



ARMAN FINANCIAL SERVICES LTD.

“Arman Financial Services Limited Q2 Financial Year 2020 Conference Call”

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ARMAN FINANCIAL SERVICES LTD.



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Moderator: Ladies and gentlemen, good day and welcome to Arman Financial Services Limited Q2 FY2020 Earnings Conference Call hosted by Antique Stock Broking. We have with us today from the management of Arman Financial, represented by Mr. Jayendra Bhai Patel – Vice Chairman and MD, Mr. Aalok Patel – Joint MD, and Mr. Vivek Modi - Group CFO. 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. Bhavik Mehta from Antique Stock Broking. Thank you and over to you Sir!

Bhavik Mehta: Good evening to everyone and thanks Jayendrabhai and Aalok for taking the time out, and to all the participants who have connected to the call. So, in the last couple of months, there has been complete madness in the sector, and it is good to see that some NBFCs have been able to hold their ground and really differentiate themselves., and Arman has tried to be in that camp. So, they have recently reached a quarterly net profit run rate of Rs. 12 crore. So, without further delay, we will get the line to Jayendrabhai to take us through what has happened in the last six months. So over to you, Sir!

Jayendrabhai Patel: Thanks, Bhavik. Good evening everyone. Thank you all for joining in and taking a timeout for our results discussion for the half-year ended FY2020. I am joined on this call by Vivek, Amit Bhai is also here and Aalok, of course, is here.

We have issued an investor presentation for the past quarter. Hopefully, everyone has had a chance to review it, if not it is available on the Stock Exchanges and the company website as well.

Despite bad weather conditions both figuratively and literally as there are macro-economic headwinds, and strong monsoon, which has caused a lot of disruption in many of the areas we operate. I think you will agree that our results for the half-year have been quite pleasing. This is our first year of Ind-AS reporting, and numbers for the corresponding period in the previous year have also been reported accordingly. I will begin by giving a brief overview of the consolidated numbers for the first half of FY2020 and then touch upon the individual performance of each of our three segments.

As you can see from the results, our performance has been quite satisfactory for the first half of this year, considering the prevailing economic slowdown in the rural sector, too much rain in many parts, and the liquidity squeeze faced by the NBFC sector in general for the last four quarters now. This makes our results a positive outlier in the industry.

Our consolidated assets under management grew by 46% year-over-year to reach Rs 753 crore. Total disbursement in H1 of FY2020 grew by 19% year-on-year to Rs.423 crore. The slower disbursement growth has been largely deliberate as we consider it to be prudent to tread carefully given the prevailing macroeconomic conditions. Most of you will also be aware of the severe slowdown affecting the two-wheeler sales during the past year, which also led to a decline in our urban two-wheeler disbursement.

Consolidated gross total income grew at a faster rate than advances by 70% to be precise to Rs.103 crore, driven by higher blended yields. Our efforts on improving our operating efficiency paid off as our cost to income ratio declined by nearly 640 basis points to 40.5%. That combined with positive tax relief announced by the government enabled us to post a 100% year-on-year increase in net profit, which stood at Rs 24 crore, this is more than what we achieved in the whole of last year.

Our consolidated debt-to-equity ratio stood at approximately 4.75:1, and we have sufficient capital in place for our growth in the near-term. Asset quality continues to remain robust and steady compared to last year as our gross and net NPAs stood at 1.2% and 0.6% respectively at the end of H1. Our return ratios, that is, return on equity and return on asset under management improved significantly and stood at 35.8% and 6.7% respectively during H1.

Furthermore, as a part of our FY2020 expansion strategy, we launched 54 branches in the first half including 14 new branches during the second quarter. Of the new branches launched, 44 are for MFIs, 9 are for MSME. Total branches stood at 223 spread across six states, which includes 182 in microfinance, 34 in MSME and 7 in two-wheeler. Our total employee strength has grown to over 1,800 as of today.

Comparing the different segments starting with microfinance, which is our largest division, continued to see robust traction with the loan book registering a growth of 57% year-on-year to reach Rs. 555 Crore.

During the first half, the net total income grew at a much faster pace of 77%, majorly driven by expansion in the net interest margin to 14.4% as against 13% in the previous year. Pre-provisioning operating profit grew by more than 100% to Rs. 22 crore up from Rs 11 crore last year, as we benefited from positive operating leverage.

The provisions came in higher at Rs.2.7 crore primarily because of additional ECL (or expected credit loss) provisioning of Rs.0.8 crore largely due to the prevailing macro conditions and impact of floods in some parts of Maharashtra and Gujarat. Despite this, the profit after tax nearly doubled to reach Rs.14 crore, and our NPA's remain well within the control at 0.8%. Post ECL adjustment, the NPA stands at only 0.24%, this ECL

provisioning on the AUM is 1.2%. Overall the microfinance division accounts for 72% of the consolidated AUM and 60% of our profit.

Moving on to the MSME segment, which essentially includes individual micro-enterprise loans to the rural segment, is our second-largest division and accounts for 16% of our assets under management. We started this division as a pilot in 2017 and have come a long way since.

During the first half of this year, AUM from this division has grown by 70% from Rs 74 crore to Rs 125 crore. We operate in three states currently, which includes an expansion into Maharashtra during the second quarter with four new branches. At present, we have an active client base of about 35,000 customers.

