Transcript

Conference Call of Arman Financial Services Limited

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Presentation Session

Moderator: Good morning ladies and gentlemen. I am Moumita, moderator for this conference. Welcome to the Q4 FY16 earnings conference call of Arman Financial. We have with us today the management team from Arman Financial, represented by Mr. Jayendra Bhai Patel, Managing Director, Mr. Aalok Patel, Executive Director and Mr. Amit Manakiwala, Whole-time Director. At this moment, all participant lines are in a listen only mode. Later, we will conduct a question and answer session. At that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the floor to Mr. Digant Haria from Antique Stock Broking Limited. Please go ahead sir.

Digant Haria: Good morning everyone. Thanks for taking out time, both the investors community as well as the management. So, we will start by the Arman management giving us a brief introduction about their quarterly and annual performance and the broad trends which they see in the microfinance and two-wheeler space and post that we can open the floor for question and answers; so over to you Jayendra Bhai.

Jayendra Bhai: Thanks Digant for hosting this call. Ladies and gentlemen, good morning and thank you for joining us today for the quarterly investors' conference call. Let me start by announcing that the decision has been made to open two more States, which are Maharashtra and Uttar Pradesh for our micro finance operations. The initial five branches have already been opened in Maharashtra and we are seriously looking into Uttar Pradesh, for which I have visited Uttar Pradesh for a couple of times and everything is ready to go. It has always been our endeavor to go for a geographical spread with conservative approach and caution. This will not only divide the risk, but we will have an increased scale of operations.

Talking about the scale of operations, Arman and Namra put together, I'm happy to announce that for FY 2016-2017, disbursement is expected at around 310 crores in Namra and 80 crores in Arman. The asset under management for the next year is expected at 270 crores. And it goes without saying that these figures are subject to how our expansion plans goes in Maharashtra, UP and in Madhya Pradesh. I am also glad to tell you that the expansion plan is encouraged by one of the lowest levels of NPAs in the industry. I am also happy to inform you ladies and gentlemen that our NPA in microfinance stands at 0.18% for the last year and the bad debt written off is 0.17%, which by any yardstick that you measure would be very encouraging. And that proves that the conservatism that we are working with is not a weakness, but it should be considered as a strength. Having said that, the total assets under the management for the company has grown last year from 115 crores to 172 crores, a 50% growth. The largest growth in asset under management came from our microfinance division, from 65 crores to 170 crores, an 80% growth. Income from operations increased by 41%, from 30 crores to 42 crores; consolidated profit before taxes increased from 30% to over 12 crores. We ended the year with a profit after tax of over 8 crores. EBIT increased 43% from 20 crores to 29 crores.

We now have sixty operational branches, fifty-five in microfinance and five in two-wheeler business. In microfinance we have thirty-seven active branches in Gujarat and eighteen branches in Madhya Pradesh. I am not counting four branches that already have been in existence in Maharashtra, for which lease agreement has already been signed. The MP expansion has been going well and now is stable. About 23% of our AUM comes from Madhya Pradesh, which is expected to increase further this year, as our branch network also increases in Madhya Pradesh. Our biggest push will be Maharashtra this year with a target of about fifteen branches in that State alone. UP also we are concentrating with five branches initially and probably five branches in a short while. The reason being, we are moving cautious with UP. The UP branches we are cautiously approaching is because there is an election coming next year in UP and the people in microfinance know that during election times, the equation changes. We have also raised tier-II capital in the form of redeemable preference shares to the tune of Rs.5 crores. This exercise was a test to the market and I am sure this practice will continue without diluting the equity.

I should also bring to your notice that last year's microfinance projections were 180 crores and we have reached 183 crores. We are continuing our DNA of being conservative lender, which I am sure will be taken as a sign of strength, as I mentioned earlier. The key drivers this coming two quarters will be to successfully expand into new geographies and to reduce the cost of borrowings. Let me also tell you fellows that we are little bit in a bargaining position right now, as we grow and as our portfolio grows and as our vintage grows, we are more or less in a driving seat. And the bank and the financial institutions are approaching us on their own and we are in this situation that you reduce the interest rate; otherwise we will go across the street. So, as they say it in English, every dog has its own day, and my day has come. It is just on a lighter note.

