"Piramal Enterprises Limited Q1 FY23 Earnings Conference Call"

July 29, 2022

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Moderator: Ladies and gentlemen, good day and welcome to Piramal Enterprises Limited's Q1 FY23 Earnings Conference Call.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Hitesh Dhaddha – Chief Investor Relations Officer from Piramal Enterprises Limited. Thank you and over to you, Sir.

Hitesh Dhaddha: Thank you everyone. Good evening. Hope you are safe and in best of your health. I am pleased to welcome you all to this conference call to discuss Q1 FY23 results. Our results materials have been uploaded on our website and you may like to download and refer them during our discussion.

The discussion today may include some forward-looking statements, and these must be viewed in conjunction with the risk that our businesses face.

On the call today, with us, we have our Chairman Mr. Ajay Piramal; Ms. Nandini Piramal – Executive Director, Piramal Enterprises and Chairperson, Piramal Pharma; Mr. Khushru Jijina – Executive Director, Financial Services, PEL; Mr. Jairam Sridharan – MD, Piramal Capital & Housing Finance and Mr. Vivek Valsaraj, CFO of our Company.

With that, I would like to hand it over to our Chairman, and I would request him to share his initial thoughts.

Ajay Piramal: Good day. I really appreciate that all of you have joined us today. I know that today seems to be the busiest day for all meetings and there are several meetings going on simultaneously. So, what I'm going to do is to make a very, very brief statement and I will leave much more time for you all to ask questions and for us to respond to them. However, if there's any more details you want, please don't hesitate to ask that.

Performance for the first quarter:

Revenues have grown by 22% over the previous year in the same quarter and now stand at Rs.3,548 crores. In this, Financial Services grew by 33% year-on-year and Pharma revenues have grown by 9%. Our net profit stands at Rs.486 crores for this quarter.

Demerger of Pharma and Simplification of Corporate Structure:

The main thing this quarter is that over the last few quarters we have taken several measures to prepare both our Pharma and Financial Services businesses to emerge as two separate listed entities. In the first quarter of the current year, we made further progress towards achieving this goal. We have received consents from RBI, SEBI and the stock exchanges earlier in the year. In July, we received clearance from our shareholders and creditors and earlier this week, we also received the RBI approval for the NBFC license for PEL.

We are now on track and the demerger and the listing of Piramal Pharma is expected to get completed by the third quarter of this year, subject to, of course, a few remaining approvals. Also, as we are moving towards two separate listed entities, we have been enhancing our disclosure both in Financial Services and Pharma businesses over the last few quarters.

Financial Services:

In Financial Services, you might recall that we had categorized the transformation journey of our business into three phases.

We've completed Phase-I and II of this transformation journey. We stated during the last quarter that this journey has achieved a major portfolio transition as well as significant growth through the acquisition of DHFL.

Our AUM grew 37% year-on-year to INR 64,590 crores with retail AUM growing 4.3x year-on-year to a high of INR 22,267 crores. The share of retail loans has also increased to 37% from 12% as of June 2021.

As part of our transformation journey, we've also hired key top-quality senior talent to ensure that we have a best-in-class team to help us build a large diversified Financial Services Company.

We have Mr. Jairam Sridharan, Mr. Rupen Jhaveri, Mr. Kalpesh Kikani, Mr. Yesh Nadkarni, and Mrs. Upma Goel, all with rich experience in their areas of specialization joining us. Mr. Khushru Jijina has retired from our Company but will continue as a senior advisor to the Group.

The Phase-III of our transformation journey now begins. We have put in place all the appropriate levers for improved performance in the future and this has started reflecting in the operating performance of our business during the quarter.

I am not going to speak a lot about the businesses whether retail or wholesale and will be happy to answer any questions that you have.

Pharma:

I would like to just cover the Pharma business.

The Pharma business grew 9% delivering revenues of INR 1,485 crores. While the India Consumer Healthcare and Complex Hospital Generics businesses grew 17% and 10% year-on-year, the CDMO business delivered a moderate growth of 8% year-on-year due to some execution related challenges and changes in order delivery schedules.

The business broadly delivered in line with EBITDA margin at 11% during the first quarter versus 12% in the same quarter last year, despite moderate growth in our CDMO business, an increase in the raw materials, packaging materials and operating costs.

As we have mentioned earlier, the nature of our Pharma business is such that we generate significant part of our profits in the second half of the financial year. Last year, the second half contributed nearly 70% to our profitability.

With this, I am going to now leave the floor open to your questions and will address them and any other issue that you have.

But in conclusion, I would like to just say, that with a strong balance sheet, the uniqueness of business models, and focus of our teams on delivering towards our strategic priorities, I believe that both the emerging listed Financial Services and Pharma companies are well-positioned to create long-term value for our shareholders. Thank you.

Q&A Session:

Moderator: Thank you very much, Sir. We will now begin the question-and-answer session. The first question is from the line of Tushar Manudhane from Motilal Oswal Financial Services. Please go ahead.

