"SKS Microfinance Limited Earnings Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q4 FY 2011 conference call of SKS Microfinance Limited. We have with us today Dr. Vikram Akula, Founder and Chairman, Mr. M. R. Rao, MD and CEO, and Mr. Dilli Raj, CFO. I would now like to hand the conference over to Dr. Vikram Akula. Thank you and over to you, Sir.

Vikram Akula: Good afternoon everybody, before we discuss the results and get in to some of the numbers M. R. Rao and I would like to make some general comments. Microfinance is going through challenging times, but let us be clear that the challenges that microfinance faces has nothing to do with the fundamentals of the business, those fundamentals are solid, they have been for decades whether as practiced since 1978 by Grameen Bank in Bangladesh or as practiced by SKS in India since 1998. What I mean is that if you give an income generating loan to a low-income household through a group lending model, people can earn income and repay that loan, that is a proven fact and studies from around the world whether the AIMS study done by the USAID or World Bank studies in Bangladesh or SIDBI studies in India prove that.

Microfinance & SKS – Relevance, Challenges and Re-invention:

Today's challenges are not about the fundamentals of microfinance, today's challenges are political, specifically there has been a serious political attack in one state Andhra Pradesh against the idea of harnessing the power of the private sector of using free markets and free enterprise to help bring about financial inclusion. In essence, what is being attacked is the idea whether liberalization is for all or just for a few. At SKS Microfinance we believe that all of India is yearning for the fruits of liberalization, for free markets, for free enterprise. We believe a liberalized economy should benefit not just the wealthy in Mumbai and Delhi but also the vast rural population in towns and villages. We believe that our company has the awesome responsibility of carrying that free enterprise system beyond the cities and in to rural areas.

We believe that we have made great strides in doing that. Today over 7.3 million rural households have access to finance because of our company. They have earned income, and step by step created a better future for themselves. Of course we have been struck a blow by vested and ideological interests who want to prevent that and now, we need to reinvent our company and that is where we are going to focus on this year. Reinventing microfinance such that we stay true to our purpose, at the same time broaden our work so that we are not vulnerable to attack in the future. Our reinvention of microfinance will take three broad themes. First, this year we are planning to consolidate our customer base as opposed to acquiring new customers; second thrust will be on diversifying our product range so as to mitigate risk of being focused on a single product, and third, we will focus on resolving the situation in Andhra Pradesh.

Consolidation:

Let me start by discussing how we see consolidation. Here, we as a company are taking a cue from the regulator, the RBI, who has created a framework that will move the industry from a highly fragmented sector in which there is a large number of small players to a sector which is dominated by a few large players. By way of background, as you know the regulator, the RBI, recognized that with the commercial success of the sector many new players entered microfinance, but these new players did not always practice the fundamentals of microfinance the way SKS Microfinance did. For example, where we focused on ensuring group liability training so that groups keep in check the amount of the loans, if the loan is commensurate with the borrowers' capacity, many new players came in and did not focus on those fundamentals. In the absence of the financial and technological infrastructure such as the credit bureau and a credit score which do not exist in rural areas for the segment, this led in some pockets to over lending. Microfinance therefore needed a strong regulatory framework that protected against such irresponsible lending. That did not exist a year ago but today it does exist in the form of Malegam committee recommendations, parts of which have already been notified by the RBI.

Three key elements of the Malegam Committee Recommendations that are relevant to our strategy of consolidation are - number one, the restriction on the number of MFIs lending. As many of you know the RBI has restricted, as the Malegam committee has recommended that only two MFIs exist per borrower. In addition, the second guideline is pricing guidelines, capping interest rates at 26%. Thirdly, ensuring that MFIs focus on income generating loans, which is what we at SKS have always been doing. These three restrictions effectively will lead to a consolidation in the sector where a few large players will be able to take up most of the sector lending. This means that SKS will have a larger ticket size for our borrowers. Now let me be clear, this is not to say that we will be lending more to a borrower.

The total exposure of individual borrowers that we currently serve will stay the same. In a sense that if today she has loans from two or three or four players, her overall borrowing will be the same but our share will disproportionately increase because of the restriction on only two MFIs per borrower. Of course we do not intend to do this type of consolidation willy-nilly. Rather we will be focusing on our existing customers and particularly focusing on those we have come to know well over the years, who have a proven track record with us. Our goal will be to provide our best customers their full financial needs rather than focusing on customer acquisition for new customers that we do not know. Now, eventually when there is a credit bureau in place and a credit score established for new customers, we will restart our customer acquisition but that would require things like unique identification, the UID system needs to be in place, so it may be 12 or 24 months before that happens and this year we will focus more on our existing customer base.

This increase in ticket size per customer will also make us more efficient in terms of operating costs time and from a funding perspective the RBI has ensured that those MFI that follow this route will continue to have priority sector lending status. We also note that the RBI has restricted priority sector lending for NBFCs that do not do this type of lending, this we expect will make more funding available to us. Our second thrust this year will be to diversify our portfolio and I would like to hand over to M. R. Rao, our CEO, who will speak about that thrust area.

M. R. Rao: Thank you Vikram. For the last three-four years we have been piloting different products which we have been speaking about.

Diversification:

There have been four products. There has been the housing loan pilot which is continuing, we have also been piloting the Sangam Stores, a unique concept where we tie up with Metro. Metro supplies the goods and we give the working capital loan to the Kirana store, but instead of giving the cash to the Kirana store we give the payment to metro who in turn deliver the goods to the Kirana stores.

The beauty about this product is the interest is free to the Kirana storeowner. Metro delivers the goods at their doorstep and we get roughly 2% commission for every order we place with Metro. This is a fortnightly order, so the IRR translates to 48% and the beauty about this is for the borrower, the Kirana store owner, it is an interest free loan. We have piloted this very successfully with 3,800 stores in Hyderabad and we want to now scale this up to 20,000 stores in Hyderabad, Bangalore and Kolkata where the Metro stores are specifically located. This is going to be the focus this year.

The housing pilot will continue to be at a pilot level for this year while we expand the Sangam Stores Project. The other product that we want to expand is the mobile phone project. Essentially, we are giving a loan for the members to buy mobile phones on installment basis. Let us say they were to go to a Nokia retail outlet, they would have to shell out the cash up front to buy the mobile phone. We are allowing them to pay in installments and the mobile is delivered to the borrower at her doorstep by the Nokia retailer. Till date, we have sold about 3.7 lakh handsets through this model and this year we plan to take this up to 10 lakh mobile phones, which is roughly around 15% penetration of our current customer base. This is a good revenue generating product because we get a commission of Rs. 127 per handset for every handset that is financed, on top of that for the loan we charge the normal 24%- 25% interest rate and the repayment is only in 25 weeks. So the loans turn around faster, we get a 25% annualized interest rate and on top of that we get commission from the Nokia distributor at the rate of Rs. 127.

The third diversification that we have planned and we have been piloting for the last six months is on the secured lending side. For long we have been focused on the unsecured side of microfinance lending but our discussions and studies with the customers have shown that most of our customers have gold which they typically pledge with the pawn broker for loan against gold at rates of interest as high as 5%-6% per month. Typically the average ticket size of loans that they get is about Rs.13,700 and our studies have shown that at any given point of time, 30% to 40% of our borrowers borrow against gold. For the last six months we have been piloting this project in five branches and the business has been pretty successful. Especially in light of the fact that we are wholly focused on unsecured portion, we want to scale up this gold loan project towards 400 branches and start building a secured portfolio. There is a pretty good response from our borrowers in the five branches, not only the borrowers, given our extensive presence in rural phase, the non borrowers in the villages that we service also are coming to our branches to pledge their gold and take loan against gold. We charge only 24% whereas the pawn brokers charge 50% to 60% per annum and the borrowers find it very attractive to borrow from us. This is also going to be a substantial revenue-generating scheme for us this year.

With this I will hand over back to Vikram to talk about the third aspect of the strategy for this year.

