around 186 branches out of which we have only 35 branches where population is more than 10 lakhs, so in those markets most of HFCs like HDFC, ICICI, LIC, and top guys and small guys also present. But the segment which they cater and the segment which we cater is the different. We source 100% in-house, and they source from DSA, DMA, and intermediary. Their main focus is on builder debt supply, our main focus is on construction, self-construction cases and smaller houses. Their more focus is on salaried customers, our main focus is on self-employed customers. The other branches which is 186 minus 35 where population is less than 10 lakhs, there our competition is from small HFCs, small NBFCs, cooperative banks, and in some part of areas, some nationalized banks also, but there we have an advantage in terms of cost of borrowing. Smaller HFCs and NBFCs, have cost of borrowing at around 10% plus and whereas our cost of borrowing is around 8.6%. So in those areas, we do not see that much competition because of these pricing aspects. Then coming back to your point with AUSFB – they operate in the same areas where we have some of our branches, but we have few agreements with them. Our top 50 employees and their top 50 employees, cannot work for each other in their lifetime. Rest of the employees for 5 years they cannot go there and work. Second, any customer of ours and theirs cannot do balance transfer with each other for a lifetime.

Trupti Agarwal: Both you and AU cannot do for each other?

Sushil Kumar Agarwal: Yes.

Moderator: Thank you. We would take the next question from the line of Nidhesh Jain from Investec Capital. Please go ahead.

Nidhesh Jain: Sir, the first question is on the growth outlook, so given the events that we have seen in last one month, is there any change in our growth guidance for this year and next year? Secondly, how should we look at ROE trajectory because in this quarter ROE is of around 10% and then if we factor in capital rates of IPO, the ROE will look further downwards?

Sushil Kumar Agarwal: On the first question, at Aavas we believe in consistent growth and we factor some of these uncertainties in our journey. We have also done this in the past, and we have considered this kind of market volatility might happen. What as a company we should do to make it consistent approach, and with this new equity raise and the kind of borrowing profile we have, where average tenure is 11 year plus and with five years of asset liability positive position, we do not raise any CP. We have no payment outstanding for next 12 months on the NCDs side and the kind of liquidity, we will maintain a conservative policy. I think next two quarters, we will able to sustain our growth the same way we have demonstrated in last few quarters.

We have already shared when we were raising this capital that as a company we focus on 2.5% plus ROA working terminology, last 24 quarters you will see our ROA has not decreased from less than 2.5%. Currently, since few quarters where we have the excess capital, we have not diluted our business model, if you see our spreads are maintained over a period of last 24 quarters around 5% plus. Apart from it, we have around 1.6% fee. Our expenses are in around 3.98% as we have heavily invested in manpower, branches, technology, and analytics. Our asset quality has remained intact, in fact 1+ DPD has further improved and 90+ is around 0.5%. So if we continue doing the same focused work, then ROE will come as and when the leverage starts playing out. We have already told this capital is sufficient for our next three to five years growth and as leverage will increase, ROAs will come but in few quarters because of this excess capital, we think we will be able to sustain our ROA level which is from last two to three quarters around 3%.

Nidhesh Jain: I asked this question because given the uncertainty in the environment if our growth falters then our ROE improvement will get pushed in the future?

Sushil Kumar Agarwal: Currently, if you see our slide on the liability side, we have 2,000 crores plus kind of liquidity in hand and I think that is sufficient for at least next two to three quarters of the growth trajectory and as the market will revive we will think of some other things in next one year, I think we are in a good position to sustain the growth which we have.

Nidhesh Jain: So we should expect around close to 50% asset growth?

Sushil Kumar Agarwal: I will not put numbers, but whatever we have demonstrated over a period of last three to four quarters, there is no reason to say that we will not be able to perform because we have put significant investment in branches. In last 12 months, we have opened 75+ branches. The manpower strength is there. Current market is giving us more opportunities because some of the prime lenders or bigger companies have slowed down their disbursements, so that is again further giving us the opportunity, but being a prudent lender, we will see organic growth only and we want to continue the same trajectory of less than 10 lakh home loans with maintaining the asset quality and the spread going forward.

