

Transcript

Conference Call of Arman Financial Services Limited

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Presentation Session

Moderator: Ladies and gentlemen, good evening and welcome to the 1Q FY17 earnings conference call of Arman Financial Services Limited hosted by Antique Stock Broking Limited. 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, please signal the operator by pressing * and then 0 on your touchstone telephones. Please note this conference is being recorded. I would now like to hand over the conference to Mr. Digant Haria from Antique Stock Broking Limited. Thank you and over to you sir.

Digant Haria: Very good evening to all of you. At the outset I would thank everyone taking out time to attend this call, especially the management, which is represented by Mr. Jayendra Bhai Patel and Mr. Aalok Patel to take out time and explain the Q1 FY17 performance. Arman had a very strong quarter, especially in the microfinance space. So, I think it would be apt at this point in time to handover the call to the management for some opening commentary on the results and the business in general. So, over to you Jayendra Bhai and others.

Jayendra Bhai: Thank you Digant. Ladies and gentlemen, please accept my sincere thanks for taking part in this quarterly call for Arman. It is encouraging to note that every quarter we have more and more people join us for this call and am moved that you find time out of your busy schedule to join us. So, thank you once again. It seems that every time, we run out of time to ask questions. So, I will keep this speech of mine little shorter this time. I am sure that everybody had a chance to see our results either on the press release or on our company's website. If you have not had a chance to look at it, I request you to look at it.

Asset under management has grown to 187 crores, 47% growth from the same quarter previous year. Consolidated income from operations grew 43% to 12.7 crores for the three months ended. Profit after taxes for the quarter was 2.87 crores. This represents 41% growth for the same quarter previous year and 30% growth from the last quarter that is Q4 FY16. Disbursement was increased in both asset finance and microfinance, compared to Q1 FY15. Microfinance average monthly disbursement increased from 13.5 crores to 17.2 crores, a 28% increase. Two-wheeler average monthly disbursement increased from 4.1 crores to 5.5 crores, a 33% increase.

We are also happy to announce that our geographical expansion plan is going well, with the two new States operational. Two new States meaning thereof is, as you probably all know that we already have our presence in Gujarat and Madhya Pradesh and we have added two more States, one is Maharashtra and the other is Utter Pradesh. We

currently have four branches operational in Maharashtra with further three branches being operational soon. We are currently expanding into North West belt of Maharashtra, mainly concentrating on rural pockets (not sure). Our regional branch will be located in North East.

As far as Uttar Pradesh is concerned, we have begun expanding into two major regions, Central UP around Lucknow area and North UP around Saharanpur. We have opened two branches in UP, one in Amethi and the other in Saharanpur. With three additional branches being operational soon. Currently our tentative plan is to open ten to twelve branches in Maharashtra and twelve to fifteen branches in UP by the end of the year.

We have also commenced a MSME pilot this quarter in two branches. This is targeting what the market calls the missing middle, customers who are a step above the bottom of the pyramid, but have little to no access to bank funding. We have started with the ticket size between 50000 to 1.5 lakhs. Initially we have considered the loan loss to be slightly higher compared to microfinance, but the pricing is adjusted to compensate for this. This will be individual loans with strict underwriting guidelines.

I guess I will now end this Digant and I would like to request to open up the call for questions. Digant, over to you.

Digant Haria: Yeah, we can start the questions and answers.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If you would like to withdraw your request, you may do so by pressing * and 1 again.

Sir, the first question comes from Mr. Vaibav Badhani, an Individual Investor.

Vaibav Badhani: Hello. Vaibav here. Am I audible?

Aalok Patel: Yes.

Vaibav Badhani: Thank you. Thank you for taking my question.

Aalok Patel: No problem.

Vaibav Badhani: I wanted to ask about your thoughts on stress of competition going forward on the interest rates and the net interest margins.

Aalok Patel: So, as far as the interest rates are concerned, there is not kind of, it is not a complicated question, but interest rates matter only to a certain extent when you are talking about some small ticket size loans. So, if there is a huge difference, of course it plays out in the installment amounts. But, if you are talking about 2%-3% difference between one competitor to the next, it really does not have a lot of meaning or bearing, because when you are talking about a low ticket size loans, the installments only matter by Rs.5-Rs.10, at every percentage point difference. What the clients care more about is stuff like ticket size. They care about quick access to funds,

minimal hazards. Those kinds of things matter most. Right now actually the competition is, the effect on competition is not so much on the interest rate side, but it is to catch the customer when they need the money. Because, of course RBI has restricted the number of MFIs to a single customer to two, so thereby what it means is that I cannot be the third lender to any customer. So, that has more bearing for us.

