"Arman Financial Services Limited
Q3 FY '23 Earnings Conference Call"

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MODERATOR: **MR. JIGNESH SHIAL – INCRED EQUITIES**

Moderator: Ladies and gentlemen, good day. And welcome to the Q3 FY23 Earnings Conference Call of Arman Financial Services Limited hosted by InCred Equities. 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 an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Jignesh Shial from InCred Equities. Thank you and over to you sir.

Jignesh Shial: Yes, thank you, Michelle, and good evening everyone. On behalf of InCred Equities, I welcome all to this Arman Financial Services 3Q FY23 Earnings Conference Call. We have along with us Mr. Aalok Patel who is Joint Managing Director and Mr. Vivek Modi, Group Chief Financial Officer. We are thankful to the management for allowing this opportunity. I would now like to hand it over to Mr. Aalok Patel, Joint Managing Director of Arman Financial Services for his opening remarks. Over to you, Aalok.

Aalok Patel: Thank you. Thank you so much, Jignesh. And on behalf of Arman Financial Services, I extend everybody a very warm welcome to our Q3 and 9 Months Earnings Conference Call for fiscal '23. With me, I have Jignesh Shial, I have Vivek Modi, the Group CFO and also representatives from our Investor Relations team.

I hope everyone has had an opportunity to go through the results, press release and presentation for the quarter in the nine months ended December 31, 2022 which are uploaded on the stock exchanges and the company's website. The global economy is progressively returning on a growth path as the western economies are gradually showing signs of recovery coupled with China lifting the COVID-19 restrictions. However, this growth has also led to unexpected inflationary pressures and interest rate volatility amongst other factors. Amidst all this volatility, the Indian economy is on a strong footing.

As per the recent budget announced by the Finance Minister India's GDP is estimated to grow by 6.5% in FY '24. The growth is attributed towards multiple growth drivers such as robust GST collections, rising consumption level and revival of the rural and semi-rural economies. Coming into the micro finance and micro credit industry in the last two to three years the industry has navigated the COVID-19 disruptions fairly well.

Credit demand has also remained unaffected despite RBI's recent repo hike of 25 bps, taking the repo to 6.5%. Specifically for the quarter 3 and nine months gone by the credit demand in the sector has rebounded and the disbursement activities have picked up which is an important and positive for the country's economy. The company too has witnessed healthy offtake in the credit to improving on ground recovery in the rural and semi-rural markets. In Q3 FY23, the company registered a strong disbursement growth of 61.2% which stood at INR 478 crores. While the disbursements for the nine months, grown by 65.8% to INR 1,135 crores.

This improved rural and semi-rural market demand coupled with implementation of company's new LOS and LMS system, has also aided our assets under management to grow by a solid 57.2%. Our assets under management as of 31st December stood at INR 1,642 crores, up from INR 1,045 crores over the same period last year. At Arman, it is our constant endeavor to service the low income underserved people of the nation who have little to no access to the formal banking or the financial services system. In this regard, the company has started offering individual business loans or IBL towards graduating micro-finance customers without any group guarantees and on an individual basis. As on 31st December '22, IBL considered 2.3% of our AUM.

The idea of the product is to retain and graduate good micro-finance customers into individual higher-ticket size loans with cashless repayment methodology and higher underwriting. So far, with this small portfolio, we have 100% repayment rate at 100% cashless collections.

We have achieved another major milestone in the month of January, where are micro-finance business has been assigned the highest-ever grading of MFI-1 by CARE Ratings. This is the highest possible gradingof a , MFI company and it validates our operational and financial capabilities to undertake sustained and scale our operations.

This grading of MFI1 will be not only help the company improve its borrowing profile but also lend confidence to all of our stakeholders of our ability to manage our operations at scale. Further our technological shift towards implementation of new LOS and LMS system will enable us to improve our efficiencies, lower the operational risk and enhance customer experiences. We are pleased to report that the entire microfinance process is completely paperless, including the loan documentation using digital signatures.

We were one of the first MFI in the country to have a 100% paperless loan originations. With immense opportunities unfolding in the MFI and MSME sector due to government's emphasis on rural and semi-rural India, the company is on track to scale its disbursements and achieve targeted AUMswhile maintaining book quality and profitability in the coming quarters.

Now coming to the financial highlights. As of 31st December, assets under management stood at INR 1642 crores registering a growth of 57.2% year-on year, 14.4% quarter-on-quarter. Of the INR 1642 crores of AUM, 81% is contributed by the micro-finance segment,13% by the MSME segment, 4% by the 2-wheeler segment and 2% by the new individual business units. During the quarter, the company's disbursement increased by 61.2% year-on year and 72% quarter-on-quarter, totaling INR 478 crores.

