



**ARMAN FINANCIAL SERVICES LTD.**

# “Arman Financial Services Q2 FY2021 Earnings Conference Call”

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**ARMAN FINANCIAL SERVICES LTD.**



**ANALYST: MR. JIGNESH SHIAL - EMKAY GLOBAL FINANCIAL SERVICES**

**MANAGEMENT: MR. AALOK PATEL – JOINT MANAGING DIRECTOR -  
ARMAN FINANCIAL SERVICES LIMITED  
MR. VIVEK MODI – GROUP CHIEF FINANCIAL OFFICER  
– ARMAN FINANCIAL SERVICES LIMITED**



**Moderator:** Ladies and gentlemen, good day and welcome to the Arman Financial Services Q2 FY2021 Earnings conference call hosted by Emkay Global Financial Services. We have with us today, 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 would now like to hand the conference over to Mr. Jignesh Shial of Emkay Global. Thank you and over to you Sir!

**Jignesh Shial:** Thanks Janice. Good evening everyone. I would like to welcome the management of Arman Financial and thank them for giving us this opportunity. I will now handover the call to Mr. Aalok Patel. Over to you Aalok!

**Aalok Patel:** Thanks a lot, Jignesh and good afternoon to everybody. Thanks a lot for joining in and taking the time to discuss our financial performance for the Q2 and the first half of FY2021. We have issued a detailed press release and an investor presentation for the past quarter, so hopefully all of you have had a chance to review it. At the outset I hope all of you and your loved ones are healthy and doing well in these very unprecedented times. As many of you might have heard Ahmedabad is going into a sort of a curfew or a lockdown for a couple of days starting tomorrow, so both Vivek and I have been a little busy with some of the continuity kind of issues, so the disclaimer here is please excuse us as we are not as prepared as usual.

Overall, we have witnessed a very broad-based pickup in the economy in the last few months. More importantly our consolidated collection efficiency has picked up significantly from 66% in June 2020 to 87% in September and 91% in October. This continuous progress on the repayment front on a month-to-month basis is encouraging and shows both the resilience and the positive intentions of our customers. In microfinance only 7% of our customers have not started repayments post April. For MSME and two-wheeler that percent stood at 3.6% and 2.9% respectively.

Now, I will start by giving a brief overview of our financial performance for the second quarter and post that touch upon the collections, liquidity, and disbursements in more detail. At the end of the second quarter, our consolidated loan book stood at 704 Crores marginally lower year-over-year as a result of the COVID-related disruptions as higher repayment rates combined with lower disbursements in the first half led to an expected decline in the loan book. Our microfinance and MSME portfolio stood at 523 Crores and 119 Crores respectively at the end of Q2 lower by 5% to 6% year-over-year. In the urban two-wheeler segment the AUM was impacted by the decline in two-wheeler sales in the preceding fiscal year and the sharp drop in two-wheeler sales during the first half of the current fiscal.



However, our newly launched rural two-wheeler product has demonstrated a relatively better performance reporting a year-on-year AUM growth of 10%. The rural two-wheeler book now constitutes approximately 12% of the total two-wheeler portfolio. We gradually resumed disbursements across all segments from August 2020 onwards. Loan disbursements for the month of August stood at approximately Rs 17 Crores and for the month of September stood at 34 Crores this number has increased to approximately Rs 60 Crores in the month of October. We expect disbursements to approach pre-COVID levels by December or January of the current fiscal year. The disbursements were mainly focused on servicing our existing customer base, as the industry began to update the credit bureau data we have begun to service new customers as well but with a more stringent underwriting process wherever possible. Our net total income increased by 4% year-on-year at Rs 33 Crores during Q2 driven primarily by lower finance cost as our borrowing declined by 15% sequentially combined with raising of debt capital at relatively lower rates from DFIs like NABARD, SIDBI and MUDRA. Our company's continuous efforts to rationalize this operating expenses also borne fruit and opex declined by 4% year-over-year to Rs 12 Crores in Q2 while our cost-to-income ratios improved by above 320 bps year-over-year to 37.6%. In keeping with our conservative approach, we strengthened our provisioning coverage by prudently recognizing provisions of Rs 14 Crores during the second quarter. Further we also took an aggressive write-off of Rs 4.6 Crores in Q2 to help reduce the NPA burden of pre-COVID doubtful assets in the future. Including the additional provisions recognized during the second quarter, cumulative total provisions at the end of Q2 stood at Rs 44 Crores at the consolidated level covering approximately 6.2% of our total loan book. At the standalone Arman level cumulative total provision stood at Rs 17 Crores at the end of September 2020 covering 9.2% of the total AUM. Strengthening our provision coverage should help us deal with any impairment on account of COVID in the future.

As a result of higher provisioning, our net profit stood lower at Rs 1.5 Crores for the second quarter while the provisioning may remain elevated for the next one or two quarters, we hope to restore our net profit to healthy levels from the beginning of next fiscal year as the provisions decline. Our GNPA and NNPA have continued to remain low and steady at 1.1% and 0.2% respectively. In terms of capitalization we remain adequately capitalized with consolidated debt-to-equity ratio of 3.3x, which excludes direct assignments. Liquidity wise we are in a comfortable position right now and at the end of the quarter we had cash reserves of approximately 135 Crores including undrawn CC limits. We have repaid all the debt obligations that were due in Q2 and repaid the loan moratoriums that we had availed in April and May retrospectively. Further we have also raised 50 Crores at very attractive rate since July 2020 to bolster our liquidity position. Speaking of a more granular breakdowns on collections, in the microfinance segment particularly the improvements in the collections has been very encouraging as repayment rates have jumped to 75% in August to 84% in September and 89% in October, all operational states besides Maharashtra reporting almost



90% plus repayment rates. At the standalone level the collection efficiency continued to be healthy and well north of 90% in September and October. In the MSME segment, the repayment rates improved marginally from 92% in August to 93% in September and 94% in October, while in the two-wheeler segment the repayment rate stood at 96% in September and 97% in October.