So, to streamline our operations and to reduce our TAT, we have hired consultants Intellecap. Intellecap, we had hired about six years ago to help setup our operations. We were extremely happy with their deliverance and we are happy to tell you that we have hired them again to look at and to look into our systems, to look into our audits and to look into how we do our business. I am sure this will take us to a great height. We are also to retain a new HR talent, to ensure that asset quality does not suffer due to the rapid growth in the past year and the next year, which is always a concern for a company which is growing. With this, I don't want to take too much of your time. I would rather have people asking me questions. So, I hand it over to you, Digant. We can open up for the questions. Thank you Digant.

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. Kashib Javeri from Capital 72 Advisors. Please go ahead sir.

Kashib Javeri: Good afternoon sir and congratulations for a good set of numbers.

Jayendra Bhai: Thank you.

Kashib Javeri: Hello?

Aalok Patel: Yeah, yeah, go ahead, sorry.

Kashib Javeri: Sorry sir. I have couple of questions. So one, you mentioned your disbursement targets for FY17 is about 310 crores, which is versus about 246 crores that you did this year and AUM is at about 270 crores versus 177 crores this year. Have I heard it correct?

Aalok Patel: No, I think you heard it partially correct. Our disbursement target for microfinance is about 310 crores and for our two-wheeler division it is about 80 crores. So, we got a total of around 390 crores this year with both of the businesses combined. So, in microfinance division alone, that has increased from 183 this year.

Jayendra Bhai: And from 183 crores, we are targeting 310 crores.

Aalok Patel: Yes but lot of it depends on how our expansion plans pans out in Maharashtra and perhaps UP and lot of other aspects. So, it could be more or it could be less. Let us see how the year goes ahead.

Kashib Javeri: Right. I have got that. And within your total portfolio size as of today, how much is LTL?

Aalok Patel: LTL?

Kashib Javeri: Long term loans.

Aalok Patel: Long term loans. Our two year portfolio accounts were about 23% or 22% of our overall portfolio. So, that is two years. And then the rest of the major, about 60% is fourteen months loan and the rest of them are twelve months and that is in the microfinance division. In our two-wheeler division, the tenure fluctuates between eighteen months to thirty six months, with an average of approximately twenty four months. So, most of my two-wheeler loans are about two years or more.

Kashib Javeri: Okay. And let's say in next year when we grow the disbursements at about 100% plus, sorry, about 70%-80%, what would be then the proportion? Would this be, would the proportion of the long term loans go up or it would remain pretty much same?

Aalok Patel: It will slightly go up, especially from an AUM perspective it will go up slightly, because the repayments come slower in the long term loans. If I am targeting about 15% to 20% disbursement in two year loans, my AUMs will be about double, all else remaining equal. so about 30 odd percent. So yes, the long term loan in microfinance that's scheduled to increase, but in the two-wheeler business it will remain approximately the same.

Kashib Javeri: Right. Second question is on the funding cost side. Our funding cost still remains quite high. What all can be done to bring it down? What could be the options which are available to us to bring it lower?

Aalok Patel: Right. So, we are exploring a lot of possibilities. One is being dependent, more dependent on banks rather than financial institutions. Now, bank funding, as Jayendra Bhai mentioned during the start of the call; we do have a lot more options from bank funding that we used to, just even one year ago or even nine months ago. The bank funding has definitely increased, but that being said, the bank funding is not really dependable, because they don't have a set turnaround time. Sometimes if the proposal is there, they can turn it around in one or two months or they can turn it around in six months. So, it is very variable. So we cannot be completely dependent on bank funding, because cash is our raw material and if we need money for this month disbursement, we will have to rely on financial institutions. We are also working on things like NCDs, which we should see a large transaction come through this quarter, knock on wood. So, those kinds of things will overall reduce our cost of borrowing. And once the asset size increases, past 200 crores, which is what we are expecting, at least in microfinance, we can start going towards large bulk securitization and stuff like that, which will be available at perhaps 11% or 11½% or something like that, which is what the banks are doing right now. For those kind of asset sell outs, banks are looking for larger asset sizes, which we don't have currently but will have in the near future.

Kashib Javeri: And for us, what would be the difference between, let's say cost of borrowing from banks versus let's say FIIs and NCDs?

Aalok Patel: The difference can be quite significant. I would say bank funding comes at an overall cost of borrowing up to 14%, that includes the cash collateral, processing fee, all the other stamp duties and stuff like that. Financial institutions can go up to 16½%. So, there is quite a large difference. The advantage there is that I can get a very quick turnaround. We have such a good relationship with many of the financial institutions, where if I need money today, I can get it in a day or so. So, it is a very quick turnaround.