Disbursement for the nine months stood at INR 1135 crores. This disbursement growth was supported by high demand in the micro-finance segment. MFI disbursement for the third quarter stood at INR 406 crores, registering a growth of 68.8% year-on year and 83.5% quarter-on-quarter.

The gross total income for the company stood at INR 103 crores registering a growth of 75.6% Y-o-Y and 11.2% Q-on-Q. This growth was supported by improvements of yields in the MFI segment. Our NIMs for the quarter stood at 14.8%. Company's pre-provision operating profit stood at INR 38 crores registering a healthy growth of 206% year-over-year and 10.3% Q-over-Q.

And profit after tax tripled and has recorded the highest ever profit during the quarter to INR 22 crores. On a consolidated basis GNPA stood at 3.37% and net NPA was almost negligible at 0.15% showing an improvement of 100 basis-points and 50 basis-points respectively from March 2022. This was on account of improvement in collection efforts and increased asset quality post COVID.

Cumulative provisions stood at INR 70 crores covering 4.6% of the on-book portfolio of which -provisions for the standalone business stood at INR 15 crores and for the subsidiary Namra stood at INR 55 crores. The collection efficiency has been improving steadily on the back of economic and business growth. Overall collection efficiency stood at 98.3% in January, this current January of '23.

Collection efficiency for January '23 for various segments stood as follows. Micro-finance segment, 98.4%, MSME segment 98.1% and 2-wheeler segment 96.5%. At present, we have presence in 8 states with a comprehensive branch network of 321 and a workforce of 2,857 team members. Of all the states, Gujarat contributes 29% of the AUM followed by Uttar Pradesh at 23%, Madhya Pradesh at 16%, 10% each in Maharashtra and Rajasthan and the balance in other newer states like Haryana and Bihar.

The company has recently forayed into two new states of Bihar and Haryana. We will continue to focus on extending our presence in newer districts in existing states, while also exploring opportunities in new states as well.

Coming to the borrowing profile and liquidity. As on 31st December, the company had total borrowings worth INR 1518 crores. This is excluding the debt component split of OCRPS and CCDs as per IND-AS of INR 53 crores. Of the total borrowings, approximately 29% is through banks, 24% through NBFCs, 16% through securitizations, which is the PTC route. 16% through NCDs and the rest is borrowed through the DFI, ECBs and direct assignments.

As on 31st December, the company has a healthy liquidity position of INR 285 crores of cash and bank balances, liquid investments and undrawn CC limits. Additionally, the company had INR 31 crores of undrawn sanctioned from existing lenders.

As per IND-AS which includes the equity split component of the CCDs and OCRPS, the company's equity stood at INR 332 crores with a debt-to-equity ratio of 3.6x. On a fully-diluted basis, assuming full convergence of all convertible instruments within the next 15 months, the total equity base stands at INR 383 crores. With the recent fund raise, the company is well capitalized. Capital adequacy for Arman stood at 48% while the subsidiary Namra stood at 21.6%.

We believe the worst is behind us and we are well poised to achieve growth and harvest the benefits of fairer weather. Our focus will be on scaling up disbursements in a calibrated manner. Having said that, I must also mention that our larger interest will be to build profitability and maintain quality of our loan book over the coming quarters and years.

Thank you very much and I would request Michelle to open the floor up for any questions-and-answers. Thank you once again.

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

Amit Mantri: Yes, hi, Aalok. Congratulations on the strong growth in this quarter.

Aalok Patel: Thank you so much, Amit. Can you hear me?

Amit Mantri: Yes, I can hear you. Just few questions. So one, the finance costs have increased significantly quarter-on-quarter.Is this because of the interest portion on the equity that has been raised in the last quarter.

Aalok Patel: So Yes, a combination of both, Amit. One is.the Interest on the CCDs and the provision in terms of OCRPS. So those are added to the burden in this quarter specifically to Arman standalone. And also the interest rates unfortunately, due to the consistent repo rate increases by the RBI, there is some level of pressure on the interest rates as well by about 70, 80 basis points on a weighted average, which is quite a large jump on a quarter-to-quarter but I think about INR 5 crores of interest expense, I believe, Vivek, correct me if I'm wrong, is related to those OCRPS equity.

Vivek Modi: And additionally Amit, if I can also add, as we kind of keep on increasing our disbursement it is important for us to also maintain a slightly higher level of liquidity. And the additional liquidity anyway will have a bit of higher level of overall financial outlook.