As we move forward, our foremost priority will be improving our collection efficiency and restoring it to pre-COVID levels at the earliest especially in the MFI segment. To complement our high touch physical collections model, we have implemented a new platform to handle collections digitally via integrated software solution using client level unique QR codes to receive payments through UPI platforms. We are currently in the pilot stage of its implementation. With the recovery in the economy, pick-up in the repayment rates in the end of the moratorium period, we now feel comfortable to scale up disbursements gradually and carefully. Hence going forward, we expect the pace of disbursements to normalize from Q3 onwards. Finally, to conclude, I would like to express my gratitude to all our stakeholders for their continued support during these difficult times. A special note of appreciation for the company's field staffs whose perseverance and untiring efforts is the sole reason why we have been able to report such a significant improvement in the repayment rates for September and October. Overall, we remain confident that we will be able to successfully navigate our way through the storm and emerge stronger. On behalf of the company, I wish all the stakeholders a very happy Diwali and a great New Year ahead. I would now like to request the operator to open the floor for questions and answers. Thank you.

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

**Amit Mantri:** Happy Diwali to you and your team as well. On the collection efficiency number, there has clearly been good month-on-month improvement and Arman is doing well or better than many of its peers. On the provision front, the cumulative provisions taken by you cover 6% plus of the loan book, which is significantly higher than any of your peers basically. So, does this mean that you are far more pessimistic in terms of the eventual credit cost that will occur in your microfinance or MSME and two-wheeler loan book or this is just abundant caution?

**Aalok Patel:** Another word for pessimistic is conservative, we have upfront taken provisions as much as the profitability allows keeping prudence in mind. I do not know what the actual write-offs related to this COVID scenario is going to be. The assumption here is it is prudent to take provisions at least in the first two to three quarters and then in March if things are little better than they appear to be then we can always reverse whatever is not required. Now, I just want to let you know that the 6.2% of the loan book, is the cumulative provisioning, so



not all of those provisionings were COVID related write-offs, obviously there will be certain standard asset provisioning that will need to be kept on the book itself. But yes, overall, I would rather call ourselves conservative than pessimistic.

**Amit Mantri:** Sure, and can you give more colour on how the state wise performance is in respect to collections?. From most of the other companies we have heard that Maharashtra has been weak state in terms of collection, so how are you seeing collection improvement in Maharashtra over the last few months and which are the states which have been doing well for you?

**Aalok Patel:** Well, there was a huge jump in the month of October. There has been constant improvement from August onwards when it was about 62% then it went up to about 68% in September and finally in October we ended up somewhere around 77% in Maharashtra. In fact, lot of the increase came from September to October on a cumulative microfinance repayment rate came from Maharashtra taking a significant lead. As far as the other states are concerned, Gujarat is clearly the leader in terms of repayment rates at about 95%, MP is almost 90%, Maharashtra as I said in October was 77%, Rajasthan is about 95% the same as Gujarat, UP has reached 90%, Uttarakhand, which is a small portfolio is about 95.5%. So, overall we have reached about 89% in October for microfinance and for our two-wheeler and MSME segments, the portfolio was primarily in Gujarat., So, the MSME portfolio of Maharashtra is doing little bit better at about 78% and Gujarat repayment rate is about 96% or 97% . In the two-wheeler segment, all our portfolio is in Gujarat where repayment rates would be about 96%, to 97%.

**Amit Mantri:** Sure, and even in the month of November are you still seeing this continuous improvement in states like Maharashtra where earlier they were challenging?

**Aalok Patel:** We were, so getting into Diwali we were on a cumulative basis about 2.5% to 3% ahead compared to the same period in the previous month, but we lost about 5 days of Diwali. So since yesterday we are about the same place where we were last month. But overall, we are expecting to see significant improvements in the last 10 days of the month. I think the lockdown is only applicable to Ahmedabad so that is not going to have any significant effect on our overall operations pan India, and honestly speaking, our systems are evolved in such a way that the operations can continue running perpetually without the HO being opened as everything is online. So, fingers crossed I think there should be some improvement let us hope to cross the 90% barrier this month for microfinance.

**Amit Mantri:** I have more questions, but I will come back in the queue again. Thanks.

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



- Parth Sanghvi:** Sir, just a couple of questions, one is with the interest rates softening, has it has been passed on to us or what has been the impact for us? How do you see the demand environment changing going forward?
- Vivek Modi:** In terms of the interest rates softening, the way it is applicable as per the RBI directive for microfinance the fresh disbursements that we are doing are at the revised lower rates.
- Aalok Patel:** Are you asking about the disbursement side or from what we borrow from the bank side?
- Parth Sanghvi:** The disbursement side.
- Aalok Patel:** Yes, as per the RBI whatever new disbursements that we have done in this quarter are at about 100 basis points lower rate. So basically, whatever gains that we got in terms of lower interest rates, unfortunately as a company we have to pass that on to the customer. But just to add this is applicable only for the new disbursements, the book that we have created in the past with higher interest rate, will continue at those same rates. **So in the short term** the interest rates declining would mean a better net interest margin for us..
- Parth Sanghvi:** What is your outlook on the demand scenario?
- Aalok Patel:** Demand is of course there. I think we are fortunate enough to be in a business where the demand is evergreen. But I think as I mentioned in the last concall that even during demonetization we had stopped for disbursement for three to four months and now also in the month of August and little bit of September most of the disbursement has been to our old customers. The credit bureau data, was stale since March, so if you pulled up the credit bureau data for the prospective customers, it would show a zero default kind of a customer. But now that the credit data is getting updated by most of the financial institutions and the banks, we will start disbursing to the new customers also. But back then we were a little bit blind so mostly we stuck with our old customers with a proven track record.
- Parth Sanghvi:** Thank you.
- Moderator:** Thank you. The next question is from the line of Amit Mantri from 2Point2 Capital. Please go ahead.
- Amit Mantri:** The interest income has increased on a quarter-on-quarter basis despite decline in the loan book, so why is that?
- Aalok Patel:** In the same quarter the previous year you are saying?