Jayendra Bhai: But, let me just also bring to your kind notice that we are in the business of selling money and hopefully we work on a JIT system. The money sitting idle is also detrimental to your own health, because what do you do with the money which is sitting idle besides paying interest? So, you have to have a finer line with what you want. You want best rate and no timeline or a decent rate with a definite timeline? You have to strike a balance. That is all.

Kashib Javeri: Sure. Thank you so much sir.

Moderator: Thank you sir. Sir, the next question comes from Mr. Jinay Gala from Florintree Advisors. Please go ahead sir.

Jinay Gala: Thank you for the opportunity. Sir, I have two sets of questions. Your two-wheeler books have not grown in this year, any particular reason on that?

Aalok Patel: I think we did try explaining it a little bit in our press release of why that is so. Just in case, I would encourage everybody to kind of go through our press release. It is on our website and it is also available on the BSE. But, what is going on in the two-wheeler business? It is not just us; it is all the two-wheeler players in the market right now. First of all, the industry is not growing as per expectations. So, when you look at the overall two-wheeler sales in India, they have reached somewhat of a maturity or a saturation point, but the growth is only around 7%-8%, at least in the target markets and in the regions that we are dealing with. So, if you want to grow faster then what the market itself is growing, you either beat them on the pricing or expand geographies. Now both of those things are difficult, because overall the margins are pretty cutthroat right now, because of all the competition. And second thing is, expanding geographically is also not easy, considering that there are lots of mature players in any geography that you want to expand into that have been operating there for years and years. To operate in two-wheelers, you need a good dealer network and that takes time. That takes time to establish a relationship with the dealer, for him to allow you to sit in the dealership and finance the customers. The second issue is the captive financiers. So, captive finance companies like for example Bajaj Finance and Hero Fin Corp. All of a sudden, those companies have also become quite aggressive in financing two-wheelers. So, on the one hand the growth is less and on the second hand the captive finance companies are kind of giving us a lot of competition. I think lots of larger companies have pulled out of two-wheeler and their portfolio has reduced. Our disbursement has continued to increase and our AUM has continued to increase; but that being said, I don't think we can expect the kind of growth that we are seeing in our microfinance division, just because it is a mature industry and the growth potential is much higher in micro.

Jinay Gala: Sir, your NPA on the two-wheeler space has been around 2.92 on 150 DPD. So, how does it look at 120 and 90 DPD?

Aalok Patel: I will have to get back to you on that. I don't have the numbers memorized. But, the RBI recently changed its rules of recognizing NPA from 180 days to 150 days. So, that has somewhat increased our NPAs from last year to almost over 2%. So, but as far as the DPD or ODs of 90 days or 30 days, I will have to get back to you on that.

Jinay Gala: And sir, also I want to know more on your capital raising plans. If you are growing so fast, you need to raise equity capital. Sir, any plans on that?

Aalok Patel: Yeah. So, our strategy has been to dilute as little as possible. So yes, our growth has been very, very rapid, but luckily our profits have also added a lot of retained earnings into our balance sheets. So, that helps us a little bit. That being said, yes, we are aware of the fact that we will need to raise capital. As Jayendra Bhai said, we are working on tier-II capital right now. We have already raised some redeemable preference shares in the last quarter. And we are also working on, as I told you on some NCDs from foreign markets. Also, we have a subsidiary and a parent, Arman-Namra, Namra is the entity that is handling microfinance, which is where the bulk of the growth is coming from. Arman, which is the parent handling two-wheeler financing has a lower growth, so it is a little over capitalized. So, we also have a scope to infuse a little more capital from Arman into Namra. So, we are not actively seeking out private equity players or anything like that in the current year. But definitely, next year we will need equity. I am not sure whether they will come through some kind of a right issue or whether they will come through some kind of a preferred route or a PE Company or what have you. So we will decide on that based on what kind of valuations we are getting.

Jinay Gala: Okay. Sir, I want to know, currently AUM you are guiding at FY17 would be around 270 crores. So, what is the internal target benchmark? 2020, where do we see the company going to, 1000 crores of AUM?

Aalok Patel: Yeah, so our target has always been growth of about 40% to 50%, total, both things combined. But we are targeting little bit aggressive growth. We have grown little bit aggressive in the last year and we have slightly more aggressive growth next year. By 2020, I couldn't tell you the exact figure. But definitely around 700 crores plus, something like that. But, it is quite far away. I have trouble deciding what to eat for lunch on most days.

Jinay Gala: And sir, any internal targets for ROA? Any benchmarking you do, when you decide what ROA you want to keep at, sustainable ROA?