Aalok Patel: Correct. So there'll be. I think specifically also in Q4. there will be slightly higher carry costs. Because we are expecting to carry slightly more amount of cash on March 31st to service somewhat slower debt volumes in the first quarter, which is usually the trend.

Amit Mantri: Okay, and there are some direct assignment that was done in this quarter. What was the size of that transaction.

Vivek Modi: That was about INR 100 crores.

Amit Mantri: INR 100 crores. So, in this transaction. So the value in the P&L, the gain has been around INR 6.6 crores and for the same INR 100 crores when it was done a year back or January 2022, the gain was around INR 5.8 crores. So are we now receiving better spreads on the direct assignment versus a year back?

Vivek Modi: Yes, you're right. To compliment you on your ability to analyze that one, but yes, we are getting lower MRR which is like the retention ratio against the last one has come down. So that kind of adds. Increases the gains on the transaction

Aalok Patel: There are actors as well like the weighted-average tenures of the assets sold and things like that also may come in the picture.

Amit Mantri: Sure, sure. Okay, and my last question. So the in the MFI, the asset quality has deteriorated from 3% to 3.3% sequentially. So what's the reason for that?

Aalok Patel: On the MFI side, you are saying?

Amit Mantri: Yes, on the Namra business.

Aalok Patel: So, partially the overall impact is about 0.15% or something. Now, as we keep on moving into more average kind of a scenario, I think it will slowly but surely come down but there is slight bit of pressure. Especially in the areas of Maharashtra. invested Maharashtra. That is what you are seeing is a bit, but it's well under control.

Amit Mantri: Okay and good luck for your future.

Moderator: Thank you. The next question is from the line of Sahil Sharma from SS Capital. Please go ahead.

Sahil Sharma: Hi, sir, congratulation on great numbers. The first thing I wanted to understand especially for MFI loans, do you track or have information on the end users that customers put these loans into. For example, at least from my understanding, the large percentage go into dairy animal related activities like milk harvesting and selling them. Is that your understanding too or do you have some rough breakup of how the loans are utilized in MFI.

Aalok Patel: I mean, you are absolutely correct. We do track the end use. When giving originating the loans we do try to track the end-use specifically. And yes, a large portion does go into things like allied agri, which is almost 35%-40% of the portfolio. That includescattle. Exact breakouts, if you email the Investor Relations team will get it out because there is a very large variety of occupation that our customers enter into. Now, one thing about end use, you have to understand about micro-finance customers.

Typically, these guys don't have like separate bank accounts or business and their personal use. Whatever money that is incoming is going into one pocket and whether it's a one fit it all mixes up, it's very hard to keep a track of. You know, something like cattle, you can always go later and see, that they have bought acattle. But if they are using it for, let's say, a kirana score for buying inventories, it's hard to track that. We tried to do a good job, but there is no foolproof mechanism to track once you disburse the money. But it's usually on a best effort basis.

Sahil Sharma: Okay sir, thank you so much. I will email the IR for the breakup. My second question is, sir, we see that the GNPA has gone up a little bit in this quarter. So are you seeing any problems on asset quality or is this more like a small variation and we shouldn't read too much into it.

Aalok Patel: It's a small blip, it's a small variation. I wouldn't put too much emphasis on it. But as I told, Amit, who was the last question guy, there was small blip which has happened in Maharashtra, which might be put in.

Vivek Modi: And additionally, what has happened is the quarter 3, the new RBI guidelines were in you know, the 90 plus DPD, once it goes into 90 plus DPD and they have classified as NPAs stays as NPA. So that kind of has further increased by about 20 basis points.

Aalok Patel: Yes, sorry. I completely forgot about, Vivek. Thank you so much.

Sahil Sharma: Yes, so largely if we can add to it because this was a regular concern also. I think since we are now absolutely aligned to the RBI's new guidelines. So the overall impact is not more than about 0.2% on the overall NPAs for the company.

Aalok Patel: Correct. And just to kind of elaborate on what this new RBI policy says although I'm sure most of the listeners are aware, earlier what was the situation was once an asset cost 90 days it was considered as an NPA. But if it went down to let's say 80 days past due, then it would be back again as non-NPA. What the new RBI guidelines says is that once the asset becomes NPA, which means it crosses 90 days in our case.

It will continue to remain as NPA until the DPDs are 0. So that means, even if a customer pays you 2 instalments and goes down to 30 days past-due, it would still be at NPA until the account is completely cleared and 0. So, Yes, that has also caused about 20 bps increase in the overall NPA recognition. Nothing has really changed in that case, it's just the mechanism of classification.