Tushar Manudhane: Thanks for the opportunity, sir. Firstly, on the overall Pharma, typically, you shared the overall revenue guidance from like two years. So, if you could share the similar number for FY23-24?

Vivek Valsaraj: Tushar, considering the overall volatility in the situation and as we have mentioned that there are certain execution issues also, which we need to fix. We are in the process of revisiting this and at this point in time, we would not like to give a guidance for FY23.

Tushar Manudhane: Sir, considering the new API plant in Canada where the initial production run has already started and upgrading of oral solid dosage capabilities, what kind of asset turn and what can be expected from these facilities?

Vivek Valsaraj: So, the investment that we have done in our CDMO facility at Canada has given us about 35% additional capacity, whereas we've got about 1.8 billion tablet capacity at our facility in Pithampur. So, both of them have been augmented keeping in mind the kind of requirements that the customer has, and we expect that over the next couple of years, we should be able to adequately utilize these capacities.

Tushar Manudhane: And just lastly, there has been good number of projects in the Phase-III, particularly in the CDMO. So, is there any kind of outlook by the customers to build up the product for the commercial part while typically in the development phase, the capacity required is very small? But as the product advances on the commercial side, so is there any kind of orders which gives the confidence of extending the development work to commercial manufacturing?

Vivek Valsaraj: So, it's an ongoing process and the kind of capacity expansions that we are doing now as well as what we propose to do in FY24 is keeping in mind what could be some of these requirements that come up. So, as you're aware that we are doing investments at most of our facilities, which offer these kind of niche capabilities and that's kind of keeping in mind the customer's requirements. So, yes, while it's difficult to put a number to it, we have kind of augmented capacity to be able to serve it as and when required.

Moderator: Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: On the pharma side again, I understand last time you gave some revenue guidance of mid-teens to high-teens, but margin guidance given volatility you had avoided. Would that be correct, or you are rethinking about it?

Vivek Valsaraj: So, as I mentioned, the situation is a bit volatile and given the tough start that we have had to our CDMO business, we are reassessing. There are a few things that we need to fix and therefore, at this point in time, we are not really giving a guidance for FY23. But having said that, our long-term guidance still remains as we have maintained and there's no change from a long-term guidance standpoint. For the short-term guidance, we should come back later.

Prakash Agarwal: Understand, but if you could give more color like what are the issues you're facing at CDMO? Is it supply chain? Is it renegotiating contracts, suppliers, or buyers? I mean, just some color would have helped.

Vivek Valsaraj: So, there are few issues, but I'll highlight the ones which are more pertinent. As you're aware, during the pandemic, we had significant attrition at our overseas sites. Being able to get the talent, fill up these vacancies, and train those employees and get them productive take some time and these are like maybe critical positions which are required for day-to-day operations. So, we are in the process of staffing and training our people.

And second is some of our customers also changed the phasing. What was supposed to be delivered in Quarter 1, they requested that to be pushed out into the subsequent quarters within the financial year. So, both of these have been the most pertinent reasons for us to kind of have some challenges in executing versus our plans.

Prakash Agarwal: There was one more product which was due for USFDA approval. Where are we in that?

Vivek Valsaraj: Sorry. Are you referring to Desflurane?

Prakash Agarwal: Yes.

Vivek Valsaraj: So, no, as of now the status remains the same. We don't have an approval yet. While we have launched in the other markets, the situation is the same as early as this is concerned.

Prakash Agarwal: We were expecting calendar '22 or '23?

Vivek Valsaraj: No, it's difficult to say that actually. It wouldn't be coming in this year at least. I don't think it will be coming in this year.

Moderator: Thank you. The next question is from the line of Prasheel Shah from CapGrow Capital. Please go ahead.

Prasheel Shah: So, in the previous quarter, we had moved some non-real estate exposures to Stage-2, about Rs. 2,300 crores and in this quarter, there were some slippages from Stage-2 to Stage-3. So, are we talking about the same accounts or there is still some stress left in that Stage-2, which was moved, sorry, which was moved to Stage-3 in this quarter?

Jairam Sridharan: There is only one account that has moved to Stage-3 during the course of this quarter. There were a few accounts that moved to Stage-2 in the last quarter and one of them happens to be this.

Prasheel Shah: So, it's slipped to Stage-3 this time?

Jairam Sridharan: Yes.

Prasheel Shah: And on the retail business, we have disbursed this time about Rs. 2,500 crores. So, what would be our focus among these four to five business segments? What would be our focus three years down the line? What products are we mainly banking on to grow in three years? What will be our NIMs and what is the PPOP that are you targeting?

Jairam Sridharan: There were few different questions there. See our core business in retail, or the anchor products, are going to be housing and MSME lending, particularly secured MSME lending. So, those are going to be our two anchor products. So, you should expect from a book composition perspective housing to be maybe a little under 50% at the overall FS-level and MSME to be a little under a quarter of the book. So, those are going to be the big anchor products.

