"Arman Financial Services Limited
Q1 FY '25 Earnings Conference Call"
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MODERATOR: MR. MAYANK MISTRY – JM FINANCIAL

Moderator: Ladies and gentlemen, good day, and welcome to Arman Financial Services Limited Q1 FY 25 Earnings Conference Call hosted by JM Financial. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I hand the conference to Mr. Mayank Mistry from JM Financial. Thank you, and over to you, sir.

Mayank Mistry: Thank you, Lerma. Good afternoon, everyone, and welcome to the Q1 FY '25 Earnings Conference Call of Arman Financial Services.

First of all, I would like to thank the management of Arman Financial Services for giving us the opportunity to host this call. From the management team, we have Mr. Jayendra Patel, Vice Chairman and MD; Mr. Alok Patel, Joint Managing Director; and Mr. Vivek Modi, Group CFO.

I would now like to hand over the call to Mr. Patel for his opening remarks, post which we will open the floor for Q&A. Thank you, and over to you, sir.

Alok Patel: Thank you, Mayank, and thank you to the JM team for hosting this call. On behalf of Arman Financial Services Limited, I extend a warm welcome to our Q1 FY '25 earnings conference call.

As Mayank said, joining me today are Mr. Jayendra Patel, Vice Chairman and Managing Director; Vivek Modi, Group CFO; and also the Investor Relations team. I hope you had the opportunity to review the Q1 results, the press release and the presentation made available on the stock exchanges and our website.

Before diving into the quarterly performance updates, I wish to start by addressing the elephant in the room. You would have noticed an uptick in the overall credit cost from the previous quarters and the reduction in volumes. This is not specific to Arman, but affects the microfinance industry as a whole. And at our size, we are not immune to the overall market conditions.

As is the tendency with such industry-wide issues, people within and outside the industry, in hindsight, try to dissect the causes behind this. In my experience, it's never one thing, but a series of factors that lead to such issues. The good news is that, in my belief, most of the reasons discussed below are fixable, and I would like to highlight some key aspects of the overall landscape of this.

After a strong post-COVID rural economy, coupled with deregulations on April 1, 2022, another gold rush started for the microfinance industry. Arman, as you may have noticed, is benefiting greatly from these favorable circumstances with record growth in profits in both FY '23 and '24. However, changes in the regulation led to some unintended consequences.

Under the previous regulation, the total MFI indebtedness of a customer was regulatory restricted to a conservative cap of about INR1.25 lakhs. This rule to restrict over-leveraging was changed to the 50% FOIR on household income rule. This was a perfectly reasonable adjustment as it was not practical to paint all MFI customers with the same brush. And both the industry and the customer had matured to move with the next phase of financial inclusion.

The challenge, however, is conducting a reasonably accurate household income assessment is a work in progress for the industry, especially due to how MFI operations are structured with credit closely connected to operations. Remember, to maintain a repayment rate of 97% plus, we have to select our customers correctly 97% of the time, a slim margin of error indeed.

To further add to that, the availability of non-MFI loans to rural customers has increased drastically with many banks and other NBFCs tailoring their existing products to reach to the emerging rural pockets. This includes loans like fintechs, MSME, LAP, personal gold, vehicle loans amongst many others. With easy access to credit and the culture of customer changing, we are suitably adapting to the changing scenario while simultaneously stopping the repayment culture from diluting.

You may recall that the risk of over-leveraging is something that we have been aware and also discussed at length over the past several quarters. This, coupled with the disruption due to elections, heatwaves and unusually high employee turnover, created a tipping point and leading to higher slippages this quarter. Both the industry and Arman are taking reasonable steps to try and mitigate these issues. Amidst the situation highlighted above, a silver lining is that the subsidiary, Namra Finance, recently received a credit upgrade improving from A- stable to A stable from ACUITE ratings. Arman stand-alone upgrade is expected to be released shortly as well.

Now turning to the Q1 FY '25 consolidated performance. Owing to the short-term challenges, we maintained a cautious approach to growth, ensuring stability of our operations. Our consolidated assets under management stood at INR2,594 crores as compared to INR2,143 crores in the same period last year, registering a growth -- year-on-year growth of 21%.

Total disbursements for the quarter stood at INR459 crores as compared to INR530 crores in the same period last year. Disbursements degrew by approximately 13%. This cautious approach aligns with our past strategy to prioritize portfolio quality over growth.