Sahil Sharma: Okay, thank you so much, sir. All the best.

Moderator: Thank you. The next question is from the line of Parth Vasani from KK Advisors. Please go ahead.

Parth Vasani: Yes, hello sir, good afternoon and thank you for the opportunity. I wanted to ask. I mean, as our top 3 states contributes roughly around 60% of our AUM. So do we plan to derisk the same going forward.

Aalok Patel: So I mean. I think, our constant endeavor was to reduce our geographical concentration. So if you look at let's say in March of 2017, 80% of our portfolio was only in one state, which is Gujarat. So we have come kind of a long way to diversify that. We are in 8 states right now. Bihar and Haryana were new states. Obviously, the overall portfolio of Rajasthan, which we entered into a couple of years ago is increasing.

So I think overall concentration in the top 3 states you should see it going down. By what percentage it will be hard for me to predict at this point. But I think it has continued to come down as time goes on and it will continue. The concentration risk will continue to come down as we go forward as well.

Parth Vasani: Okay. And how have the new geographies of Haryana and Bihar performed.

Aalok Patel: Bihar is doing excellently. Haryana is doing fine as well but a little slow as far as the growth is concerned. But Bihar is surprisingly even much better than our own anticipation, so touchwood that continues to be the case.

Parth Vasani: Great. Okay sir, that's it for now. Thank you.

Moderator: Thank you. The next question is from the line of Alok Shah from Srinath Securities, please go ahead.

Alok Shah: Thank you, Sir, I just had two questions. First was with funds coming in, what kind of growth are we expecting for FY '24.

Aalok Patel: We typically don't give growth targets, Alok. Typically we target somewhere between 35% to 40% growth on a long-term CAGR basis. So, it would be similar to somewhere around that neighbourhood in the coming year.

Alok Shah: Okay. And sir, what kind of leverage are we comfortable with.

Aalok Patel: Typically we try not to go beyond 5x on a debt-equity ratio. We never take below that. Case in point like right before we raise these funds but typically we try not to go above 5x.

Alok Shah: Okay, all right, thank you sir, that's it from me.

Moderator: Thank you. We have the next question from the line of Devendra Pandey from DP Financial Advisory Services. Please go ahead.

Devendra Pandey: Thank you. Good afternoon, sir. My first question is on our MSME segment. So the government has announced various schemes and initiatives for the MSME scheme over the last few years. So what is your strategy here and what kind of growth are we targeting in this segment.

Aalok Patel: I mean, most of the schemes that are arranged by the government, typically we don't apply for it, because, you know, MSME is a very-very broad, it can include a one lakh rupee loan, it can include 10 lakh rupee loan and it can also include a 5 crores loan. But there has been some movement backed by SIDBI of getting these low scale MSME workers into what is it called, Vivek.

Vivek Modi: There are multiple schemes but one of the schemes is called PRAYAS which we are evaluating and hopefully use in the next few quarters

Aalok Patel: To get them on but usually we don't or our customers don't qualify for many of these MSME schemes. That being said we are growing steadily in the MSME segment. It's a segment that is performing very-very well. And for us, specifically given you know its profitability, its margins and even its asset quality which is not very-very different from micro-finance space. So it's slightly higher operating cost are there in that but the margins more than offset it. The only thing in that segment is you have to grow very carefully, you have to understand the customer and their businesses.

So that is very quick growth that people are used to seeing in MFI segment, that we have come to realize is difficult or slightly, I don't want to say dangerous, but it's better to be avoided in that segment if you want to grow carefully. So we are very bullish on that segment. But you know the kind of growth that is possible in JLG micro finances will be hard to catch-up in MSME in the short-term. But in the long-run, we feel that MSME will overtake microfinance if you visualize three to five years or five to seven years down the road.

Devendra Pandey: Got it. And sir, cost of borrowing as of nine months.

Vivek Modi: For the consolidated, it will turn out about. 12.7% to 13.0%

Devendra Pandey: And how much we expect it to remain in the range for the next two-three quarters.

Aalok Patel: We'll try to maintain it here or maybe about might expect another 25 bps increase.

Vivek Modi: I mean, it's dependent on a lot of environmental factors. One, Alok just shared with you for microfinance we have already been graded as MFI 1. So that does get us better credit rating with most of the lenders. So that could see some bit of softening from most of the existing lenders.

Along with that, generally it is seen that the interest rate seems to be kind of topping out for at least for us. As interest resets happen for some of the loans that have not seen the interest reset it might push that up. So on an average, I think we are trying to maintain this at these levels only. And hope we are kind of successful doing that in the next couple of quarters.