Vikram Akula: Thank you M.R. Diversification of our portfolio is going to be the second thrust area. The third is that we hope to resolve the AP situation this year.

AP Update:

Now the credit loss that we reported last quarter was driven largely by our inability to operate in Andhra Pradesh because of the Microfinance Act and when I say we cannot operate, let me explain. We are legal and we are registered in the state of the Andhra Pradesh, but the difficulty is that because of some onerous rules we are not able to get permission to give new loans. When we do not lend new loans, customers lose confidence and that has affected repayment. Unfortunately, though we have applied for 73,000 new loans, only 1,600 were approved, so we need to resolve that issue and be able to lend before we can bring back the confidence of customers and pick up repayment.

We expect that will change for a couple of reasons, a couple of dramatic things have happened in the last week that makes us very hopeful. The first is, the RBI now has very firmly and clearly stepped in. As you all know, in the monetary policy statement the governor notified parts of the Malegam Committee recommendations and when it came to the Andhra Pradesh Act, when he was asked after the monetary policy statement, he said some very favorable things about microfinance and I want to quote his comments verbatim. When it comes to the Andhra Pradesh Act, Governor Subba Rao said "there was a recommendation in the Malegam Committee that if the regulation is implemented as suggested by them, there would be no need for individual State Governments to have their own respective laws and I believe that is a fact."

The governor went on to state that the RBI is in dialogue with the AP government and he also concluded by saying that he hopes that the state government will proceed to withdraw individual legislation because it is no longer necessary. Now, this kind of statement from the regulator makes us hopeful that the AP Government will stand up and take credit for having created a catalyst to bring about a national regulatory framework but also recognize that they no longer need to have an act because the RBI regulations actually go even farther than the act. We are further saying we are confident because we do not necessarily want the state government to withdraw the act, simply we are asking to make the conditions for getting prior permission for giving new loans less onerous.

We are hopeful that if that is done we will be in a position that we can start lending and that will bring about confidence and then eventually the AP situation will be resolved. Of course, there is also a legal case that is pending in the high court and we are hopeful that there is some possible relief that may come from that as well. In addition, we also recognize that it is not as if the need of finance has been replaced by some other party, the state government has not dramatically increased its lending. So there remains to be a vacuum and popular sentiment among the people is that they desperately want access to finance so they continue to run their small businesses and meet their financial needs. In addition, we are also getting some confidence because the RBI has succeeded in ensuring that no other states have come up with a comparable act. So, in 18 of the 19 states that we work in, we continue to have vibrant operations and we are hopeful that the AP situation will be resolved as well. So, with these three areas we hope to have a strong future this year, the first being consolidating the industry, the second being diversifying our portfolio and the third being resolving the AP situation.

I will note in closing, before handing to Dilli Raj, that the best companies in India faced political attacks in the past. As liberalization has slowly gotten rid of inefficient systems and gradually allowed people to bear the fruits of free market and free enterprise, whenever these things have happened, there have been political attacks. Since we are working in an unchartered territory, we are facing this with SKS Microfinance today. Just as the best companies in India have overcome political challenges, we are confident that we will do so as well. In these we note we have faced political challenges throughout our history, whether when we were working in one village or one district or one state and just as we have been able to overcome those political challenges in the past we are confident that we will do so here. We are confident that we will do so in a way that is in the best interests of both our customers as well as our shareholders. With that, let me turn it over to Dilli Raj.

Dilli Raj: Thanks Vikram. Let me just straight jump into the credit cost issue. Our credit cost approach is much more stringent than the extant RBI norms. If you had merely followed the RBI norms, the credit cost for Q4 FY 2011 would have been a mere Rs.40 Crores compared to the P&L hit of Rs.187 Crores which we have voluntarily taken, so we are talking about excess hit of Rs.147 Crores. If we had completely toed in line with the regulator's recommendation, then we could have remained P&L positive for Q4. The excess provisioning for FY 2011 as a whole is Rs.184 Crores. Is it over? Of course, in the near term there will be pain, so there is a near term pain maybe for a quarter or two. But if one is raising question on medium term prospects, we are very optimistic.

Medium term prospects:

What makes us to say that we are optimistic on medium term prospects - let us look at the AP crisis this way. I think the AP crisis has raised questions on five or six fundamental aspects of microfinance as a business activity. First and foremost, there was a regulatory haze, who is going to regulate us- RBI, State Government, NABARD or the Central Government. Secondly, there was funding uncertainty, there was so much apprehension about withdrawal of priority sector credit. Thirdly the question was, will there be a contagion spread to other states from AP? Fourth was basically business model validity was challenged. Fifth the economics, the unit economics under the new regulated interest rate regime, what would that be. Finally, the AP portfolio - which way it would go. Now with the Malegam committee recommendation and most importantly RBI notifying the MCR, we do have absolute clarity on five out of the six issues. I would like to believe that we at least have directional clarity on the final issue of AP.

Regulatory Clarity:

Now let me articulate, first and foremost regulatory clarity. RBI will be the sole regulator for NBFC MFI and it is not just a mere expression of intention. RBI has taken the pain to regulate us on all functional aspects like pricing, customer protection, governance, the numerical cap on aggregate borrowing, lending limits, the whole works. That leaves no regulatory void or gap for anyone else to step in under the pretext that there is a void or gap.

So, this effectively exempts or precludes the respective state governments from regulating this piece.

Funding Certainty:

The next one is funding and funding certainty. Today we have certainty because RBI has notified that the priority sector status for MFIs is here to stay, but just that we will be the only game in town so for as priority sector dispensation is concerned. To just look at the data, the incremental limit put out by banking system for all NBFCs under this route last year was about Rs.1,50,000 Crores. If we succeed in accessing a mere 5%, that number for you is Rs.7,500 Crores. In my assessment that brings in lot of funding certainty.

Contagion Risk Mitigated:

The third is contagion risk. MCR has very clearly requested other state governments not to get into this piece and most importantly you would agree that propensity into jump in something like this and rush with similar legislation is more pronounced in the beginning of the exercise. As you would notice, no other state government has followed this. 18 of them have held back and it is not just inaction on their part but action in the sense, as you would know the Eapen Committee of the Central Government constituted by Central Government, seven state governments where prominently microfinance business entities are there, have joined them and it is a clear indication that the contagion risk is behind us.

Business Model Validity:

The fourth thing is the business model validity. The credit demand in AP and other states remain intact. In AP we have not been able to lend incrementally over the last six months, but if you really look at it is not that alternative models have gained currency, it is not that someone has invented a new credit delivery model and fulfilled the need. So it has two implications. The first and foremost inference is that the business model validity is intact and most importantly that would help us to resolve the issue. The reasons why they borrow remain intact. The reasons why they repay 99% remain intact so long as we could resume this incremental lending.

Unit Economics:

Now that leaves us with finally the unit economics in the new order. We have put out a slide in the deck where you would see that even under the new regime of 24% to 26% interest rate, 1% processing fee upfront which would translate into an IRR of 2.1%, on a steady state credit cost of 1.5%, one could get an ROA of 3.6% to 4.6%. That clearly says that the unit economics is not adversely impacted and 3.6% ROA still would be the best among financial services play.

Q4FY11 Update:

Having said that, if you have to quickly take stock of what have been our priorities or objectives for Q4 this year, apart from the AP situation and preventing the contagion, three other things we focused on. First and foremost we wanted to deliver on all our promises to our credit granters and I am happy to report that we fulfilled all those corporate obligations. The second thing was to protect your investment in franchise building intact, which we have done. There has been a natural attrition in line with historical trends. That apart, we have been able to protect the investment in the franchise building intact and that helps to play the diversification game that M.R. articulated.

The third priority was basically controlling cost. In October, when this AP crisis started, the operating expense was something like Rs.48 Crores per month. That has been brought down to Rs.29 Crores for the month of March. Two-thirds of that is driven by personnel cost and that has been driven down from Rs.31 Crores to Rs.20 Crores for March on account of natural attrition and some minor tweaking on actuarial valuations on leave encashment and other benefits.