- Amit Mantri:** No, from previous Q1 versus Q2, so the interest income is higher in this quarter than in the last quarter despite loan book having declined may be around 13% to 14%?
- Vivek Modi:** Amit, there could be a marginal impact, there a couple of things that have led to this. The interest income also includes interest on the fixed deposits and cash collaterals, the component of the fixed deposits have considerably increased in the last quarter or so and additionally if you look at it, at the beginning of Q2 the portfolio was pretty much high, so an average basis the portfolio was not much lower
- Aalok Patel:** I think the average portfolio would be a different story. The repayment rates increased drastically in August and September, so overall if you look at the average AUMs there will be a little bit of a difference.
- Amit Mantri:** Understood that now. Is the interest income being recognized on the entire book or are you assuming that some part of the book will be NPA, so interest income should only be recognized maybe on a slightly lesser book or will that lead to interest income reversals whenever NPAs show up in the next few quarters?
- Vivek Modi:** Partially what you said in the last is the right. because under the Ind-AS anyway even on the NPA you need to book the interest.
- Aalok Patel:** And unfortunately, until 90 days you are supposed to recognize the interest, which I completely disagree with by the way. So we have a large portion, where the interest is accrued but not received, and we are of course building the provisions for that as well. However, the way we structured the moratorium is that when the customer pays off I guess the moratorium you can call it as a type of restructuring only, so when the customer pays off that interest accrued but not received part gets hit first, so I do not think that there will be a very large reversal as a result of that. But if you look at the 6-7% of our customers who have not paid since the moratorium started, then of course there the reversals would be required but then provision we have made till includes the provisions on these assets.
- Amit Mantri:** If you were to only consider those who are paying fully or even partially then the interest income would be lower by around 6% to 7% of which is the number who is not paying?
- Aalok Patel:** No, the interest income would be lower by a little bit more than 6-7%. I do not have the exact numbers with me, right now. Let me put some thought into it and get back to you on this.
- Amit Mantri:** Sure, I got it. You had a fair bit of excess liquidity on the balance sheet, the debt has declined and there is a fair bit of cash that is sitting on the balance sheet now, so is the plan to continue to carry the kind of excess liquidity even going forward?



- Aalok Patel:** Not so much, I think about Rs 100 Crores or so is what we have been working with. So, we will try to keep it around between Rs 80 Crores and Rs 100 Crores, and as the disbursements pickup I think that excess liquidity should continue to go down. So, we are trying to manage it and plan it in a way based on what we project our disbursements to be, in fact in a couple of days we are closing another NCD transaction for example.
- Amit Mantri:** Now because the disbursements have started and you did Rs 60 Crores in October, so now the loan book is unlikely to decline further going forward right?
- Aalok Patel:** Yes, so we have reached that stability now. At least in the last month we reached a stage where the repayments were about the same as what we disbursed, so starting from this month or maybe next month the portfolio should start going up again.
- Amit Mantri:** Okay. Thank you very much. That is all.
- Moderator:** Thank you. We take the next question from the line of Srinath V from Bellwether Capital. Please go ahead.
- Srinath V:** I logged in about 5 minutes late so if my question is repetitive, I am sorry. I just wanted to understand given that the MSME business has done very well, in the last three months you had above 90% collections. So, are we looking to slowly scale up disbursements there because the disbursements number if you were to assume that the disbursements were done only for a month, the numbers are a bit on the lower side. So, just wanted to understand and also given that there is an asset income loan the slightly stale bureau data in at least MSME should not be that much of hurdle, right, just wanted your clarity?
- Aalok Patel:** So, we are starting to push for the disbursements in the MSME side also. Of course the incomplete credit bureau data, which we rely a lot on was incomplete and there were a lot of different kinds of businesses that we had sort of blacklisted until the COVID situation improved and those were essentially occupations, which we thought would be highly disrupted due to the COVID issues, such as the roadside Dhaba type eateries and hospitality kind of small establishments. So, I think going forward that should pickup. As far as the repayment rates in MSME is concerned, if you compare apples-to-apples of course MSME is slightly better than micro, but if compare it to a state-to-state for example in Gujarat, the repayment microfinance is only marginally higher versus MSME repayment rate.. So, I guess we got a little bit lucky from the geographical standpoint, I am just kind of trying to be fully transparent here, but that being said, yes I think starting from Q4 onwards we are already trying to figure out our next expansion in terms of branches and areas for both MSME and microfinance. So, honestly my biggest goal is to put COVID behind us by the time April 1, 2021 comes around. I know that is a long way away, but hopefully we reach a





spot where you know whatever has to be provided is on the books by March and essentially we get a fresh start from April 1, 2021 and continue our growth story.

**Srinath V:** I think during the last cycle Gujarat was the pain area, so is that to be diversified because it is so difficult to take this?

**Aalok Patel:** May be this is not the right forum, but I always joke around with the people including Vivek here that last time we got kind of shot in the foot at Gujarat and as a result of that we diversified across these different states. If I would have just been in Gujarat, I would have been better off, but of course this is not the lottery system you cannot just make decisions based on luck. So, I do not regret to make those decisions, but it is just one of the ironies of the life.