Devendra Pandey: Got it. And are we able to pass on this increase in average cost of borrowings to our end-customers.

Aalok Patel: Yes, thankfully due to the new RBI guidelines that were issued in March of '22, obviously the larger (Higher) -- the margins that you are seeing are as a result of that. And Yes, we are you able to pass it on to our customers so far at least.

Devendra Pandey: So can we expect the yields to remain in the similar range for the next few quarters at least. Or do we expect it to increase a bit.

Aalok Patel: It will likely increase a bit. The older lower interest portfolio kind of runs out and is replaced by a slightly higher margin portfolios. So there's not a lot of that portfolio left. But you can expect some marginal increase in the NIM.

Devendra Pandey: Got it. Thank you sir, that's all from my side.

Moderator: Thank you. The next question is from the line of Amit Chordia from World Foods. Please go ahead.

Amit Chordia: Hi, sir. I wanted to understand the gross income gone up by 72% but the PAT has moved up by 73%, so could you help in understanding the margin expansion.

Aalok Patel: Well, the PAT is dependent on a lot of other factors. So while the revenue has increased as we come out of COVID overall provisioning requirement has gone down considerably.

Additionally, the cost of funds the main effect would also play out in fact that our profitability keeps on increasing. So that is as much a function of the leverage. So I think if I understood the question correctly, it wasn't very-very audible.

But if you're talking specifically of our margins, see if you look at our employee cost and stuff like that, they have not increased as much as the portfolio has increased. So we are gaining some efficiencies as far as staff cost and everything is concerned. And provisions have also gone down significantly which were you know higher due to COVID, now they're getting back to somewhat normalcy. So all of those things will have impact to the overall margins. Does that answer your question, I'm sorry, I didn't quite understand your question.

Amit Chordia: Yes. I got my answer.

Moderator: Mr. Chordia, I am sorry to interrupt, sir. I would request you to use your handset to ask a question. Sir, the current participant has left the queue. We will move on to the next question which is from the line of Kuneh Ghelani from Vivriti AMC. Please go ahead.

Kuneh Ghelani: Hi, thanks for the opportunity. Hi Aalok, hi Vivek. A question on ticket sizes. It seems that the ticket size over the last 12 months or so increased, again on the MFI. I see that increase from 36,000 to 46,000 in one of the slides. I'm just trying to understand, is this a reason on account of maybe higher cycle of customers or is it because of the new guidelines, which is allowing you to be a bigger part of the balance sheet of your customer or are you able to underwrite more with better conviction to offering high-ticket size. Just trying to understand what are the factors that are going into that number going up.

Aalok Patel: So I think there are three or four factors. Factor number one is of course as the customer shift from lower cycle to higher cycle. As you said correctly, the ticket size on average does go up. Number two, I think the slide which you are looking at which is talking about from 36,000 to 46,000, that was in September of '22 which we were being slightly more conservative due to COVID first wave, second wave, third wave and those things kind of coming in.

So artificially we had reduced our ticket sizes into something that we were not so comfortable with. And third thing is about the fact that like it or not, this is the industry trend. Overall,our average ticket size seem to be slightly lower than the industry average. And the general trend and the tendency in the industry has been to increase ticket sizes. Now as far as things like interest rates, our customers are not very sensitive. They are more sensitive to things like ticket sizes and turnaround times. So if you want to be in the market, we cannot be a complete outlier in the lower-end.

We just have to balance the ticket sizes according to what is kind of ongoing in the market. And finally, also to give you a little bit more comfort around this fact. See, almost 10% to 15% of the customers have kind of left microfinance because during COVID, they had a default or an overdue. We are not servicing the customers. But whatever customers are left after removing are the type of customers that repaid us or repaid whoever else during COVID also.

And so can you afford to take a slightly higher risk on these customers. I would say, yes, probably you can. And really the proof is in the pudding. I think the overall default rates that we observed are not, I mean if you look at our data, this is going into slightly more detail than you probably want. But if you look at our data of current default, post COVID default rates, there is not much of a correlation between the ticket sizes and the chance of default, the chance of overdue.

Kuneh Ghelani: Understood. Yes, that's very helpful. My second question was on the capital structure and with the equity raise, the position has become lot more stronger. But of course, on account of accounting-related compensation part of the sort of the capital is recognized not fully as equity. There, what have been the conversations like with investors in terms of convertibility, in terms of what sort of timelines we're tracking.

Aalok Patel: Majority of these instruments were in the form of CCDs, INR 76 crores is CCDs. So they are compulsorily convertible. So they are tier-one equity and they will convert in another 13.5 months or so.