Vaibav Badhani: And sir, about your future fund raising plans tier-I and tier-II capital, if you could share?

Aalok Patel: Yeah, we just had a tier-II equity raised very recently. We are planning another tier-II very soon this quarter. Of course when it comes closer to it, we will announce it as far as the terms and all are concerned. As far as tier-I is concerned, as you know we just had PE, some of you might know that we just had a PE investor that exited from the company. And now that the exit is done, we are opening the doors slowly to consider tier-I investment. So, between now and the next six to nine months, we are considering a tier-II capital infusion. But, it is a little too early to tell what the quantum will be or under what terms and conditions will be.

Vaibav Badhani: Okay, tier-I, you meant tier-I in nine to twelve months, right?

Aalok Patel: Yeah, tier-I. So, we have adequate, with the new tier-II coming in, we have adequate capital to take us through our projections till the end of the fiscal 2017. So, we are covered till then. But, we want to start thinking again a little bit. So, we are thinking about it for sure.

Vaibav Badhani: The tier-II capital raised last time was 5 crores, right?

Aalok Patel: That's correct, yes. The last tier-II one was only 5 crores. Next one will be around that area, around 5 crores-10 crores or so.

Vaibav Badhani: Okay. Thanks sir. Thank you.

Aalok Patel: Sure, no problem.

Moderator: Thank you sir. Sir, the next question comes from Mr. Jatin Kalra, an Individual Investor. Please go ahead.

Jatin Kalra: Hello sir, congrats for a great set of results. I have a question. I have a question on how much interest rate are we earning in the MFI division?

Aalok Patel: So, the interest that we can start to work to our customer is heavily regulated by the RBI. So, the formula, this will be old to most people, but the formula for that is that you have take the lower of 10% over your (inaudible) or 2.759, the average base rate of the top five banks of India. So for us, our borrowing is around (not clear) and therefore our average cost to the customer is 25%. So, we have a margin over our cost of borrowing of approximately 10%.

Jatin Kalra: So, actually this question came because as in, if our book size is less than 100, I think it was a question that was asked two quarters back by

(audio disturbance) that if our book was less than 100, then we could charge 12%, (audio disturbance), so that has been reduced to 10% (audio disturbance)?

Aalok Patel: Yeah, that has been reduced to 10%, (audio disturbance).

Moderator: Mr. Jatin, could you please mute your (audio disturbance) while asking questions, because (audio disturbance).

Jatin Kalra: Sorry.

Aalok Patel: Anyway there is lot of disturbance. Yeah, that is better. What I am saying is that originally, we haven't been in the 12% regime for about couple of quarters right now. Even before that we were more close to around 11% (audio disturbance) higher of (audio disturbance). So, with the RBI cutting interest rates very aggressively, we were trending somewhere around 25.75(audio disturbance). So, we had to reduce it about 75 to 100 basis points. But, overall our expenses have also decreased. So, the profitability has not declined so much.

Jatin Kalra: Okay sir. And sir, my second question is on the whole industry scenario, as in we have seen RBI giving license to a number of small finance banks and banks also are becoming, as in Jan-Dhan Yojana has come in. How do we see the industry and ourselves five years down the line?

Aalok Patel: So, the second question, I will answer your second thing first about the banks getting into Jan-Dhan Yojana. Jan-Dhan Yojana is there for making deposits. So, in that case it is not directly competing with me. There is Mudra Yojana is there, if you are getting a little confused. But, the Mudra Yojana is basically operating through pass through entities such as myself, NGOs, banks, MFIs, those kinds of small banks, those kinds of things. So, in a way it is just a way to give access to funding to companies like myself. Whether that has worked or not, that is arguable. But, that is the core intent of it. As far as the banks are concerned, we are not banks at all. Banks, MFI business, there is no room for banks to actually work in there. Their operating structure is just very much different than ours. So, that poses no threat to us. Small finance banks, yes, you are correct. So, there have been about eight licenses issued to MFIs for small finance banks. However, the main thing there is that their operating model will not be that much different from us, except on the liability side. So, they are anticipating to raise a lot of deposits from the rural side. How that will happen or how useful that will be, is the question mark. So, RBI themselves have said that this is an experiment. Overall whether it is feasible to go forty kilometers away to collect to Rs.100 or Rs.200 or Rs.300 worth of deposits is questionable according to me. How most of them might meet their goal is actually to collect money from the urban side and lend in the rural side, this is what (audio disturbance). However, with small finance banks, I think they have certain (audio disturbance) they have to keep for deposit side on the rural versus the urban. So, it will be interesting to see. However, I don't think it will impact the MFIs too much. In fact it will probably help us increase our business slightly, considering that the small finance banks will have to operate under a higher operating cost. So, I think the natural tendency will be for them to move towards the more higher ticket loans. So, that leaves enough room for me to operate in the rural (audio disturbance).