**Srinath V:** Got it and I just wanted to understand what is happening in Maharashtra. Is this a political kind of an issue or is there a difficulty to reach the customers? Again, as much as possible if you could share some qualitative flavor on what is happening in that market then that would be very helpful?

**Aalok Patel:** I think different areas have difference problems, but largely earlier on it was about reaching the customer. About political issues, a lot of those issues have gone away and so I would say Maharashtra whatever gains that we made in June, July and August let us say in Gujarat we had a late start in Maharashtra, so those gains optimistically should be forthcoming in Maharashtra as well , albeit a little later. But I think primarily issue was that because earlier on there were a lot of political issues, they are still there, but relatively the a lot lower than what they were 2 to 3 months ago and of course access now is not much of an issue, which was a huge issue in those earlier days.

**Srinath V:** Got it. Thanks, Aalok. Wishing you and your team a happy Diwali.

**Moderator:** Thank you. The next question is from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

**N. Chandrasekar:** Few questions on the competitive intensity in the last two to three months obviously in your area, my guess is that the smaller NBFC-MFIs struggle for a liquidity or have you seen some players step up disbursements. Just wanted to get a sense of supply of credit.

**Aalok Patel:** I think most of them have cut back on the disbursements, may be not as much as us, but enough so where the repayments were higher than what they were disbursing. So, I do not think that liquidity is too big of an issue. On the field level when you talk about microfinance, basically what you need to understand is the same guy who is disbursing is also the same guy who is collecting. So, as the management sitting at the HO we kind of



have to try to find a balance that what is the priority and accordingly what we want So do we want them to focus on collections. 30 days out of the month or we want them to focus on collections 70% or 80% of the time and then focus 20-30% of the time on disbursements. So, I do not think that there is one clear right or wrong answer here, I think you have to tackle each area differently, and each branch differently, obviously for states and branches which have reached 90% to 95% repayment rates, it would be foolish to focus 100% of your time for that incremental 1% kind of a repayment rate increase. So, basically, as the repayments increase, I think disbursement is naturally going to increase. As far as competition is concerned, I think most people barring a few exceptions they will always be the outliers, lot of people cut down a lot on the disbursements compared to even pre February levels or even the same period Q2 of last year itself I think the disbursements were just probably 40% to 50% in the areas that we are working in. So, overall a pretty large decline from the disbursement side, but everybody is going to be picking up again, so based on my informal talks with lot of the senior level people at different companies, I think everybody during Diwali and post Diwali is planning to ramp up disbursements, so let us see what happens.

**N. Chandrasekar:** Thanks for that colour and in terms of **scenario** on the ground, are you seeing top up loans happening to customers who have not able to pay instalments for even a month?. ?

**Aalok Patel:** Honestly I cannot comment on the number or who is actually doing it; however, it is not a big secret I think companies are doing it, there are top up loans out there, there are net of loans out there. Another way to increase your repayment rate is to just start disbursing a lot of money because on a static pool your repayment might be down, but whatever new portfolio you are creating obviously that will be assuming at a higher repayment. so then your weighted average will go up. But there are companies that are making top up loans, there are few companies that always used to make top up loans and they will continue to do so, there are certain MFIs who are netting off their outstanding and issuing a whole another new loan, so which is not very different from a top up loans. but a different kind of mechanism. I am sorry, I do not think I have the right answer in terms of how many companies are doing it and how rampant it is, but for sure. I can assure you it is happening in few companies and some more than others.

**N. Chandrasekar:** Understand, one more question, the 6% to 7% of the customers that you mentioned have not made any payment since April this seems ballpark in line with **what other MFIs are reporting**. Can you give any colour on what occupations the customers come from and from which states?

**Aalok Patel:** We have all of this data, but to be honest with you, I do not have all of it in front of me right now, so maybe we can take it out separately. But just to provide without getting into the actual percentages, I can tell you that about half of those nonstarters or whatever you want



to call these customers are in Maharashtra. , Also out of the defaulting customers, most of these customers are involved in non-agriculture kind of activities, so most of our customers that are involved in providing livelihood kind of services versus lifestyle kind of services, are obviously doing a lot better compared to let us say the hospitality people and the street vendor type of people. Obviously they got disrupted quite a bit, but they are back on their feet, but clearly not in a way that will allow them to start making repayments for lot of these guys. Another curious thing is that for many customers who are showing an intent to repay it is not like the progress is steady, what I am basically trying to say is that imagine a customer who pays in August and September, well although there is a small chance but there is still a chance he will miss October's payment and then pay in November. So, the assumption that most of us made earlier that once you get them to start paying they will continue paying, but that is in fact not the case in a small segment of customers who are paying one installment, missing one, paying another, missing another, so it is a kind of random in that sense.

**N. Chandrasekar:** I am asking the customers who would have their loan tenure restructured, on average how much longer would the tenure be?

**Aalok Patel:** That is interesting On average I guess on a weighted average basis it would be 3 months. Anyway, I am sure you can backward calculate it with our repayment rates.

**N. Chandrasekar:** Thank you.

**Moderator:** Thank you. The next question is from the line of Shreepal Doshi from Equirus Securities. Please go ahead.

**Shreepal Doshi:** My question is with respect to our disbursements of new loans, I know that even now the credit bureau data is getting updated, but what number of installments are we seeing that the customer would have paid, and what is the strategy on evaluating the credit bureau data before disbursement?

**Aalok Patel:** Certainly, we want prospective or new customers to have restarted their repayments, so the criteria that we came up last month was that they should have made at least three continuous payments for us to consider it this was for the MSME segment. For the microfinance segment, we came up with a criteria of two continuous payments with absolutely no kind of defaults in the previous months, but as I said the credit bureau data was quite stale at that time and there was a certain High Court order or Supreme Court order that was restricting even post-moratorium due to which some of the financial institutions were not sharing the data adequately. So, for evaluating a lot of new customers we were kind of relying on our own experience. But going forward that will become important the criteria, yes.