Then there is going to be a category of products which are unsecured in nature, right. And there will be three or four different form factors there. It could be digital unsecured, embedded finance or it could be personal loans which is branch distributed. It could be microfinance. It could be a few other form factors, but unsecured lending. We should expect that to be little over 20% of the book in the end-state. So, I hope you heard the answer that I was talking about portfolio composition, ~45% housing, 20-25% MSME, about ~20%unsecured and whatever is left will be the other secured lending products. So, that's the composition that we are targeting.

Overall, at an FS-level, we believe the kind of business that we are building two-thirds retail, one-thirds wholesale, multiproduct retail with the composition that we just spoke etc., this type of a business we believe should be able to deliver a high-2s to low-3s (%) kind of ROA. So, that's where I would leave it instead of going into individual line items or the PPOP levels.

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

Vivek Agarwal: Thank you for the opportunity. Sir, although you don't give any revenue guidance, is it possible for you to share any color on the investment, especially in the CDMO injectable space over the couple of years?

Vivek Valsaraj: The question was regarding the CAPEX investments in the business?

Vivek Agarwal: Yes. So, what is the overall CAPEX that you are planning over the next couple of years and in which areas actually, if you can clarify?

Vivek Valsaraj: So, our investment plan for FY23 and FY24 is about $200 million per annum. So, in the mid-term we are stepping up our investments to create capacity. This include expansion of our antibody drug conjugate capacities at Grangemouth, high-potent API capacities at Riverview, and we are also looking at increasing capacities for our API facilities in India and for potent-injectables at Lexington.

Vivek Agarwal: So, overall, $400 million you are planning over the next couple of years.

Vivek Valsaraj: Correct.

Vivek Agarwal: And sir, on the Desflurane is widely talked about for us, but would you like to share the number of new products introduction in the injectable space for the next year, for the next FY23 and FY24?

Vivek Valsaraj: Yes, we have indicated a pipeline of about 40 products. They are on the presentation in terms of the various stages at which they are. You can please refer to page #45. The details are there.

Vivek Agarwal: That I will do. And finally, sir, one thing I just want to understand, why the revenues in CDMO space are relatively more skewed towards second half, if you can clarify?

Vivek Valsaraj: So, it's slightly difficult to put a finger as to exactly why they are skewed towards second half. There are multiple reasons. It depends upon the overall phasing of the customers' requirements, which has been over a period of time and also the kind of time period required to kind of being able to from the time we received the order to be able to deliver, it gets skewed towards the second half. So, it is just way the orders have been historically.

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

Abhijit Tibrewal: I just wanted to understand, I mean, like in this quarter we have quoted that we have launched the MFI business through the BC model. Not sure if we have in the past suggested that we are looking to enter the MFI segment as well. Just trying to understand, what are the other newer products lines that we are looking to enter, because I'm not sure that somewhere I heard from someone that we will also enter into gold financing now, through a partnership with a Gold-lending fintech. So, what are other newer product lines that we will try to enter? And the other related question here is are we not trying to spread ourselves too thin, too fast into newer product lines for this, I mean, over 20% of the book that we talked about digital embedded finance, personal loans, MFI and some of the other unsecured lending products? So, that is my first question.

The second question is more on this wholesale account which you suggested that moved from Stage-2 to Stage-3. If you can just give some color what was the quantum, what was the nature of the account and what kind of led to this slippage from Stage-2 to Stage-3?

Lastly, on this Wholesale Lending 2.0 strategy, I don't know, in our Wholesale Lending, 1.0 strategy, we clearly acknowledged that perhaps it was not in the best interest of the company and which is why we decided to run it down and decided to make the book a whole lot more granular. Now that we are again building on a wholesale piece, understandably in mid-market residential products, much lower ticket sizes – do we have that confidence that this time around wholesale lending will be much, much better than what we did in the Wholesale lending 1.0? Those are the three questions.

Jairam Sridharan: Thank you Abhijit for your questions. Your first one was around product strategy in retail. The intent, Abhijit, very much is to build a diversified portfolio in retail. Our belief is that through the cycle for you to build a resilient book which can perform well across various risk cycles, it is important to have adequate level of diversification. Portfolios that are dominated by a single product, we believe, are going to be more fragile through the economic cycle. And hence, we've been quite clear that we will continue to build a diversified book.

Now we are still at the stage where we will experiment with a lot of different products. You mentioned gold, for example. It is at a very, very low-key experimental level. I won't actually talk very much about it. We've barely done a crore of business in that partnership. So, we will try a bunch of different things, see which have adequate traction in the market and just scale on those things. Microfinance, we felt good about the feelers that we were getting in the market and how early experiments panned out. So, we are scaling that and hence we made that announcement during the course of this quarter that we are committing to that business and are moving forward.

In terms of what's next in the other big business which we have chosen to commit to, we haven't actually started the business yet. So, you should expect to hear about next quarter is a branch-led personal loans business. So, unsecured, salaried segment lending done out of our branches. That's the other business that you should expect to see. Apart from that, we don't have any major plan through the rest of the year. There are a few different experiments. You spoke about gold. Yes, that is something that we are experimenting with. We will experiment a little bit with loan against securities etc. But those will be very, very low scale just for us to learn something so that we know whether they are worth building out in the coming years. So, that's your first question.