Jatin Kalra: Okay, that is nice to know sir. That is it from my side. Thank you.

Aalok Patel: Thank you.

Moderator: Thank you sir. The next question comes from Mr. Bhavik Dave from Reliance Mutual Fund. Please go ahead.

Bhavik Dave: Sir, just a question on your standalone Arman Financial Services, so we see that we have seen a decent growth of 12% in your AUM. But, I am not able to understand what is the reason for the revenues dropping so sharply. So, are we experiencing yield pressure or what has happened in this line of business? Can you throw some color on that?

Aalok Patel: Yeah, so you are comparing it into with Q1 FY16.

Bhavik Dave: First quarter, last year, right.

Aalok Patel: First quarter, last year. First of all, I can understand why you are confused. So, let me apologize firstly. It is not what things are not exactly what they appear to be. Overall our interest income from hypothecation has increased 15%. So, this isn't available of course in the extract of the quarter ended results, which we submitted a standard format. But, so if you are seeing Q1 FY16, the income from operations is about 4 crores. And Q1 FY17 is 3.76%. So, there is a lot of intercompany stuff drawn that is resulting in that. So, earlier in the last quarter we had about 46 lakhs worth of income from intercompany loans that the parent provided to the subsidiary. So, on a consolidated basis that will be eliminated. But, on a standalone basis that will be shown. So, that 46 lakhs is right there an increase. And apart from that, there was about 38 lakhs worth of residual micro loans that were still in Arman's books, which were later on transferred to Namra's books. So, that side has also decreased. Overall interest from asset financing in Q1 FY16 was about 3.05 crores, which has increased to 3.50 crores. So, that is about 15% increase on the hypo loan interest rate. So, I apologize for that. I know it seems confusing, but all these intercompany stuff, these confuses things.

Bhavik Dave: Right. So, if you could just like mention it in the press release that you had put, it would have been easier.

Aalok Patel: I will do that next time.

Jayendra Bhai: Thank you. Thank you for the suggestion. I think we could have done that.

Bhavik Dave: Sure sir. And sir, if you see, there are no yield pressures or any of that sort in the two-wheeler, three-wheeler loan book. So, what would be the yields on that book? How are they trended over the past one year, in which range?

Aalok Patel: Don't get me wrong, there is of course the yield pressure. But, it is highly competitive business. So, the first question that I got, I think I should have answered it in two folds. On the microfinance side, the yields don't matter too much. But, in a highly competitive environment like two-wheeler financing, it does matter to a certain extent. 1% here and there, doesn't really matter, but anything significant in the installment side, it will matter. So, there is pressure, but I think we

have, overall we are not the most expensive lender and we are not the cheapest one. We are somewhere close to the cheaper side. So, we have been able to compete in that aspect. And I think we have a very deep-seated relationship with the dealers, which has helped us quite a bit as well. But, you are still seeing a lot of competition coming from the captive finance people, especially Bajaj Finance and Hero FinCorp. So, but somehow we have increased the business also this quarter. And overall our targets have always been to increase business between 10% and 15% year on year. So far we have been successful doing that. And it is going quite well for us. The industry is mature. But, it is definitely a good business. And if the two-wheeler market keeps growing at about 8% to 10%, long term you can expect the business to continue growing at about that rate.

Bhavik Dave: Sure. So, we can assume that 10% to 15% growth for this entire year on that book will be feasible?

Aalok Patel: Yeah, definitely.

Bhavik Dave: And something on your MFI books, like we have seen that decent growth of around 40%-50% that we are seeing, that we have clocked. I just want to understand that is this the run rate that we will go with for this year, for the entire year as a whole?

