"Arman Financial Services Limited Q4 FY2022 Results Conference Call"

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Moderator: Ladies and gentlemen, welcome to the Q4 FY2022 Results Conference Call of Arman Financial Services hosted by Emkay Global Financial Services. We have with us today Mr. Jayendra Patel, Vice Chairman & Managing Director, Mr. Aalok Patel, Joint Managing Director and Mr. Vivek Modi, Group Chief Financial Officer. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference, 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 over the conference to Mr. Manjith Nair from Emkay Global Financial Services. Thank you and over to you Mr. Manjith.

Manjith Nair: This is Manjith here. Good evening, everyone. I would like to welcome the management team of Arman Financial and thank them for this opportunity. I shall now hand over the call to the management for their opening remarks. Over to you Sir!

Aalok Patel: Thank you Manjith and good evening to everybody. This is Aalok Patel here and as always it is a pleasure to connect with all of you again and thanks for taking the time out of your very busy schedule to join us over this call and to discuss our financial performance for the quarter and the year ended March 2022. We have issued a detailed press release and investor presentation for the quarter, and I hope you had a chance to review it. The presentation was uploaded with a minor delay today morning so my sincerest apologies for the delay.

I will start with the brief overview of the industry and the business during the last quarter and last year and then we will move into our financial performance. The year gone by had its fair share of challenges starting with the second wave of COVID-19 with the delta variant during the Q1 and then the third wave with the Omicron variant in the Q3 and the Q4. However, with several COVID waves and lockdowns in the past few years, we have managed the third wave with very minimal disruptions. The second wave however proved to be highly disruptive as I am sure all of you are aware. But that said, the situation is a lot different today. For now, it seems that COVID is behind us, and things are back to normal. With the normalization of the macro environment, the demand for credit is also back to normal however if another wave is hiding around the corner, we feel a lot more confident in our ability to deal with it. In fact, the disbursements made post the initial lockdowns have a repayment rate of 98% despite facing the second wave and the third wave. With the new RBI regulatory framework for microfinance loans, the NBFC and MFIs will have a level playing field with other microfinance players and also allows to price in risk for different microfinance loans. Although the new regulation is targeted more towards bridging different categories of lenders that is banks, NBFCs, asset based etc., under one regulatory umbrella, it seems that the NBFC and MFIs stand to gain the most from the new regulations.

I will now give a brief overview of our financial performance for the Q4 and the year ended March 2022 and post that touch upon liquidity, disbursements and collections in more detail. Coming to the brief overview of our financial performance for the quarter, it gives me immense pleasure to inform you all that despite the challenges, our consolidated loan book as on March 31 2022, stood at a record high of Rs.1,233 Crores lead by expansion in branch network which helped cater into new customers in geographies along with pent up demand from exiting geographies. Our active customer base this year has crossed pre COVID levels at over 4.6 lakh. Segmental AUM for microfinance stood at Rs.1,022 Crores higher by 59% year over year. AUM for MSME stood at Rs.165 Crores higher by 32%. For the two-wheeler segment our AUM stood at Rs.46 Crores. Consolidated loan disbursements during Q4 and FY2022 stood at Rs.337 Crores and Rs.1,023 Crores respectively up by 23% and 101% year over year. The total MSME and two-wheeler disbursements in Q4 and FY2022 were Rs.58 Crores and Rs.183 Crores respectively higher by 7% and 39% year over year. While microfinance disbursements stood at Rs.279 Crores for Q4 and Rs.840 Crores for FY2022 higher by 22% and 101% year over year respectively. This encouraging performance was as a result of our consistent endeavor to remain in close touch with our customers and provide them with timely delivery of credit. I would like to highlight here that while we grew our disbursements in AUM our core focus will always remain and always lie on maintaining the quality of our assets and/or enhancing profitability. Gross total income during Q4 and FY2022 stood at Rs.76 Crores and Rs.235 Crores respectively up by 68% and 20% year over year. Profit after tax stood at Rs.16 Crores and Rs.32 Crores for Q4 and FY2022 respectively. FY2022 PAT grew by 3x year over year aided by growth in disbursements and especially lower provisioning requirements due to better asset quality of the loans disbursed post COVID-19. These are loans disbursed post August 2020. The annualized ROE for the Q4 has crossed 30%. Consolidated GNPA stood at 4.1% and NPA stood at 0.7% for March 31, 2022. The company has steadily created adequate provisions to take care of the unprecedented impact of the COVID pandemic. Loan impairment cost for the quarter stands at Rs.10.8 Crores. Cumulative total provisions and write offs for the year was Rs.37 Crores as on March 31, 2022. The total provisions on the books stood at Rs.65 Crores as on March 31 2022, covering 5.73% of the total on book AUM. The company enjoys a healthy liquidity position with Rs.150 Crores in cash, bank balance, liquid investments and undrawn CC limits aided by pickup in collections along with incremental debt capital raised. The company has duly repaid all debt obligations that were due in Q4 FY2022 and last year with debt equity ratio of 4.65x on March 31 2022, and while shareholders equity stood at approximately Rs.213 Crores. ALM continues to remain positive, and the company continues to have access to new sources of funds due to the company's robust balance sheet, long vintage and prudent lending practices.