The gross nonperforming assets or GNPA stood at 2.79%, while net nonperforming assets or NNPA stood at 0.18%. We have implemented stringent corrective measures and enhanced our monitoring mechanisms to address asset quality stress. We are confident that our proactive approach and focused efforts on improving collections and credit assessments will lead to a gradual improvement in asset quality in the coming quarters.

Collection efficiency for the month of 2020 -- June 2024 in our Microfinance business stood at 95.1%, MSME business stood at 97.2% and two-wheeler business stood at 96.1%. Overall, consolidated collection efficiencies stood at 95.8%.

Total borrowing amounted to INR2,217 crores comprising of a diverse mix of financial instruments. We maintained substantial liquidity of INR248 crores in cash/bank balance, liquid investments, undrawn CC limits and a comfortable debt-to-equity ratio of 1.8x, with a healthy capital adequacy ratio of 48% for Arman stand-alone and 38% for Namra.

Cumulative provision stood at INR101 crores, which is 3.9% of the consolidated assets under management. Of these provisions of Arman stand-alone business stood at about INR20 crores and Namra stood at INR81 crores.

In terms of branch expansion, we have opened 91 new branches over the last 12 months, bringing our total branch count to 434. This expansion has been complemented by successful penetration into the newer states and geographies where performance has been promising. Additionally, we have initiated a pilot for the rural Micro LAP product in Q4 of last year. AUM for this loan product as on June '24 is INR6 crores. While it is too early to comment on its success, we are optimistic about its long-term potential.

Looking ahead in the short term, we will remain vigilant and selective in our growth strategy. Our priorities include continuing to strengthen our risk management practices and collection efforts to protect portfolio quality, adopting a measured approach to expansion by focusing on markets where we have a strong understanding of local dynamics, and enhancing our capabilities to ensure operational efficiency.

Now let me run through the key consolidated financial numbers for the quarter ended 30th June 2024. The gross total income stood at INR184 crores, registering a growth of 23% year-on-year compared to INR149 crores in Q1FY '24. Net total income amounted to INR119 crores, registering a growth of 39% year-on-year as compared to INR86 crores in Q1 last year.

Pre-provisioning operating profit, PPOP, stood at INR85 crores, registering a growth of 34% year-on-year as compared to INR63 crores in Q1 last year. Profit after tax stood at approximately INR31 crores, registering a degrowth of 22% year-on-year as compared to INR40 crores in Q1 FY '24. Lower PAT was on account of higher impairment cost and slightly lower yield in the MFI book. Consolidated yield stood at 25.4%, net interest margin stood at 15.5% and cost to income stood at 28.7%.

To summarize, our industry has matured and has ebbs and flows like any other industry. However, we are confident that the company, our customers and the industry are resilient. While the rural economic environment remains uncertain, we are well-capitalized for future growth and are confident that our prudent approach will enable us to navigate any challenges effectively and yield better performance in the coming quarters. We are confident that many large and small initiatives we are taking will be adequate and, before long, we'll be well on our way to continue our growth story.

Thank you very much for your support and attention. And I'm sure there will be many questions, so let us begin the Q&A session, please.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Rohan Mehta from Ficom Family Office.

Rohan Mehta: Yes, yes. So sir, with the SROs mandating up to 150 basis points of interest rate cuts and a stricter underwriting standard, how do you plan to adapt your microfinance operations? And just while you're on that point, what impact do you expect to have that on yields and your cost to income?

Alok Patel: So as far as the SROs mandating certain self-imposed regulations, those are largely related to underwriting norms such as no more than 4 institutions lending to a particular borrower and no more than INR2 lakh of outstanding. So this is something we have been following for a while. In fact, ours is a little slightly more stringent than that also because we look at it on a household level and not on a customer level as well.

As far as the interest rates are concerned, there have been no particular orders that have been shared for reduction of interest rates However, as you are aware, there has been regulatory pushback on reducing rates. And Namra also has reduced rates slightly, and therefore, the yields have declined to a certain extent. But those were marginal decreases. So we don't expect yields to decline too much further, maybe by another 25, 30 bps in the coming quarters, but nothing larger than that.

Rohan Mehta: Got it, sir. And could you also elaborate on the specific factors that led to the INR31 crores write-off for this quarter? So were there any particular regions or borrower profiles that contributed most to this?