Your other sort of question 1b, which was around execution risk of trying to do a lot of different products at the same time. This is a very good point, Abhijit, and it's a really good risk to keep in mind. We are super aware of the fact that execution on multiple product lines is not easy. It requires specialized skills etc. Thankfully, we have a fairly strong team with a very broad set of experiences and once something clears our experimental hurdle, then we are willing to commit to it by getting industry experts in and hiring the right people who will be able to lead some of these business and as you have seen over the last year and a half, as we started MSME lending first and then used car financing and now microfinance etc., while it seems like a lot is going on, but essentially, we are launching one major product every six months or thereabout. So, I think that pace is a pace that we can take from an execution risk standpoint and we feel pretty comfortable with growing that out.

The next set of questions you had was about the account that moved from Stage-2 to Stage-3 of the wholesale book. You might recall that there were some challenges that we have been facing in the non-real estate wholesale portfolio. It was 13% of our portfolio last quarter. It is now at about 12% of our portfolio, but one of the accounts in there was this quarter migrated down to Stage-3. The ticket size of the account was low-INR 100 crores. So, that was the size of the account that moved. Not much more to say. It is a non-real estate account had been facing payment challenges. The account continued to age from Stage-1 to Stage-2, and then it aged further into Stage-3 as it went past 90 days.

Abhijit Tibrewal: On the Wholesale lending 2.0.

Jairam Sridharan: Yes, Wholesale 2.0. See, again, good question on execution ability and confidence on executing it well. As you have seen so far, under wholesale 2.0, there are two parts to it, the real estate part where we have not yet done disbursements. We are at the stage where we are evaluating about INR 600-odd crores of worth of deals. We will see when we make our first disbursement etc., then there is a mid-market stuff, which is very low-ticket size like INR 50-odd crores ticket size business, where we have over the last six to nine months disbursed a total of about INR 650 crores.

So, as you can see, we have been very slow and deliberate about the way we are building this. We are not going to rush into this. You are not going to see us disburse thousands of crores all in a hurry. We recognize that the business that we are attempting is different in nature than what we have built in the past and hence requires different approach.

Internally, from an organization's structure perspective as well, we have built a different org structure where we have moved to a more traditional lending type architecture, where we have a separation of coverage team and credit team and we have an oversight from a risk team on top. So, the so-called three pairs of eyes type of architecture for underwriting as opposed to the two pairs of eyes architecture that we have had in the past, right. So, that org structure also needs some time to get adjusted and settle in. So, we recognize that all this takes time and we are in no hurry. So, will be very careful and very deliberate and we will keep looking at signals from the market in terms of how this strategy is panning-out before we hit on the accelerator too hard.

Abhijit Tibrewal: If I can squeeze in just one last question, are we in a position to now answer whether all this unsecured loan portfolio that we are building, will it be housed in the listed NBFC entity?

Jairam Sridharan: I think you will see a significant part of it being housed in the listed NBFC. Not all of it. Remember that regulatorily, the housing finance company, which is the subsidiary has to predominately house assets which are related to residential housing. So, we will stick to the commitments that we have made to the regulator in terms of portfolio composition in NBFC versus HFC.

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

Kunal Shah: Sir, firstly, with respect to this provisioning, so, again, on Stage-2 assets that is some provisioning which is done of almost INR 300-odd crores, and I think maybe from the slippage, as far as slippage is concerned, maybe there we have done 54-55% provisioning on the new slippage. So, last time I think you highlighted that at least this 5.7% seems to be quite comfortable and there might not be too much of an increase. But in fact, we are still seeing almost INR 260-270 odd crores incremental stage or ECL provisioning which is being there.

Now so just wanted to understand what goes into this and what is the kind of further risk which we are seeing wherein there could be a more provisioning which will flow through?

Jairam Sridharan: So, Kunal, this is not coming out of any significant portfolio review or anything like that. The way to think about this now, Kunal, is that the big kind of revaluation, kind of relook at the portfolio in a post-COVID context, was what we did last quarter. You saw the impact of that. And after that as now a lot of the clients have all come out of either restructuring or whatever ECLGS they might have had with other lenders etc. And now the situation is becoming a lot clearer, in terms of what the different clients' financial position is and based on that if we see some natural aging, you will see that getting reflected. You will see that getting reflected in Stage-2 and further if the aging doesn't stop, you will see that reflected into NPA. So, think of that as a flow of stress, if I may, on the pool business, not a one-off revaluation type exercise.

You might have noticed, Kunal, that this quarter in terms of our disclosures, if you look at our presentation on page 34, we've disclosed a new way of looking at our provisions number. You see that we have shown our trailing 12-month credit cost as a metric and how it has trended over the last 8-10 quarters. And if you look at that, you will see that in the calendar year '21, our credit costs were slightly south of zero, right. And what you have started seeing in these last two quarters is a trailing 12-month credit cost which is in that 1.5 to 2% range. Not nearly at the level that it was in calendar year '20, but not the sort of negative number that was in '21. We would see how this goes and we will see the financial health of our clients every quarter in terms of their ability to pay.