Basically we seem to have achieved these objectives, but the fourth important objective is liquidity. Now if you have to look at our solvency and liquidity, as we speak today, we have a networth of Rs.1,781 Crores. The AP exposure is a fraction of that networth and not a multiple of that networth and as you would notice, our portfolio outstanding reduced from Rs.4,321 Crores to Rs.4,111 Crores. But what is missed is we consciously held on to cash and bank balance of Rs.558 Crores. So, if we wanted, we could have easily translated a substantial part of that into productive credit assets but the idea was to get liquidity and stay liquid. We did access incremental debt of Rs.823 Crores for Q4 and one should not forget that the banking system reinforced its confidence in us and lent that money amidst the number two, number three and number five player of MFI sector going for CDR. So we are very confident that with the notification of MCR that is what the banks were waiting for - regulatory clarity - because we have a common regulator. As it is more positive than MCR, the notifications are further liberalized, further increased restrictive limits, the banks have no problem in resuming lending to us, at least players like SKS who are well equipped to comply with the new regulatory regime.

With that I would wind up and we would invite questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, the first question is from the line of Amit Ganatra from Religare AMC. Please go ahead.

Amit Ganatra: Just a few clarifications; on slide no. 6, you have given the state wise portfolio mix. Now what is the difference between your gross loan portfolio and future receivables? For example, in Andhra 34% is the gross portfolio and about 19.3% is future receivables so what is the basic difference?

Dilli Raj: Basically the gross portfolio in especially AP includes the overdue principle also. For instance, the AP exposure is Rs.1,285 Crores. Of that the over dues are Rs.665 Crores. If you just take future receivables, which are not over due, that ratio would come down to 19.3%. So one is gross loan portfolio and other one is future receivables.

Amit Ganatra: But against that gross loan portfolio of Rs.1,285 Crores, how much provisions have already been made or how much write offs have already been or this is net of write offs or any provisions?

Dilli Raj: They are net of write offs. Basically if you go to slide no. 12, and no. 13, we have broken out the numbers on how much provisioning we made. Basically here the credit cost has got four integral parts. One is the interest reversal, second is provisioning, the third is bad debt written offs, and the fourth is loss on short collection on assigned loans. AP portfolio of Rs.1,285 Crores is net of the write offs. So, what we have done is instead of providing for it, basically we have reversed an income of Rs.81 Crores for the total portfolio and we have written off Rs.38 Crores on the AP portfolio, also we have written off another Rs.29 Crores on off balance sheet portfolio relating to AP receivables. Now the point is, you will see that the accent is on write offs rather than provisioning because of tax treatment. If you write off that is a tax-deductible expenditure but if you make provisioning that is not a tax-deductible expenditure. So the credit cost has been taken in a very tax efficient manner.

Amit Ganatra: Second thing is that in terms of state wise collection efficiencies that you have provided everyone can understand that it is 10.5% in AP due to various reasons, which are highlighted. Why has West Bengal dropped to 90.5% and it is very different from all other states?

Dilli Raj: I have the district wise data. First of all, let me reassure you that it is not the contagion risk, which one talks about, because this is not a top down pressure from the state legislation or anything like that. We seem to have a problem in one particular district where the collection efficiency has come down to something like 70% and that has pulled down the state average. Let me give you the frequency distribution of collection efficiency for Q4 for the 17 districts in West Bengal. Nine districts have 97% to 100% collection efficiency and five districts 90% to 96% and two districts 80% to 89% and it is just one district where we have 70% collection efficiency. Having said that, this is a regional level problem as Vikram alluded to, we keep having. For instance, if you have taken a look at our credit losses history in FY'10 Karnataka accounted for 35% and that number for you today is 2% in FY'11. So it is a particular problem in a particular district or a region.

Amit Ganatra: So if one were to understand it correctly, basically 90.5% collection efficiency does not represent that 10% of the portfolio in West Bengal is at risk?

Dilli Raj: Absolutely.

Amit Ganatra: But then how much is that district having, how much is that district exposure in the total portfolio?

Dilli Raj: We will give you that number. That is Rs.81 Crores, total exposure in that district.

Amit Ganatra: Basically 70% is the collection efficiency on that portfolio?

Dilli Raj: Correct. That pulls down the ratio for the whole state.

Amit Ganatra: Sir, in that pro-forma, in terms of return on assets that you have provided in slide no. 16, the second note mentions assuming a borrowing cost of 12% and margin cap of 12%. Now has there been any margin cap, which has been put on by the Malegam Committee Recommendation?

Dilli Raj: Both in MCR and especially in notification of MCR by RBI there are two aspects; one is interest rate cap of 26% on individual loans and a margin cap of 12%. That means you cannot lend at a rate of more than 12% over your borrowing cost. So this 1% processing fee and the credit shield administration charges, which you can pass on are outside both the interest rate cap and margin cap. That is why we have given numbers under both the regimes.

Amit Ganatra: Then what is the logical number to look at, is it 3.6% or is it 4.6%?

Dilli Raj: We have just given an example. If your borrowing cost is 12% then you can take an ROA of 3.6%.

Amit Ganatra: But what if it is lower than 12%?

Dilli Raj: That is fine; 3.6% would be same, because that whatever is the borrowing rate plus 12%.

Amit Ganatra: So margin cap basically is a way to look at it in that sense?

Dilli Raj: Fine.

Amit Ganatra: So, from understanding perspective if current things stand and other assumptions remain same, then one can expect a return on assets of 3.6% from this?

Dilli Raj: Right.

Amit Ganatra: Thanks.

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

Jaynee Shah: What I wanted to understand is that you have articulated that this year our focus is going to be on consolidating the client base. Having said that what is the quantum of growth that we can look forward to in the non-AP portfolio?

Dilli Raj: If you look at the book as of now, the total book is Rs. 4,111 Crores. If you remove the AP exposure of Rs.1,285 Crores, the rest of non-AP portfolio is somewhere around Rs.2,800 Crores. We are looking at something like 50% growth because as we explained earlier what is holding up at is not demand generation. That is not an issue. Now that the regulatory framework is in place, we are optimistic that the funding lines would start in a big way and we are looking at a 50% growth on that book, that would be Rs.4,250 Crores.

Jaynee Shah: Great. Thank you, so much for that. That is it from me.

Moderator: Thank you. The next question is from the line of Ashish Sharma from Enam AMC. Please go ahead.

Ashish Sharma: Good evening Sir. Just wanted to get a sense on the disbursements. You mentioned that next one or two quarters could be tough. I mean the disbursements runrate for Q4 was Rs.780 Crores, now I would assume that there would not be much disbursements happening in the AP portfolio. Now would the same trend continue, this subdued disbursements would continue in the next two quarters also? I mean what is the sense? How will it shape up for the business both in AP and non-AP going forward in the first half?

Dilli Raj: The near term pain I referred to primarily is from the credit cost and related pressure. So in terms of incremental disbursements, our assessment is that Q1 is always a lean period for us and for many others because bankers do wait for the annual results and their audit, so we would get some funding by June. Q2 onwards, we do not see any issue in beefing up the books, which we have talked about. So the near pain relates to the credit cost and not to other aspects.

Ashish Sharma: What further credit costs we need to absorb from the AP portfolio? What sense based on the profile? Let us assume that the situation or the deadlock between the AP and RBI does not end soon Sir?

Dilli Raj: There are two ways to look at. One of the other reasons why we said that we will look at RBI provisioning norm is that you and I know that MCR is out there as a recommendation and that does advocate an approach which is drastically different from the extant provisioning norms right from the approach because the RBI norms talks about the future receivables approach whereas Malegam Committee referred to the over dues installments approach. So that part of the Malegam Committee Recommendation is not yet notified. So we do not know what exactly finally would be notified, what the new provision norms would be. That would be the primary approach document. Having said that, for a moment if you say that the RBI provisioning norms continues without any amendment, then on Rs.1,285 Crores portfolio of AP, there could be a 10% provisioning. That is what the RBI norms advocate. So it is absolutely up to you to go about and increase to whatever, but the minimum would be 10% of that portfolio.