Alok Patel: What we find is, at least in the last quarter, and what we find is that there is no particular state that is -- or region that is immune to the overall decline. However, there are certain states or regions more affected by others, places such as Maharashtra, Rajasthan, MP to a certain extent; while markets specifically like Gujarat and UP are behaving better, so -- while the deterioration has been noticed across the board for pretty much every state.

As far as profile is concerned, we have found no correlation as far as any product or customer (Inaudible 14:43) profile or income or anything like that, that can be attributable overall to the write-off. Now the reasoning for this, I think I covered in my opening remarks, of course, as I mentioned, there is no one things like this, it's like things passing through Swiss cheese holes, right? I mean there's never one thing that causes blips like this. There is a combination of many factors.

In my belief, over-leveraging, which I kind of explained due to regulatory changes, would be one of the primary reasons. However, the tipping points were things such as heatwave, elections, high employee turnovers and other factors as well.

Rohan Mehta: Okay, got it. Got it, sir. And just a final follow-up on this. What would be your guidance in terms of asset quality and disbursement for FY '25?

Alok Patel: It's -- honestly, it's a little premature for me to give guidance on this. Honestly, I think we'll have to wait another quarter or so to kind of figure out. But if I had to venture a guess, I would say that post-Diwali, you should start seeing improvements come again.

As far as disbursements are concerned, I think people who have followed Arman for a while would know that at the first sign of trouble, we reduce disbursements. And you can take that as an advantage or a disadvantage or however different people have of looking at it. But we never really compromise on quality for growth pressure. So we will grow whenever we are comfortable growing and not before that.

Moderator: The next question is from the line of Suraj Das from Sundaram Mutual Funds.

Suraj Das: Sir, actually one question on the MFI business. If I see, last quarter, your GNPA was INR64 crores. This quarter, your net write-off, including recovery, has been INR31 crores. So broadly 50% of GNPA of last quarter, you have written it off this quarter. So just wanted to know what happened this quarter that you -- I mean such aggressive write-off this quarter. And I mean, have you lost hope of recovery from this customer? Or what happened? Because this quarter, the write-off number is elevated, it seems like.

Alok Patel: It's nothing like that at all. I think we are trying to stay ahead of this, to be honest. And we have been more aggressive in writing off, just pure and simple to be extra conservative, right, and to stay ahead of this. So as far as operations are concerned, write-offs or operational write-offs don't really happen for a long time in our LMS systems. So the recovery efforts continue. These are purely sort of accounting write-offs.

Suraj Das: Sure. But in that context, do you think that the write-off will continue to remain elevated in the next couple of quarters as well because everybody is highlighting probably this quarter, it stands -- I mean this one is stronger,(Inaudible 18:35) and then 2, 3 quarters of write-off. So do you expect that similar 50% of outstanding GNPA write-off would be there again next quarter or next to next quarter?

Alok Patel: Honestly, from an accounting standpoint, maybe I'm the wrong person for this question. Vivek can add to it. But as far as total impairment, whether provisioning or write-offs, I don't expect too much of a decline in the coming quarters. However, by Q3 or Q4, we should start seeing a decline.

Vivek Modi: So Suraj, just to kind of add to that, one, write-off, taking it upfront kind of as on the tax front. The second is also the fact that if we have overall provisions, the incremental provisions have not been there. The overall NPAs, if you look at it in microfinance, has remained stable or rather fallen down. Hence, it's biting-the-bullet kind of a situation when you're writing it off. And as Alok added, these are more on the accounting side of it. As far as the field is concerned, the recovery efforts continue on these customers in a lot of time...

Alok Patel: For years.

Alok Patel: In a lot of cases, rather. I mean we are still recovering from COVID, believe it or not. So I think we don't really give up on anything until it's absolutely the last thing or we have no other choice, operationally speaking.

Suraj Das: Sure, sir. Understood. And a couple of more questions. I mean in terms of this new SRO regulation, as you highlighted in the opening commentary that you have been more stringent on it. So if you can just maybe provide...

Alok Patel: Excuse me, can you maybe take it off handset -- or take it off speaker?

Suraj Das: Okay. Yes. No, no, sir, I was asking about this new SRO guideline. So since you highlighted in the opening commentary that you have always been more stringent, so if you can highlight in terms of plus 1, plus 2 or plus 4 lender, I mean what is the mix in the AUM? And are we -- also, in terms of, let's just say, borrowers who have more than INR2 lakhs total exposure, including retail or whatever, I mean I'm sure that you must have done some calculation or some study in your portfolio. So if you can highlight that...