Income from operations in MSME has more than doubled to Rs.20 crore in H1 as against Rs 9 crore achieved in the previous year.

Lastly, our oldest division which is two-wheeler financing division, has been impacted by as most of you are well aware, the severe slowdown in the domestic two-wheeler sales, which has seen a decline of almost 20% in the first half of this year vis-à-vis last year.

Our AUM in this division stood at Rs. 96 crore. Urban two-wheeler portfolio has been relatively stable, and we have added Rs. 7 crore of rural two-wheeler portfolio. Income from operations in the two-wheeler segment grew by 17% to Rs. 12.7 crore in H1 of FY2020 led by expansion in yields. Furthermore, we commenced a pilot of to start rural two-wheeler financing towards the end of last fiscal. This is essentially based on the hybrid of our microfinance and MSME business model.

So far, the asset quality and the margins have been encouraging, but growth is low here, given the current environment. But we hope this pilot will prove to be a new avenue of growth for our two-wheeler division in the future.

Now to give you an update on the ongoing liquidity crisis in the NBFC sector. I am pleased to report that given our naturally positive ALM and our strong past performance track record, we have been able to raise adequate funds to finance our ongoing operations without any hiccups, although at a marginally higher rate. The rate for new fundraises in the last two months have seen a gradual decline.

To further minimize the impact, we have focused on and been successful to an extent in diversifying our sources of debt financing. Further, financing from PSU banks has also opened up in the third quarter. As I mentioned earlier, for a company of our size, we are a strong outlier in the industry, as far as our ability to raise debt funding goes. We have maintained sufficient cash reserves for two months of operations, which has resulted in a

negative carry cost of about Rs 1.5 crore during H1. We will continue maintaining our liquidity policy at least until the end of the fiscal year and re-evaluate post the year-end.

Overall to conclude, we are sufficiently capitalized and remain on track to achieve strong growth in the second half of this year as well. Having said that, however, our first priority as always will be on exercising prudence and maintaining the quality of our book. One of our unofficial mottos has always been that it is easy to give money, getting it back is the trick.

With this, I would request the operator to open the floor for questions. Thank you so much.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Pallavi Deshpande from Sameeksha Capital. Please go ahead.

Pallavi Deshpande: Congratulations on an excellent set of numbers in this tough environment. I just wanted to understand what is the amount of securitization done. If you could have numbers on that and how much gain on this was booked in the interest income?

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Vivek Modi: Cumulatively, I think we have about Rs. 100 crore on the book. What we have done primarily is multi-originator transactions, which are PTC transactions, and these under the Ind AS are completely on-book items. So, they kind of take the texture and color of regular borrowing only.

Aalok Patel: To further add to it to there are certain rules under Ind AS about what constitutes as a true sale and that has to do with whether it has recourse or does not have recourse. So, for a lot of the PTC transactions, we had to re-recognize them back into the balance sheet after Ind AS implementation.

Pallavi Deshpande: I got it, I saw that on the balance sheet, the recognized number. So, on the interest income does it include any upfronted gains due to this?

Aalok Patel: No, it does not include any upfronted gains.

Pallavi Deshpande: Thanks, Sir.

Moderator: Thank you. The next question is from the line of Avinash Tanawade from Dalal and Broacha Portfolio Managers. Please go ahead.

Avinash Tanawade: Congratulations on a good set of numbers. First my question is about the MSME portfolio. Overall the industry, if you look at the banking and even in the NBFC system, they are avoiding the MSME space, but still, we are growing our business in the MSME. So, could you just explain something about your MSME portfolio and why we are bullish about the MSME portfolio.

Aalok Patel: So, I think calling our division MSME has been a bit of a misnomer to a certain extent because you know when you talk about doing microfinance that comes in a probably a single flavor model, the group kind of a model. When you talk about MSME that comes in all kinds of flavors. So, what we are doing is basically is different from what most people would assume when they hear the term MSME. Ours is completely rural-focused individual loans and it involves door-step delivery and door-step collection. So, it is basically kind of taking the best parts of microfinance and adding the level of underwriting which is not possible in the microfinance side and that is how we originate the loans. But the ticket sizes are between Rs 50,000 and Rs 1,50,000 with an average of somewhere between Rs 70,000 to Rs 75,000 right now. Our focus is mostly on the rural side to reach up a couple of steps above the pyramid. So, in microfinance, you are covering the bottom of the pyramid, while in MSME, we hope to reach a couple of steps higher than that. People who are still not in the formal banking segment, but still they are a little bit more mature in their business cycles to require a little bit higher ticket loans; however, they cannot access it from the mainstream as of yet.

Avinash Tanawade: Could you give some examples of what kind of customers we have?

Aalok Patel: It could be larger cattle dealers, it could be scrap dealers, it could be larger kiranas, small machine and, tyre shops, small highway stores that you run into while passing the rural areas, etc.

Avinash Tanawade: But if you look at in terms of the yields that we are generating from this business is between 30% to 35%, right?

Aalok Patel: The yields are yes, so all in rates would go as high as about 35% and a low end of about 30%.

Avinash Tanawade: Why are these customers not going to the microfinance and coming to us because some microfinance companies like Bandhan, for instance, is giving loans of up to Rs 1 lakh or more even Rs 2 lakh or Rs 3 lakhs. So why they are coming to us rather than going for them because if I remember correctly, then Bandhan is providing loans at 18% to 19% yields.