Coming to collections our consolidated collection efficiencies saw further improving trends during the quarter and grew from 92% in Q3 FY2022 to 95% in Q4 FY2022. Collection efficiencies for the month of April crossed more than 98%. Robust collection efficiencies were a result of passionate on groundwork force, continuous customer interactions and the customer focused approach. We have successfully completed our branch expansion plants and added 30 new branches in the MFI and MSME segment. Our total branch network as on March 31 2022, stands at 292 branches. The expansion has not only given us deeper penetration by tapping into newer districts in existing states, but also given us an opportunity to explore new geographies. Due to our asset light business model the capex spent on branch expansion was fairly minimal allowing us to reach branch level break even quite quickly. Finally, to conclude, I would like to say that our company remains dedicated to serving the most under served and unserved population of India. Our endeavor is to make them part of India's growth story by making them financially independent. Today India has a massive growth potential in the microfinance lending landscape. Financial inclusions remain a key goal of Government of India. With the new RBI guidelines, the outlook for the sector remains very much positive. I will also conclude by saying that in September of this year, Arman will be celebrating its 30th year in operations. We have seen a lot of ups and a few downs as well. None of it would have been as enjoyable or meaningful without the relationships we have built along with way with our employees, customers, lenders, investors, the board, our peers and all the other stake holders. It is a big thank you from our side for your constant support. Thank you and I would now request Michelle the operator to open the call for the question-and-answer session.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Amit Mantri from 2Point2 Capital. Please go ahead.

Amit Mantri: Sir just a couple of questions on this quarter's results so the yield has increased a lot this quarter and even the provisions has continued to be elevated so what is the reason for both of these things?

Vivek Modi: The yields have in particular gone up because we have done a securitization transaction of Rs.100 Crores being off loaded to State Bank of India and under Ind-As requirement the gain on such transaction needs to be book up front so there is a gain of Rs.5.8 Crores on this transaction in this quarter and especially in Namra's balance sheet in Namra's P&L which obviously flows into the consol as well.

Amit Mantri: But even if I exclude?

Vivek Modi: So that is one and overall in the Q3 when we talk if we were to kind of compare Q3, Q3 if you remember was a quarter wherein the fresh disbursement had to take place at a lower yield because of the CGS corporate or rather a central government guarantee scheme in microfinance so those were at a lower yield of 2% at that point of time so on a comparative basis from Q3 to Q4 the delta would be slightly higher.

Aalok Patel: Due to timing differences and due to an overall increase also in the yields in the last quarter.

Vivek Modi: Then maybe I can just also add a bit on the two-wheeler side wherein again the yield has been moving up. Primarily what is happening is about 30% of the books are now rural two wheelers wherein our yields have been higher and as that component keeps on increasing…

Aalok Patel: Provision side I think they are pretty much done. Overall, we had I think I keep saying this on the Arman side I do not think the provisions are very, very high. From the Namra side, we were doing lot of clean up kind of an exercise and the write offs that we were doing Amit and it is what it is. Besides that, I do not know.

Vivek Modi: Generally, Amit what has also happened in Arman if you see the overall provisioning requirement for the last couple of quarters anyway has been very fairly stable or rather on the decline. In Namra because of the basic completely unsecured quality of the book, we have kept on providing as far as possible and required and at a consol level since we continue to have about 5% provisioning on the overall AUM. I think largely if we can say, we are well provisioned and hopefully I hate to say this because every time we say this something goes wrong may be but largely it feels that we have seen a reversed quarters that COVID had to show us.

Aalok Patel: A lot of this you are seeing is related to the second wave specifically not so much the third one, but the second wave.

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

Savi: I think Amit dropped out. Sir I have a couple of questions. One is, I think there is some loss that you have taken through the other comprehensive income what is that?