You might have also noticed, hopefully, that we have given a lot more granularity in terms of disclosures of our wholesale portfolio and if you have not, I would encourage you to take a look at slides 22 and 23 on our presentation, where we have disclosed a lot of information about what the Wholesale portfolio looks like. Our intent here, Kunal, is to show all the information to the investing public and allow you to make your own judgment calls about what the implied health of the portfolio might look like. We are not offering any specific forward guidance on credit cost etc., but through some of these new disclosures that we have added, hopefully, that will give you a good sense of how the portfolio is positioned.

Kunal Shah: Sure. So, just on that I wanted to ask a follow-up question on that. In terms of when we look at this early-stage projects, almost like 24-odd percent exposure and even mid-stage another 18-odd percent and when we look at it in terms of the bullet payment maturity almost 16-odd percent, what are the risk which are there with these project? Last time also we said, we have re-evaluated and then there was some further provisioning, again this time it is there. So, are we done with the exercise or maybe this is going to continue, and we should see some flow-through in terms of the provisioning? I understand in terms of the steady-state credit cost and that chart which you have shown that it will definitely not be negative or low, but overall behavior of the Wholesale, are there risk coming out eventually?

Jairam Sridharan: The way I say this, Kunal, is that the residential housing market has went through some challenges around COVID. Now some of those challenges are over, but some of the projects in which one might have exposure, our projects that are launched pre-COVID and you know, how consumer mindset works nowadays, right now sales are not happening on the consumer end in early stages at all. Sales are happening when the project is well on its way to completion and the consumer can actually see the property. So, the consumer behavior has changed, and we are also watching our developer portfolio as well as all our other portfolios very closely to see what impact it has in terms of their repayment to us. You rightly pointed out the 24% early stage, the 16% if you look at it differently, 16% in bullet payments, etc., those are all pockets that are pockets of vulnerability and we are watching it just as closely in terms of what might come in. So, we will let you know as and when things develop. There is no one-off revaluation exercise that we are planning on taking up, if that's something that that you are thinking about. I'm inviting Mr. Jijina to add to this as well.

Khushru Jijina: Couple of points here. I think, in early stage itself, let me define early stage. Out of that, the 24%, 16% is actually under construction but they are early stage, but they are under construction. That's number one.

The second thing about your question was on the provisioning, which I would like to answer a little differently. What is happening is that in real estate and this is for, let me attempt, I have done it before also, for the same question. While we have already done the entire reval last year, last quarter. What will happen in real estate is that there is value at the end, when you complete project, but in between like you look at the additional provisions this time in Stage-2, why do we do that? Because sometimes if we have to enforce or if we have to take some action to get the project off hand and away from the developer, we may have to take it to Stage-2 or even to Stage-3 to ensure that we take over the asset and complete the project.

So, let's differentiate between what will happen quarter-on-quarter. Yes, there could be a case again in future while on an overall health of the portfolio, we can confirm that, after we have done the reval and especially for the non-real estate, which happened in March, there shouldn't be any surprises in future. But if we have to ensure that we recover our money in a real estate project, and if we have to enforce, even if have to take it to Stage-3 temporary before we get our money back, we will do so.

Jairam Sridharan: One comment if I may add on that taking a slightly different angle, Kunal, is that while these provisions come on the more steady credit cost structure plays out, there is adequate level of other revenue streams which are creating the ability for the Financial Services business to still deliver a 2%-plus ROA, right. Like you saw this quarter, the POCI book and the recovery from there are giving you the ability to actually take that and use for some of these provision requirements and hence, even though these provision requirements have come we are still seeing a 2%-plus ROA during the quarter and hopefully, we will be able to continue to generate some of that cushion through POCI and some of those other means in the future quarters as well.

Kunal Shah: And one last question on this DHFL again. So, the recoveries, any lumpy recoveries from the wholesale portfolio this quarter from DHFL erstwhile book?

Jairam Sridharan: No lumpy recoveries. There was a minor or small portfolio sale of a couple of deals, but no big lumpy recovery. All the big lumpy stuff is going to go through a big long process of litigation etc. So, we will keep watching the space. We will do small ARC-type transactions every now and then, but nothing huge yet.

Kunal Shah: And support of these recoveries is somewhere around 1-1.5%. Do we expect that to continue?

Jairam Sridharan: For the next few quarters, absolutely.

Moderator: Thank you. The next question is from the line of Vivek Ramakrishnan from DSP Mutual Fund. Please go ahead.

Vivek Ramakrishnan: I have a couple of questions on the Finance and a question on the Pharma business as well. In the Financial Services business, given the fact that you are experimenting with microfinance and also with gold finance, is acquisition a real possibility of some other company? Because these are all very physical, touch-point oriented business typically and the branch network will be complementary to yours. So, that's question number one. In the Pharma business, I understand you are making CAPEX and you've not given any guidance. But could you also broadly give in terms of the indebtedness cap that you might have within the group, let's say, high level debt to EBITDA numbers or any financial covenant that you would have?