Aalok Patel: So, as we keep increasing our leverage, the ROAs will keep coming down, because you are leveraging more. And your ROEs will keep going up. But, our internal target is to keep them somewhere around at least 2½% to 3% ROAs and an ROE of about 18%, 17% to 18%, which is about what we have achieved in the last year.

Jinay Gala: Okay. And sir, you are telling that you will be expanding more into Maharashtra for MFI. But, Maharashtra I think so is in a highly competitive State for MFI, already it is into higher penetration. So, how do you see you will be positioning yourself there?

Aalok Patel: So, I think nowadays any viable State has a lot of competition. Things have changed from what they were ten years ago. However, I think there is still a lot of scope for few reasons. First of all, we are concentrating mostly on the rural markets. So, over 80% of our portfolio is in rural and semi-rural areas. And for example, our first branch which we opened in Maharashtra was in Dhule. So, in Dhule there is only about four MFIs present currently. There is a lot of scope. And now if you go into Pune and places like that, of course there will be a good 25-30 MFIs present there. So, those are the kind of areas we want to stay away from. But, with all the rapid expansion, with the industry in general, I think people get a notion that there is too much competition and there is too much lending going on. While that is true in certain pockets of India, overall client size, overall number of active microfinance loans in India is about 3 crores. Now, India has a population of 125 crores and we have only covered around 3 crores and that is not even counting the repeat customers. One customer might have taken from two MFIs. So, let's say we have only covered about 2 crores household, so there is still quite a large scope for expansion in microfinance. But, I think as we keep going forward, this 80%, 90%, 100% growth will become more and more unfeasible, unless you want to compromise on your asset quality. And we can probably settle down on a more reasonable target of 30% year on year, which is long term I am telling. But, to answer your original question about Maharashtra, yes, I am aware that it is a little bit crowded. But, that is not in all pockets. There are still pockets which are not very deeply penetrated by MFIs and those are the pockets that we will be targeting.

Jinay Gala: And sir also one more question, on MFIs basically you would be following JLG model. I just wanted to know a little bit more on your collection, how do you handle collections, with your NPAs at minimal level? So, how do you mitigate your risk at for a smaller size? And do you follow weekly model or monthly model? What kind of collection strategy you follow?

Aalok Patel: So, collections are done on a biweekly model. So, every fourteen days is when we go and collect the money. Most of my competitors nowadays, especially for the larger loan accounts are following the monthly model but our target is to keep the overall installment less than Rs.1000. That is because, especially when you are talking about my target segment of rural customers, having to pay more than Rs.1000 on per installment might become a little bit difficult for them. Especially let's say if they miss a payment, then to catch up, it will be also very difficult. I follow a classic JLG model, which I don't know how familiar you are with. With a few minor tweaks and exceptions, one is that we have separated sales from our credit. So, the sanctioning authority actually is different from the person doing the sales. This seems quite obvious to an outsider, but in microfinance that is how the, I guess, one of the weaknesses in the industry system is that, in most cases the branch is doing the sales and the branch is doing the credit. So, we have tried to separate that. So, that is what sets us somewhat apart. We do the cash collection. We are also mostly reliant on one year products. So, slowly we are getting into two year products as well.

Jayendra Bhai: Sir, I just wanted to shed some light on the issue that you said about two years and one year product. Aalok just said that we are into mostly into a 1 year product and about 22% of my portfolio is into two years product intentionally. As we said it earlier that conservative approach is the name of the game and we have not ventured into two years product. The reason being, we want to watch the cash flow and we don't want to overburden them with the installments. Most of the MFIs in India have gone into two years product and a higher ticket size. If I have done two years product first, my AUM figures would have been doubled, because my repayment becomes half and ticket size also increases. But, intentionally we are not after the number game. We are here to produce the results. We are here to do the serious microfinance without losing the JLG spirit. So, in the competitive spirit that lots of MFIs are doing today, they are losing the spirit of the JLG. That is what I have to say sir, thank you.

Jinay Gala: Thank you sir. Thank you.

Moderator: Sir, our next question comes from Mr. Ravi Sundaram from Sundaram Investments. Please go ahead sir.

Ravi Sundaram: Good morning sir. Congratulations for a wonderful set of numbers. Some of my questions have been answered…..

Aalok Patel: Sir, you will have to speak up. I can't hear you at all.

Ravi Sundaram: Okay. Sir, is it louder? Is it audible?