Aalok Patel: I mean, that is a good question. But I can ask the same thing that why somebody is going to Bandhan at 18% or 19% when they can go to SBI for 12% or 14% or they can go to Japan for 4%. So, it has to do with my service model number one. So, with a lot of lending firms,

they do not provide door-step collections. I provide door-step collections in cash which a lot of people appreciate because there might not be bank branches in that area, where they have to go and deposit the money on a month-to-month basis. There are other factors as well, like for example, I provide a very quick turnaround. I get down to the ground level and try to assess their cash flow, and if we are not comfortable with their cash flows, then we reject the customer as well and that is hard to estimate for, I mean you need some level of local knowledge and some level of experience with the different occupations. The other fact is also that our loans are unsecured. When you are talking about an Rs.4 to Rs.5 lakh loan in MSME, very few people are doing it on an unsecured basis, it is mostly some level of LAP loan or something like that. So, that also has not only a higher cost but a higher hassle and a higher turnaround time, and frankly speaking at the micro level when you are talking about loans of this size our customers are not very price sensitive. For us, if you are talking about a large loan in crores even a 5 basis points should make a difference right, but when you are talking about an Rs.70,000 loan, yes I mean 5% will make a difference in the installment but maybe by only Rs.100 to Rs.200 or something of that sort. So, a lot of people do not care about that as long as they get it in time and with the least amount of hassle as possible.

Avinash Tanawade: And when you talk about the MSME business, which are are the three major states that we are catering to?

Aalok Patel: So, we just started this in 2017 with the pilot as Jayendra Bhai said. We started it primarily in Gujarat, which represents the majority of our portfolio. Around mid to end of last year, we went into MP as well, and then in the last quarter, we went into Maharashtra. So, Maharashtra is a negligible portfolio right now, and then we have about 20% of the portfolio in MP and the remaining portfolio is in Gujarat. But that will change in about a year.. and Gujarat will hopefully go down to about 40% to 50% by the next year.

Avinash Tanawade: Did we add any branches in MP and Maharashtra?

Aalok Patel: Yes, so we added about 14 branches this year. In Gujarat, today, we have 23 branches. In Maharashtra, we have 4 branches, and in MP, we have 7 branches. So, in MP and Maharashtra, most of the branches we launched this year or within the last six to nine months basically.

Avinash Tanawade: In Gujarat, on average per branch, what kind a loan portfolio we have?

Aalok Patel: It depends as a lot of them are new. Some of them can be as high as Rs 10 to Rs 12 crore, others the newer ones, could be less than Rs 50 lakhs also. On an average it will basically be around Rs 3.5 crore to Rs 4 crore.

Avinash Tanawade: What kind of growth are we looking at in the MSME portfolio?

Aalok Patel: We have not released the projection figures, or we have not given that guidance. But our two cents are that as microfinance becomes more mature, this growth will be a sort of replacement in the mid to long run because there is ample opportunity here. However, the rejection rate is high and you have to find those specific customers. So it is not recommended and probably not possible also to grow as fast as most people are used to seeing in the microfinance sector, because you do not want to make sudden moves in this segment and also it is relatively new for us, so we are treading carefully. Thank you.

Avinash Tanawade: Thank you, Sir. That is it from my side.

Moderator: Thank you. The next question is from the line of Ankit Gupta from Bamboo Capital. Please go ahead.

Ankit Gupta: Aalok, if you can talk about how the overall microfinance market is doing given the kind of stress we are seeing in the economy and in general. So, like your loan growth does not suggest any slowdown or impact of challenging economic scenario. So how is the market shaping up and do you think the growth that we are seeing is suggesting that there is hardly any impact on the client that we are serving. What is your view on that?

Aalok Patel: I mean, you know it is a fair point at least in the last six months, there has been a lot of scary kind of talk around the macroeconomic conditions especially in the rural segment, and to a certain extent I have been expecting it to kind of deteriorate since the last six months. I have not seen that yet in the rural segment. During the monsoon, there was some level of disruption caused due to the monsoon, but overall things are back to being stable again, and I have not noticed it even though I am a bit of a pessimist myself, so I have been expecting it, to be honest with you. But so far, we have not seen any deterioration, except only a marginal 5 basis points here and there every month. As far as our growth is concerned, I think I mentioned it, but we have already kind of slowed down relative to what are projections were about a year and a half ago or even six months ago. So, we are not growing too fast. In fact, we have the capability of growing faster, but we are kind of holding ourselves back. If you were doing a secured high ticket loan what you could do is increase the underwriting, in microfinance that is not really the case, so what you have to do is you have to slow down disbursements in certain branches or certain districts which you might feel are having or might have issues in the future, which is what we are doing in certain districts of Maharashtra and in South Gujarat, Eastern UP, those kinds of areas. We are trying to slow down the disbursements in few branches selectively, but otherwise, things are going well, or business as usual.

Ankit Gupta: Another thing I wanted to ask you is regarding the competition that you are seeing in the geographies where you are operating because we have been hearing about stress or the market getting overheated in the eastern side of the country particularly West Bengal,

Assam and other Northeastern geographies. We have been hearing that there has been a lot of overheating; there has been a lot of overleveraging of borrowers which is happening on that side. So how is the situation in the geographies like Maharashtra, MP, Gujarat, UP and Uttarakhand, where we primarily operate on the microfinance side?