Vivek Modi: I mean, the hard line will be a couple of days before March 2024.

Aalok Patel: Yes, March 2024, is when they will convert. As far as the OCRPS is concerned, that is about INR 38 crores. The issue price was 1230. Today's price is somewhere around 1,500 plus or minus. Not seen it today If it's, you know, it just depends on what really the price is at the time of conversion. I have not really talked to any of the investors. It's too early to talk to them. But we'll see. You know it's, I'm not too worried about it. Let's just put it that way.

Kuneh Ghelani: Wonderful, great to hear that. Thank you so much. Wish you the very best for this current quarter. Thank you so much.

Moderator: Thank you sir. The next question is from the line of Shubham Ajmera from SOIC Ventures LLP. Please go ahead.

Shubham Ajmera: Hi sir, thanks for providing me the opportunity. Sir, I had few questions on the cost of fund side. So in the current quarter, as you mentioned increase in finance cost and one part of that is due to CCDs and OCRPS also. So can you please share how much cost is due to the quantum of amount and also if you can share like it will be a one-time one quarterly impact or like it would be going forward in the same manner.

Aalok Patel: No. I mean, I think I had mentioned, it was approximately INR 5 crores. Exact amount, I don't recall.

Vivek Modi: But yes, it will continue for the period the CCDs finally convert. So, for whatever, another 13.5 months.

Aalok Patel: So you have. I think about INR 3 crores will be, Vivek, for CCD.

Vivek Modi: And approximately INR 2 crores–for OCRPS

Aalok Patel: Maybe slightly less, so let's say comfortably between INR 4.5 crores to INR 5 crores. Exact figure if you want just email and we'll send it out to you. And this will of course be for every quarter until they convert which will be until March '24. But the good part–

Shubham Ajmera: And end of 5 quarter it won't be the same.

Aalok Patel: Yes, but see, the good part about equity is immediately as soon as these instruments came in, there was going to be an additional load because obviously, we cannot leverage on the new equity right away within 90 days. So that was to be expected. We're going to have some load or some burden immediately. But as we keep leveraging on that extra equity overall the extra burden will be far offset by the extra income that we generate on the, portfolio growth that we leverage on that INR 115 crores. I hope that makes sense.

Shubham Ajmera: Yes, understood, understood. And sir, after improvement in the credit rating, so can the cost of borrowing will come down like by how much basis points, it can come down.

Aalok Patel: So it's hard to tell. Honestly, it's always the function of supply and demand. More and more that we do this. And even banks and financial institutions realize that now that the margin caps are removed, they are also anxious to increase their margins. So. It's always a function of negotiation and supply and demand but the more offers that we have from people offering us that the more in a position of negotiation will be.

So with things like ratings and grading and other factors, the hope is that you are in a better negotiating spot with the lenders and that way it will result in a slightly decreased cost of borrowing. But whether that gets offset by consistent increases in the repo rate by RBI. There are too many variables, too many things to really predict now to the basis-points of how much it will reduce or increase in the future.

Shubham Ajmera: Yes. Got it, got it. And sir my last question is on this interest income part. Disbursements during the quarter increased to around 70%. But on Q-o-Q basis,.Our interest income is up by 4% only, so like what could be the reason for this.

Aalok Patel: So I think disbursements and income correlation will be hard for you to do, because the disbursements will help us in interest income for a period of two years. -- Vivek, did I understand the question wrong. I don't think it's an apples-to-apples comparison.

Vivek Modi: One answer to that is absolutely it's not an apple-to-apple comparison. The second part is I'm just looking at the interest income alone. Or are you also looking at the income generated from the sale of portfolio because there has been a sell of portfolio that has happened in the number which has got INR 100 crores.

Shubham Ajmera: Actually, I was looking at interest income alone.

Vivek Modi: Yes, so because when you sell off the portfolio, the interest income that you will be able to generate has already been taken into the gain on sale of the portfolio.

Shubham Ajmera: Okay, got it. Understood. Thank you. Thank you so much.

Moderator: Thank you. The next question is from the line of Akshay Doshi with InCred Capital. Please go ahead.

Akshay Doshi: Yes, thank you sir for giving me this opportunity. Sir, my first question is that do we have any co-lending arrangements as of now.

Aalok Patel: We do not have any co-lending arrangement as of today, sir.

Akshay Doshi: Okay, so any plans to venture into that.