Alok Patel: I don't have it handy with me. Of course, I can give you approximations. So customers with over INR2 lakh of outstanding during origination will be probably less than about 4% to 5% in the overall research that we have done. As far as on an individual customer level, customers who have more than 4 MFI trend lines will be negligible. From a household level, customers who have more than 4 retail and MFI trend lines will be approximately 15-odd percent.

But I mean, these are a variety of different loans. Sometimes they are very small loans as well. So it's not very practical to look at it on a total loan outstanding because there are many MFIs who have multiple loans also going on with the same customer. But largely speaking, our target would be to cut down on the overall leveraging of the customer, and that would mean higher rejection rates, and that would result in a slightly lower disbursement.

Suraj Das: Sure. Understood. And one last question in terms of credit cost guidance. I think last quarter, you guided for something like 2.5% to 3%. So does that still hold? Or I mean, do you want to revise it upwards or, I mean, whatever?

Alok Patel: Maybe by 50 bps at this point, but nothing too crazy.

Moderator: The next question is from the line of Yash from Stallion Asset.

Yash Gandhi: So I just wanted to understand, you had some -- you said something about INR1.25 lakh limit. I wasn't clear in your initial commentary. Could you elaborate on that?

Alok Patel: So basically, what I was trying to say is that the deregulation in April 1, 2022, basically, the rules that governed over-leveraging in MFI was an overall outstanding cap of INR1.25 lakhs, if I recall correctly. Now when the deregulations came, they changed the rule that instead of an overall cap, you assess the household income and your EMI ratio would be 50% of their monthly incomes.

And so what I was trying to draw out is that once that rule changed, and earlier on it was super conservative, basically, the onus came on the MFIs to evaluate incomes properly and make sure that the product is tailored to what they can afford, the EMIs are tailored to what they can largely afford.

Now what I'm saying is that while it was a very practical thing to do and there is absolutely zero criticism from my side of that rule change, what I was trying to say is that it was -- it's difficult to assess income. And the way the MFI operations are structured is that at the branchlevel, there is a tendency -- there could be a tendency to also overestimate a person's income or given the fact that these are rural customers, income could vary year-on-year significantly based on agricultural output and other factors, right?

And so what I was saying is that we need to do a better job of assessing the incomes and assessing -- and underwriting the customer. And that goes from an industry level rather than an Arman level as well. Of course, we also need to improve. So let me just start by saying -- or I'm sorry, let me add by saying that we have begun to separate credit from sales. So historically, microfinance has kept credit assessment in the hands of the branch managers. Now Arman also has centralized credit teams to provide secondary checks, but the benefit that provided to ensure that the customers were not over-leveraged is ambiguous.

So at the branch level, many employees and customers knowingly or subconsciously would have a tendency to overreport the household income to ensure the loan is sanctioned. And so now we have started a pilot with all the new branches basically. And by the end of -- beginning of early next quarter, we hope that at least 100 of the branches would have such credit managers that would be responsible for sanctioning. And also, we have also hired a Head of Credit to oversee this new department.

So a lot of these learnings came from our MSME credit department. So if you notice, overall NPAs and repayment rates in our MSME departments, those are much superior than the MFI department. And so we are hoping that this new -- separating the credit would -- operating costs would increase, obviously, if we do decide to go ahead on this on a nationwide level. But my thought is that the benefits would largely exceed the cost.

Yash Gandhi: Okay. Okay, got it. And sir, my second question basically is there was a time where, obviously, in earlier quarters, you used to go 30%, 40% AUM growth. And now I understand that you wanted to slow down because you're seeing some sort of over-leveraging in the industry and, of course, there's been new competition as well.

But in your assessment, how long is -- prolonged would this cycle sort of last? Do you think this will sort of sort out itself in like a couple of years from now? Or do you -- are you seeing any sort of grounds of improving from hereon, where there is some sense from the new fintech players to sort of slow down or any regulatory pressure to -- once everything is in control, then you can sort of start growing at that sort of AUM level, 30%, 40% and beyond?

Alok Patel: So a couple of things. You said a couple of years, I mean that is way, way longer than I hope it will last, to be honest. I'm not expecting it to last a couple of years. But fingers-crossed, by Q4, we should start seeing improvements at the very latest is my estimate, and I'm hoping I'm correct on this.