Aalok Patel:

Yes, I think these things kind of change around with time. You are correct; there has been a lot of negative news in Assam, West Bengal and others about some overheating. Fortunately, we are not present there and we try to stay away from overheated areas. But you know nothing prevents an area from becoming overheated after I move in. But typically, we will try to stay away from areas like that. As far as MP goes, right now, touchwood it is one of my best performing states as far as asset quality is concerned. We have just moved into Rajasthan, so our portfolio is not very large, but there also, it is almost zero NPA, which is typically what we target and expect in the first year of operations in any new states that we go to. In UP there is little bit of pressure in the Eastern UP side. In Maharashtra, around the Jalgaon area, there is a little bit of pressure. But otherwise things are fine. There were also some flood-affected areas, some political issues going on but, I mean, that happens every year to an extent in different areas. It is not something that is beyond our expectation and it is not something that we can control either. So far for us, it has not been bad at all. To give you my larger perspective on the industry, see in the Eastern side, also there is a bit of regulatory arbitrage in the regulations surrounding NBFC-MFIs. You have that two lender rule and the Rs 1.25 lakh limit, which has kept things in check since the AP crisis. But the regulatory arbitrage has sort of been created with the SFBs and Banks. So there has been some level of efforts from the industry organizations to come out with something called as the CRL, Code of Responsible Lending and that for the microfinance practitioners is kind of like a code of conduct that you would not over-leverage a customer and you will behave in certain manner which not only protects the customer but also protect the industry. So, more people have signed it, but a few large outliers are there without mentioning. However, the RBI is taking notice of it. RBI whether you call them proactive or reactive to a certain extent, after the Assam situation, I am sure will notice and take steps surrounding this overleveraging.

Ankit Gupta:

Would you have any data on what will be the average borrowing of your customers, like I am including borrowing from Arman and other MFI, NBFC MFIs as well as SFB's. Will you have any data on that, and what will be the average borrowing of our customers?

Aalok Patel:

There is industry data available. Our average disbursement is somewhere around Rs 26,000 to Rs 27,000, last quarter, it was around Rs 26,000. So, we are probably on the lower side of the disbursements. I think for all the microfinance customers in India if I remember this data correctly and do not quote me on this, but I think there are somewhere around 1.4 loans per active client as per the credit bureau data, and the average outstanding is somewhere between Rs. 20,000 and Rs.25,000 per account..

- Ankit Gupta:** But will you have any data on how many exclusive customers we have, who have taken loans only from us and not from other NBFCs or SFBs?
- Aalok Patel:** First-time loans taken are approximately 27%; this basically includes first-time borrowers in the credit bureau at least. It varies from district to district, but then the average turns out to be around 27%, and this is including the informal sector by the way.
- Ankit Gupta:** Yes, of course, informal data you will not be having on the credit bureau. And a few questions on the MSME side, how many of our MFI customers who have graduated from let us say 2nd or the 3rd cycle to MSME customers?
- Aalok Patel:** In our case, it is very little. It is about less than 5% currently, but there is a very high, about a 70% rejection rate that we have. But in a lot of cases, the women might have some microfinance loans either in the past or currently active loans, but when we pull the credit bureau data, we pull CIBIL reports and high mark reports for both the customer and the spouse. So, the idea is that it will cover all the housing loans or bank loans and stuff in case there is high -mark. And then there is high- mark with microloans, and we cover all of that in our cash flow assessment and the overall assessment of the customer. But while we have such restrictions as in if they have borrowed from one person or four people or whatever, for us, it is more about cash flows and what their installments are on a monthly basis.
- Ankit Gupta:** One question on the MSME side, what is the kind of NPA levels you expect? It is a new business for us, and it is an unseasoned business as we are just two, three years into the segment and our delinquency rates or the NPA rates are still lower than microfinance. Our ticket sizes are higher, our yields are higher, it is an unsecured loan so where do you see the NPA settling in long-term let us say one or two years down the line when the seasoning would have happened for the entire portfolio?
- Aalok Patel:** We have been doing MSME for two years now. Every quarter the NPA levels do marginally go up, so currently, it is at about 0.2%. So, actually the performance on the asset quality front has been beyond my own expectations as well. These are post facto, in hindsight, I can try to extrapolate why that is the case, but the product was designed to expect about a 3% to 4% loan loss not even the NPAs. So it is our highest ROA product right now because the loan losses are so low. To a certain extent, it is climbing on a quarter-on-quarter basis, but it is very marginal.
- Ankit Gupta:** On the bank funding and NBFC funding side, can you give an overall view on how things have improved, that banks are becoming a bit less cautious in lending to the sector as well as our company. Any color on that would be helpful?
- Aalok Patel:** Things started improving in Q2. So, we got new lines from SBI. Earlier on, they were interested in doing a lot of securitization, asset buyout kind of transactions, especially the

private banks. PSU banks were kind of staying away from the NBFC sector in general unless you are probably very large, but it has started to open up in the last couple of months, so let's see.

Ankit Gupta: What will be the cost of borrowing for the new account that we have got the new bank line that you would have got.