Vivek Modi: Savi on the Ind-As side since we need to kind of mark to market the portfolio and under the new rate of interest that we are charging in the future the overall, average interest rates have gone up and based on that the OCI will turn out to be a notional loss if we can put it that way. It is more like an Ind-As adjustment.

Savi: This must be a loss on your bond portfolio, but I presume that will be low duration?

Vivek Modi: It is not a bond portfolio.

Aalok Patel: This is for the entire portfolio under the Ind-As.

Savi: This will be your liquid funds, right?

Aalok Patel: This is not related to liquid funds. It is a little bit complicated to explain. It has nothing to do, in reality if I want to put it that way. Basically, the market rates have moved up and the portfolio that we have created in the past has a lower interest yields so Ind-As requires to take a notional loss through OCI, but it has nothing to do with the cash flows or anything like that.

Savi: This will reverse over time? Is it expected to reverse?

Aalok Patel: Yes, it will automatically reverse let us say if the interest cycles kind of come down. Fundamentally why this happens is that microfinance and MSME and even two wheelers so all our three segments, the lending is done at a fixed rate. It is not a flexi rate which adjusts. Hence if the interest rates were to rise, we will have a notional loss and if the cycle reverses, then we might have a notional profit. Over a period of time either as we keep on building the book our average yield might increase and hence the notional loss will become a bit smaller or if there is an interest rate cycle reversal in a couple of quarters then again it might lead to a notional gain. Even I do not completely understand it myself.

Savi: Sir on the net NPA have you knocked off all the prevision including floating provisions while calculating that number?

Aalok Patel: When you say floating what do you try to mean on that.

Savi: Like this is net of all kinds of provisions that you have taken till date? Is this number net of all or only net of the specific provisions?

Aalok Patel: This includes all the provisions, so eventually to cut the answer short, this includes the total provisions against specific loan account. This includes all the provisions including the floating provisions specifically associated to that particular account or the NPA accounts so there is no additional separate NPA floating provision apart from what has been already deducted from the gross NPA to have arrived in NPA.

Savi: I will join the queue for further questions.

Moderator: Thank you. The next question is from the line of Piyush Jain from Hansraj Virendra Capital Private Limited. Please go ahead.

Piyush Jain: Sir many congratulations for a good set of numbers. Sir can you just throw some highlight on the new geographies where you are expanding, and second question would be in the new geographies how do you see the market with respect to the home state or I would say the Gujarat market means with respect to either the loan disbursal or the collection is there any process improvement or after seeing the market? Are we are doing something different to perform better over there or let us what is the performance over there if you can throw some light?

Aalok Patel: I think we expanded into Haryana late end of last year and early this year, so we have about 15 branches there and we have opened up around 12 odd branches I believe in Bihar, so these are new geographies for us. Both of them as far as NPAs go they are practically zero at this point, but when you move into a new area because you start very, very cautiously to begin and you have a lot of management bandwidth there to begin with. Both of them are slightly different areas so Haryana the scope is probably just to open 15 odd branches so being a small state and with areas relatively being richer if I can use that term. There is no potential for a very rapid growth in Haryana, but it is still extremely good area to operate into as far as our experience is concerned so far. Bihar on the other hand is a very concentrated area, but if data proves anything it is one of the best areas in India to operate considering that if you look at demonetization data and if you look at the past COVID data one of the best performances has come out of Bihar as far as the repayment is concerned, but that being said it is a bit forbid. It is either going to expand into Bihar. It is better to do it sooner rather than later to gain market share. So far, I think, the disbursement volumes are average. It is little early to tell so I would say we will have to give it at least another six months to a year to kind of give you a real kind of a feedback on how that state is turning out to be. And I think your other question was how does it compare to my state. Well, every state is a little different and you have to approach a little differently, but the good part about microfinance is that it is applicable across stateliness as well, so you do not have to begin from scratch 90% of what you do in Gujarat is the same as what you do in Bihar or any other place. The trickiest part is managing the people so operationally it is quite intense, but from understanding perceptive it is not very effective. I do not know if that answers your question.

Piyush Jain: Yes, Sir that is all from my side. Thank you so much.

Moderator: Thank you. The next question is from the line of Kuneh Ghelani from Vivriti AMC. Please go ahead.

Kuneh Ghelani: I wanted to understand how is it that you guys are reacting to the changes which RBI has come up with for MFI guidelines both with respect to the yields and also on ground processes, practices and underwriting norms as well?