Aalok Patel: Yes, yes, so that is what we have been targeting. I think we have a target of about almost 300 odd crores in the disbursement side for the microfinance. And that will translate also in the books side. So, definitely you can expect that kind of growth numbers. But the disclaimer here is that a lot depends on how our expansion plans and stuff works out. So, we are expanding into UP and Maharashtra simultaneously. And there are always surprises, no matter how well you plan. So, let us hope that we can.....

Jayendra Bhai: Especially in UP, there are the elections coming up.

Bhavik Dave: Yeah, that is going to be a challenge I am sure. Sir, one more question. So, we have seen a disbursement period of 28% in this quarter in the MFI books. But, our loan book has grown 70%. So, how do we think about this? If there is 30% disbursement growth and 70% AUM growth, how does that (not clear)?

Aalok Patel: So, last year our book was completely one year loan, so twelve month loans. And after the first quarter last year, we introduced two year loans. We also introduced fourteen months loans. So, those were not that different from the twelve months loans, but our loan book right now is full of fourteen months loans and twenty four months loans. So, the tenure has helped us as far as the AUM goes. And then last year in the first quarter, we were restricted to the amount of money that we could lend to the customer for a one year loan to 15000. So, RBI has graciously increased that from 15000 to 30000. So, overall our ticket size has also increased, so those (not clear).

Bhavik Dave: So, what would that be? So, what is our ticket size now?

Aalok Patel: It depends. It was earlier like 10, 12, 14, and 15. Right now it starts at 15 and then 15 or 18, then it goes on to 21, 25, and 30 and after that there is two years.

Bhavik Dave: For the entire book, what would that be? Like on an average basis?

Aalok Patel: It is about 22000, average disbursement.

Bhavik Dave: So, for twenty four months it will be on the higher side and then for the fourteen months it will be a relatively lower side?

Aalok Patel: Yeah, yeah.

Bhavik Dave: So, fourteen months would be 15000 to 18000 and twenty four months would be the higher ticket size, is that the way to look at it?

Aalok Patel: Yes. So, if you look at our fourteen months product, average ticket size will be around 18000. And our twenty four months' product, average will be somewhere around 40000. But, our loan book is still quite small for the two years size, so it doesn't have that much of an impact.

Bhavik Dave: Correct. And sir, what will be our total number of active customers as of the first quarter, on the MFI side?

Aalok Patel: Active customers on the first quarter?

Bhavik Dave: Yeah, yeah, as of now, as of today (inaudible).

Aalok Patel: As of today it is around I think about 107000 I think for the microfinance, about 107000.

Bhavik Dave: Alright, okay. Thank you. Thank you so much. All the best.

Aalok Patel: Sure, thanks a lot.

Moderator: Thank you sir. The next question is from Mr. Deepak Agarwal from Impetus Advisors. Please go ahead.

Deepak Agarwal: Hi. What is our capital adequacy?

Aalok Patel: Capital adequacy on the microfinance or in the subsidiary side is around 21 right now, that is including tier-I and tier-II. And on the parent it is about 40. So, we are slightly under capitalized. We are slightly under capitalized in the subsidiary and slightly over capitalized in the parent. So, what we are planning to do is, infuse some more money from the parent to the subsidiary, because the subsidiary has the highest growth right now and that is along with the rest of the our plans. So, when we were planning, as I was telling for tier-I fund raising plans, overall by the end of the year, we are expecting overall consolidated CR to be about almost 25.

Deepak Agarwal: And what will be now, the consolidated CR?

Aalok Patel: I am not 100% sure, because I calculated on, the RBI requires you to calculate it on individual levels. I can certainly calculate for you and get back to you on that.

Deepak Agarwal: Okay. And but the parent infuses, let's say funds into the MFI, we can still think it is substantial. We can still grow our books by 50%, without raising any capital, right?

Aalok Patel: Yeah, yeah, absolutely. Our growth targets are making our book size somewhere around, I think it is about 275 crores approximately. And we do have a tier-II capital raise coming up soon as well.

Deepak Agarwal: What is the 275 crores sir?

Aalok Patel: That is basically our target for the year. So, we will end the year at about 275, consolidated.

Deepak Agarwal: Okay. And what is the average cost of borrowings?

Aalok Patel: Average cost of borrowing all inclusive right now is about 15. So, which has come down quite a bit since last year, almost about 75 basis points it has come down. But, so that will continue to come down. Just to give you an idea, the average cost of borrowing for the industry, according to the last micrometer is 24.86, I believe. And that is including the larger players, smaller players and everyone together, on a weighted average basis.

Deepak Agarwal: 24?

Aalok Patel: I am sorry, excuse me, 14.87.