Aalok Patel: The interest rates would be like sub 11%, so 10% point something. Overall cost would work out to be somewhere in the neighborhood of 12.5% to 13% after adding into the cash collaterals and processing fees and all of that other stuff that they put in. Certainly not cheap by any standards. So there is the published rate and the IRR rate, so we always calculate the IRR rate taking into account every kind of combination and permutations that people put in the sanction letter.

Ankit Gupta: Thank you, Sir, so much and wish you all the best for fundraising. Thank you, Sir.

Moderator: Thank you. The next question is from the line of Srinath V from Bellwether Capital Private Limited. Please go ahead.

Srinath V: Aalok just wanted to get a better understanding of the rural two-wheeler product, and what is the kind of target market? How does the client sourcing model work and how has the credit experience been? And the currently in the presentation is it getting clubbed with the MSME or with the two-wheeler business?

Aalok Patel: I am going to add one more layer of confusion. So the MSME or the two-wheeler pilot has been split into two, one part is happening through our MSME division, which is mostly direct sales, so through referrals, not by DSAs or anything like that, but through our own field officers sourcing at the field level. So that portfolio is approximately Rs Crore7 Crore currently. And then there is the other pilot where we opened two branches. That is like a very young pilot to begin with and is being done through our existing two-wheeler division, It involves working with sub-dealers, so it is kind of like a similar model to what we have in our urban two-wheeler market. However, the difference is that we are trying to target sub-dealers or locations which do not have a lot of competition and it would be a cash collection. We are trying to combine the best factors in MSME and microfinance and we strongly believe that one of the reasons why we get a lower NPA in our microfinance and especially in the MSME division, is this concept of the doorstep collection and of building that relationship and the rapport with the customers. So, so far we have both of those pilots running. Because of the increased network that we have in our MSME branches, that portfolio is growing slightly faster in the two branches that we have opened, specifically, for rural two-wheeler. The asset quality is performing fantastically, but the sales are a little bit slow right now. I do not think that has anything to do with the business model; I just

think that it is due to the macroeconomics that impacting the two-wheeler market right now, so let us see what happens there.

Srinath V: How is the PAR 30 performance in this kind of a book. And because you have cash collection, is it mirroring our MSME business, is that a fair assessment?

Aalok Patel: Yes, so in the exclusive two-wheeler branches, we do not have a single overdue yet, but we only have about 350 odd customers. And in the MSME side where we have about Rs 7 Crore, I think the PAR 30 figures is around 20 cases for a total of 2,300 customers

Srinath V: At what point would you be looking to kind of scale this particular model, or do you have a time horizon in mind or would you like to kind of see the credit experience for another one year. How do you see this model kind of scaling up over the next couple of years very broadly?

Aalok Patel: We are definitely interested in scaling it. But ideally, you want to see the bottom before you commit yourself too strongly. So, we have not been through that one cycle yet. We have seen the top, but we have not seen the complete bottom like for example, demonetization in microfinance was the complete bottom. That is where you felt that, okay this is the worst that could have happened. We have not seen that in the MSME in the new segment, so we are growing cautiously

Jayendrabhai Patel: But basically we are bullish on the cash collection from the doorstep model, and I think that is the way we want to go because even in two-wheeler you can see the difference between both the sort of semi-verticals, when you take PDCs or when you take NACH or when you take ECS or something; versus on the other side when my person goes and visits that household to collect the money, you see that the customers are under pressure and the default ratios are much less. And I guess that is the future that we want to follow is the household collection.

Aalok Patel: Yes, so when people are talking about Fintech, we are talking about taking a step back and doing cash collections. So, I know it sounds counterintuitive, but it works for us, and it works for us really well.

Srinath V: Thanks, Aalok, and fantastic set of numbers. Congratulations to the entire team.

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

Parth Sanghvi: Just one thing I wanted to know, what is your current customer base, and how do you all plan to grow it going forward, like which geographies we have been targeting?

Aalok Patel: At present, in microfinance, we are in six states; most of the portfolio is in four of them. In Rajasthan, we just entered, so that is a very young portfolio. I think the portfolio there will be around 4%, and then we have about 30% in Gujarat, 25% in MP, and around 20% each in UP and Maharashtra.

So, Rajasthan is going to provide a larger growth over the next 12 to 18 months. In Uttarakhand, we have a few branches, but we have no plans to grow there. The question is that when do we consider going from six states to seven and we have not decided on that yet, I mean, we will consider it when the time comes. However, there is plenty of areas to expand in the existing states where we are currently present. So, while in Gujarat, we have pretty much opened most of the branches that we wanted to, t in Maharashtra we have barely scratched the surface. In UP, we are present in a few areas in eastern and some in the northwestern side but UP is a huge state as you know, and even in MP, we have covered only about half the areas that we want to cover there, half to about two-thirds at the most. So, there are plenty of areas to expand in the existing states that we are already present in.

Parth Sanghvi: Got that, and just one more thing, are you all allowed to do cash collection from MFI customers as per RBI? I mean, is it only allowed when you have overdues or something. Is there like any regulation on this?

Aalok Patel: No, there is no regulation. I know that at least 99.9% of microfinance companies are following a cash collection methodology. In the MSME as well, there is no regulation surrounding it. You can do a cash collection.

Parth Sanghvi: No, but can you all visit the customers, how is it?