Ashish Sharma: Assuming any deadlock improves and as per our provisioning policy will there be any write backs also going forward, if the collection efficiency improves. How is the accounting on that, Sir?

Dilli Raj: Absolutely. As I said, the write offs relates to two parts, bad debts written off as well as the loss on short collection, we have taken also the income reversal. On all those three metrics, if we have collections, the amounts will be written back on cash basis.

Ashish Sharma: Okay. Thanks a lot.

Moderator: Thank you. The next question is from the line of Pankaj Chopra from Shanthi Asset Management. Please go ahead.

Pankaj Chopra: Thank you for taking my question. Sir, could you explain this 3% ROA with the 12% cap and in the way I would see, if you got a 12% cap you have got 9% operational cost, 1.5% credit cost and we are left with 1.5%. I am unable to get the logic of three. How do we get that?

Dilli Raj: You are right. If you take 12% as a margin cap, deduct operating cost of 9%, provision and write off 1.5%, what happens is the 1% processing fee is completely outside the interest rate cap or for that matter the margin cap. Since you are collecting that 1% upfront, that translates into an IRR of 2.1% for a one-year loan. If you do that then you will get 3.6% and we have also assumed 1% as other income. There are certain things, which are not permissible under the MCR regime. For instance, you cannot collect any additional membership fee. You will see that is zeroed in and group admin charges, now RBI has said that you can collect as per IRDA norms since we do not have clarity we have left it open. But there are other revenue streams, which are allowed under MCR, so that we have continued with 1%. If you add back all these three you will 3.6% post tax.

Pankaj Chopra: Sir, the second thing is ,we have seen the kind of operation cost that we have had, do you think it will be possible to have a number between for earlier quarters it used be 12, 13, etc.,. To have a number as low 9, would that be feasible given the conditions that you are working?

Dilli Raj: Basically if you look at operating cost on an annualized basis it was 10.4% for FY'10 and it has slightly increased to 10.9% in FY'11. Actually what happened was, in the beginning of two quarters we did reduce it in percentage terms, but what has happened is when the denominator got contracted i.e, the portfolio outstanding reduced from peak level of Rs.5,028 Crores to Rs.4,111 Crores, in percentage terms the cost has increased. Therefore, if you see 50% growth in non-AP portfolio, automatically this percentage will come down.. If you go to slide #23, from a peak level of Rs.48 Crores of monthly operating expenses in October at the start of this AP crisis, the total operating expenses in absolute amount has been reduced to Rs. 29 Crores. So you are talking about almost a 39% reduction on a monthly basis.

Pankaj Chopra: We can see the numbers actually coming down in absolute terms, but these are exceptional times, we are going through exceptional period of change, if I may. The question to be asked is you already are one of the largest in the country in terms of what you are doing. So the benefit of scale may not flow down any further. I mean how much further operational efficiency could kick in. So are we really balancing on a very fine line in terms of operational costs so that even a slight slip up could lead to negative surprises? Would you have some comments on that, please?

Dilli Raj: The operating leverage in our business has got to be looked at from two perspectives. Sure it is abnormal times, but if you dig deeper, you go down to the second illustrative model there, the primary cost driver is the personnel cost. That has been brought down from Rs.31 Crores to Rs.20 Crores purely out of natural attrition. Now the second kicker for the operating leverage is form our branches. We have been opening branches, which now stand at around 2400. Our assessment is, if you are not acquiring new customers, because even if you were to take care of the credit requirement of 7.3 million customers, we could grow the book easily by 50%. If you look at the expenses policy of SKS, whenever we open a branch we do not capitalize that. We do not treat it as deferred revenue expenditure. We used to just expense them off and we used to incur something like Rs.1.8 lakhs per branch and branches do take time. In our case, it used to take 4.5 months for break even and nine months for pay back. In three months time or even today, we are looking at a scenario where 90% of your branches are old branches in the sense they have paid back the investment. So if you can stop at that 2400 for a year, meet the customers requirement, obviously that is another kicker on the operating leverage side.

Pankaj Chopra: Sir, could you give us two or may be a couple of parameters, which you look in terms of efficiency where you could kick in, say number of members handled by the managers or something like that which the company looks at as a parameter to understand that this number could may be double and that could lead to operational efficiency. Which are the numbers we should look at?

Dilli Raj: I think absolutely the member per field officer is one of the key numbers. Member in the sense you could either look at the member or the borrower. Borrower per field officer is one key metrics we capture and the other one is the portfolio outstanding per field officer. Later you can consolidate that into branches but those two would be key metrics.

Pankaj Chopra: What would be those numbers now and where could they go to, Sir?

Vikram Akula: The factor that we are keeping in mind is that with Malegam Committee Recommendations being notified which we expect the detail notification to happen shortly, require you to restrict to two MFIs. Today in places where you have three or four MFIs each, let us say having an outstanding of say Rs.7000 per MFI, the total exposure would be in the case of three MFIs something in the range of Rs.21000. If you have only two, naturally each of the remaining players would move from seven to let us say Rs.10,000 or it may be more than Rs.10,000. This would not happen right away, there will be a transition period, but this is the way in which one expects the portfolio to increase per loan officer.

Pankaj Chopra: Sir, the second parameter was the credit cost. Do we see that staying at 1.5%, really you have little idea as to why or what that number can be after these changed circumstances and the transition. Would that be a fair assessment, 1.5% credit cost?

Dilli Raj: Steady state. That is why we have clearly said barring AP, on a steady state basis, 1.5% would be acceptable. Now, going back to your earlier question on those two metrics, if you go to the slide no. 5, we have captured the metric there. The members per sangam manager as of now are 477, so the optimum level could go up to 600. The stretch case would be 750, but we do not want to go out there, 600 could be easily achieved. If you look at the portfolio outstanding per sangam manager, that number is Rs.26.83 lakhs as of March end and that could go up to Rs.40 lakhs.

Vikram Akula: Then what is the control in terms of credit costs. Keep in mind that this year we are focusing on our existing customers, and we have a track record with them, some one year, some as much as seven or eight years. So we are able to be in a position where we can be more carefully focused on those customers versus doing a lot with new customers, those who do have a demonstrated track record. This is the way that we can, control credit cost to have a better handle on the credit cost than in a hyper growth mode.

Pankaj Chopra: You have initiatives which are non-micro finance oriented if I may, the gold loans and the home finance and the retailing businesses etc. Do we think that because these themselves would need some level of management bandwidth and may be whether we can call them a proven business model How confident are we that these will kick through and we have a scalable part in the overall portfolio to add that couple of extra ROA points.

Vikram Akula: A strategic way in which we think about this is, the three products that we were thinking about sort of expanding in terms of diversified portfolio are products where we do have a demonstrated track record. When we do a pilot, for us the pilot is already a fairly large scale. If you take mobile phones, we have already financed 3.7 lakh handsets. Now for us that is a pilot, but it is indicative of our ability to do this in a demonstrated way and only then do we take it to a roll out. The gold lending for us is new. In five branches the pilot is going on, but clearly it's not a new business. Likewise with the third area, the Kirana store lending, retail lending that is something that we have been spending a lot of time over the last couple of years perfecting the pilot. The pilot was at something in the range of 3,800 stores and now we will be adding 16000 stores. But the point is that we pick these three because this is where we have had success. In areas where we have not been successful, we have decided not to roll those out. So we are seeing when we take the three, these were the ones we really are confident of and the ones that have not gone past pilot phase are ones we say may be those are the things that for management bandwidth or expertise we hold off on.

Dilli Raj: Fortunately it's the same set of customers, to start with.

Pankaj Chopra: What I sense is that the common thread seems to be the income generation and the mobile phone's part does not seem to be that. Would that be a correct assessment? I mean that is something, which stands out.