Aalok Patel: Yeah, little bit louder would be better please.

Ravi Sundaram: Sure sir. My first question was on the risk management practices more on the channel level. In one of the other interviews I heard from a competitor that they are trying to reduce as much cash as possible in the collection level to reduce the channel risk. So, what are we doing about that sir?

Aalok Patel: Of course, you are absolutely correct. Right now everything of ours is in a cash basis. There is a cash disbursement and a cash collection. There are few MFIs which are trying to reduce cash management. If you are following true microfinance, right now it is impossible to shift 100% of your portfolio in a bank based model, wherein the disbursement occurs through a bank and the collections occur into the bank accounts as well. All in all, that becomes a personal loan and we all know what a disaster that was in India about ten years ago. So yes, it is possible to at least disburse the money in the bank accounts; although I don't see it viable if you expect the clients to go to the bank to deposit the money. No. In my experience, I don't think that is viable, because the reason for such a great repayment rate in microfinance is, because you are going to their doorstep to collect the money. Some of these are really rural villages, where they don't have bank account running. So, if you expect them to travel 20 kilometers to go and deposit the cash, that is not going to be viable for them. We did an informal survey of finding out how many of our customers actually have a bank account. And that amount has increased because of the Jan Dhan Yojana, which stands at about 60% to 65% of our customers actually now have a bank account. But having a bank account also doesn't mean that they are using it. Most of them are zero balance accounts. One time they have opened their account and they are now dormant. Sorry, did you want to add anything to your question?

Ravi Sundaram: No, I think got what I wanted. My next question was on the cost…

Aalok Patel: Just let me interrupt. We are exploring a possibility of people paying money through the bank accounts. I think we are still about a year away from that being a possibility. But, I don't think it is ever going to be 100% possible. But at least for our more mature branches in India, where there is a good bank connectivity, we can consider it. Definitely we are considering and also right now.

Ravi Sundaram: Okay. That makes sense. And the second question was on the cost. We are expanding into newer geographies, Uttar Pradesh you just mentioned about it; how much of that will have impact on the cost to income ratio?

Aalok Patel: Your voice was kind of cutting off. Did I get your question correct? You were asking about what the effect will be on the expenses related to the expansion?

Ravi Sundaram: Exactly sir, yeah.

Aalok Patel: Okay. Of course it is very expensive to move into new geographies, especially in the initial stage. That is something that is not avoidable, because you have to put in a lot of HR infrastructure. You have to put in a lot of branch infrastructure. You have to put in IT related items and MIS related items. And you have to create this entire team to take care of things, even before you make a single disbursement. The second cost aspect comes in as far as the surveys and research are concerned. So, lot of our team people go and do very massive surveys of the area and the surrounding villages and experience lending there and all those kind of things. So, that is another expense. So, the idea is to find the key balance. I think when we expanded into MP also, our profit margin slightly dipped, just because of that expansion plan. So yeah, I think in the coming couple of quarters, definitely there will be a minor effect on the profitability due to that expansion.

Ravi Sundaram: Okay. One more question on the same line sir. The question is on, how long does it take for a branch to stabilize after it is opened, six months, eight months, something like that?

Aalok Patel: Basically it depends on the location. It ranges somewhere between six months to fifteen months, depending on the area. On average I have seen it take between ten and twelve months to reach that. Typically, about 800 clients is what it will take to reach a breakeven point. So however long it takes us to acquire about 800 clients that is when we reach the breakeven.

Ravi Sundaram: Okay. Probably a repeat of what the previous participants had asked. So, for FY17 we are looking at 310 crores from MFI and 80 crores from two-wheeler, is that number correct sir?

Aalok Patel: That is correct, yes.

Ravi Sundaram: Okay. And one last question from my side. It is an accounting question. What is the rough book value at which we are operating right now? I can crosscheck (not clear).

Aalok Patel: I think our book value is about 68. We have 50 crores net worth consolidated and about 69 lakhs shares, so whatever that works out to… about 12 lakh of those 69 lakh are DVRs, so not sure if you want to consider them at par with common equity.

Ravi Sundaram: Thank you very much sir. Thank you.

Moderator: Sir, we have got a question from Mr. Shivakumar from Unify Capital. Please go ahead sir.

Shivakumar: Sir, first of all congratulations for a great quarter sir. And I had a few questions. The first one would be, sir, what is the movement in the number of borrowers over the last one year? And also what was the movement in the average ticket size?