Aalok Patel: Yes, of course. There is some regulation that you cannot go past a certain time; it is in the NBFC MFI guidelines for overdue collection.

Jayendrabhai Patel: But here the timing is given to a customer that somebody from us will be there at 10:30 AM in the morning, and that is being followed month after month.

Parth Sanghvi: Okay got it, that is it. Thank you.

Moderator: Thank you. The next question is from the line of Amit Mantri from 2Point2 Capital. Please go ahead.

Amit Mantri: Congratulations to the entire team on a good financial performance. A question on the MSME side, so we have added 9 branches, so that is a substantial growth in the number of branches. So now are you looking to become more aggressive on the growth front on the MSME side, because the branch count has increased from 26 to 34, in this one quarter alone?

Aalok Patel: Yes, so, we are done with opening branches for the year. Earlier on our branch openings were always staggered. For the last two to three years, we have kind of done a better job , because there is a constant detraction of opening branches, so we try plan in advance. Like for example, we have already started planning for next year's expansion, how many people you need in the pipeline; and how many promotions you need in the pipeline; in which areas; and all of that. So, I do not think aggressive is the right word here. I think we are just following the plan that we set out at the start of the year that. Although I have some thoughts on this, I don't think I am ready to disclose what my plan for the next year is or anything like that. But we are targeting about a 40% to 50% growth, so let us see.

Amit Mantri: Even now, you are having customers in the MSME segment who are in the second or third cycle?

Aalok Patel: Yes, we already have customers in the second cycle. I am sorry, but I do not have the exact figures at the moment, but it is not a substantial amount.

Amit Mantri: So, it will be insignificant as of now, like less than 5%?

Aalok Patel: Yes, it will be under 5%. The second part is that these numbers keep on increasing because they are mapped to the kind of disbursements that have happened in 2017-2018. So that is something which keeps on increasing.

Amit Mantri: In this also, would you go with higher ticket size or lower interest rates in the second or third cycle, because now I think this number will keep increasing. You will have more and more customers whom you may have already lent to?

Aalok Patel: You know the thing is Amit, first of all, as far as the loan size goes, we do a complete secondary evaluation for them. What we can do in the second cycle is that whatever net positive cash flows are there, in the first cycle, we take only 40% or in some areas 50% of the net positive cash flows. In this case, we can increase it by 10%. So that generates an ability to borrow a larger amount and if the customer demands it. , we are happy to do that. But it would not be automatic that you paid back one loan, so here is Rs 20,000 more or Rs 50,000 more or something like that.

Amit Mantri: Because there is a high degree of cash collection that happens even in the MSME segment, how do you manage the risk of fraud, be it on the customer side or on the employee side. How are you managing those risks?

Aalok Patel: Well, that is why we are all sitting here. The hard part of this business is managing the logistics on the ground and managing the operations. So, it is a very operations intensive business. We have lots of checks and balances with lots of layers, almost like a casino to an extent, where everybody has to watch everybody else. We also have daily reporting

structures that, if something does go wrong, we know about it on the same day. Even then, you cannot prevent somebody who has Rs 50,000 to Rs 60,000 in his pocket from running away. So that does tend to happen on rare occasions, but it is not a very large amount and we have ensured to cover even those kinds of small thefts or whatever you call it, but our systems are set up in a way where we do not typically run into a very large-scale fraud or anything like that.

Jayendrabhai Patel: The issue here is how to keep your employees happy and ticking. The issue is every human being has a weak moment in his life. If you can take care of him during his weak moments, you got it. This is what we need to do, so we give them ESOPs, and we give them medical loans, and we give them medical insurance, and whenever they need, their money is on tap. So, you try to minimize those things, and you try to keep them sort of as members of one large family. I agree with you, but we try to minimize it as much as we can.

Aalok Patel: So, we have invested significant money and time in our microfinance side for this new ERP system, which will make everything almost Fintech-ish to a certain extent, where everything is mobile-based, and you get real-time data & analytics, and stuff on the field, and in fact, even tracking every single one of our customers by geo-tagging. Further, we will also start implementing something very similar for our MSME division from April 1 of next year. And that plan is already in the works. So, of course, we have a lot on technology and software to also help control things, but there is no one factor. I think it is a combination of a lot of things.

Amit Mantri: Thank you very much. Again, congratulations and good luck for the future.

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

Jignesh Shial: Thank you for the opportunity. Just a bit of a confusion on what Parth has been asking you. In our MFI model, we follow the center visits model right or we do not have that concept right now?

Aalok Patel: No, we do have that concept. The money is collected at the center meetings.

Jignesh Shah: At the center meetings, right?

Aalok Patel: Correct.

Jignesh Shial: So, there will be a weekly, how does the collection happen? Is it weekly, biweekly, or monthly? How do we do it?