- Shreepal Doshi:** So, the current disbursements that we are doing I understand we are doing it primarily to our own customers. So, we would sort of have an understanding of whether the customer has paid the last two EMIs for the MFI segment and then accordingly we will be taking a call right?
- Aalok Patel:** We were taking a call based on our own experience with the customer and by our own experience we gave them a free pass if they did not pay for April and May and in some cases June as well. For July and August if they continue their payments and their loans was finished then we were happy to give them a loan.
- Shreepal Doshi:** I understand that the previous question was also with regards to this, but what percentage of our customers have a 4-month of loan tenure extension?
- Aalok Patel:** About 25% of the customer would have 4 months or above. Essentially customers who have not paid even for 3 months then also it will be more than 3 months because there would be some bit of interest. It is hard to access all this data on a moment's notice, so if you need more information on this just send e-mail to our investor relations firm and we will help out with the required details.
- Shreepal Doshi:** Sure, one last question was how are we seeing the securitization and off-balance sheet portfolio opportunity coming up in the last one and one-and-a-half months?
- Vivek Modi:** The enquiry for portfolio purchase is high across all segments, even in the two-wheeler and MSME segment off course microfinance is always in demand because of the PSL. The difference now is that most of the institutes are inclined more towards the PTC kind of transactions rather than DA transactions. We have been fortunate that in the 7 months that have gone by for this financial year we have added enough liquidity especially from institutions like SIDBI, MUDRA and NABARD. So, we have a good lineup of such transactions, but as I said the interest is more towards the PTC transactions where the risk coverage for the investor is higher.
- Aalok Patel:** Lot of banks and financial institutions are looking for good places to deploy money and so we are getting a lot of offers from both the securitization side and the term loan side. Unfortunately, we have always had enough cash, so most of those things we turned down. But most of the financial institutions at least the better ones are sitting on a lot of excess cash because they have not been able to deploy it in the last few months and if I can blow my own horn I would consider our company as a good place to deploy that money, so we are getting a lot of offers and we are in a position to pick and choose the more favorable ones.



**Shreepal Doshi:** Sir, if I can squeeze in one last question, which is something like you alluded in the lead part of your comment, now we are seeing imposition of curfew again even in smaller towns where the curfew or lockdown sort of situation is not imposed by administration, but there also we are seeing slowdown in economic activities by the discretion of their particular business organization, so do you see this will create some hindrance or some delays in the collection efficiency improving going ahead?

**Aalok Patel:** Absolutely, I will tell you in lot of even village areas if there are certain cases in the village even the panchayats are making kind of ad hoc decisions of implementing their own version of lockdowns and stuff like that so on a daily basis we face those kinds of situations. Even in branches that are located in areas where there are a lot of cases where formally or informally those place become containment areas, so we have to figure a way out to get other people to start collecting. So, these are constant operational issues that come into place in this new COVID world, but hopefully we can put this all behind us in the next kind of 3 to 6 months. .

**Shreepal Doshi:** Sir it would not be sort of easy to extrapolate the current disbursement trend for the second half, is its fair understanding?

**Vivek Modi:** No, we have reached about a run rate of about Rs 50 Crores in the microfinance, so this month we did about Rs 50 Crores of disbursement against pre-COVID levels of about Rs 70 Crores. So, I would say by about December or January we should be at least at around Rs 65 Crores levels, why that 5 Crores gap is because there will be certain branches where I would not be able to start disbursements, branches that are allowed to be a little slower. So, already we have a plan in place of those branches whether to merge them or keep them as collection branches with kind of a lower staff level and we already have a plan also in place to open around maybe optimistically 15 to 20 branches between December and January. Now those branches will be more for the next fiscal year because it takes about two to three months for disbursements to ramp up, so they should provide at least a little bit of help this year as well. The situation is very fluid right now, you know every day there are new challenges to firefight, but thankfully we have managed going through all of those so far, so let us hope that continues in the future as well.

**Shreepal Doshi:** Sure, Sir that is it from my side. Good luck. Thank you.

**Moderator:** Thank you. The next question is from the line of Savi Jain from 2point2 Capital. Please go ahead.

**Savi Jain:** Mr. Aalok, happy Diwali. Just a couple of questions, one is on the credit cost you do not have a clarity on what the eventual credit cost will be, but I think all the industry players when we were at the peak of the COVID crisis they felt that the ultimate credit cost would



be lower than demonetization, that was something that many people spelled out with quite a bit of confidence, so now a lot of time has elapsed and what is your opinion on that will it be lower or higher?

**Aalok Patel:** For the record I was never the person to say loss will be less than demonetization. I have never believed that to be the case because demonetization was the cash related issue and this was more of a loss of income and loss of enterprise issue, so I always felt it is going to be a higher than demonetization and I still continue to feel it is going to be higher than demonetization. But honestly I always call myself as a bit of a pessimistic person so what I was imagining the loss to be in around April and May, it is going to be a lot lower than that if it makes you feel any better.

**Savi Jain:** No, even we felt it that way, but I think there was a tremendous amount of confidence, which still there is. But it seems like there would be a minimum of 7% credit cost for the entire industry, which is at least a minimum of 7%, which is more than what was there in demonetization?

**Aalok Patel:** In demonetization, like for example, ours on a static pool basis we lost about 4% to 4.5%.

**Savi Jain:** Yes, you would be among the lowest in the industry, as low as maybe Bharat Financial or some of the good ones, but I think overall the average was more than 5%.