Deepak Agarwal: Okay. So, as you said our marginal cost of borrowing, since you go and borrow today, so it will be lower than 15%, right?

Jayendra Bhai: Let me also, sir I am Jayendra Patel, let me also shed some light on it. Couple of years ago the things were little different. The microfinance was just coming out of the Andhra Pradesh crisis. And people were, the banks especially were reluctant to give money to the MFIs. Now, the situation has changed. And I tell lots of bankers myself that every dog has its own day. That means, today I am in a bargaining position, meaning thereof is that, I am in a position to bargain. I tell the banks that, okay, 15% is quite high. And I can go across the street and get a reasonable price. Banks now have tried and now the MFI industry being the healthy situation that it is, banks are also are agreeing to our offers. And let me also tell you, we recently got something like 20 crores at the rate of 12%. So, things are changing sir. Things are becoming better and the MFIs are little more in a bargaining position.

Aalok Patel: Let me also just clarify one thing. In fact when I say that my weighted average is 15%, I mean that it is all inclusive. So, this weighted rate might be 12½%-13%. But, with processing fees and cash collaterals and all of that, that will push up the rates. So, I am talking about an all inclusive rate.

Deepak Agarwal: Okay. Given that our consolidated leverage is only around three times currently, we still have lot of scope to borrow. Now, so given that our, even if I take the average cost of 15%, the post tax cost comes to only around 10%. Then why should we go and borrow preference capital at 13%?

Aalok Patel: Why should we borrow preference capital?

Deepak Agarwal: When we borrow preference capital at 13%, why should we do that? When we can borrow at 15%, which effectively works out to 10% post tax?

Aalok Patel: It is the same thing. It is the same thing, because the other one will be post the pre tax, it will be essentially, yeah, I guess in a way you are right. But, we needed tier-II capital at least in the subsidiary. And the amount wasn't very large, but it would allow us to borrow a lot more money. And also it would be beneficial for the company to start entering into such transactions and getting a history with such transactions. So, that is another reason why we entered into it. Of course we are quite happy that the AIF which lends the money, which is a domestic AIF agreed to give us money. And overall for a tier-II capital, the cost was quite reasonable, if you compare to lot of the other ones. So I guess we can go on, yeah, we can go on debating about the cost benefit kind of a thing. Overall we made a judgment call that this was the right move to make and so we will keep it at that.

Deepak Agarwal: Okay. And I thought that given that you have a tier-I still unutilized, there is no need to actually borrow tier-II and at a much higher, 30% higher cost.

Aalok Patel: There are other things to consider as well, which will get quite complicated to discuss over the phone, but there are stuff related to concentration norms and stuff by the RBI and there is formulas of how much money a parent can put into the stuff, which was recently, later on removed also. But, there were considerations like that in place. So, there were other considerations, besides just the pure cost.

Jayendra Bhai: But, your suggestion is very well take sir, thank you so much.

Deepak Agarwal: I am done. Thanks.

Moderator: Thank you sir. The next question is from Mr. V Srinath from Bellwether Capital. Please go ahead.

V Srinath: Congratulations on a good set of numbers. I just wanted to find out we have actually set up Madhya Pradesh and have kind of stabilized it. And we have decided to go into two market in one go, considering some sort of cost cut will be involved in setting up a head office at that particular geography and so on. What prompted us to take such an aggressive step to get into two geographies at the same time? And management bandwidth would also be required for the same, your views sir?

Aalok Patel: So, we started expanding into Maharashtra slightly before we started expanding into UP. So, it is not, (not clear) towards or something. It wasn't a simultaneous expansion. Initially we had the same doubts that you were saying, okay, are we going to manage handling it? Are we making the right move? Overall I think in any small company lifestyle, there are certain times where you have to make couple of

hard decisions, which will define you overall in the coming next three to five years. This was one of those decisions where we nearly didn't want to go the MP way, where we opened the branches slowly, stabilized it over one or two years and then consider another State. Microfinance is not the same industry it was five years ago. When we first started, it was an ocean and we could cherry pick the clients and we could do all kinds of things. Now, there is a lot of competition, especially on the urban side, but there is still room to expand and get market share in the rural side, which is our specialty. So, I think the biggest reason was, I will give you a few reasons. The first reason was that, it was, we had the infrastructure, we had the manpower, we had the IT, we had the MIS, we had everything in place, where we thought that we could do it. We also hired some consultants to help us decide about places and do the odd kind of surveys for us and fix up our systems. That was the first reason. The second reason is, we found good manpower. So, at the end of the day, UP is several thousand kilometers away from Ahmadabad. So, I need the right people for the right job. And Maharashtra we found the right guy and UP also we found a really good guy, who has many, many years of experience. When we originally, I guess Jayendra Bhai can shed some light on that also.