Nidhesh Jain: Sir, secondly just a data point question, what is the quantum of loans that you have assigned in this quarter corresponding to which you have earned that income, if you can share that number for this quarter and the last quarter that would be great?

Ghanshyam Rawat: Last quarter (Q1 FY19), we did one transaction of assignment of Rs. 50 crores, this quarter (Q2 FY19) it is Rs. 100 crores. Corresponding, last year Q1 it was NIL, and in Q2 it was approx. Rs. 200 crores.

Nidhesh Jain: This income will also be very volatile because in the quarter where we will assign, we will get that income and then no income in subsequent?

Ghanshyam Rawat: Now, we are following Ind-AS accounting. Like what I mean is say one company wants to have let us say 10% in the balance sheet, as some portion will be unwinding in the coming years, same proportion they will have a fresh assignment deals. So after three to four quarters, industry wide phenomenon will be stabilized. But it will be volatile till it get stabilized.

Nidhesh Jain: There is no securitization transaction that we have done, it is all the transaction assignment?

Ghanshyam Rawat: No, during this year, we done only assignment transaction. If you see till now, we have done securitization of approx. Rs. 150 crores till March '18. All securitization transaction come back on the balance sheet as assets and liability, but assignment transaction goes off to the balance sheet.

Sushil Kumar Agarwal: In H1 FY 2018 we had done approx. Rs. 200 crores of assignment. This year in H1 FY 2019 we have done approx. Rs. 150 crores of assignment.

Ghanshyam Rawat: H1FY18 to H1FY19 from Rs. 200 crores to Rs.150 crores. As you know, we have a very good spread on at that rate we do assignment and what my book yield, so even a small 50 crores transaction is a significant profit on the balance sheet.

Moderator: Thank you. The next question is from the line of Umang Shah from HSBC. Please go ahead.

Umang Shah: Sir, my reference is with Slide # 27 where you have given the breakup between floating and fixed on the assets and the liability side, what sort of assets do we have on the fixed side and what sort of loans are these?

Sushil Kumar Agarwal: It is a normal home loan and mortgage loan, so it depends on, in rural and semi-urban areas. People do prefer more on the fixed side because of this. We do not want budgetary or the interest side, so there our average lending rate is around 15% and average cost is around 8.23% and floating rate loans are all the same, home loan and mortgage loan, average ticket size around 9 lakhs. These are more in Tier-2 and semi-urban or metro side, they are more salaried customers. They prefer floating rate on the interest side. There our yields are less.

Umang Shah: The top up loans and the home improvement loans that we give, so typically will there be any tenure differential between the fixed and the floating rate loans?

Sushil Kumar Agarwal: We can give that data reference point further also.

Ghanshyam Rawat: My fixed rate asset versus fixed liability, there are two important points to be noted. On fixed contract, when we given the loan every three years, we have right to re-price that contract, so in all interest rate risk perspective, my fixed rate assets are not more than 3 years. Every 3 years I can re-price that whatever is the increase in cost of borrowing. I can pass on that contract after three years. When you see our liability side, average maturity of borrowing on liability side has is 6.5 years plus for the fixed contract, so we are very well protected on the spread wise also and tenure wise also.

Umang Shah: Sir, on the same slide coming to the liability or the funding mix, 12% of our funding comes through NHB refinancing. Off late there have been some media reports where we have heard about the refinancing being, I mean the funds released to housing finance companies have been deferred or delayed, are you experiencing anything of that sort or for you the refinancing is pretty much on time?

Ghanshyam Rawat: Today there is again article in the newspaper that NHB has stepped up their refinancing to all the HFCs and banks. At this moment, we already have unutilized line from the NHB, which we will utilize in this quarter or for the fresh limit. Proposal is already proposal at advanced stage. We do not see any sort of let us say negative impact. We already have very good limits from NHB. They are positive on that part.