As far as our growth, our growth comes in spurts. I think during crises, we have degrown also, like COVID and demonetization and other types of issues. So our growth comes with when there are sufficient opportunities in the market. But if -- historically, if you look at us, I think crisis is sort of a ladder for us. So usually right after the crisis, we are well positioned to kind of grow quickly. And while the sample size of that is not adequate, I hope that it's also proved this time.

Vivek Modi: Just to add to that further, Yash, I think April, May, June historically tend to be low on disbursement across most sectors, including microfinance. So while the disbursements have seen a Low or kind of be flat for some part of the year, but there is no reason to kind of completely believe that the festive season this year is going to be really bad. There are enough hopes on that.

Moderator: The next question is from the line of Srinath from Bellwether Capital Private Limited.

Srinath: I want to first get some understanding of how July has played out from a collection perspective. Has it seen any sort of improvement from June? And given a large part of our collection engine, even for August, would have been finished by 15th, any indicative understanding of how things are progressing?

Alok Patel: No. Unfortunately, I cannot say that there has been any improvement. So largely, things remain stable for now. And I don't think that we're going to see significant improvements in Q2, although I don't believe we'll see significant downside as well. So I expect it to be stable.

Srinath: Perfect. Moving on to the MSME business, like you had mentioned in the last answer, it's consistently showing better collection efficiency. So what has kind of worked out for that business? And second, our quarter-on-quarter disbursements there have come off a bit. Is it a good time to kind of, given that we have a system and process in place, to continue to grow that business in this financial year?

Vivek Modi: And we have, right, Srinath. So we -- I think the overall AUM of MSME has increased by about INR15-odd crores in quarter 1. I mean quarter 1, normally, Srinath, we do not expect too much of an AUM growth. On a sequential quarter, obviously, quarter 4 of last financial year is something difficult to beat in the quarter 1 because you're doing transfers and promotions and employees moving around. But having said that, on Y-o-Y basis, MSME portfolio has grown, MSME disbursements have also shown considerable growth.

Alok Patel: Right. And so from Q1 to Q1 same previous year, I think it was INR67 crores and INR89 crores this quarter. So -- and even after the ticket size being pretty much the same, unchanged average ticket sizes. I think the -- really, what is differentiating is the credit. And as I mentioned to the previous person who asked the question, the -- we are trying to kind of replicate that for microfinance as well. I think the industry has evolved to a point where you definitely need to do a better credit assessment rather than relying on the JLG culture. So -- but yes, we'll continue to concentrate on MSME.

Srinath: Got it. So that is a business line that is likely to scale this particular financial year.

Alok Patel: Yes.

Srinath: Perfect. And on loan against property, I wanted to understand how that product line is progressing, how comfortable are you in the kind of loans you have done in the last 6 months? Yes, it's not a seasoned portfolio, but in this heatwave and so on and so forth, elections, did that portfolio hold up well?

And the last question is, is there an overlap between this and the MFI business where MFI customers who have finished like 4, 5 circles, rounds of dealing with us, are they the upper funnel for this particular business? If you could spend some time on this, that will be a great help.

Alok Patel: It's studied. So as far as Micro LAP is concerned, the volumes have not been as high as expected probably because of the region that we are in right now in the pilot, which is Gujarat. So I think I have received a lot of market information that this is a product that might be more suited in the southern markets. So we might be launching that in our Telangana branches pretty soon, maybe as early as this quarter.

As far as the portfolio is concerned, I think it's about at INR6 crores, INR7 crores right now. We have reached a run rate of almost about INR1.8 crores a month of disbursements, and that is increasing on a month-to-month basis. Rejection rates are high. Customers are also kind of hard to -- hard to find those specific customers that are willing to mortgage their residence and have clean papers. So that has been the challenge.

As far as the quality of the portfolio is concerned, I mean it's very early to tell, but right now, we have 100% retail rate. So we don't have even a single delayed installment in Micro LAP yet, which is great, Touchwood But obviously, that is to be expected during a pilot phase, and our book is not mature enough.

Now what was your second question? I'm sorry, I forgot.

Vivek Modi: So opportunity, obviously, on a longer-period trajectory, I mean we have some 8 lakh customers and overall some 15 lakh customers who've been with us over our journey for the last 15 years. So that's an opportunity, but it's too early to probably start looking at that.