Jayendra Bhai: I will tell you, as far as UP is concerned, when we started the microfinance operations, one gentleman who was involved in SKS and he was involved at the highest capacity in SKS and he was friend of mine who helped me in setting up the pilots in Gujarat and tried to help us in setting up the microfinance business. He was ready in UP and believe me, that was one of the driving forces for me to go to UP and start UP. Rest is the history and rest Aalok will be able to tell you. As far as the UP is concerned, I told you the reasoning.

V Srinath: So, we have a very credible management setup in the UP side?

Jayendra Bhai: Yes sir, that is what I think so and that has prompted me to start UP, even though the odds were not fully in favor of me, compared to other States. But, I think we have a very credible start. And that is what it is.

Aalok Patel: Also as far as UP, UP gets a lot of negative press. But, when I was going on the survey, UP dues is humongous and you find all kinds of people there. But, because of the negative reputation, the gap is really high between the number of MFIs and the number of potential customers and that was at least my assessment.

V Srinath: Okay, the potential opportunity in the market is much larger?

Aalok Patel: Much higher, much higher, yes. So, those were the few reasons and I think hopefully we didn't bite off more than we can chew. I don't think we have. But, time will tell.

V Srinath: I just wanted to also find out, since now Madhya Pradesh at least from the branch opening side, we have like tapered off growth. Has the profitability of these branches significantly improved? Because, about a year back, there was some kind of hiccups in profitability in these branches, have they now stabilized and are they profitable?

Aalok Patel: The branches which have about 1500 clients plus, which will be about 40% to about 50% to 60% of my branches, they will be with a stable profit. The ones below that or at least below 800 will probably be not profitable. 800 to 1500 is more the coin toss in my experience, where profitability can go either way. So, that being said, it is a balancing act, because opening up new branches and new regions and stuff gets expensive very, very quickly. And before you are even disbursing the first loan, you have lakhs and lakhs of rupees of expenses, payrolls and in surveys and in travelling and so many other things. And sometimes it just, we know it just doesn't click and if it doesn't click, all that money is down the drain. So, we try our best. Let us just put it that way.

V Srinath: Thank you sir.

Moderator: Thank you sir. The next question comes from Mr. Vishal Modi from Maybank Securities. Please go ahead.

Vishal Modi: Hi, I have just one question on your asset quality. So, it has behaved well till now, but since we are increasing the tenure in going into new geographies, how confident are you in maintaining this kind of NPA levels? So, that is it from me, thanks.

Aalok Patel: So, on microfinance at least, the NPAs are quite low. We hope that we can keep them this low. Overall long term and I feel from three to five years down the road, I don't think that such low level of NPAs are really reasonable or sustainable or possible. Around 1% NPA would be somewhat more on the reasonable side. But, right now since the industry is growing so fast, the denominator is growing much, much faster than the numerator. So, right there you have a little bit of unbalance. And for us, of course we are very, very conservative. So, we all like to keep the results as low as possible. But, I don't really think that long term three to five years, you can expect less than 1%.

Vishal Modi: Yeah, my question was that, can you discuss a bit on your, I would say, process or systems that you have in place, which shows that this kind of level of around 1% is there in the future and we don't see a spike? Some bit of check that you have.

Aalok Patel: I think our systems are quite elaborate. It would take a very, very long time.

Vishal Modi: No, I understand, but something that we do differently to ensure that there is credit quality is maintained.

Aalok Patel: Sure. So, we have a decentralized decision making process as far as the sanctioning goes, where many MFIs are following a branch or a cluster model. We are following a head office model, where all the sanctioning gets done by separate teams sitting at the HO, which have no kind of connection to the branch itself. We are doing third or a fourth level TVRs, telephone verification with the customer, doing the applications, pre-disbursement, post-disbursement, all of those we are doing. We have a fixed center model, so that means once the group in the center is formed, there are no incomings or outgoings for members. Most MFI follow that once the center is formed, people enjoying the center at any time leave at anytime. So, what that creates

is, sometimes it creates issue, where the clients refuse to pay you until a loan or something is disbursed with the center. So, those are the three things on the top of my head that we do differently.