Umang Shah: But there are no delays that you are experiencing?

Sushil Kumar Agarwal: No.

Umang Shah: Sir, what percentage of our loans qualify for NHB refinance?

Ghanshyam Rawat: NHB as you know, there are various schemes for NHB. There are urban low income housing fund, rural housing fund housing for women etc., As my average ticket size is 8.5 lakhs size, lot of books qualify for the NHB refinance, but it depends upon NHB as every year, they step up refinance, first year we received Rs. 25 crores, then Rs.50 crores, then we got Rs. 200 crores, last year we got 300 crores. So every year we are getting our limits enhanced from them, so it is not based on what portfolio qualify for them, it depends upon increase in the balance sheet size (we have created a pure retail book). NHB accordingly enhances the limits.

Umang Shah: Sir, my last question is on I was looking at our average borrowing tenure which you mentioned is about 11 plus years, now given that 48% of our borrowing mix is through term loans which should be bank lines, what would be the tenure of our bank borrowings, we mean to take our overall average borrowing tenure to 11 plus years?

Ghanshyam Rawat: All our term loans from the bank, lot of books qualify for the PSL. When we take a private sector loan from the bank, it has to coincide with my assets maturity, so generally our term loan from the bank for PSL segment comes around 10 year plus. When we take the loan from non-PSL, it comes 7 to 10 years tenure basically, so our average tenure or our term loan is in the range of around 9 to 10 years.

Umang Shah: But again the interest reset would be at shorter periods, right?

Ghanshyam Rawat: Interest reset you can take annual, all these loan are one year MCLR, so year after year loan gets re-priced as per the interest rate scenario. Like in falling market scenario, interest rate contract was 12%, we brought down them 8.6%.

Moderator: Thank you. We will take the next question from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Just continuing the conversation that we had on the accounting of loan sell down, now I was just wondering what happens if the customer actually prepays the loan, then do you need to like reverse the income?

Ghanshyam Rawat: There is scientific methodology to do accounting for all these things, based on every Company's past history, they have the average tenure of assets. Accordingly cash flow gets recasted for that tenure and accordingly it worked out to excess interest spread then there is a discounting methodology, it gets discounted. Every year the remaining pool get again tested on each year-end, what the pool has been left, what is the remaining tenure accordingly it gets re-rated what we have already booked, what is the current value, the difference goes to current year P&L.

Nischint Chawathe: When you are doing the transaction and booking the income upfront, would you have made some judgment on what the prepayment could be?

Ghanshyam Rawat: Obviously, we do prepayment like my average maturity of the pool is around 13 years, so in Ind-AS accounting we have considered 7.5 years.

Nischint Chawathe: The other question was on data point, if you could give a breakup of your loans and ECL between Stage 1 and Stage 2, I know you have given Stage 1 and Stage 2 together and Stage 3 separately, but if you could just your breakup I think that would be helpful?

Ghanshyam Rawat: I think we have given a separate Slide # 38, where we have given the complete breakup of Stage 3, Stage 1 and 2. If you see Stage 3, today Rs. 22.74 crores is total Stage 3 portfolio, which is 0.57% of total on-book AUM against which we have created ECL provision of 16%. Next stage, Stage 2 is total portfolio which is remaining portfolio which is 99.43%, against which we have treated a provision Rs. 6.5 crores, which is 0.17%.

Nischint Chawathe: The point is that can you give the breakup between Stage 1 and Stage 2 in terms of the breakup?

Ghanshyam Rawat: We will debate internally and then if required then we will publish the information for everyone.

Nischint Chawathe: Just one point because your ECL provision coverage for Stage 1 and Stage 2 at 0.17% is sort of a little lower than what it is there for competition, so maybe that is the reason?