Jairam Sridharan: Let me start with the FS thing and I'm sure Vivek will jump in and offer you guidance or offer you some thoughts on the Pharma side. See, firstly, one quick clarification. The microfinance business we are now committed to, it's no longer in experimental mode. We like what we see. You are going to see us make further investments there. The gold one is absolutely in experimental mode. We might or might not go ahead with it. So, we will see how that plays out.

To your question of are we open to M&A in these spaces, yes, we are. As you all know, we are an extremely well-capitalized company with a lot of spare capital available and as a group, we have had a rich tradition of successful M&A. And these businesses that you absolutely rightly pointed out, are businesses which are very M&A friendly. So, we will continue to watch the space for potential M&A opportunities, but I want to caution that as a group we are generally value oriented M&A player and some of these spaces are extremely rich from a valuation standpoint right now. So, it might not work out right now on that dimension, but if we find something which is a good product fit and it checks the box on values and valuation, I think we will be quite open to it.

Vivek Valsaraj: Yes, Vivek, while we have not given a specific guidance for pharma, let me reaffirm that the demand remains strong. In fact, we are seeing the highest inflow of RFPs ever than we have seen before. It's just that decision making is taking a little bit more time at the customer front and with respect to your question on debt, well, the guidance we have given is that we will cap it at about four times the EBITDA of the business.

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

Piran Engineer: Just a couple of clarifications on the POCI book first. How much of it is retail versus wholesale? And just so that I understand this correctly, this INR 3,300 crores of book, so whatever the recoveries are, like this essentially your profit in the same?

Jairam Sridharan: So, the POCI book is all retail, Piran. There is no wholesale in there. And the way to think about the POCI book is there is a face value. We have disclosed this on the slide, if you see, there is a face value of this asset, which is let's say about INR 9,500 crores. It has been markdown by 65-odd percent to about INR 3,500 crores or thereabouts. That's what we see. If recoveries are greater than the mark, then you get P&L flow. If it's less than the mark, then you get a P&L hit. That's the way to think about it.

Piran Engineer: So, this fair value is essentially part of your net worth then and then plus minus of this fair value because debit or credit to the net worth.

Jairam Sridharan: Yes. The INR 3,500 is part of the balance sheet, if that's what you mean.

Piran Engineer: Okay, it's part of the balance sheet.

Jairam Sridharan: Yes.

Piran Engineer: Then the next question is who will lead the wholesale business now that Mr. Jijina has retired?

Ajay Piramal: So, Mr. Jijina, though he has retired, he continues as advisor. We have got now a Wholesale 2.0, where we have appointed Mr. Yesh Nadkarni. Yesh was earlier with KKR and he is also going to be involved. Also, the teams remain the same.

Moderator: Thank you. The next question is from the line of Deepak Gupta from SBI Pension Fund. Please go ahead.

Deepak Gupta: My first question is on retail disbursements. The one-offs from Dewan Housing book has been quite elevated in the last three quarters running at a run rate of about INR 1,600-1,700 crores per quarter. How do you see this going forward?

Jairam Sridharan: So, Deepak, the runoffs are total run-offs here, and not just the Dewan book. Please remember that we're doing about INR 150-200 crores of disbursements of embedded finance. These are very short-term products and run-offs there are pretty high too. So, even in our organic business, the 23% of the organic business that you see on slide 13, which is digital embedded finance, those are all very short-term businesses and hence the scheduled repayments are going to be quite high in there. So, essentially, a lot of the runoffs that you see here, the mix is shifting more from attrition towards scheduled repayments, as we continue to press the pedal on some of these digital pieces. So, the attrition pressure has actually come down. In the last quarter, attrition pressure has been meaningfully lower. Of course, Q4 is always very high pressure on attrition. So, both seasonally, as well as, more structurally, attrition pressures are lower in Q1 than they were in Q4.

Deepak Gupta: The second question is on incremental yields on the book versus incremental cost of funds. Somewhere in the presentation I saw incremental embedded yield is 12.6%, but then the next slide is also showing a 13.1%. So, I was a bit confused on that.

Jairam Sridharan: Sorry. So, maybe we were not super clear. So, see in the 12.6% that is on page 13, we have excluded the digital embedded finance, the 23% of disbursement. The reason we have done that is that we don't want investors to be modeling in disbursement yields into a longer-term book, because the embedded finance book will churn out very quickly. So, 12.6% is all disbursements ex of embedded finance. When you include embedded finance into it, the yield increases to 13.1%. So, from a modeling perspective, if you are trying to model the full book, I would encourage you to keep 12.6%, as a number rather than 13.1%.

Deepak Gupta: And what will be the incremental cost of borrowings right now?

Hitesh Dhaddha: 7.9% right now.