Vishal Modi: Yeah, that was it. Thanks.

Aalok Patel: We don't chase numbers. That is another thing. We really don't put a lot of pressure as far as the disbursements are concerned. So, we have a very bottom up budgeting target setting process, where we start from the very bottom, which is the field office and work our way up, rather than me telling the people that, okay, you must disburse 25 crores this month and having it go down.

Vishal Modi: Sure, thank you.

Moderator: Thank you sir. The next question comes from Mr. Jehan Dhadha from MOSL. Please go ahead.

Jehan Dhadha: Good evening sir. Sir, my question is on the SME financing pilot model that we are trying out. Sir, could you just help us with your strategy, how are you going to tap this business?

Aalok Patel: So, SME is something unique that they are doing. I think this model is slightly different than what banks and some of the other financial institutions are doing. So, what we are trying to do is that replicating or not replicating per se, but the collection model at least we are trying to replicate the microfinance model that we have right now, that the collection takes place in cash at the house or the business of the customer. Earlier I think the lot of the quality issues in the SME side comes from the fact that people rely on PDCs and ECSs and those kinds of things, where you are losing touch with the customer. If you are going to their place, if you are getting in touch with them, if they have a field representative that is in constant touch with them and that they can use for all their needs, that will be a big advantage to us. If you look at overall in India as well, if you look at Mudra Yojana (not clear) numbers, the missing middle thing was coined by SIDBI. They said that there are 8 crores small businesses in India, which have no access to funds right now. And these are not the bottom of the pyramid kind of people. These are people that have well established businesses that are running for, not even for many years, but sometimes many generations. But, they are not getting any funding help. Right now they are relying on, even sometimes people like, MFIs only, borrowing higher ticket from two or three MFIs or having their family members borrow and that is how they are meeting their needs. I can be a one stop shop for them. I can do their entire underwriting process, which we have developed over I think many months of trial and error and working out the different things that we can and cannot provide, because remember the main thing about them is that this should be paper friendly. I cannot expect tax returns and stuff. So, we have developed a program, which hopefully captures their credit worthiness properly. And I think there is a real necessity, if we can make it work, then this will be a third vertical for Arman. Hopefully we will be just as big as microfinance, who knows. So, it is a pilot and we have started it from two different branches. Let us hope that it is successful and that we can roll it out to all of our branches.

Jehan Dhadha: Right. Sir, in terms of the amount that will be disbursed, so that will be as a particular LTV of the security that is provided or as well as you will be looking into the cash flows of the business, how is that part going to play out?

Aalok Patel: So, we look at the cash and we look at a lot of things. One of the things which we look at is the cash flows. So, one thing which we have done is develop very carefully of how to assess the cash flows. So, if they have like bank statements or if they have some way to prove what their cash flows are, it is a no brainer. But, what we have gone in and done is that, we try to pick it out, okay, how many people are in the household, how many people are earning people in the household, how many are dependent? So, based on the number of people in the households, we automatically calculate what household expenses may cost like, food and medicine. And if there are kids in the house, what schooling might cost. Some of the businesses, we have put in the formula. So, there are let's say, agriculture. We have put down, if there have so many acres, then this is the kind of income that they can make. It is very conservative. It is not 100% scientific, but it does the job. Then what we do is, we will find out their cash inflows. We will find out their monthly outflows and we leave a little margin. So, depending on how comfortable we are with the client and what kind of paperwork that they have, we can go up to 50% of the difference or 70% of the difference. The amount is also, right now we have started with 50000 to 1,50,000 initially. Later on we can go towards the higher side of that as well. So, let us see. But yeah, we do cash flows. Security, unfortunately it is just not possible to get, we do take PDC from them, in the event that they default, we can do 138. There is no security that we can realistically take from these guys. Even for the higher ticket size, we are still Rs.1 lakh. The legal cost and everything involved with different kinds of securities that they may or may not be able to give is just not feasible.

Jehan Dhadha: Okay. So, in that scenario, if we are aggressively pursuing this business, then if it gets larger and in terms of risk there would be significantly higher risk, say even as compared to MFI, because in MFI there is a group lending mechanism. But, here we will be able to?

Aalok Patel: We should expect probably around 3% loan loss in this business.

Jehan Dhadha: And what are the yields you will charge for this business?

Aalok Patel: So, we started it off between 28% and 30%, just to account for that higher loan loss. Perhaps we can go a little higher. And if things prove to be that okay, the loan losses aren't that high, we can go a little lower. Right now around 30 is what I decided is probably the right number.