Aalok Patel: Yeah. So, I think this year in the overall number of borrowers we have about 1,26,000 clients, active borrowers and that is compared to around 1 lakh borrowers that we had in the prior year. So, that is little over maybe 25% increase. And as far as the overall disbursement or the size of disbursement has increased; as you are aware that the RBI increased their one-year loan limit. Earlier on in the year it was approximately 15000 limit for a one year product. Now, they have increased it to 30000. So, our average size of disbursement has approximately gone from 13800 to 16300. So, that is the overall increase in the average disbursement size.

Shivakumar: Right. Sir, when you say that the expected disbursement in FY17 would be 310 crores, so the incremental 130 crores, would it be coming from, how much of it would be coming from the existing borrowers and how much of it would be coming from the new borrowers?

Aalok Patel: So, I don't have the exact calculation, I am sure I can dig up the granular level detail of the projections as I don't have it committed to memory yet. But, overall in my experience we have approximately about 35% drop off of our clients. So, I would say about, as far as the disbursement is concerned, we can rely, about 65% of our disbursement we made this year; we can rely on our existing customers. And the rest of the 35%, we will have to find new customers. But, I think when we expand into new geographies, the number of customer increases quite rapidly there, in those areas. So, adding clients to a mature branch is a lot more difficult of course, for obvious reasons, than adding customers to a new branch.

Shivakumar: Right.

Moderator: Mr. Shivakumar. Sir, if it is not a problem, could you come back in the queue again? We have other people on the call as well.

Shivakumar: Right.

Moderator: Thank you so much for your time. Thank you sir. Ladies and gentlemen, we request you to restrict your questions to only two per person during the initial rounds. Thank you.

Sir, we have our next question from Mr. Jehan Dhadha from Motilal Oswal. Please go ahead sir.

Jehan Dhadha: Sir, could you tell us what is your funding mix right now from financial institutions and banks?

Aalok Patel: What is our what, sorry, can you repeat it?

Jehan Dhadha: Funding mix, the liability mix?

Aalok Patel: Yeah, I can look that up for you. I think approximately 40% is from financial institutions at year end and 60% was from banks.

Jehan Dhadha: Okay. Sir, how can this mix change over the next two years? How much can you go further up on the banking side?

Aalok Patel: Yeah, I think we covered that earlier on in the earlier questions as well that we cannot be completely dependent on banks, because the timeline of disbursement from bankers is somewhat unreliable. So, while I don't think our reliance on financial institutions will ever go down to completely zero, we are working on very diligently to reduce that. And in fact we have reduced it. I think when we started Namra, when we demerged our operations from Arman to Namra in 2013; we were almost 90% reliant on financial institutions. We only had one bank in our balance sheet initially. And slowly, slowly that number has gone up, as our portfolio increases, as our vintage increases, as our profitability, as our ratings increased, as our track record increased. So, overall our strategy, more and more is cutting down our reliance on financial institutions. I shouldn't complain about financial institutions, believe me, because they are responsible for a lot of the growth that we have achieved. The only problem is the cost of funding, because financial institutions are much more expensive. So, that being said that is one of the key reasons we are trying to reduce it. But, we have actually negotiated with some financial institutions which have also cut their rates significantly. And… I have the exact numbers for you. Bank is 61% and financial institution is 39%. So, I was right, very close in my earlier estimation.

Jehan Dhadha: Okay. So sir, could we assume that bank funding could go up to 75%-80% going forward, if not more?

Aalok Patel: I definitely think it will go up to at least 70% this year so yes, definitely yes.

Jehan Dhadha: Okay. So sir, what will be our NIMs right now?

Aalok Patel: What is my capital?

Jehan Dhadha: Net interest margin right now?

Aalok Patel: Net interest margin, are you talking about as far as the microfinance…..?

Jehan Dhadha: Overall. Overall for the company, for the entire company?

Aalok Patel: I think it is in my press release. It is about 19% or so. So, that is my overall margin. But, my cost of borrowing minus my interest rate tax to borrowers will be about 10%, little less than 10%. But, if you add equity into that, it will increase.

Jehan Dhadha: Right. So, what I was getting into is, could we expect expansion in margins in the next year?

Aalok Patel: No, expansion is actually unlikely. Unfortunately, we have to reduce our margins by crossing 100 crores. So, increasing that margin between the cost of borrowings and the final rate which applies to a client is unfortunately controlled by the RBI. So unless RBI gives a little bit of a leeway on that, it will be slightly difficult to increase from that 10%. But, what we can try and do is, as I was telling you earlier that if we start securitizing on a lower rate, then you can get a little bit of increase on the margins. Because securitization is just of balance sheet debt and that is not considered in the overall RBI margins. So, in that respect, we can do that. Another way we can do it is by selling ancillary products, which is lot of competitors does that. So, these things can all be done after we achieve some scale.