Deepak Gupta: And the next question is on asset quality. If you could give a breakup of GNPAs between retail and non-retail? And secondly, I know this question has been answered before, but just some more clarity on the increase in Stage-2 loans? Because I thought last quarter you had mentioned that you had done a review of the entire book and whatever had to slip has been slipped. But again, we have seen about INR 400 crores of slippages at least moving Stage-1 to Stage-2. How should we read this? Do you think Stage-2, what exactly is going on here if you could give some more clarity on that?

Jairam Sridharan: So, Deepak, I don't think we said last quarter and we are not saying it this quarter either, that whatever needs to slip has already slipped or come into Stage-2 etc. The way to think about it is that over time, the big 'reval' exercises, the one 'reval' exercise that happened two years ago in March 2020 and another one that happened last quarter etc., through some specific accounts where you feel like hey, you are underprovided and you need to do some work. That process is not going to happen every quarter. It will happen occasionally, maybe once a year or there about, right? But from a flow perspective, if there are specific client situations where the client actually goes through some trouble and some flow happens, like this quarter, we have seen like a total slippage of roughly 1% annualized. So, some level of slippage, some level of Stage-2 creation, some rate of that you should expect to see. These are idiosyncratic situations and not any broad brush strokes or sort of portfolio effects that are there.

Khushru Jijina: To give color to this Stage-2, let me divide it into few parts. Some of them were small loans where we actually did a one-time settlement and maybe there were some INR 5-10 crores difference and that's what we provided extra and actually those loans are getting settled. Actually, there are two large ones and again, here, there is an embedded value here. One was a real estate company in the south where the developer had some trouble. In fact, there was an ED enquiry. So, we decided to take the loan to Stage-2. So, not that he has defaulted. Actually, the account is standard, but we decided as a caution to take it to Stage-2. I think it's good you asked this question again so that we clarified.

The other one actually, again, a hotel which has now started doing well, but since there has been some mismatch of cash flows, we decided to take it to Stage-2. Again, if you ask me the value of the hotel, it's far more than the value of the loan, so if that clarifies.

Deepak Gupta: And if you could share the breakup of GNPAs between retail and non-retail?

Jairam Sridharan: We did it last quarter. I don't intend to do it every quarter to be honest. We will do it once a year. We are not doing a full segmental reporting yet. So, let these businesses settle down. We will start doing full segmental reporting at that point of time.

Moderator: Thank you. the next question is from the line of Abhiram Iyer from Deutsche Bank. Please go ahead.

Abhiram Iyer: I had two questions. One is, could you just highlight your methodology in which you brought down the interest expenses from 8% to 7.1%? And the other question is, could you also highlight how capital adequacy ratio has gone from 21% to 25% over the last quarter?

Jairam Sridharan: See on the first one, which is the cost of borrowing, there are a few different factors mostly related to the point that, you know, back in 2019 and early 2020 when liquidity environment was quite challenging, there was a lot of higher rate borrowings that the Company had to take up and now that the liquidity situation in the Company is just completely different, and all of those borrowings have gone past their pre-payment penalty dates, we are prepaying more and more of them and we are able to borrow in the market now incrementally at much cheaper prices and that is slowly reducing the cost of borrowing. So, even though the market is seeing an increased or elevated interest rate environment, our cost of borrowing continues to come down.

Ajay Piramal: It was not 7.1%, I think.

Jairam Sridharan: 7.9% is the incremental borrowing cost just in the last quarter. At the portfolio level, the average cost of borrowing is 8.8%. Now your second question was on capital adequacy. Capital adequacy is at just over 25%. Two things have changed. One is, of course, addition of profits in the numerator, and in the denominator there are some risk weightage – on a weighted average basis, risk weights have come down a little bit and nothing very dramatic, but that's what has resulted in the move that you see.

Abhiram Iyer: Sir, could you just clarify on the risk-weights coming down? Is this because of the mix of loans or is there any other?

Hitesh Dhaddha: So, post the DHFL acquisition and with the improving mix on the retail, you can see the mix of retail has gone up from 12% to 37%. So, this is what is resulting in change in the risk-weightage where the risk weightages have improved towards retail side and you are seeing the capital adequacy ratio.

Abhiram Iyer: Agreed, Sir, but that should have been reflected in the previous results as well, right? So, net-net from a book perspective, the composition hasn't significantly shifted over the last quarter.

Hitesh Dhaddha: So, last quarter were provisional. These are audited numbers right now.

Abhiram Iyer: So, provisionally, we lowered the capital adequacy.

Hitesh Dhaddha: We were conservative on that.

Khushru Jijina: I just wanted to add on the cost of borrowings, quickly. The other important thing which people should note that while the interest rates are going up, our spreads as a 'AA-rated' entity has been consistently going down because of the performance of the Company and especially with retail coming in etc. So, that's the other point to note.

Moderator: Thank you. The next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: I just wanted to understand the ROA target that you are putting at around 2-odd percent. This includes the benefit of recoveries from the erstwhile DHFL credit impaired book or should we expect that to kind of further add into these numbers?