Jehan Dhadha: Okay. And sir, would this business be done under the microfinance subsidiary or under the parent?

Aalok Patel: No, we are doing it under the parent, just because, I don't want to deal with qualifying asset norms and stuff like that with RBI. So, the subsidiary is purely for micro-finance that is it.

Jehan Dhadha: Right. So, there would be no upper limit as such on this particular....since this is not a part of MFI?

Aalok Patel: No, that is what the advantage that we have. Under the same umbrella, we have an NBFC, AFC and we have NBFC MFI. So, we can really do any kind of financing that we want, even housing to a certain extent, unless we wanted funding from, anyway that is a whole another thought.

Jehan Dhadha: And sir, where do you see this book by the end of this year or end of next year?

Aalok Patel: I have no idea. I have set aside around 50 lakhs-60 lakhs on the pilot itself. But, really it is just the pilot. It is premature right now.

Jehan Dhadha: Okay, thanks a lot sir.

Moderator: Thank you sir. And we have the last question for the day from Mr. Amit Jaswani from Stallion Asset. Please go ahead.

Aalok Patel: Hello? Hello?

Moderator: Mr. Amit, please go ahead.

Amit Jaswani: Yes sir, my question is on the disbursement side. Our target for the disbursement was 310 crores. But, we did about 52 crores this quarter. So, broadly to keep achieving our target, we will have to do 85 crores-86 crores per quarter. Do you think that target is achievable now?

Aalok Patel: Yeah, we have a lot of new branches in the pipeline right now. And you are right. We have a lot of catching up to do. But, I for one, we are never too aggressive as far as the disbursements are concerned. So, we have certain calculations in place where that should be achievable. But, that being said, we will just have to catch up little bit in the later part of the year.

Amit Jaswani: Sir, what was the problem that we were facing in this quarter that we couldn't achieve our target, like was it the quality of people were not good or what was the real problem of not achieving our target this quarter?

Aalok Patel: We were, there were a couple of factors, we were pretty busy with this geographical expansion. And overall there are certain places, which we actively stopped disbursement or cut down disbursement significantly, because they were eating up, especially in the Gujarat market with a lot of competition. So, I think that is according to our conservative nature. We never really, as I said we don't chase numbers, so we judgmentally decide that we don't want to disburse in this branch or disburse too much in this area. We make that call on an ongoing basis. This quarter maybe we were a few crores shorter than where we should have been and that is typically the case also with the first quarter, if you look at it every year. First quarter always starts out a little slow. I don't doubt that we will probably catch up in the later part of the year.

Amit Jaswani: Right sir. Sir, my second question is about, this is just a thought. Have you thought about cutting down disbursement on the two-wheeler

financing business, because it is a low ROE, high NPA, high competitive market and investing that capital in the microfinance business more?

Aalok Patel: No, two-wheeler side has been our bread and butter for a long time. It is essentially (audio break) it is on auto mode, as in that we don't have to spend that much time and energy. It is still a profitable venture. The NPAs are of course higher than microfinance. But, I always like the fact that we are diversified and that we have multiple products and our endeavor is also to increase the products. So, I don't really want to be dependent on one State or one product or one anything. So, perhaps the profitability is slightly higher in microfinance, but then again I like to be a little diverse. So, that is my thought on that.

Amit Jaswani: Last question, are you thinking to diversify on the housing finance thing as well?

Aalok Patel: We thought about it, along with this, SME housing was one of the option. But, I didn't think that we were quite there yet. It was, housing finance is a whole another piece. Then you need a very strong legal team for that, because every area has mortgages and stuff like that, plus with a simultaneous State expansion, we already had a lot on our plate. So, we deferred that housing thing until maybe next year.

Amit Jaswani: That is fair enough. Thank you sir. That is it from me for today.

Moderator: Thank you sir. And that will be the last question for the day; now, I handover the floor to Mr. Digant Haria for closing comments. Please go ahead.

Digant Haria: Thank you everyone. Thank you all the participants and the management for taking out time. I hope that it was an insightful call. Have a great day evening. Thank you.

Jayendra Bhai: Thank you Digant. Thank you so much.

Moderator: Ladies and gentlemen, this concludes your conference call for today. Thank you for your participation and for using Door Sabha's conference call service. You may all disconnect your lines now. Thank you and have a good day everyone.

Note:

- 1.This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.