Aalok Patel: So that is excellent question so first of all of course the yields have gone up as far as we are concerned so our yields right now are between 24% to 26% depending on different geographies we are charging to the customer. Over and above that, the ticket sizes have gone up slightly as well and thirdly we have begun some level of income verification from our customers at least the household verifications are concerned so lot of work, work in progress both from a credit bureau side and our own internal working side wherein as far as credit bureau data is concerned we have to capture the entire family's credit bureau data so right now there are auto algorithms which are pulling the member and their spouses data as far as credit bureau is concerned, but anybody else our system is not consolidating it. What is going to wind up happening is in the next one or two quarters there is going to be a holistic credit bureau report generated for the entire family but lot of complications. I do not want to get into it. It will take the entire basically session to talk about it, but yes there are definitely challenges in evaluating the entire households indebtedness both in terms of microfinance and any other loans that may have and both in terms of the income and when you talk about the income of the rural segment by far and large lot of these guys are involved in multiple activities and their earnings are also variable throughout the year right so there are always questions that come up whether you want to count it at the low end which makes more sense or do you want to average or God forbid count it on the higher end as far as the monthly incomes are concerned so these all remain very unanswered questions but on the other hand when the RBI talks about Rs.3 lakh household income as the limit for micro loan that is pretty much broadens the market quite a bit for us. If you consider that the vast majority of the Indian households will make less than Rs.25,000 a month so it is quite inclusive of what is considered as a micro loan, but yes margins have definitely increased, and we are evaluating the customer both on a household income level and on the household indebtedness level.

Kuneh Ghelani: Also just a followup right because you mentioned margins have gone up and hence you are able to potentially recycle equity better right so to that extent within the MFI book itself, so to that extent how do you look at capital allocation between the three products the two-wheelers, the MSME is also a high yielding product, but now MFI also you are able to squeeze an extra bit of margin so both from a capital allocation point of view between three and the overall capital that you have is the leverage that you are this point what is the sort of runway that you are looking at it with those sort of capital levels?

Aalok Patel: So as far as the product mix itself is concerned two-wheelers have become sort of negligible so let us put that on the side for now. Lot of the lines, which were drawn between what I had called MSME versus microfinance have today now started to blend so when you talk about MSME versus microfinance preregulations you are talking about on one hand a JLG product with very minimal underwriting and on the other hand the MSME product was doing an income at evaluation on a household level and using that to give a loan but all of a sudden that includes microfinance as well so the lines have sort of merged to an extent and so wind up is happening in the MSME side is that the evaluation will increase and the ticket sizes will have to probably increase as well. Now as far as the product mix is concerned as I have said I am very keen to do more. As I have said in the past, I am keen very keen to do more MSME and we have been growing that book well at least in the last one year I think from a percentage standpoints the disbursements have increased, and the AUM has also increased. I think that AUM increase by about 30% to 35% over the last year but microfinance today is still the dominant segment for the company. That will probably likely change in the next three to five years but today microfinance will still remain at about 80% of the book

Kuneh Ghelani: I just had one followup if I can very quickly squeeze it is? Just trying to understand from an overall leverage perceptive as well right so on balance sheet we are 4.6% or so if we had been managing to sell we go over 5% right so to that extent how is that we are looking at leverage the consol basis and possibly the equity as well? What sort of runway are we looking at right now?

Vivek Modi: Yes, the issue is approximately at about 24% odd on a consol basis like kind of normally you do not need to look at the consol basis because these are two different entities. When Arman standalone it is about 29% and in Namra, I had to maintain something closer to 20% but hypothetically if we were to look at the consol then it was about 24%?

Aalok Patel: It is a wholly own subsidiary so basically whenever the subsidiary needs more capital historically it has asked for it, from the parent. Now from a leveraging perceptive, I think your question is that how far can our equity push us so right now as Vivek said we are at about 24 CAR. We have taken steps in the past quarter to reduce that or increase the CAR percentage even further by putting some of the off-book kind of transactions which is the DA transactions, and we are of course looking for equity as well but for now we are comfortable. There is not much of a concern at this point.

Kuneh Ghelani: Thanks so much and wishing you all the very best.

Moderator: Thank you. The next question is from the line of Sachit Motwani from Param Capital Research Private Limited. Please go ahead.

Sachit Motwani: So, my first question is pertaining to what other large industry peer you are seeing that post this new guidelines April and May has been very slow, so I just wanted to understand if you guys have also seen a similar trend in terms of April and May disbursement?