Alok Patel: Right. What is -- I think you said about second, third cycle customers and stuff that was -- we are using those customers, of course, and good customers. There has been some level of cross-selling which has started as well. But it's funny because we do a lot of -- I mean we have now our entire business intelligence unit.

And at least in the last quarter when we did the analysis, there is not too much of a difference between a first cycle, second or third or fourth or whatever in terms of repayment rates and default rates. Yes, there's a marginal improvement that you can say, so I'm not going to say that there is no correlation. But it's kind of funny that there is not too much of an advantage this time between first, second, third cycle and so on and so forth.

Srinath: Yes. I think this has been a feedback across the banking industry also that across different cohorts, there's been -- delinquency is worsening. So I think that's the same kind of playing out in MFI, too.

Alok Patel: Yes. I mean, to a certain extent, this was expected. And I think over these calls and other meetings, and we have been talking about over-leveraging, I think, since the last 4 quarters or so. But what has been surprising is the speed of which it kind of came in. And I think that probably has to do, as I said, with the tipping point of election and heatwave and other factors.

Srinath: Got it. And this Micro LAP business, would we be able to like scale it up to kind of over INR10-plus-crores disbursement quarterly? Do we have that kind of machinery in place, processes in place? So how do you kind of see the scale-up in disbursements there?

Alok Patel: The mission is definitely there. And as I told you earlier, I'm very bullish on this product. But it's -- I think we need -- I need to do a little bit more work on the geographical aspects of this product. So definitely, if I can get it to INR10 crores, INR15 crores, INR20 crores or even higher than that by next year, that would be fantastic. But it's a little early, honestly, to give any specific comments on it.

Moderator: The next question is from the line of Ashlesh Sonje from Kotak Securities.

Ashlesh Sonje: The first question is around your comment on employee attrition in the MFI business...

Moderator: Sorry to interrupt, sir. There's a lot of disturbance in your background.

Ashlesh Sonje: Sir, first question is around your comment on employee attrition. Is there any specific reason why attrition is unusually high recently?

Alok Patel: No, it's really across the board. This has been happening since the last -- it's been more than 12, 18 months that this has been happening. There is no real good reason except the fact that there are many, many opportunities in the market nowadays where people tend to, I don't know, I guess, find easier jobs or jobs which are closer to their residences or a lot of other opportunities which are available. So it's kind of funny. I think Jayendra bhai always said, it's a function of the growth of the country that there are just a lot of opportunities available.

And the second reason, honestly, is the fact that everybody has been growing over the last 2 years post deregulation and post-COVID. And there are not enough people to go around, not enough experienced people to go around. So I think people opt from MFI to MFI, and that is probably leading to it.

Vivek Modi: We are a microfinance business with work-life balance. Is a surprise factor

Alok Patel: Yes, work-life balance and stuff is becoming very important, although the older people will kind of disagree I don't know.

Vivek Modi: No, that's a national debate going on that en. We were surprised in our own internal employee survey. But even in the rural areas, employees said that they needed more time for family and more time off from work.

Alok Patel: Right.

Alok Patel: So MFIs, I think it's -- they make good money, but it's hard work, right? It's -- you have to get out in the rain or wind or cold or sun or whatever it is, you've got to go on the field, collect money, source customers and disperse. And so the survey that Vivek was mentioning was a survey that we did to the employees, that we asked them to rank 1 to 10 of what would convince them to kind of stay, right, and continue to work here.

And so we have done surveys like that in the past. And at the field officer ground level, usually, the first thing is more money, right? So that is a given. It's the second, third and fourth thing that we try to look at. This time, surprisingly, work-life balance issues were #1. Of course, salary was a close second, but it's just a changing scenario in the overall country, I guess.

Ashlesh Sonje: But would you say a rough proportion of your employees is moving...

Alok Patel: You're not audible. I'm sorry.

Ashlesh Sonje: Okay. I'll come back in the queue.

Moderator: The next question is from the line of Bhaumin Shah from Sameeksha Capital.

Bhaumin Shah: Sir, in your last opening remark, you said that Namra's rating got upgraded, and you are expecting that Arman's rating will also get revised. So are we expecting cost of funds to go down? And are you able to maintain the NIM at this range? Or will it go down by -- because there is attrition of -- duration of the rates on MFI standpoint?