Aalok Patel: So let me put it this way. The purpose of getting into co-lending can be a lot of reasons. Primarily people enter into co-lending, because it allows them to not worry about fundraising, for example, both equity and debt. Or they don't have to dilute or they don't have to leverage their own funds and they can rely on a larger bank or something to do it. So for us, we don't face those problems. So purely on a commercial basis, if there is the opportunity available on co-lending or BC or something we are happy to explore it. But not for the first two reasons which I gave.

Akshay Doshi: How are you going to make lending going ahead. Like are we planning to add new products like personal loans, etc. to our portfolio.

Aalok Patel: I missed the first part of your question because your voice was not audible. The part which I got was that whether we are planning to add any more products. Complementary products like IBL and stuff, we have added, MSME something that we added in 2017. Obviously, I hate to say it, but micro LAP has been on the kind of a to-do list since pre-COVID. Finally, now that things have stabilized, something that we can consider down the line.

But it's , running an NBFC it's always nice to balance between the numbers of products you have. You don't want to be a jack of all trades. You need to find like a niche product that you are good at, like you know, you are not a bank where you can do 20 different products and so as an NBFC, its always important to find a good balance between number of products that you do and how many of them you go really well.

Akshay Doshi: Okay, okay, sir I understood. Sir, and my third question is that also we have been increasing our digital mechanism. So does our underwriting method have witnessed any improvement due to this digital innovation?

Aalok Patel: Yes, yes. I think in the presentation and other stuff, I think we did mention all the benefits that we are getting from it. Just to name a few we are using for example facial recognition with ML for the KYC documents. That is the KYC, OCR verification directly done with their OCR pictures. We are using penny drops for bank account verification, voter ID verification. Every step of the way we are geo tagging.

There is a center risk categorization. We are using e-signatures. I mean, there are a lot of new tools that are available to us now that will reduce the TAT and also reduce the overall risk in underwriting, -- there is auto algorithms to go through their credit bureau system, so 80% of our customers, the credit bureau data is not even seen by human, it is auto approved by a computer.

So there are lot of benefits that we have gained and overall, the turnover time has reduced already by about two days.

Akshay Doshi: Okay. It's great to hear from you and that was very helpful. So, all the best and thank you, sir.

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

Savi Jain: Yes, hi sir. I just had a question on MSME lending rates, which are around 36%. Now there are money lenders in every town and every district who lend at about 40% without any kind of income assessment or any documentation. So how exactly are you competing with these guys despite your onerous process?

Aalok Patel: It is not 36%, Savi,

Vivek Modi: Again, 36 from the yield, it includes the processing fees and other things. So that is how it kind of -- the yield kind of looks high, but again. I think the competition definitely is not with the money lenders that you kind of talk about because when we are getting into structured MSME, the way we have been there for last five years or so, it's about the entire predictive mechanism and the engagement with the customer that is more important. That's why they keep on coming back to us or kind of we have this engagement that keeps on running into multiple cycle of loans for the customers.

Savi Jain: No. Why would they want more engagement? They want faster turnaround and closure rates. So if your rates are not very different then are you getting like subprime customers whom even the money lenders are not willing to lend to because the rates are not really very different, right?

Vivek Modi: Savi, I will not be able to comment on what the money lenders are charging. My guesstimate is that it's a very different world when it comes to money lenders.

Aalok Patel: I can comment. It's typically 5% to 10% a month, so you are talking about 60% to 120%. It's not less than 5%. I don't know what it is in Maharashtra, but at least in Gujarat, that is the current rate is. Largely speaking, Savi, our customers are not very-very price-sensitive. And we don't really compete so much on the interest rates, it's, as you said, it's the availability of funds. Certainly, our rejection rates are north of 70% even today.

And that is a provable facts, so I would say that we are cherry picking, not sub-priming it. So that is just the reality of the market into this scenario. And I think, you know, the micro-finance rate before the overall RBI law came up in 2013 that was no different. That was still about 35% to 36% on an IRR basis. So, typically speaking customers more are attuned to understand flat rates. And if you calculate on a flat rate basis, it turned out to be about 15% to 16%. And that is something that the customers are willing to pay.

Now if there is ever a circumstance where the market is demanding for me to cut my rate, you know, I've said it openly, I'm happy to cut it. There is just no requirement today but as competition increases we might be required to cut our rate and given the margins there is probably room to cut it as well. Just today, I don't see the need–

Savi Jain: And one thing I was like, I don't know if you've been following Ujjivan but they are seeing huge recoveries on loans that they had written-off. And as a result, they're having like net 0 credit cost for some quarters now. So are you also seeing some recoveries on loans that you wrote off sometime back?