Aalok Patel: No in fact it has been the opposite for us. The disbursements are quite high. It seems that the demand is quite high as well so yes operationally it has been challenging but luckily, we had a lot of practice with income evaluations and things through our MSME so that helped us quite a bit from an intersegment kind of a wave to take our learning from the MSME segment and put them into microfinance so that I think is probably what you are referring to. I do not particularly know which year that you are referring to, but lot of peers were facing issues with income verification and evaluating indebtedness and stock on a family level so I think we have done if I can prove to my own horn a little better based on the unique skill set that we had from the MSME division.

Vivek Modi: Further if I can add I think within microfinance we also started something which is called the individual business loans which were individual loans so that is still in pilot phase but since it was set into almost 70 branches at one go in pilot phase itself though very small book there about 2% only, but still that kind of prepared us in income assessment in Namra itself at each of the branch level.

Aalok Patel: Idea was a product that we had started doing in microfinance to graduate the customers into an individual loan with the cashless repayment methodology and higher underwriting so that is basically what Vivek was referring to.

Sachit Motwani: Got it, but your MSME would also be on similar lines right with a slightly higher ticket size?

Aalok Patel: Yes correct.

Sachit Motwani: The other question was on the securitization that you have done so now that the gain is booked at Rs.5.8 Crores is there any future credit loss or any guarantee that Namra had to give or any collateral or FLDG?

Aalok Patel: By definition the DA transaction cannot have any recourse, so there cannot be any guarantee or any cash collateral or anything of that sort. Otherwise, it would not be considered as a direct assignment transaction, but Vivek can add here something.

Vivek Modi: So ideally what is happening is as per the definition under Ind-As but true sales where there is no recourse on the percentage of the cash flow which are assigned there cannot be any additional security in the nature of FLDG or any enhancement structures so to that extent there is no additional provisioning requirement on those assets. Something similar to that are being done through PDC transactions which remain on books only because overall the credit enhancement is about 10% to 15% or 20% at times so those are anyway on balance sheet and are covered under the provisioning that required for the entire asset class.

Sachit Motwani: Got it and after this Rs.100 Crores securitization that is done in the Q4 are you looking at more such deals coming in the coming financial year?

Aalok Patel: Yes absolutely. It is kind of a win, win situation because the rates are also quite competitive on DA transactions number one and number two it helps with this ER ratio as I mentioned earlier because the asset is completely removed from our balance sheet so yes, I think given that there is enough market interest we are open to doing more such transactions in the future.

Sachit Motwani: Got it and even without the securitization income if I look at your cost to income it works out to be 40% so obviously you are targeting some branch opening and all of that but the scale at you can we expect this to further moderate down the cost to income ratios?

Aalok Patel: I think for sure now that we are charging higher interest rates and the operating cost will not increase to a large extent. It will take a few quarters probably because all the stuff that we have created in prior quarters was at lower interest rate so the weighted average interest rate will take some time to catch up to the current charging levels, but yes there is definitely a lot of scope for improvement with the new RBI rules.

Sachit Motwani: Got it and Sir another was even without the DA transaction our other income was a bit higher this quarter so any particular reason for that? You had Rs.9.2 Crores of which securitization was Rs.5.8 Crores so remaining what was the reason for the remaining other income? Was it that higher liquidity that you were sitting on of Rs.160 odd Crores?

Aalok Patel: You kind of answered it for us. Basically, it has been that the liquidity has been generally high and that is about it has resulted.

Sachit Motwani: So, going forward what liquidity would you be comfortable on the balance sheet?

Aalok Patel: It will be as much as possible really because we have pretty descent growth targets. Ideally speaking I would like at least one month’s worth of disbursements as liquidity. It has not been always the case for the past couple of months. The Q1 is always light in terms of lenders, but yes, I think it is just nice to have the liquidity available and there have been so many incidences in the last four to five years demon and DHFL kind of crisis and COVID and stuff. There is that external equity has daily helped us, so it does come at a cost of negative carry, but I think it is well worth it to have it, so we really want to work in just in time kind of a system. What has really helped us in the past is having large CC limits, but we are in a sort of a minority where NBFCs are concerned. Most NBFCs did not have very large CC limits. Most of the funding was done through term loan kind of structures, but the debt portfolio increases more and more the CC limits become less and less meaningful from a percentage basis for us also. Negative carry will continue to impact us from a P&L standpoint in the future.

Sachit Motwani: And lastly on the two wheeler side though it has become like below 4% of your AUM and it as good and meaningless at this point of time but you were at Rs.100 Crores plus AUM in this two wheeler book so I just wanted to get your long term thoughts on this like are we looking at scaling this up to a Rs.200 Crores to Rs.300 Crores AUM at some point of time?