Vikram Akula: See from a regulator perspective yes, it is not an income-generating loan, it would not fall in the qualifying assets. The regulator allows for 15% non-qualifying assets. Having said that, if I step out of the regulatory framework for a moment and take a general view of mobile phones, particularly in rural areas, the data suggests that there is a correlation between increases in income and adoption of mobile phones. This is because obviously low income households in rural areas do not have the flows of information. If you put in a mobile phone, whether it is access to prices or discussions with customers or suppliers, they are in a better position to do so. So we certainly think that there is a benefit from income-generating activity though you are correct that the regulator does not view that and ultimately we will account for it accordingly.

Pankaj Chopra: Fair enough. Thank you. That is it from me.

Moderator: Thank you. The next question is from the line of Rudy G. from Fidelity. Please go ahead.

Rudy G.: Thank you for taking my question. The first one was really on the approach that you are currently taking towards solving this issue in AP. I think historically if you see companies that have got into some kind of regulatory strife, it always tries to convince and manage the state government, the regulator, whoever be the case. In this particular instance, it seems like you have, over a period of time, taken a very defensive view of the whole thing and even in the last call and in this call you seem to be suggesting that what RBI is doing really is what matters and what the state government is saying has absolutely no value. So just from a philosophical perspective, I know you are trying your best to deal with the AP government, but do you think in hindsight this is the right approach to take given that rs.1285 Crores is locked up in AP?

Vikram Akula: I would start by saying that we have made a tremendous effort to reach out to the state government both in terms of politicians as well as bureaucrats and we have a very healthy dialogue with them. But it just happens that on some substantive areas there is a difference of opinion that is hard to get to a situation where you can build consensus although we continue to strive to do so. Our view is not that there has to be a choice between private sector and public sector i.e., state government driven finance for finance inclusion, but that the private sector can play a complementary role. We have no misapprehensions that we are trying to replace the state, at best we will complement the state. We are hopeful that we will be able to convince the state government over time and more so that ultimately our customers who we feel are being deprived of finance that their voices will be heard. So perhaps it does not come out as clearly. Our approach has been multi-fold. When we turn to the RBI, it is not so much that we expect the central regulator to step in and play sort of the big brother, but simply to say, the central regulator is there for a reason. There is a logic to having an independent regulator and we think that the guidance the independent regulator gives should be taken very seriously by the state governments. Certainly the state government is a sovereign entity and has the right to regulate those within its jurisdiction and we have fully complied with the state government. That is the approach we have taken, but I will take your question as one of guidance as well, which is that perhaps we need to publicly articulate this approach a little bit more holistically than comes out some times.

Rudy G.: I guess my second question was really to Dilli, because he has managed and seen through a lot of these NBFC crises before, which is, given this AP issue has gone on for so long, how much of this Rs.1,285 Crores do you think, irrespective of what happens with MCR and the state government, is now basically dead money?

Dilli Raj: Basically, the point is we say that incremental lending we are not able to do, that is what is holding up the collection. Now, as time passes the question we need to answer is, even if you resume, how much of that will come back. For that, the primary aspect is, has anything changed from the customer's perspective? The answer to that is nothing has changed.To give you some hard data, in H1FY11 the MFIs in AP put out Rs.5,035 Crores, that number in H2FY11 is Rs.8.5 Crores. If you look at the banks, the AP government and others felt that once MFIs cannot lend, the banks would step in and meet that credit demand, but if you really look at the off-take, it is Rs.2,400 Crores in H1 and that number for you in H2 is Rs.300 Crores. Simply said, something like Rs.7,000-Rs.8,000 Crores of rural credit demand has not been met in AP and they remain very much as it is. So, the basic fundamental business case for MFI is not lost and if you were to resume lending, the promise of the next loan is intact and you know that would help us to recover the money.

Rudy G.: Thanks a lot and good luck guys. I think this is obviously a challenging environment, but I am sure you guys know best. I am sure everything will be okay. Thank you very much for taking my questions.

Moderator: Thank you. The next question is from the line of Dhaval Gala from Birla Mutual Fund. Please go ahead.

Dhaval Gala: Thanks for taking my question. I understand that our AP portfolio outstanding is Rs.1,280 Crores?

Dilli Raj: Rs.1,285 Crores.

Dhaval Gala: What would be the proportion of the current outstanding loan book as on date?

Dilli Raj: Rs.4,111 Crores.

Dhaval Gala: So this 1285 Crores is both on balance sheet and off balance sheet included?

Dilli Raj: Absolutely.

Dhaval Gala: What would be the receivables, which would be outstanding on this Rs.1,280 Crores?

Dilli Raj: This Rs.1,285 Crores takes into account the over dues and future receivables. The over dues are Rs.665 Crores and the rest of them are future receivables. They have not yet become due.

Dhaval Gala: So roughly 65% is something which is future receivables?

Dilli Raj: 52%.

Dhaval Gala: Sir, what would be the provisions which you would be having on your AP portfolio and the amount which is written off purely in the AP portfolio? Is it something what is done only in the fourth quarter or the entire year FY'11?

Dilli Raj: It has been throughout the year. If you go to the investor presentation, look at slide no. 12 and no. 13 we have given the breakouts for these numbers for AP and non-AP.

Dhaval Gala: But I think that are only for the fourth quarter?

Dilli Raj: Both for the year and fourth quarter. I can give the numbers to you. If you just look at the AP portfolio, for the fourth quarter alone the total debit is Rs.137 Crores and for the whole year it is Rs.210 Crores.

Dhaval Gala: Rs.210 Crores that is the amount written off?

Dilli Raj: Total, when I say written off, there are four parts to it. What we mean by credit cost, as I said earlier, has got four integral parts; one is the income reversal, second is provisioning, third is bad debts written off, and fourth is loss on short collection on assigned loans. That for Q4 on AP portfolio alone is Rs.137 Crores and Rs.210 Crores for FY'11 as a whole.

Dhaval Gala: The income reversal what you are doing is basically from the topline that is the NII line, right?

Dilli Raj: Correct.

Dhaval Gala: Okay. Thanks a lot. That is it from my side.

Moderator: Thank you. The next question is from the line of Manish Choudhary from Citi. Please go ahead.

Manish Choudhary: I just wanted to check with you one thing that you talked about product diversification. But this product diversification, will it continue to be within the guidelines set by the Malegam Committee or could you go even further than that?

Dilli Raj: If you look at the MCR, we initially talked about 10% leeway and when it got notified, RBI has increased the leeway to 15%. So, if you look at the numbers, to start with it would be very much be within that 15% eligibility. If we are crossing that, then we need to look at a new structure.

Vikram Akula: I will just say in one of the three products - the sangam store, which is the Kirana Store lending, the primarily revenue driver there is a commission that we received from the wholesaler, in this case, Metro. The actual loan itself is an interest free loan, so our sense is that should still be within in the framework although we are going to get specific clarification once the MCR gets fully notified.

Manish Choudhary: Because there was some cap on the fee income side as well right?

Dilli Raj: That is why if you go back to that ROA slide no.16, some of the services you can do, some you cannot. For instance, membership fee is not allowed, but other products you can do. Another important point is the model. If you look at the revenue model in Sangam stores, we are not charging commission from our customers.

Manish Choudhary: That is true.

Dilli Raj: We are charging from the third party vendors and I am sure RBI is happy about it. Another thing on the loan outstanding on sangam stores is, it is designed as a working capital loan. The outstanding would be rolled over every 15 days. So, we are not really talking about huge outstanding of that.

Vikram Akula: And for those who do not know this product, the value proposition here for the Kirana store, the retail grocer is quite significant. Normally, the rural markets are so efficient so that mark ups by the time it gets to the village of Kirana stores are quite high. We are basically cutting out the middlemen and going straight to the wholesaler, allowing them to get a significant reduction in cost. Also, because we are getting the commissions from the wholesaler, we are able to give loan at a 0% interest. So, it is a huge value proposition to the Kirana storeowner and hopefully we expect that since commission is coming from the wholesaler to SKS, it will comply with Malegam Committee Recommendation.