Jehan Dhadha: Okay, sure. That is all from my side sir. Thank you.

Moderator: Thank you sir. Sir, our next question comes from Mr. Srinath V from Bellwether Capital. Please go ahead sir.

Srinath V: Great set of numbers sir. Just two questions. I just want to find out if the Q4 numbers are on a 10% spread or 12% spread? And the falling base rates right now, do they put this 10% number also at risk? That is one. Second one is, I wanted to understand what is the critical scale needed for a particular micro geography, because we have actually scaled up NPA and are kind of now looking at another State? Have we exhausted our growth opportunities in terms of MP, before looking at Maharashtra? What is the kind of critical scale we need in a specific geography? Thank you sir.

Aalok Patel: So, thank you by the way. To answer your first question, your first question was regarding the, what was it again?

Srinath V: The limit, is the Q4 number based on the 10% limit or the 12% limit?

Aalok Patel: To be honest with you, since the last two quarters, we were never charging, we were never getting a 12% margin to begin with. We were more at 11%, because there are two formulas which we have to apply. One is, adding whatever percentage it is over the cost of borrowing. And the second is, 2.75 times the average base rate of the top five banks that changes every quarter. Since RBI was, in the last three or four quarters has been aggressively cutting rates, the base rates for the banks have been falling. And because of that, if there is 1% reduction in base rate for the banks, MFIs have to cut their rates 2.75%. So, I think we covered that in the last call as well.

Srinath V: So, have we now come below 10% in Q4?

Aalok Patel: In Q4, in the last month of Q4, we have come at 10%. Going forward it will be 10%. But, prior to that, we have cut it marginally about 90 basis points.

Srinath V: Okay. And we had a representation; the industry had a representation with RBI to go easy on the second rule, which is based on the base rate. Has there been any reprieve on that or has RBI indicated that they are looking into it?

Aalok Patel: Yes, RBI has indicated. So, MFIN, which is our SRO, I think we have got a letter from them about two or three months ago. They had a special meeting to discuss this topic. And RBI Governor also instructed somebody else in RBI to look into it. I don't recall the exact nature of that communication, I can look it up. But definitely people in the highest levels are aware of it and they are working to change it. I just don't think it probably falls very high in RBIs priority list of to-do's. So, they will probably get to it when they have time.

Srinath V: Great sir. Sir, on Madhya Pradesh?

Aalok Patel: Yeah, on Madhya Pradesh, definitely in fact in this quarter we are planning to open four more branches in Madhya Pradesh as well. We have eighteen branches in MP. And we have covered lot of the areas West of Bhopal. But, as you know Bhopal is somewhere in the middle. So, we haven't even covered half of the State yet. But, I don't think it is the right business strategy to just wait till you saturate one State and then move on to the next. I think if you want to plan long term, you have to mitigate the risks, as far as the geographies are concerned as well. And you know political risk is also a concern for us, after what happened in AP. Of course I don't think that will happen again, but even in terms of natural disasters, flood or famine. So, I think it is always recommended that you expand geographies as well. And the second thing is that, I think we will continue to expand in MP. And also the hardest part is over in MP. Now, we can safely start making all the branches more profitable, getting more efficiencies; expand at a reasonable rate, about two branches a quarter or so. So, to just to give you a kind of, for comparison purposes, we have 37 branches in Gujarat and that took us about five years to open. So, I don't think it is fair that we can just open branches in a State left and right.

Srinath V: Thank you sir. That was very useful sir.

Moderator: Thank you sir. Sir, our next question comes from Mr. Amit from Ocean Capital. Please go ahead sir.

Amit: Good morning sir.

Aalok Patel: Good morning.

Amit: A very good set of numbers and congratulations on that part. Sir, one thing which I would like to know is, what is the average cost of borrowings for the financial year 2016?