Aalok Patel: So right now, the market conditions are such that it is kind of on ice at the moment. As the conditions improve, we will make a call whether we want to kind of reenter this segment even on a substantial level or not. We are doing two-wheelers which is generating pretty good decent gain and that is essentially a tag on product for our MSME books, so it does not require a whole another operation to do it. Lot of it is being done through our MSME branches. I do not know. I am little bullish on the EV side. It is little too early to start it but definitely something to consider down the road and let us see. I think two-wheeler has been our bread and butter for a long, long time through very rough or when we were much, much smaller than we are today so also there is a bit of a sentimental attachment to it as well but of course sentiments have no place in running a business but still we do not want to completely shutter the door. We want to keep some door open where we can get into it in the future.

Sachit Motwani: Got it. I have some more questions, but I will come back in the queue.

Moderator: Thank you. The next question is from the line of Yash Mehta from Steinberg Asset Management. Please go ahead.

Yash Mehta: Thanks for the opportunity. On your MSME business we have seen obviously in a couple of quarters there were elevated slippages? That has obviously normalized to the current levels let us around 8% or so of the NPA? How do you see let us say traction on this business and any guidance that you would like to give on the scale up of your?

Aalok Patel: Scale up which segment are you talking of? What are we talking of.

Yash Mehta: MSME.

Aalok Patel: No, we are trying to scale up. It takes kind of a unique customer, so it is not as simple I want to say microfinance is simpler, but it takes a specific kind of a customer and a specific occupation to do a MSME kind of a loan. Of course, the margins that we enjoy in MSME are far superior as well so there are no complaints there but yes it is very difficult to grow the MSME book at microfinance levels of 50% to 60% a year. Still, we are managing to grow at about 35% to 40% on a year-on-year basis and I think you should see that continuing for the years to come.

Yash Mehta: So, let us say obviously on our current base of the MFI business that we have what share of customers would you say actually qualify for some of these MSME loans? They must have had some credit history with you, and you would like to kind of upgrade them to becoming MSME customers, right?

Aalok Patel: No these are not upgraded customers. These are completely different segments so we don't' approach MSME like lot of our peers do that. You have been with us for four to five years and here is the higher ticket size loan and enjoy so it is not like that. We are trying to target to customers who are one step above the microfinance customer's right so these could be male customers. For example, microfinance is purely concentrating on GLG female customers. It could be male customers and their businesses would be at sort of a higher level than a simple like a household income generating activity like a tailoring machine or buying one cattle or something to sell milk so it would be at a higher level and so we are not relying on our microfinance customers to do our MSME book.

Yash Mehta: Sir can you give some broad used cases for which you have been giving MSME like in terms of let us say your buy of the mix?

Aalok Patel: It could be 'kirana store'. It could be scrap dealers. It could be people involved in the spice trade. It could be people who supply textilers who do embroidery job work and even if they are dairy then the larger cattle in the dairy side so preferably, I think one thing is that the MSME in Arman are completely different branches and segregated areas and they do not kind of generally overlap with the other geography except for a few branches here and there but generally these are absolutely different geographies and these are absolutely different dedicated branches for MSME and microfinance.

Yash Mehta: Understood and my last question is let us say we have seen our yields now obviously currently at 22%? They are going to 24% to 26% and that range incrementally. Then the question is would you go deeper in terms of let us say a customer that you have not approached before because now you, ability to prize that customer also is much better? We do not have a particular customer segment earlier at a certain yield level.

Aalok Patel: Yes, so geographically we are definitely evaluating so let us put it that way so not on an individual customer level but there were certain geographies that we were more riskier than others or certain geographies that came at a higher operating cost than others so we would be looking at those for sure.

Yash Mehta: Alright that is all from my side. Thank you very much.

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

Amit Mantri: Aalok sorry I got disconnected earlier. Just again on the same question just a bit more understanding so as of now in the new regime so you had mentioned that one you are doing region specific pricing of inters straights is that the only criteria right now or there are other factors also that determine the interest rates be it safe? With cycle the borrower is or anything else?

Aalok Patel: Yes, so there are numerous ways to divide it up. One is by ticket size. One is by geographies. The plan is to add a level of sophistication on the interest side. Of course, competition would also play a factor into the equation but right now we are just doing it on geography because this is lot to concentrate on.

Vivek Modi: Aalok if I can add. Geography plus ticket size. Now ticket size is Amit a function of cycle also so as you give larger ticket sizes you are basically going to the same customer, that customer will be third or fourth cycle upwards.