Ghanshyam Rawat: If you see my 1+ DPD, it used to be between 7.5% to 8%. That has come down to 4.8% in March '18, and has further come down as 4.1%. So our portfolio quality in this last 12 months has improved, so that is why you are seeing my provision is lesser than the competition. Secondly, the entire book is 100% retail book, we do not have any developer book, we do not have any under construction property funding, our majority of the customers are end-users, they live in the house, my LTV is at 50%, so EY put a separate team to evaluate our past performance and accordingly they work out all these ratios, that is from our side.

Sushil Kumar Agarwal: Nischint, you can count this because we have given one DPD plus number and you have bucket three numbers also, so one DPD plus minus bucket three is your bucket one and two.

Nischint Chawathe: Just one final thing is if you could just give some color on growth in terms of, I know you do not want to mention very specific numbers but in terms of what proportion of new business that you would do in the next one year comes in from the existing centres and what comes on because of expansion?

Sushil Kumar Agarwal: Our growth trajectory will be consistent and existing branches, we have some capacity utilization and normally what happens is the new branches which we open up in the same six months, they work in 25% to 40% kind of utilization; after six months they move to around 50% and after 18 months they work on 60% to 70% capacity utilization. Depending on this, the branches normally perform in the past, so going by that way the existing branches will have capacity utilization improvement from 60% to 70% to 75% to 80% and rest of the branches as per the tenure of the branch will show the capacity utilization. Since we have invested in branch, network, technology, analytics, manpower, and we have sufficient asset liability profile also which can sustain our growth. I am hopeful that we will be able to continue the same growth journey at least for the next two to three quarters.

Nischint Chawathe: So basically what you are saying is that even for the new branches that you set up, it will take a while for them to really meaningfully start contributing to the overall number, but it is a gradual?

Sushil Agarwal: These branches will be open for the future growth prospective, so that will give us a consistent growth over a period of near-term.

Moderator: Thank you. We will take the next question from the line of Karthik Chellappa from Buena Vista Fund Management. Please go ahead.

Karthik Chellappa: Sir, what will our share be of the loan book from rural versus semi-urban and Tier-2 cities?

Sushil Kumar Agarwal: Karthik, on this we need to further deep down and we will give you breakup, but it is not available readily. But you can see that less than 10 lakh branches population, we have around 85% of the total branches and more than 10 lakh population, we have around 35 to 40 branches and business happens in 30 to 70 ratio, but again for confirmation, we will discuss internally and we will publish the data for everybody's interest on this side also.

Karthik Chellappa: Sir, the reason I ask that question is today if we look at our fixed versus floating mix, that is like around let us say I think 53 to 47, but if we look at our lending rate, our lending rate on fix is at least about 300 basis points higher than the floating-rate and our spread on the fixed product is sizably higher than our overall spread, so is there a risk that progressively that people might actually see this and opt for floating-rate loans because although floating-rate loans may get priced higher or lower depending on the interest rate scenario, the effective interest what they are paying is still lower than a fixed product?

Ghanshyam Rawat: What happens in the geography where we work in Tier 2, Tier 3, Tier 4, Tier 5, borrowers feel comfortable with fixed-rate product and it is more suitable to them., Accordingly we work out our strategy between fixed and floating offering rate across the market., We offer more floating product in the state headquarters, city headquarters and district level. But when we go little interior in Tier 2, Tier 3, Tier 4, we prioritize on the fixed-rate products, so that is why if you see fixed-rate product, we keep our good margins which protect us from interest rate cycle. When we come to the variable rate, we have the margins of around 3.75% to 4% spread is there, this is a difference between 300 basis in both the papers, but then they take care of our interest rate cycle. If interest rate rises then we also increase and pass on to them, but beyond that as I mentioned earlier that every three years our fixed-rate product also, we have a right to re-price those contracts, so our risk is not beyond a point. Like recently, we have increased 35 basis points to our base rate, which is going effective from November 1st still our cost of borrowing has not increased to that extent, keeping the market scenario in mind, we have increased our base rate by 35 basis points which will get passed to contracts which have completed three years.

Karthik Chellappa: Sir, one data point, would you have the headcount number this quarter and similarly for the second quarter last year?

Ghanshyam Rawat: Can we take the next question in the meantime.