**Aalok Patel:** Yes, I would say that estimate is not far off, but you know lot of these things will be spread, you have the restructurings available and you have of course the gentlemen before talked about top ups and stuff going on. So, I do not think it is going to have a systemic issue and honestly I do not think this is just going to be related to microfinance, it is going to be the entire financial services which is going to have to bear this including banks and NBFCs and MFIs and MSMEs and everyone. There will be a few, may be the gold loan guys who might not have to deal with it because they are fully collateralized. But everybody else is going to have to take a hit, the sooner you can accept that the sooner you can move on.

**Savi Jain:** Also on the top up loan you were discussing with the earlier participant, now we obviously share a lot of lenders with our borrowers, they would be borrowing from larger banks or SFBs, etc. Now they are clearly very aggressive in terms of giving top up loans to their customers and therefore these customers do not show up as NPA even for you probably because these guys might be paying you from those loans. So, how do you really discriminate and understand who is really a good customer, bad customer because if this is happening on a rampant scale and because you mostly would be sharing your customer with at least one financial institution, right, so if it is happening on a very large scale then especially the smaller players would be suffering because of poor underwriting by the larger players?



**Aalok Patel:** No, I do not think it has reached to that level, I do not think it has become a systemic issue or anything like that. Let us say in the case of Arman as well now if we borrow from SBI and have a repayment for Kotak this month, then does that mean we have borrowed money from SBI to pay off Kotak, of course it does right, that is our business, nobody says anything wrong about it, so there are right ways to do it and wrong ways to do it number one. Number two it is not like I have anything against top up loans, off course I am not a big fan of them, but top up loans done in the right way although I do not know exactly how to distinguish what is the right way or wrong way, , but you know if you fully disclose it that you are doing top up loans then you have a certain level of criteria for doing it where at least the management level of a certain company feels it is the right thing to do and the underwriting standards are adequate and finally the positives outweigh the negatives then go ahead and do it. Only thing I am against, is that you use it to cover up your losses and kind of hide your problems, so that is the main issue that I have with the top ups, otherwise there are companies who have always been **doing this for the last couple of years**, so we have been against top up personally.

**Savi Jain:** Lastly in the last five years we have seen two six sigma events and when they occurred they called it six sigma, but if the six sigma events occur so frequently then they are not really six sigma. So what is your learning in terms of how you are going to build your business going forward because every once in four, five years something like this happens, which can really even jeopardize your very existence, so what is the broad change in strategy that you will undertake after this?

**Aalok Patel:** Honestly from demonetization there was a lot of learnings. As far as the pandemic is concerned it was on such a global scale that, I am sure there are lessons we learned and there are good lessons to be learned, but we have been just so busy firefighting, that maybe ask me this next quarter and I will be able to give you a better answer for this.

**Savi Jain:** Pandemic and obviously it will not be a pandemic maybe it will be an earthquake or whatever I hope not, but I am just saying that if you are concentrated in one state it is just you could not have done anything to have prevented it and then you are unlucky because you were like I said you are present in Gujarat in a big way so that kind of also helps sometimes they did not. So, how do you future proof this business of microfinance and MSME lending, obviously geographical diversification is something that is there, so I think you will continue on that part right irrespective of what has happened?

**Aalok Patel:** We had plans to expand into Bihar in certain areas, which all got out of the window. Also, there were certain branches in Haryana and places that we wanted to expand into through Western UP, of course there were big plans for this year. What I want to do as these things happen from time-to-time, unfortunately as I said these kind of events one after another in 2016-2017 we had demonetization and then of course we had COVID, so unfortunately



these events I do not know if it is a coincidence they happen so close, let us hope it is a coincidence because I do not think my nerves can take it happening every three years.

**Savi Jain:** Just a last question on this, basically if this is a brunt that the entire industry has to face from time-to-time, so one way probably to tackle this is that you could have higher NIMs or eventually you make very high ROEs in some years and then you do not make any ROEs, obviously the problem with that is the spread cap that RBI has. So is there any thoughts that you might go to RBI and say that this was a fallout of the AP crisis probably, so now the things are much more stabilized there should not be any such spread gap in any benefit of efficiency and banks can still retain it right, but you cannot?

**Aalok Patel:** There has been attempts in the part to ask RBI for a relaxation of the so called ceiling for the interest rates and RBI in those cases did not look at it too favorably very honestly. Whether that stance has changed now, off course they would have to be approached by MFIN or some of the other industry associations, which by the way have already approached them about the 2.75x cap because it was really ridiculous formula right, for every 1% decline we have to reduce our rate by 2.75%, so it just did not make a lot of sense. So, RBI is looking into that.

**Savi Jain:** You have lesser interest because from the heydays of 28%, 29%, 30% now the bigger banks are lending at 19%, so it has already come down to a very respectable level?

**Aalok Patel:** In my experience, a lot of the government officials do not understand the nitty-gritty, operational issues of microfinance or how expensive it is to do what we do and you know as you say every two, three years there might be a zero ROE kind of a year. I have met many government officials in my career and you know when you explain to them that what you do, they love the story you are helping the women and all other stuff. But inevitably the question will come up that how much you charge and the second 24% or 23% comes out of your mouth you have lost half the battle, it does not matter how much you try to justify to them about operational cost and credit cost and the last mile delivery and all of that stuff, in their minds you are taking unfair advantage of the poor people. So we have come a long way, I think, the central and most of the higher state level officials understand what we do and why it is necessary to have these rates; however, anyway we can always try, there is nothing wrong in asking, it is just that in my opinion when you are asking them to increase rates, they do not want a newspaper article saying that RBI allows charging poor people an extra 2% right, it is a nightmare form them so I do not think they will allow that.

**Savi Jain:** That is, it from my side. Thank you for your answer.

**Moderator:** Thank you. The next question is from the line of Saptarshree Chatterjee from Centrum PMS. Please go ahead.