- Aalok Patel:** We have a small portfolio as a fortnightly; that is every 14 days, but the majority of our portfolio is monthly. We collect from the 1st to 12th of every month.
- Jignesh Shial:** So, the customer gathers at a place, and then the team leader will collect the money and hand it over to you in person. Is that the same process as a normal MFI that you follow?
- Aalok Patel:** Similar process. There are group leaders and center leaders, but we have tweaked the system a little bit. So, basically our average center size is actually smaller than a lot of the other MFIs. Our center size is such that it serves only seven to eight customers on average because it is a static center model.
- Jignesh Shial:** Understood. Now, since we are discussing and I had a word with Spandana also. Basically, there are banks that are following a model whereby they follow a limit based sort of lending. Immediately after an individual assessment has been done, they allocate a limit to a borrower, which is much larger, say Rs.80,000 or Rs. 1,00,000 and all. So are you seeing this being a spoiler in the markets in general? Do you think this is a spoiler or do you think this is a model that gradually all MFIs will be following.? Just need your view over this?
- Aalok Patel:** I will give you my opinion. It may be wrong. But, my opinion is that when people say that we are assessing a customer in the microfinance side, my first question is how? The level of underwriting which we do in MSMEs is what would be required to done in the microfinance side to practically assess that how much money he or she would be good for. So, I think what you are trying to say is where some of the MFIs are saying that we assess the customer “for Rs. 60,000,” so we start him off with Rs. 30,000 and then in six months we give Rs. 20,000 more. I mean, that is a top-off loan. That is the MFIN way of following a top off loan. I do not believe in top off loans. I think that it leads to certain level of indiscipline as far as ever-greening and stuff goes. I might change that view. I am open to that at a future juncture, but for now, I do not think it is a good idea.
- Jignesh Shah:** That is what I was expecting from you. Thanks for this.
- Moderator:** Thank you. The next question is from the line of Anand Jain, an individual investor. Please go ahead.
- Anand Jain:** Thanks for the opportunity. Congratulations on a great set of results. So, my question is mainly around at what level of debt-to-equity are we comfortable and what type of capital are we looking to raise?
- Aalok Patel:** You are referring to our recent board announcements?
- Anand Jain:** Yes.

- Aalok Patel:** I mean, there is a potential to do true sales and offload some of our loan book to off-book to a certain extent. Further, there is certain level of sub-debt also that we have. So, with that being said, we are probably comfortable at around 20% CAR on a consolidated basis, if you want our policy on that. So, given our growth trajectory, we have created a provision to raise funds. There is no immediate need for it, but definitely by Q1 of next year, if we continue this growth trajectory, we will probably need it. Equity raising depends on a lot of factors, so let us see how that goes.
- Anand Jain:** Like on Rs 150 crore equity right now, we have around 750 crore loan book, so we are pretty much at 20% CAR, right?
- Aalok Patel:** That is correct.
- Anand Jain:** So, in some ways, unless we offload some part as sub-book, there is kind of an urgent need to raise funds?
- Aalok Patel:** Yes, we are getting close, but remember, we are adding about Rs 12-odd crore in equity every quarter. So, if you include that, then your portfolio can keep increasing. So, if your ROEs are at 30%, then you can comfortably keep growing at 30% even without diluting.
- Anand Jain:** Clear, but we are growing faster than that.
- Aalok Patel:** Correct.
- Vivek Modi:** Just to add one more point here. There is always enough room for raising sub-debt in the short term. Because at present, we have a very minimal kind of a sub-debt of around only Rs. 15 crore on our books. So, that route is available. Having said that, on a debt-equity of 4.75, we have a better CAR if you include the Tier II capital as well.
- Aalok Patel:** So, basically, we have Rs 20 crore of Tier II capital, as well. So that increases the CAR by another Rs 20 crore or so.
- Anand Jain:** Thank you.
- Moderator:** Thank you. The next question is from the line of Pallavi Deshpande from Sameeksha Capital. Please go ahead.
- Pallavi Deshpande:** Thank you for the opportunity again. I just wanted some more data updating numbers. Would it be possible to share your attrition rate at the microfinance employee level and also attendance percentage for the center meetings?

- Aalok Patel:** The attrition rate in microfinance last year, after discounting the first-month post joining, it is about 18% to 20% in the microfinance side. As far as the center attendance goes, honestly, it is about 65%. It depends on state to state, but it is between 65% and 70%.
- Jayendra Patel:** Just to add a point here, we are very strict as far as the presence is concerned. And at the beginning of the second cycle, we take note of the customer's presence during these center meetings.
- Aalok Patel:** But you know the JLJ has been changing in the last few years, and the attendance in the industry as a whole has been going down, which is something that not only concerns me, but it concerns practically every practitioner. We are trying to make moves to improve that as well, but let's see.
- Pallavi Deshpande:** The new CRL which you spoke about. Does it speak to some extent about customer attendance?
- Aalok Patel:** It does not talk about customer attendance.
- Pallavi Deshpande:** Does it then refer to the number of lenders per borrower or what is the focus, I just wanted to understand that?
- Aalok Patel:** The CRL is basically trying to bring everybody at a level playing field. Earlier on, when the NBFC-MFI guidelines were created by the Malegam Committee in 2011 and subsequently into the NBFC-MFI guidelines in 2012 by the RBI, that was the time when the NBFC-MFIs ran 99 % of microfinance portfolio in India. Now because of the SFB structure where a lot of the larger MFIs moved on to become SFBs and then you have one large bank, also Bandhan, which is in MFI, that share is going down. And so, the idea is that the two NBFC-MFI rules or three lenders holistically with a total cap of earlier it was Rs 1 lakh and now that RBI increased it, it is Rs 1.25 lakhs holistically. So, no matter what institution it is you will not cross that Rs. 1.25 lakh loan amount and call it a micro loan. If you want to do it, then you can do it with more underwriting or something like that. That is the primary purpose of it.
- Pallavi Deshpande:** Thank you. But then the target for CRL would be only the NBFC-MFIs, is that right?
- Aalok Patel:** No. As of today, most of the SFBs have signed it, most of the NBFC-MFIs have signed it, the NGOs, and other larger NBFCs have also signed, and this is a little complicated. But there are also larger NBFCs which are not MFIs who are doing it, like L&T or Fullerton and some of them are doing it as BC even Yes Bank and ICICI Bank have signed. The only one outlier is Bandhan, which has not yet signed. I guess. I am only sharing it because it is public knowledge that they have not signed. It has been in the newspaper as well. So that is the only significant outlier right now. Otherwise, most people have signed.