Manish Choudhary: Second, I just wanted to understand this AP portfolio, the amount of NPLs that you have shown on this is, as of now based on the RBI recommendations. But if you were to look at the MCR on this, the amount of recognition of NPLs then have to become over dues and the provisioning required there also would increase substantially in the next quarter, is that right?

Dilli Raj: Our AP provisioning is more conservative than RBI norms. It is not that we have parked ourselves in the safe harbor of RBI on this portfolio. Point is that, if you look at income reversal of Rs.81 Crores, if we just merely go by RBI norms then you can take up to 180 days. So that piece we have not waited for 180 days. That has been completely reversed. It is only on the provisioning ageing norm we have said 180 days. Of course, we have taken some of the write offs and hits on the off balance sheet portfolio, which is not really recommended or advocated by RBI.. The real issue is, MCR refers to overdue installment, but that part of MCR has not yet been notified. So, we are waiting for that.

Manish Choudhary: In this income reversal that you have taken of Rs.81 Crores, this pertains to how much of the principle outstanding?

Dilli Raj: It is just interest reversal.

Manish Choudhary: This will basically be pertaining to the write offs and NPLs that you have taken, right?

Dilli Raj: No, on the entire portfolio.

Manish Choudhary: This will be on the entire AP Rs.1,285 Crores of AP portfolio?

Dilli Raj: Yes.

Manish Choudhary: This is till FY'11 whatever income you have recognized and not collected?

Dilli Raj: Because the issue started in FY'11 only.

Manish Choudhary: That is all. Thanks.

Moderator: Thank you. The next question is from the line of Suresh Ganpathi from Macquarie. Please go ahead.

Suresh Ganpathi: Just two quick questions; one is on West Bengal where the collections are down particularly beacuse of a particular district. Has there been any political issue ahead of elections due to which such problem has occurred in that district? Is that the reason? Secondly, on your product diversification strategy where you would obviously be confined to the 15% limit, how are you going to manage funding for that because you are not going to get PSL status for it? So, effectively may be bank funding may not be that easy to get for that part of the book, basically, so just some color on that would be great?

Dilli Raj: Suresh, basically the logic is that, to start with, even if 15% of your books are non-eligible assets, you will still get priority sector for the whole enterprise. So, 15% is a tolerance limit. Let us say you have a book of Rs.5000 Crores and Rs.750 Crores of that does not meet the parameters laid down by MCR. Still the whole enterprise would get the priority sector status because the idea of MCR and RBI is that, beyond a point money is fungible so long as there is a reasonable tolerance limit, let the whole enterprise access that. Having said that, even if you say that if you cross that 15% then what would happen is, in things like gold which is a secured portfolio, you could always securitize them and get funding. Of course, you would not get cheaper funding because if it is not priority sector, people would not pass on that reduction, but otherwise raising funds would not be an issue because at the end of the day it is on the balance sheet strength.

Suresh Ganpathi: The West Bengal front?

Vikram Akula: It is not related to the election. In fact we were pleased to see that both West Bengal and Tamil Nadu where one could have imagined some kind of a popular stance with regard to microfinance, that there were no electoral issues related to the problem that we had in West Bengal.. It was a very much a local situation confined to that particular district and as Dilli had mentioned, invariably we face these sort of outliers every so often, so last year it was in and around the Bangalore area, this year in a particular district of West Bengal and invariably you are going to face some kind of local political situation, but it was not related to an election stance of one sort or the other.

Suresh Ganpathi: One thing on this is, just a general question rather, to get an idea about what is the status of affairs with respect to money lenders. Because there is a perception among analysts that somewhere down the line, the money lenders are going out of business because of these private lenders and they indirectly are influencing the government to pass the laws and they have a vested interest to see to that these laws do not change because they are making lives much more difficult for you so that they can survive and they can make money in the overall scheme of things. I know this is a very sensitive issue, but what do you think, your perspective on this. Do you think this is really the issue and if that is going to be the case, it is really going to be a tough situation to change considering how India has operated over the past several years?

Vikram Akula: The data on this is clear that for example, when we hear from our borrowers in Andhra Pradesh today, and we are in regular touch with them, they are not shutting down their micro enterprises. They are going to moneylenders and borrowing at much higher rates. So clearly that is an element. I do not want to say that is the only element, a complex set of political economic factors has driven what has happened in Andhra Pradesh, but clearly moneylenders would be a part of that. Having said that, I am actually hopeful that change can occur. I think, people want to do something different, and I think recent movements against corruption in India show the popular sentiment. But we do not see it necessary in the news, reports what happens in rural India, I think there is an equal desire to see a change. So, I am actually hopeful that we have reached a tipping point in rural India just as we are beginning to reach a tipping point in urban India as well.

Suresh Ganpathi: Has anybody from the highest levels of Andhra Pradesh government given you any kind of indication that they are just willing to reconsider this AP act to be revoked or is that simply talks which are going indefinitely?

Vikram Akula: We do understand that politically it is difficult in the current context to make a bold statement and we understand why some politicians may be constrained to make public statements, but privately we continue our dialogue with them. It is a healthy dialogue. We continue to work with the bureaucrats as well as with the politicians and we are hopeful that there will be a resolution that works for our customers.

Suresh Ganpathi: Thanks so much Vikram.

Dilli Raj: Suresh, just one point. It is not that at this stage one is looking for revocation of the act. By now, we have learnt to live with that. Initially there were so many apprehensions, but if you look at registration, data supply, all that it is not a problem for us. Just one issue is, the ability to disburse incrementally has been taken out by a particular provision, section 10, where every single credit application has got to be cleared by a particular government office. That is the only thing. If that were to change, it is fine with our customers and us.

Suresh Ganpathi: But fundamentally also, you were saying that if you are moving from a weekly to a monthly payment, considering these are poor people, the money does not stay in hand for a month, so even on fundamental terms it could get affected, if it remains on a monthly basis, right?

Dilli Raj: Basically what would happen is, even in MCR and RBI has said, choice should be given to the consumers. Finally that has to be weekly or fortnightly as they choose. But the real issue is incremental disbursement.

Suresh Ganpathi: Okay, fine thanks so much.

Moderator: Thank you. The next question is from the line of Shrey Loonker from Reliance Mutual Fund. Please go ahead.

Shrey Loonker: Vikram, you mentioned in your opening remarks that all the lack of funding that has been happening for the last six to nine months in the AP segment, has not been met by anyone else.Just two clarifications there; one, have not the moneylenders filled that up? Second, if not then was it ever a need base financing earlier?

Vikram Akula: Sure, this is of course very hard to get data, but I will give you the data that we do now. If you take the six months in the second half of the last fiscal year, compared to the first six months, we know in the first six months the MFIs in Andhra Pradesh had disbursed Rs,5,035 Crores. We know that in the second half of the year the same MFIs disbursed Rs.8.5 Crores. We merely know that there was a gap from the MFIs. Now whether that was filled up by moneylenders, pawnbrokers, again is very hard to get data, but clearly from our customers we are hearing that now they are going to moneylenders. When I say moneylenders, I am not talking about formal pawnbrokers and moneylenders, but informal sources where they are paying 4% borrowing against gold, 5% borrowing against silver and this is what we hear from them. So our sense is that some of the gap is being filled by these groups at higher interest rates, some of it is completely being unmet, so I think it is a combination of these two things. Now having said that, to your second point of your question, it is true that may be some of the Rs.5,035 crores that have been lent in the first half was not exclusively for income-generating activities, and I say that because we cannot control a lot of the newer competition that have come into play in recent times. But I can say that we do extensive loan utilization checks and ensure that a loan is used for productive purposes. But there is a pool that may not have been for productive use that may have been lent by other microfinance companies who have recently come into the sector.

Shrey Loonker: Second I just wanted to get some sense on the cost of operations of 9.5%. Will that remain at 9.5%? Would that be a fair estimate even after Malegam Recommendations are instituted and probably when the situation stabilizes may be a year or two down the line?