Aalok Patel: Average cost of borrowings are for microfinance, which includes, before I give you that number I think I should say that it includes interest rates, it includes whatever processing fee and auditing fees that might go. It includes also the cash collateral expense, most of the banks charge something called the cash collateral, which means they force you to deposit cash in a FD. They retain a small portion of the loan, so mostly about 10% or sometimes 15% as a cash collateral. So, it even reflects that. So that being said, in microfinance it was about little over I think 15½%. I think it is available on my balance sheet. And for Arman two-wheeler it was about 14½%. So, micro is slightly higher, because banks consider it as an unsecure loan. And two-wheeler is slightly lower, because they consider it as a secure loan. And of course, there is a lower tenure as well. So, because of the lower tenure, the effective rate goes up, because the processing fees and other fixed costs, you divide it over a lower tenure versus a larger tenure. So, the effective rate goes up.

Amit: Sir, what is the average ticket size in microfinance?

Aalok Patel: It is about 16800 for new loans. Overall about 21000 including old clients.

Amit: Sir, do you think that in the year going forward, maybe one or two years or maybe three-four years down the line, the ticket size would increase?

Aalok Patel: Yeah, definitely it will increase. As your older clients keep maturing, you want to shift them towards higher and higher ticket sizes, if they can afford it of course. So, we already have products like for third, fourth, fifth cycle clients we have products like 30000, 35000, all the way up to 40000 loans even. So, those things are there. But, it represents a very small portion of our book right now, because we have been doing microfinance for only about five years; of which couple of years were during the AP crisis. We are little bit conservative compared to others as well. But, as our vintage keeps increasing, I think the average ticket size will also continue to increase. So, that is one way of getting into as a natural growth, where the old clients mature into higher ticket size loans.

Amit: So, actually sir what I am trying to understand is that at this cost of borrowings say somewhere around 15%. I am sorry, I haven't asked, I just (not clear) complete the question.

Aalok Patel: Can you speak up please?

Amit: Sure sir. I am saying, if you could provide me with the average lending rate in the microfinance?

Aalok Patel: Average lending rate is 25.6%.

Amit: Yeah. So, my question is, with the ticket size going to increase in the near future and with all the big microfinance companies into the picture right now, with having good capital, adequate capital and lower cost of borrowings with them, how are we supposed to compete with that? Because, before that, before it was lower ticket size and maybe the interest rate would not have been much, as a part of the component. But, now with the increasing ticket size, the interest rate would matter to the small borrowers. And maybe that would hurt us a bit? Could you comment on that? Could you suggest how to look at that?

Aalok Patel: I know where you are getting on. And I think we are running out of time, so I will make it slightly quick. Overall as I mentioned to you earlier that minor differences in a few basis points don't really make a significant difference with the borrowers. In the installment it only matters Rs.5. But, I get your question saying that higher ticket size, that Rs.5 might be Rs.20 or even maybe Rs.50, if you talk about it in a monthly basis. Overall our rates are not that different from our competitors. If you look at companies like Ujjivan, if you look at companies like Equitas, two names you might have heard of quite recently, their rates hover around 23-24%. So, I might be a little, maybe 1% more than them. If you talk about, I think I know which company you are referring to. I think you are referring to other listed entity SKS whose rates are lower than 20%. SKS is an outlier. I think for whatever reason they wanted to call themselves as the lowest lending MFI in India. I am not exactly sure how they are pulling it off. But, that is an outlier. I think the next cheapest loan will probably be right around 22-23%. So, we are not really too different…

Amit: That was the main question sir. Thank you for answering that. I really appreciate it.

Jayendra Patel: Hopefully I answered it. The timely delivery of the credit in this business is more important than anything else. We have taken this issue also at the Finance Ministry, when I was involved in the MFIN. And I would say here and there a percent is not going to make a material difference to the person who is going to use this money on a very priority fashion.

Amit: So…..

Aalok Patel: I think it is also somewhat prudent to note that as we keep reducing our interest rates, we have to pass on the savings to our customers. So, our overall rates will, I think one of our key goals this year is also reducing our overall cost of borrowings. We have to pass on that savings to our customers. So, that should definitely bring us in line with what our competitors are charging. But, just to give you an idea, we are probably one of, for our size we are one of the cheapest microfinance companies. Companies similar to our size are charging much higher than us, by even a couple of percentage points. So, if you compare mid size, small to mid size MFIs, between 100 crores to 500 crores, we are still one of the cheaper ones.

Moderator: Thank you sir. Now, I handover the floor to Mr. Digant Haria for closing comments. Please go ahead sir.

Digant Haria: Thank you everyone for being on the call and listening patiently. And thank you Jayendra Bhai, Aalok Bhai for sharing your insights on the company. Have a great day everyone.

Aalok Patel: Thank you. Thanks every one.

Moderator: Thank you sir. 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 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.
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