**Saptarshee Chatterjee:** Just two questions, one is can you just talk about what the proportion of customers per cycle, the second cycle and how is it in the case of Maharashtra?

**Aalok Patel:** So, in Maharashtra, since we moved in there like about 3 odd years ago, so there are lot of full cycle customers almost I would say about 70% will be first cycle customers in Maharashtra. Overall if you look at it for the Microfinance portfolio, I would say about 50% of our customers would be first cycle.

**Saptarshee Chatterjee:** Understood and secondly just a clarification in the balance sheet March versus September, there are two items the financial assets and investment, so what is the increase if you can give some flavor increase in other financial assets. What are these items and in the investment side these are primarily G-SEC or mutual funds or what are these basically?

**Aalok Patel:** Those are highly liquid kind of risk-free kind of liquid funds, which we put it in either in SBI or Kotak or some combination is there.

**Vivek Modi:** Could you repeat the other question?

**Saptarshee Chatterjee:** Yes, basically the other financial assets, which increased from Rs 7.5 Crores to around Rs 12.7 Crores from March to September, what are the basic items if you can give some colour?

**Vivek Modi:** You are talking from March to September, right?

**Saptarshee Chatterjee:** Yes.

**Vivek Modi:** So, this includes the interest accrued, but not received on the loan assets.

**Saptarshee Chatterjee:** I understood. Thank you so much and all the best.

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

**Srinath V:** Aalok, just wanted to get a few data points, just wanted to understand how the rural two-wheeler book had fared, given that it is in a pilot phase it will be very useful to kind of see the data because if this product survives COVID then we can significantly scale it over the next 12 to 18 months, so could you share some feedback?

**Aalok Patel:** Yes, last month it was about 93%, so it is a little bit on the lower side compared to the MSME, but still not too bad as far as compared to the urban side. So the cheque bouncing in the urban side has been on an average about 40% of instruments on NACH and overall level



are bouncing, which is huge, that means people are still in some level of severe disruption, I am not exactly sure what is happening. As far as we are concerned our pre-COVID bounce rate in the urban two-wheeler side was about 20% and even in the current month that number is around 34%, so significantly higher, but then when you show up at their doorstep it seems that we manage convincing them to give the money, but it is kind of a weird phenomena I am not sure exactly what is going on there.

**Srinath V:** So, net-net one would assume you are reasonably satisfied with 93-94% collection which is fantastic. So, at the right time you would look to scale that business line would that be a fair understanding?

**Aalok Patel:** Yes, absolutely. Right now is not the right time because it just seems that people have lost the interest in buying two-wheelers, the sales are really low, it has not been a very good season at least in the areas that we operate in. I know that is contradictory to some of the articles, which are coming from Hero and other talking about record sales and stuff taking place, so how do reconcile that with own my operations, I would like to look at it in more detail in the next few days. But overall the last year-and-a-half to two years have been difficult on the two-wheeler side.

**Srinath V:** Any other product that we have piloted and could you share how the credit performance has been., I am aware of rural two-wheeler, but outside that if you have piloted any product it is very useful to see the strength level?

**Aalok Patel:** No, I do not think so. There is no other product that we have it on pilot right now.

**Srinath V:** Got it. This addition of 15 to 20 branches that you had just mentioned to a previous answer just wanted to understand that we are looking to open in Q4 to kind of set up growth for next year. What kind of diversification, what kind of geographical areas are we looking to expand into and are we looking to start some branches, so if you could give a branch outlook in terms of where are we expanding and where are we contracting from in Q4?

**Aalok Patel:** Right now, the areas under consideration are some areas of Rajasthan and Western UP into neighbouring states as well. So, 15 to 20 branches is not a very large number, the idea is to hopefully concentrate on areas where the repayment rates of course that goes without saying, but even our experience with Rajasthan and Western UP has been fantastic, overall repayment rates have been 95% for the past few months. So we are looking to expand into those areas, but I think a lot of research and time and efforts go into before selecting the exact branches and areas, we are not quite there yet, we have a lot of work to do before we decide on the exact areas.

**Srinath V:** Thanks, Aalok. I will get back in the queue.



**Moderator:** Thank you. We take the last question from the line of Vinay Ambekar, an Individual Investor. Please go ahead.

**Vinay Ambekar:** In the previous conversation I heard a whisper about trade secrets, so can you elaborate or talk a little bit about this digital collection initiative that you said you had started. Is it in MFI or MSME segment? and how the performance been and how you are thinking about scaling it?

**Aalok Patel:** So there are two things that we are doing, one side is there is a unique QR code that gets generated for every customer and you can use any UPI based either Paytm or PhonePe or anything like that or even your banks app and if you scan the QR code the money will automatically get reflected into my bank account and the customer's account will automatically get credited in the LMS system. So, we also have mechanisms where the customer can pay via unique codes over a phone if we are trying to do collection efforts or things of that sort. We have also tied up with the Fino Payments Bank wherein either the customer or the field officer can go to their nearest Fino merchant and deposit the cash directly and have it been reflected into their account directly. So, those are the two things that we are doing, let us hope the uptake is good. But I think this is a long-term, you know I do not think you are going to see results in a few quarters, I think it is going to take a few years to permeate through the system, but at least the hope is that we can shift the customers at least partially to a non-cash based payment, but not lose that high touch kind of models, so still do the center meetings and things like that, but have lot of them pay money via a cashless mechanism.

**Vinay Ambekar:** You continue to offer in the MSMEs doorstep collection, so do you see a part of it getting replaced with digital collections?

**Vivek Modi:** I think right now the situation itself wants you to prepare yourself for having this digital collection system more available, not that you want to replace the high touch model that we have on the microfinance or MSME side, that will have to continue the way at least into the foreseeable future. But as somebody earlier asked that how are we preparing ourselves for the next big black swan sort of an event, so I think this is one of the those initiatives, that would help if offered to a larger set of customers, and so it would be good if we are have digital collection mechanism that has worked well in place then. .