Pallavi Deshpande: Would you be concerned about the increasing ticket size versus the number of borrowers for the industry as a whole?

Aalok Patel: It is only in pockets. I think if you look at it overall since we started in 2009, until now, it is only a marginal increase if you remove inflation from that. So, we started our loan size at Rs 10,000, and now, we are at Rs 27,000. But that is over a period of 10 years. So, you got to account for inflation. Overall the ticket size increase for us in the past five to six years, I believe, has only been a CAGR of about 15%. So it is not a very large increase, and a lot of it is due to the inflation, and this is not just one cycle, but includes all cycles, so you got to account for that as well. So, as your customers keep maturing the idea is you can increase the ticket size a bit.

Pallavi Deshpande: Thank you, Sir.

Moderator: Thank you. We have one more question that is from the line of Amit Mantri from 2Point2 Capital. Please go ahead.

Savi Jain: I just needed to confirm you said 85% of your portfolio is monthly collected, right?

Aalok Patel: Yes, and slightly more than that now.

Amit Mantri: But your presentation on page #28 says that 15% is the monthly collection and 85% is fortnightly collected?

Aalok Patel: It might be a typo. I will correct that. I am sorry about that. It might be transposed or something.

Aalok Patel:

Savi Jain: Secondly, in your MSME loan book, now you are making around 33% to 35% yields.. Will the customer be making some 100% kind of ROE on the money that is utilized? And if you take the microfinance and the people say that is for income-generating loan, but everyone knows that is for consumption mostly. But in the case of MSME, I am assuming it is definitely for-income-generating purposes. So now a guy has taken a loan from you and he has obviously expanded his capacity substantially and his income has increased substantially because he is making a lot of money on that investment. So after having paid the money back to you, why would he come again?

Aalok Patel: He might not come back again, or he might come back to me like after a year. So, there is no like rule in MSME.

Amit Mantri: So, the renewal rate in MSME is not as high as it is in microfinance.

- Aalok Patel:** I do not have the exact numbers for you. I can pull them out. Because it is such a small size right now, and we just crossed that two-year kind of a barrier, but I mean there is nothing necessitating them to borrow further. To answer your first question about the income-generating side. See at the micro-level and I say this a lot, if you think about it, they are running sole proprietorships. There is no differentiation between their household expense and business expenses. So, if they have to pay a hospital bill, it is going to come out of the same pocket, they do not have a separate pocket for their business and they do not have a separate pocket for their household. So to a large extent and after doing this for a long time, I mean we make sure it goes towards the business, but if somebody is buying money for inventory in their Kirana store or something, it is very hard to see where that money is actually gone. I am mostly concerned about discretionary spending because if money is needed for the household, it has to come out from somewhere. So that is one part. The second part is what you said about I can underline that question is that you are saying that what business are they running where they can afford to pay me 30% to 35%?
- Savi Jain:** No, I did not mention that. We can definitely do that. We can make 100% ROE, but it cannot be scaled so when you come for second cycle, third cycle, that is what is worrying me, because a single person cannot manage say 5 machines but then he will have to start adding employees and then his incremental ROE will go down substantially. But obviously we do not have data point it is just two-year-old business so that was my question.
- Aalok Patel:** Yes, I do not have a lot of data points right now. The thing is that in microfinance, there is a lot of data available from a lot of different sources. In MSME, there will be a lot of data, but what I am doing is not really MSME, it is something different. And It is hard to split between your model and somebody else's model because there are so many different kinds out there.
- Amit Mantri:** And have you seen what Vistara does? Are you doing something similar?
- Aalok Patel:** Yes, they are present in this segment, but I think they are doing a lot of secured loans as well and they don't do doorstep collections either for most of their products. Although for a lot of the loans, you have to do doorstep collection because of the bounce rate being high. But it is somewhat similar; however, the ticket sizes are different.
- Amit Mantri:** Thanks a lot for answering my questions.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.
- Aalok Patel:** I was not expecting to say closing comments. But, thank you, everybody, for joining us and hope everybody has a good evening and a good week ahead. And we will see you next quarter, I guess. Thanks a lot and take care.

Jayendrabhai Patel: Nothing much to say except that “*Hamare Arman toh Apke uppar Hain.*” Thank you so much, guys.

Aalok Patel: Thanks, everyone, bye.

Moderator: Thank you. Ladies and gentlemen, on behalf of Antique Stock Broking, that concludes today’s conference. Thank you for joining us, and you may now disconnect your lines. Thank you.