Dilli Raj: I think the 9% number we have talked about in the template is saying that in a year or two we could achieve once we grow the portfolio, in percentage terms. But if you are looking at two-years timeframe and especially in the context of MCR, I do not know whether Vikram referred to that point earlier, also if you are looking at a consolidation, which is anyway there, because you are becoming something like SBI or ICICI of microfinance. So the cost of client acquisition is going to come down and with that if you increase the ticket size, that would be another driver to bring down this operating cost, but it would be fair to assume that over a period of two to three years definitely this number can be further brought down to somewhere around 7.5% to 8%.

Shrey Loonker: In the illustrative ROA tree that you have given, there seems to be a margin and spread implication of 16.5%. That is very different from 12% as prescribed. How would that impact your ROAs?

Dilli Raj: In fact if you just come below the table there are two notes where we are saying if we just go with 12% margin cap and disregard this entire interest rate cap, then the ROA would be 3.6%, because the processing fee 2.1% is outside that.

Shrey Loonker: Great. Thanks Dilli.

Moderator: Thank you. The next question is from the line of Jyoti Kumar from Spark Capital. Please go ahead.

Jyoti Kumar: What is the frequency with which you are conducting your meetings in AP currently - the sangam meetings?

Dilli Raj: Sangam meetings are conducted on a weekly basis. It is just that the APMFI act says that the periodicity of the loan repayment could be monthly, but there is no bar on customer interaction on a weekly basis.

Jyoti Kumar: So what percentage, is it almost 100% of the meetings are conducted? Is it a fair assumption?

Dilli Raj: No. We do not have the data right now readily, but we can send it across to you, but itis not 100%.

Jyoti Kumar: Would it be significantly lower, a broad sense, even if it is a 50 or 60?

Dilli Raj: Along that line. Definitely not 100%.

Jyoti Kumar: For the rest of the places of the places is it a concern because local politicians do not allow you to come in or how good is the dynamics there?

Dilli Raj: I think that part is behind us, but I think if you are not incrementally disbursing the loans then what is the motivation to keep coming week after week. So that is the thing. The moment we resume lending, that is why we are saying that the ratio could drastically improve.

Vikram Akula: To give you a data point, in the places where we have disbursed 1600 loans, you see an immediate spike in subsequent weeks in terms of both attendance as well as repayment. Now unfortunately we have been unable to continue that lending which is why it has not been sustained so that is the data point that suggests that once you start lending, actually attendance and then thereafter repayments will increase.

Jyoti Kumar: Fair enough. Thank you.

Moderator: Thank you. The next question is a follow up question from the line of Shrey Loonker from Reliance Mutual Fund. Please go ahead.

Shrey Loonker: If you can just give me a sense on the change on how is the average duration of the non-AP book tracking and the ticket sizes?

Dilli Raj: If you look at the Q4 disbursement off-take average and the loan outstanding, primarily it relates to the non-AP books. So that data is available. In terms of duration and maturity it is exactly 50-weeks. So the average maturity would be six months and the weighted average maturity is 4.8 months.

Shrey Loonker: Sorry, I just did not comprehend that the ticket size bit, how do I decipher that?

Dilli Raj: If you go to the operational highlights slide no.5, we have given the offtake average and ticket size. That in Q4 solely relates to non-AP because all the incremental disbursement was in non-AP portfolio only.

Shrey Loonker: How is that been behaving over the last few quarters? How is the weighted average duration moving? How is the ticket size moving?

Dilli Raj: The duration would remain the same, because we have not tweaked the door-to-door maturity of 50-weeks, but in terms of off-take average, it was Rs.10,620 for March 10 and in March 11 it has slightly increased to Rs.10,811.

Shrey Loonker: But the durations have not lengthened in the non-AP book?

Dilli Raj: No, because the point is the 50-week is a cookie cut.

Shrey Loonker: Thanks Dilli.

Moderator: Thank you. The next question is from the line of Jigar Walia from OHM Group. Please go ahead.

Jigar Walia: Good evening everyone. I wanted to understand that with the MCR recommendations coming in, there would be only two lenders for a particular borrower. How does one identify this or the operational aspects of it?

Dilli Raj: This was mentioned in the MCR document, but if you look at the final notification they have not been carried forward, because obviously there could be some implementation issue. As of now, that piece of regulation is not operative, but just to address your question, not just on this, even if you take the threshold income limit, in a rural area typically there would not be any tax return or anything. RBI and of course the sector is aware of it, so what RBI has articulated is, primarily the whole MCR framework or the new regulatory framework would revolve around three key principles; the first and foremost is self declaration, which would address this till institutional back up like Credit Bureau comes. Second is whatever they said would be prospective and if there are certain areas where you need to tweak it, they would give a transition time.

Jigar Walia: Other thing on this particular issue. Is there a possibility since as we have already seen that repayments and attendance happen when disbursement happens, so disbursement is a key to continuity in terms of business. So if a customer is going from five lenders to two lenders, so the other three lenders who he does not go to, those will have a bit of anNPA fructification risk?

Dilli Raj: It is true, because the promise of the next loan is important, but I think we need to slightly articulate that better, in the sense it is not that it is imperative that you give the next loan to the very same customer who has to pay this week. For her, what is important is, in that center, at least one of her colleagues should get the disbursement - that is the demonstration effect she is looking for. Because in our scheme of things, we can even give a loan to a new customer unless otherwise there is a six months cool off. So it is not that you go back and give the loan to the very same set of borrowers who have to pay you that week.

Jigar Walia: Other clarification was in the ROA tree. You said the 3.6% with a 12% margin cap includes 2.1% processing and other income. This would include the extra operating cost for that extra other income?

Dilli Raj: Correct.

Jigar Walia: That is inclusive and the 3.6% takes care of the cost to that?

Dilli Raj: Yes.

Jigar Walia: My last question would be regarding in terms of the gold loan that we have been doing. If you can say in terms of size, how are we doing about in terms of valuing the gold and a bit in terms of that operation?

Dilli Raj: Basically we have started the pilot in five branches and as you would readily agree, in our case the pilot is not really to vet the demand because you and I know that it does exist out there. More to dot the i's and cross the t's in your case, get your internal systems equipped for that. In terms of appraisal, we have just followed the same method whereby we have got specialized appraisers, not just our field officer who are specially trained to evaluate the gold.

Jigar Walia: Full time on our payrolls actually.

Dilli Raj: Absolutely. No external franchisees. Moving forward also, that is the model that we are looking at and in addition to that there would be a carat meter because in a ramp up phase what you are looking at is, even for instance can go up to Rs.9 lacs per branch of capital cost, a fully equipped branch with carat meter, safety walls, integrated computer systems, special vigilance and the whole works - that is the model one is looking at.

Jigar Walia: When we speak of unorganized market and moneylenders, these are typically all secured loans either with gold or land or crop or something like that. None of the moneylenders would be doing unsecured, generally.

Vikram Akula: While many of them would be secured in terms of land or gold, in villages especially, we do have labour relations that also sort of guides moneylender lending. It is hard to parcel the data and some of these things are sometimes combined and that would be another element. If there was landlord who employs people for agricultural labour, he is likely to lend to them as well. There is also all sorts of share cropping and arrangement tenure, lease arrangements that result in certain upfront lending as well. So it is a mix of these things.

Jigar Walia: Okay. Thanks a lot.

Moderator: Thank you. The next question is from the line of Raunak Agarwal from RBS. Please go ahead.

Raunak Agarwal: Sir, the RBI notification says the tenure of loan should not be less than 24 months if the amount exceeds Rs.15,000. How big is the segment for us and how does this specific provision effect the repayment behavior?

Dilli Raj: To start with, if it is a two-year loan, it conditions the repayment behavior better, because your EWI could come down. Instead of one year if you say two years then you are talking about a lesser EWI and I guess that is repayment positive for them.. We are working out the numbers on how much that would be, but our first cycle loans are typically less than Rs.15,000 at the enterprise. There would be outliers, but if you look at the enterprise off-take average, it is somewhere around Rs.10,800 to Rs.11,000. So you are looking at more of third and fourth cycle loans falling in this category, which you are talking about, more than Rs.15,000.