Aalok Patel: But it comes at higher risk.

Vivek Modi: Higher risk so to that extent it might sound counter reductive but as we kind of always said generally speaking the unsecured loan borrower is interested agnostic. It does not mean that we charge them anything that way but generally if a customer in the third or fourth cycle was limited to Rs.40,000 and now we have kind of increased it to Rs.50,000 and Rs.60,000 so the timely delivery of credit and the higher ticket size, there is the room for better margin there.

Amit Mantri: Sure, understood so ticket size increase basically that?

Aalok Patel: In terms of criteria that it can use while one is of course ethics that we should really take advantage of a situation and so the board has set a hard limit on what that you cannot cross a certain interest rates but other than that there is demand and affordability and competition and operating cost and risk premiums and tenure also you can do a size, role cycle, gauge of the branch that as the number of customers increases your operating cost in the branch increases so you an price it according to that. There is also a credit cost and profit margins and what peers are charging so there are numerous possibilities for pricing. Lot of it that elevate as time goes on.

Amit Mantri: Sure, understood and currently there are Rs.65 Crores of provisions on the book so can you give a breakup of that how much of it is say standard provisioning and how much of it is NPA related and how much if there is anything apart from that of the Rs.65 Crores?

Vivek Modi: Just to give a breakup between Arman and Namra it is about Rs.47 Crores for the microfinance book and the balance Rs.18 Crores is on the Arman book for the two-wheeler and MSME book. In terms of, I think Rs.18 Crores is on standard assets. NPA is about Rs.30 Crores. The overall NPA as far as the Namra book is concerned is approximately, we have provisions of Rs.28 Crores for the NPA specific provision and as far as Arman is concerned, we just had about Rs.13 Crores as NPA provisions so overall about Rs.48 Crores out of that Rs.65 Crores is the NPA provisions.

Amit Mantri: Rs.48 Crores is NPA provision and the rest Rs.17 Crores would be standard asset is it?

Aalok Patel: Yes, standard asset provisions. That would be correct.

Moderator: Thank you. Moving on to the next question. The next question is from the line of Savi from 2Point2 Capital. Please go ahead.

Savi: Sir I think again Amit was lost, but from this the standard provision has not been netted off right? It is the net debt of the net NPA will go zero, right?

Vivek Modi: No. The standard NPA provision, see the gross NPAs for let us say just speak for a minute about Namra. In Namra, the microfinance the gross NPA is Rs.34.5 Crores and even that Rs.34 Crores there is a Rs.28 Crores NPA provision so the net NPA will turn out to be 34 minus 28 which is about let us say Rs.6 Crores right so that is the net NPA there and similarly for Arman the gross NPAs on Arman that we would have, to give you a segment wise breakdown, the gross NPA numbers for two-wheeler is Rs.3.17 Crores against which we have a provision of 2.23 Crores of specific NPA provision so my net NPA is just 0.94 Crores in two-wheeler segment, in MSME our gross NPA is 12.89 against which we have a provision of 10.67 Crores giving a net NPA of 2.2 Crores, so in Arman the net NPA is about 3.15 Crores which means about 1.79% and in Namra microfinance side it will turn out to be less than 0.6%.

Savi: But against these if you also look up the standard provisioning then.

Vivek Modi: Okay so what you are saying is in terms of provision coverage that is one way of looking at it. So, if you look at it that way probably the overall provision for micro finance both would be much bigger, it may be about 130% and Arman turns out to be almost 150% but again more specifically, I think.

Aalok Patel: We have 100% provision of NPA interest also. The ECL has really kind of confused matters on what is standard and what is not because there is the RBI method of calculating. There is ECL process of calculating and you have to kind of take whatever is high which in our case is always the ECL, so I know where you are coming from the typically speaking pre-Ind-As we reported standard assets separate then NTA provisioning separate. Now it is just kind of one big blended number.

Vivek Modi: Again just to further clarify what happens is generally we have seen the practice PH ration now typically when you are doing an expected loss calculation then I think generally speaking it is a good ration to just show but it probably does not really mean to much because I require provisions against standard assets as well and against the NPA assets there has to be a specific provision so I think the specific coverage is rather more important so my NPA gross asset have a coverage of roughly 80 plus percent that is to our understanding a more important think to be prepared for because if my NPA asset are let us say 50 Crores and against that 50 Crores my NPA specific provisions on the specific asset itself is 40 plus Crores which is almost like 81 % to 82% rather more definitive way of gauging loses rather than saying that against the 50 Crores of NPA I have a provision cover of 65 Crores which is 130%

Savi: Got it so this quarter what was the reason for increasing provisions was it to increase the coverage ratio on the NPA. I mean collections are pretty good so what was the reason I mean Q-o-Q also there has not been a decline.