**Aalok Patel:** Also, another way to look at it is that you do not want to be stuck in a position where if you cannot reach the customer due to whatever reason, whether it be a pandemic or an earthquake or something, there has to be some backup option available and customers have to be trained and their culture needs to be changed, wherein okay we can come and collect it, but if we are not able to then you need to transfer the money by some method. So that will take some time.



**Vinay Ambekar:** Right, second, just to extend the point that you had made about balancing collections versus disbursements because the same field officer is doing both and as you are likely to increase disbursements going forward there could be lesser time spent on collections. During demonetization and just after that there was a separate team that was formed and I think Jayendra Sir was by overseeing that to focus only on collections, so is there some thought around these lines in this current situation?

**Aalok Patel:** Absolutely, I think that is the plan, we have already started recruiting on the MSME front because those repayment numbers have sort of stabilized right, so whichever customers are there, which are either not started or have started in no meaningful way, so those are the customers that we will be targeting. So, we are starting the team of about 20 people in MSME and that will expand and hopefully the thought here is the same one that we had, as long as the amount collected is more than what is the cost I think will continue having yet. So that will be probably a long-term plan. In the microfinance segment, we will have it once the repayment rate stabilizes, so the current team is still continuing to make progress on a month-to-month basis, once we see some level of stability we can implement that RO structure, recovery officer structure on a branch-to-branch basis as well.

**Vinay Ambekar:** Right, a clarification on disbursements, when you said that you will probably reach around Rs 60 Crores to Rs 65 Crores of disbursements may be by January or February or December and also you mentioned that the preference is to give loans to existing customers and you also said that currently we are not doing top up, we are only serving those who have closed their loans. So, I would assume that for the next six months say till March you would have the data available about which are the customers whose loans are going to be closed and then based on their performance history you will probably target them for disbursements. My specific point was that out of the Rs 65 Crores or whatever number you are targeting, do you have some sense how much would be new and how much would be these kind of customers that you would end up by March?

**Aalok Patel:** Not by March, unfortunately my chief operating officer will probably be a better to give picture on that. But I think what you did was very fair assessment of what we did, so to reduce a lot of their burden we ran a pre-approved kind of a scenario as far as our old customers are concerned and basically ran the high mark in the credit bureau not on the request of the branches but from our own data in the HO and we send the list to the branches directly saying that these are the old customers who are maturing and we have ran that credit bureaus and these are the ones, which are pre-approved as far as the credit bureaus and stuff are concerned, so there it becomes a little bit easier as far as the underwriting is concerned. So that basically that is what we did. Now in terms of almost all of the disbursement that we did were old customers. In the month of September almost about 75% of the new disbursements were to old customers, but soon enough we are going to run out of old customers. So you will have to start concentrating on new customers as



well, so I am not exactly sure what that number is going to look like going forward, but I think overall our reliance of course for old customers go on for perpetuity.

**Vinay Ambekar:** Right, just a last question on this, because I believe in the MSME we have been primarily targeting new to book customers, so is there a thought where our late cycle MFI customers who have grown with us, is there a thought to increasingly tap that database for the MSME pool and how do you see any number forming in your mind, how much would that constitute or something?

**Aalok Patel:** Actually the microfinance division, itself we are considering of starting disbursing of loan of around Rs 50,000., What has actually happened in the past when we started to do inter-departmental kind of transfers and this is something that you will find when you are running this business is that the MFI team members do not want their hard earned fifth cycle customers to go to the MSME division, so off course there are ways around that as well. But in the MFI book as well we are starting the Rs.50,000 loan product on an individual basis, so that we will go through its own pilot stage, and hopefully we can launch that in December or January sometime. As far as numbers are concerned, we are not exactly sure about that, it would not be a very large number this year, but depending on how the pilot goes it may be about 5% to 7% of the portfolio in the long run.

**Vinay Ambekar:** That is good actually because if the MSME is catering to their own separate pool and then you have within MFI larger customers getting some similar kind of offering then it may probably prevent a leak to other lenders right?

**Aalok Patel:** Yes.

**Vinay Ambekar:** Wonderful, yes, just one last data point, within the 6.2% cumulative provisions that you mentioned would you have a breakup of how much is COVID specific extra provision that you have taken and how much is the normal standard provisioning that you would have made?

**Vivek Modi:** Yes, Vinay that would be about 3.86% is the COVID provision and the balance will turn out to be the normal standard ECL provisioning.

**Aalok Patel:** Even ECL will be bounced up for COVID as well.

**Vivek Modi:** Because in the ECL you would have a higher rate of provisioning for the cycles or the 30-day period cycle, hence the ECL provision itself has bumped up, but the COVID provisioning itself stands at about Rs 26 Crores odd for both the entities taken together and that turns out to be almost 3.9%.



**Aalok Patel:** That would be a part of the standard asset provisioning, COVID provisioning right now would be considered as a standard asset provisioning.

**Vinay Ambekar:** Right, okay got it. Thank you Aalok and thank you Vivek for your detailed answers. Thank you so much. All the best.

**Moderator:** Thank you very much. That is the last question Sir. You may please go ahead with your closing comments. Thank you.

**Aalok Patel:** Thank you everybody for joining. I think this has been a sort of a record where we have gone half an hour over and above what we typically do, but it was a nice experience. There were lot of questions that got us thinking towards the right direction as well, so thank you for that and hope to see you all in the next quarter and hope you all had a Happy Diwali and have a great New Year ahead. Thank you so much.

**Moderator:** Thank you. On behalf of Emkay Global Financial Services we conclude today's conference. Thank you all for joining. You may now disconnect your lines.