Jairam Sridharan: So, two things. Firstly, the guidance or not guidance, but the aspirations and the goals that we spoke about was high 2s, low 3s. So, 2% would be a bit on the low side. I don't think that's what we are putting out there. And that's what, let's say, between now and five years out we should get there. See the whole recovery story on the POCI book and all the DHFL book etc., would mostly have played out by then. So, in the interim all the recovery story etc., will keep giving us the ROA boost, but the sustainable business should be giving that kind of ROA – four, five years out, right, without having to depend on recoveries, because there will be no more book to recover five years out.

Nischint Chawathe: So, basically, what we are trying to say is that this is a benefit that we probably get in the interim period.

Jairam Sridharan: Correct.

Nischint Chawathe: And when you have evaluated the real estate and the wholesale book, you have kind of and we are saying that look, it is now adequately provided. Are we taking any credit from this or is it something where you have provided this independently and just kind of maybe just provide some more to further buffer on that?

Jairam Sridharan: I'm not sure I fully understood your question actually. Let's see. There is one consolidated balance sheet. I mean, whatever comes in the provisions line, whether it comes in one part of the business or another, it goes to the same line. So, we are not thinking of it separately. It is all one integrated company and one integrated set of numbers.

Hitesh Dhaddha: Nischint, maybe you want to clarify the question what you were trying to ask?

Nischint Chawathe: So, I think, what I am trying to say is that when you have evaluated the wholesale book and probably going project by project and create adequate provisions against it, are you taking any credit from this particular pool of recoveries or are you trying to say that look, this pool of recovery is something, which might in the quarter like this, help you to offset the hit that we saw in this quarter or probably it may not. We don't want to take any credit of that. So, when you are trying to, I mean, I'm sure internally you have some numbers of the quarters.

Jairam Sridharan: These are two independent events, like there is one team that will continue to focus on getting recoveries from the old book that is stressed. Hopefully, we will be able to create through that stream a steady flow of recoveries and a steady P&L stream for the next few quarters. Independently, client behavior or slippages etc., might result in provision requirements. We don't want a color our judgment on one, depending on the other, but as it happens, there will be situations like in this quarter where there is adequate money coming from one to pay for the other, but it is not something that we are, sort of, there is no master design that we are trying to do behind it. We will do whatever is prudent in any given quarter.

Hitesh Dhaddha: Also, Nischint, from a disclosure's perspective, if you see we clearly disclosed separate line item for credit cost and separate line item for recoveries from POCI book. So, I think that should clarify your doubts on that front.

Moderator: Thank you. The next question is from the line of Aditya Jain from Citigroup. Please go ahead.

Aditya Jain: Could you talk about how large is the pool purchase? Just to get a sense of how much is the organic growth in retail and how much is being driven by pool purchase? And also, what are the loans which are being bought?

Jairam Sridharan: Pool purchase is about 5.2% of the retail book right now, Aditya, and it will always remain in that broad range. I don't think it's going to ever be a whole lot. The kind of product that we are doing in pool purchase are so far, we first started with microfinance, because we are very keen on actually getting into the microfinance business ourselves. So, we wanted to actually get a sense of how the book is performing with a lot of lenders. So, we did some pools in microfinance and that's what gave us the confidence and also gave us a little bit of a sense of which geographies are working well etc. We are doing a little bit of small business and we are doing a little bit of housing. What we are not doing is cars or trucks etc. We have not done anything meaningful there.

Aditya Jain: So, it was 5.2% of the retail book in the last quarter as well. So, this was the share of 5.2% of the retail book or the pool purchase? This was the amount in the last quarter as well.

Jairam Sridharan: Of the stock.

Aditya Jain: Of the stock.

Jairam Sridharan: Of the stock. Correct.

Aditya Jain: And then the OpEx declined quarter-over-quarter in Financial Services. Material decline. So, in terms of thinking about it going forward, do we think of it as bulk of getting full activation in DHFL is done, so cost should be stable to a large extent in this year? Or is it more seasonality or some other element?

Jairam Sridharan: See, in general, you see a little bit of seasonality in this, Aditya, like you will see Q1 being a bit low and then like, for example, we have not started our mass media campaigns etc., yet. It will probably start later in the year. Some of the staff that are still being hired for the completion of this year, all that cost will start coming in a little bit later. So, I would say that just keep in mind that there is a little bit of seasonality with the Q1 low and the Q4 high, right. But otherwise, your point that our stabilization cost of DHFL etc., fully baked in and settled, I think the answer is yes. Now you should think about it purely as organically to fund growth.

Aditya Jain: And then just lastly, the equity breakup that we have is on March. Is it possible to tell the equity and Financial Services as on June end?

Hitesh Dhaddha: So, typically, we would be keen to disclose on six-monthly period when the numbers, balance sheet get audited.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, that was the last question. I now hand the conference over to Mr. Hitesh Dhaddha for closing comments. Over to you, Sir.

Hitesh Dhaddha: Thank you, everyone. If you have further questions, please reach out to the IR team. Thank you.