Aalok Patel: Well, in the MSME book, i.e.in the Arman book, we are getting is negative impairment cost right now. So what you're saying is true. Even on the Namra book we are collecting, but not as much as we are providing or writing off as of today.

Savi Jain: So, you are reporting almost net zero in NPA. Aside of these specific provisions towards NPA, how much extra provision do you have including standard asset provision.

Aalok Patel: So there is no standard anymore, it's all ECL. And so overheads, Vivek, it is about 1.2% to 1.5%.

Vivek Modi: Largely, since our NPAs are 100% provided for and our NPAs kind of turn out to be about INR 50 crores odd, put the organizations together, the balance about INR 20 crores stands at the standard asset provisioning which is about 1.75% or 1.5%.

Aalok Patel: So it's about 4.6% is the total cumulative provisions against the gross NPA of 3.37%. So balance would be about, what is it, 1.3% or something

Savi Jain: Was this number higher before pre-COVID or lower.

Aalok Patel: No, it was lower. I mean, pre-COVID NPAs were less than 1%, Pre COVID was micro-finance, in particular, was a very different regime because the entire sector probably was reporting, less than 1.5% of NPAs. We were, in March 2020, GSK in MFI was 0.53%. And the hope is that we stock away for a rainy day, so I don't expect this number to go down. In fact, it might go up, the provisions.

Savi Jain: Your provision quarter-on-quarter are still increasing. So it's basically more of standard provisioning rather than NPA provision.

Aalok Patel: It's some combination thereof, so. I think overall specifically for micro-finance, 2%- 2.5% kind of loan loss is something that you would have to expect going down the road. So forget about COVID, but even in our current book, which is about,post COVID book would be INR 1,500 crores or something like that. So that would be even on that you have to expect about annualized 2%- 2.5% cost on an annual basis.

Savi Jain: How much of your liabilities-- is MLD and what will be the impact now because of this budget.

Aalok Patel: MLD, I don't know how much–

Vivek Modi: The total MLD which are in the MLD structure would be about 45 crores in all. But in terms of the overall impact, since we have already issued we don't really see any impact, we only have to pay the interest regardless of what tax regime is. As far as the future investments are, the interest of the market in MLDs is yet to be seen. So right now obviously, we do not see that the investors will be coming back so easily pass or pass to the MLDs

Vivek Modi: That's why it will be more like an NCDs but the regular taxation and let's see if there is an active interest to what extent the active interest comes back.

Aalok Patel: We could see a lot of interest in the future.

Savi Jain: Is there some tightness in now the sourcing liabilities. Are you seeing some kind of a pressure there?

Aalok Patel: Thankfully, for us, no. I don't know about the market but we are okay so far, touch wood.

Savi Jain: So you don't have to calibrate your growth downwards based on availability of liabilities.

Aalok Patel: As of today, no. Is there a chance that could happen in the future, I don't know, possibly. But as of now, no.

Vivek Modi: Is this kind of related to the MLD kind of a thought, then I think historically what we've tried to do is diversify as much as possible on the liability side as well in terms of the products and the lenders kind of buckets and hence if one kind of a lender is not working out in a quarter or a half year, there are others who are kind of more than willing. So it's having their eggs in multiple baskets, so that there is more predictable outcomes.

Aalok Patel: Yes. So, the funds are typically available. It's just been what is right. For example, during COVID, we got a lot of cheap funds from the DA funds and so that helped us greatly to reduce our overall cost of borrowing. So now. I mean, it's being replaced by bank funds or NBFC funds which are obviously not going to be as cheap as the NABARD, SIDBI or Mudra funds. So, availability will be there, but from who is the question.

Savi Jain: Got it. Thank you.

Moderator: Thank you. The next question is from the line of Kunal Kadam from EasyMill LLP.

Kunal Kadam: At INR 2,500 crores AUM, what revenues are we targeting. And what will be sustainable finance margin at this volume.

Aalok Patel: Say that again, at INR 2500 crores AUM what are we targeting.

Kunal Kadam: What kind of revenues are you targeting?

Aalok Patel: I am sure we cannot really specifically answer that kind of question to be honest. I don't think I can answer that. I'm sure we have projection built up but that's disclosable or not.

Vivek Modi: But largely, if our ROAs and ROEs or any kind of guesstimate. And I leave it to the market

Aalok Patel: Yes, right. I would like probably assume the NIMs would be constant and do your own calculation. I would assume a 14%, 15% NIM and then go forward from there.

Kunal Kadam: Okay, sir, thank you.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today, with that we concludes this conference call. On behalf of InCred Equities that concludes this conference. Thank you for joining us, and you may now disconnect your lines.

Management: Thank you.