Raunak Agarwal: For the existing segment above Rs.15,000 what would be the average tenure of the loans we have on the books currently?

Dilli Raj: As of now all loans are for one year. So this would be a new change we would do.

Raunak Agarwal: Does that mean the segment automatically goes off the books as for the growth ahead?

Dilli Raj: No. The point I am making is all our loans till date are 50-weeks. Now in the new regime, if we are looking at third and fourth cycle loans and ticket size beyond Rs.15,000 we are not opposed to giving a two-year loan.

Raunak Agarwal: Second question, SKS has microfinance exposure to a borrower. Banks have similar exposure in the form of self-help groups. So a generic question is how is this portfolio of banks behaving in Andhra Pradesh specifically, just a broad comment?

Vikram Akula: They are also having repayment challenges in the state led sort of self-help group lending. There has been a spillover effect on that portfolio as well and part of the reason here is that from some politician, particularly opposition politicians, there are statements made that your loans have been waived, it is actually wrong statement anyway, but even then for a borrower to make a distinction between a private MFI like SKS microfinance and a PSU SHG loan, there has been spillover problem there.

Raunak Agarwal: All right. That was helpful. Thank you.

Moderator: Thank you. The next question is from the line of Shadab Rizvi from Darashaw & Co. Please go ahead.

Shadab Rizvi: Good evening. My question is regarding some developments in Andhra Pradesh. First is regarding the AP Government contemplating an NBFC of its own, so do you think that would be a challenge. And secondly, there have been some offers from some SHG that they are willing to repay the loans at 12% with the amount already paid being adjusted. So will you be open to that offer?

Vikram Akula: On the first part if the AP Government wants to start an NBFC, clearly we think that there is plenty of scope for a number of channels to provide access to finance. We are one channel, we will compliment those until this happens we would welcome that as another complement to meeting the existing needs. When it comes to an offer to repay with a reduced interest rate, today we are not charging additional interest on any overdue installments, so affectively we are simply asking for the interest and the principal that was due for a one year period, but if you were to collect those installments today, we have to do the math, but you are already much lower than 12% interest if we were to do that. So I would certainly entertain the offer. It seems to me that offer is probably higher than what we are even ready to collect, because we are just asking for the outstanding plus the installment interest that we are due for the one-year period.

Shadab Rizvi: But do you think that offer was one-off offer from one SHG that one is willing to make those repayments or is it a widespread offer that will be coming from the different parts of the state?

Vikram Akula: To start with, I would say that we have not received any such offer. We have read about it in the paper, just as you probably have. Second, the SHG federations are diverse groups that are often district specific and I do not think there is any kind of aligned offer among them. These are federations that are typically district wise, so sometimes even as low as block wise or mandal wise in AP and we will have to have discussions with individuals SHGs. So, until we get something formal, we cannot sort of entertain that kind of proposal.

Shadab Rizvi: Just one last question regarding provisioning as per the Malegam Committee Recommendations. I was just little curious to understand as to what would be the actual hit on the financial statements if you were to strictly adhere to the MCR?

Dilli Raj: If you talk about MCR, you have to provide 50% of the overdue installments beyond 90 days and they are not talking about future receivables but talked about overdue installments. If you look at the overdue installments more than 90 days within 180 days as of March 31, it was Rs.292 Crores. The number is starting from Q3 which we gave. If you take 50%, the total provisioning requirements would be Rs.150 Crores, but that is the overall balance sheet position. We have Rs.68 Crores on the balance sheet, so if you were to deduct that it would have been somewhere around Rs.82 Crores of the additional hit, but you will see that in Q4 we have taken much more than that in a tax efficient manner.

Shadab Rizvi: Thank you, so much.

Moderator: Thank you. The next question is from the line of Subramaniyam PS from Sundaram Mutual Fund. Please go ahead.

Subramaniyam PS: Good evening. My question was on the gold loan business that you plan to enter. Is there a risk that once you start doing the gold loan business, you might not be eligible to be classified as an NBFC MFI or would you be doing this out of a separate subsidiary?

Dilli Raj: As we said, if you look at the MCR notification they give you a leeway of 15% of the total book. As we speak, our book size is Rs.4,111 Crores so 15% is sizable number of Rs.600 Crores. You have the flexibility to keep it within your enterprise so long as you do not cross this limit. We may have to walk the path of subsidiary as and when we cross that limit or if the plan is that if you are confident about crossing that then you can look at a 100% subsidiary approach.

Subramaniyam PS: Secondly, on incremental asset quality trends that we might see or incremental NPL additions that we might see based on what is happening even during the current month, where do you see these numbers stabilizing at?

Dilli Raj: As we said, except AP we do not see any surprises anywhere else and if you look at the gross NPA coverage ratio we have got 48%, so it really relates to this one portfolio of AP.

Subramaniyam PS: Are all the loans where you are not seeing receivables coming through classified as substandard already, have they been recognized as gross NPA or do you think there are some more loans that are yet to be recognized as NPLs?

Dilli Raj: Basically as I said, out of Rs.1,285 Crores the over dues are Rs.665 Crores, you have some future receivables. The remaining Rs.620 Crores is yet to be due. Once MCR is notified on the provisioning side that is the real clarity that we are seeking from RBI, because if you look at just RBI norms of 10% provision, then the additional hit could be somewhere around Rs.125 Crores, net off the Rs.68 Crores on the balance sheet. But we need to wait and see what else they would dictate.

Subramaniyam PS: Okay and thirdly on growth per se do you think it is the right time now for you to start talking about or looking at growth or would you still wait for some more clarity to emerge?

Dilli Raj: Definitely I think as and when we start getting funding from the banks, we did access incremental debt of Rs.823 Crores for Q4, but our assessment is that this flow would be substantially increased because some of the banks were waiting for the MCR notification. There is really no issue about the AP portfolio because they know that we have a very strong networth and basically AP exposure is a fraction of that. So the concern is not on that. The concern is what would be the new regulatory regime because the model MCR talked about banks funding and monitoring this. They talked about a four-pillar approach. Banks monitoring the MFI business was the key pillar of the regulatory framework and in a way that made the banks wait for it. Now that that notification has been done and most importantly it is further liberalized from the initial MCR report, I do not see that as an issue. Once banks come,we should not talk about growth on the non-AP portfolio.

Subramaniyam PS: So what plans do you have Sir for growth for FY’12?

Dilli Raj: I think on the non-AP portfolio at least, we would target to grow the book by 50%.

Subramaniyam PS: Thanks Sir. That answers my questions.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the floor back to Dr. Vikram Akula. Thank you and over to you Sir.

Vikram Akula: Thank you everybody for taking time to listen to us. I will conclude by saying the six months of the last fiscal has been an extraordinarily challenging time for us and we have learnt a great deal about the sector and about how better to make people aware of what we are doing. In some ways the process, while challenging for us, has been good because I think it has led to a certain cleansing that has happened in the sector. May be unscrupulous, irresponsible lenders have now stayed away from microfinance and even in places where we may have had some process lapses we have done some introspection and made sure that our own processes will become tight. While it has been challenging, we are confident that the worst is behind us and while this year will be a year of consolidation as we comply and start these new lines of business, the future is much brighter. What also makes us emboldened to solve these problems is that what is at stake here is much more than the future of just one company, it is much more than the future of just one sector. It is about whether the idea of economic opportunity is there for everybody in India or for only some in India and we are hopeful and confident that what people want is the idea of economic opportunity should be for all and not just for some.

Dilli Raj: I just would conclude by saying that near term pain, medium term positive, long-term extremely bullish. Thank you.

Moderator: Thank you Sir. Thank you, members of the management. On behalf of SKS Microfinance Limited that concludes this conference call. Thank you for joining us.