Karthik Chellappa: Just one last question from my side, Sir, if we look at Au Small Finance Bank, they indicated that they are starting to do mortgages right now, I think the book is very small, it is only about 8 odd crores or so, but you alluded to a number of things in terms of agreements that you have between the two, but incrementally although they may not go after your customers you may not go after theirs. Incrementally given that the market is wide open, there could always be a possibility of both of you actually competing at least in the same vicinity or geography, right? How do we address this because they also have some very good business knowledge in their key markets which is overlapping with yours, so how are you proposing to address this so that the growth does not get split or cannibalized between the Small Finance Bank and yours?

Sushil Kumar Agarwal: We should not see only Au Bank. Housing as a market is a wide spread market, the current scenarios which we are seeing say around 15 lakh crores kind of housing growth over next 5 years. In that, we are seeing 1% share, so there is scope for everybody to grow and do the business. But since we are a mono-product company, we have our processes and systems well-defined, distribution, technology and analytics is there. I think we do not see any kind of situation where we will not be able to do things in this market, but yes, there are 13 SME banks and there are 93 licenses in HFC, but market is there for everybody. But with strong distribution, technology, processes stabilized, we have edge over others I feel. So in the same market both of us can coexist.

Moderator: Thank you. Due to time constraints, we take the last question from the line of Nilang Mehta from HSBC Global Asset Management. Please go ahead.

Nilang Mehta: I just wanted to get a sense that from a funding point of view, how much going forward will assignment and securitization be, this is just to get a sense that how much growth will be there in your on-book loans versus off-book?

Ghanshyam Rawat: As you see, we have roughly around 20% of the book as off-book of the total AUM. We are moving in the way, even in this year, have already done Rs. 150 crores assignment. So depending upon entire market scenario and banks interest and what products are available at a lowest cost of funding to us. Accordingly, we work on the strategy on the funding side also, There may be few percentages here and there, but we have strategy in the similar fashion, we will grow our assignment and securitization i.e. off-book as your AUM get increased.

Nilang Mehta: In pursuit of growth in next couple of years, the developer financial will be off our radar or is there?

Sushil Kumar Agarwal: Normally, as a philosophy from the first year itself we have avoided risky assets in our book, no developer funding, corporate loan should not be there, no high ticket LAP, no under construction property, so we want to maintain the same for the next two to three years. We do not want to enter into developer funding and other kind of products. Mostly these products are taken by companies to maintain the end of the book and while they are getting lower interest rate on the housing loans. I think as Aavas, we are in a good position to create housing loan book at the similar rates maintaining the spread, so we do not have necessity and we do not have intent to do this business in the near-term.

Moderator: Thank you. Ladies and Gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. Sushil Kumar Agarwal for his closing comments.

Sushil Kumar Agarwal: Thank you everybody for participating. This was our first call, we will try to improve ourselves in the future calls also and whatever data requirement today we have got maybe we will incorporate going forward so that you all can get better perspective about the company, but to summarize we at Aavas, will continue to focus on low and middle income, self-employed customer that remain underserved and unreached. We want to be in the same smaller ticket size segment less than 10 lakhs. It will be our endeavor to improve margins and profitability by way of growing our business and improving efficiencies in our business. We will leverage our strength built in technology to improve customer retention and reduced TAT further, improve productivity and collection efficiency also. We will continue our efforts to reduce borrowing cost by expanding lender base, adding the long-term instruments and improved rating. We will keep a close watch in having a balanced asset liability management at all the tenures. Our portfolio will continue to have best-in-class asset quality. For any further information, we request you to get in touch with Himanshu in our investor relation team or SGA, our Investor Relationship Advisors and partners. Thank you very much, thanks for patience listening and given the market scenario, I think we are well-placed to maintain our niche, our character of being Aavas.

Moderator: Thank you all. Ladies and Gentlemen, on behalf of Aavas Financiers Limited, we conclude today's conference. Thank you all for joining us and you may disconnect your lines now.