Vivek Modi: It is all the past stuff first wave, second wave all of that stuff. We just have to clean up. I mean something which is like pre COVID and still not a NPA bucket but is in 30 to 60 day bucket or what we call as a stage 2 asset will continue to have a higher coverage provisioning requirement because what is also happening honestly is that lot of these are moratorium interest as well so lot of the microfinance customers when they took the original moratorium or we gave it to them there was an interest that was accrued during the moratorium period, however you know now it is disputed lot of customers who could not understand moratorium interest I think most people did not before this before COVID crisis came so they say that we have paid as per the regular schedule and what is this extra money that you are asking so lot of clean up exercises well where there would be couple of thousand rupees spending per customer and that was disputed and the cost or recovering that small amount was far exceeding anything the cost would exceed any recovery effort that we would make so the option was to just essentially write it off or provide for it.

Savi: So, in this year in FY2023 will we have a normalized credit cost which is near to the pre COVID level.

Aalok Patel: I do not think they are really going to go back to pre COVID level this is my humble pessimistic opinion. The days of 1% credit cost in micro finance are behind us. They were behind us even before COVID. I think the loan losses you will have to expect it at slightly higher number. I do not want to give you any number. I am not going to say it is going to be 5% or anything ridiculously large like that but definitely it is going to be higher than 1% maybe slightly less than 2% even on an ongoing basis that is the weightage but thankfully with the new RBI regulation I can pass that on, so it is not going to impact me too much.

Savi: But anything specific to the COVID waves, all of that has been cleaned up in this quarter now nothing extra left there.

Aalok Patel: By far and large it has been cleaned up plus provided for so the reason why I say by far and large is that we would not know completely until August of this year because you will still get into those interest disputes and things like that towards the end of the loans so by far and large this is behind us.

Savi: Another outlook for growth can you give a number for FY2023?

Aalok Patel: Unfortunately, we are not giving it, but we are expecting a pretty good year. We are used to growing at 40% to 50% so at least that much.

Savi: But that would lead to significant increase in leverage unless you do direct assignment traction so what is your thought on it. Are you comfortable with the given higher leverage from here on?

Aalok Patel: So, we are evaluating different options, one obviously is raising more capital second is more DA transactions, third is tier 2 kind of structures but if we can raise further equity nothing like it.

Savi: It may also affect your credit rating if you continue to increase the leverage.

Aalok Patel: So, we will never go beyond like 18% CAR or anything like that.

Question: And last question is on your diversification so there is some significant progress there and now MP is almost equal to Gujarat and UP is even larger than Gujarat so I mean it looks like a conscious decision for you to diversify across states but what is the implication in terms of cost to income and asset quality and what is your experience in the newer state in terms of asset quality how are you looking at that.

Vivek Modi: So geographically yes it is a conscious decision to kind of de-risk ourselves in our existing geographies of let us say Gujarat and MP that we had been historically present slowly but surely we have moved into new geographies including UP, Haryana. Rajasthan. UP definitely is a large state and we have seen over the last five years that we have been there generally a good.

Aalok Patel: Touch wood UP has performed extremely well during COVID probably if you discount the newer states that we opened probably it has been the best performing state the worst has been Maharashtra, so the plan is to not open for branches there at least for the time being and Madhya Pradesh after that with specific districts Jabalpur and areas like that but rest of the other states have performed well. I would say between Madhya Pradesh and Maharashtra there should be over 2/3 of our credit cost so largely what we are trying to do is what we have been already seeing these two situations where each of the state kind of represents less than 25% and then slowly represent less than 20%.

Savi: And in terms of hiring, you have been hiring a lot of people in the junior people or are you also looking to hire people at the senior level now that you have become large.

Aalok Patel: I mean we get junior, senior and middle level all the way, so I think we just hired a chief risk office as well, so he comes with 30 to 40 years of experience in the banking and NBFC, so we hired a good IT person as well at a higher level on the software side, hardware we already had so at all layers we are hiring.

Savi: Thank you that is it from my side.

Moderator: Thank you. Ladies and gentlemen, we will take that as a last question. On behalf of Emkay Global Financial Services that concludes this conference. Thank you for joining us and you may now disconnect your lines.