Alok Patel: I think, Vivek, what is the...

Vivek Modi: In terms of the rating upgrade, obviously, Namra has happened and Arman we are still waiting. So that's one part of it. In terms of the cost of funds, surely, the rating upgrades will definitely help the company bring down the overall cost of funds. In the last 6 months, I think post the QIP, as the debt/equity (Inaudible 42:56) ratio has come down, our incremental borrowings, you've seen the rates have down, despite the fact that the MCLRs have moved up during the period.

So we definitely expect to have a better or lower cost of fund going forward on the incremental borrowings. And yes, there is also, on the other side, the pressure on the lending rates because of the regulatory reasons that Alok spoke about. So I think at somewhere, we will be able to hold our ground in terms of both the NIM and the trade-off between the yield and the cost of funds.

Moderator: The next question is from the line of Anil Tulsiram from Contrarian Value Edge.

Anil Tulsiram: Yes. Sir, first question is, do we have any plans to take CGFMU and new credit insurance for our MFI and MSME loans? And if not, can you elaborate your reasons for the same?

Alok Patel: That is an excellent question, and we have evaluated it and we are considering it. I don't -- I'm probably at 50-50. I think the internal calculations we have done is it makes sense if you expect credit cost to go over up, what was it, Vivek?

Vivek Modi: 3.5%.

Alok Patel: 3.5%. So we are right in that fine edge right now where it makes sense to do it from a cost perspective. But yes, on the other hand, if you want to sleep better at night, it is nice to have. So it's probably not going to -- I mean it's a tremendous expense to do it, let me be very honest with you. Just reading the document, it sounds like it's not very expensive, but you have to pay the premium on the disbursement and you have to pay it every year.

So if it's a 2-year loan, then you are -- and remember, if a default occurs, the payout does not occur on the disbursement amount. It occurs on the outstanding amount, and that, too, it is 75% of it. There is -- obviously, the worry is also there that how quick the claims will come in and also what will be the overall claim ratios. So I don't know, there have been Few MFI players that have started doing it and we'll take feedback from them as well on their experience, and we'll decide.

Anil Tulsiram: Got it. Sir, and in the past, whenever any industry-wide issue has happened, generally, it has resulted in the credit cost of 8% to 10%. So what gives you confidence that this time this issue is different than industry-wide and at the company level, we won't incur huge credit cost? Like you mentioned max 3%, so it won't be like 4%, 5%, 6%, touch wood, but what gives us confidence that this time, the crisis is not as big as the last crisis, whatever has happened in the past?

Alok Patel: No. I mean, frankly speaking, even during demonetization, I think the overall credit cost was, what?

Vivek Modi: About 5%, 6%.

Alok Patel: 5%, 6%. COVID was a different story where, I mean, it was COVID, right? It was not restricted to just MFIs. I think it was probably 80% of industries got impacted. So leaving COVID aside, if you look at this as a demonetisation level kind of disruption, it was quite a big one. But I mean I can -- if you are putting me on the spot and asking me, is it going to be restricted to 3%, 3.5%? Obviously, I cannot say definitively that it would be. But my experience and the fact that we have somewhat stabilized on the repayment rates -- leads me to believe that it shouldn't get really worse than 3.5% or so. But other than that, I cannot give you any other confidence.

Anil Tulsiram: Got it. Sir, in the opening commentary, you have spoken about stringent quality measures, and you have already spoken about some of them. Can you elaborate in more detail what are those measures? And how are they going to help us in reaching the credit quality -- in bettering the credit quality and reducing the credit cost going forward?

Alok Patel: Yes. So as I mentioned, we have started to separate credit from sales. So I think we'll be in a better place to give you more information on that by next quarter. Other than that, we have also started developing a stronger ML-based algorithm to try and predict customer behavior over and above any leverage cash that we have also taken to tighten credit. We have slowed down disbursement significantly. And right now, we are also trying to, of course, concentrate on the MSME book.

We are, in some of the branches, we are shifting collection days from 1st to the 12th of every month to throughout the month. And so the 1st to the 12th model that you collect on the first part of the month and then concentrate on disbursements on the latter part of the month, that is really an excellent model during the high-growth phase of the company. But it's not very effective when you have to concentrate on collections. So we are working on changing that.

We have created and are expanding special team of recovery officers for selected branches. This is a strategy that has worked well for us in the past, during times like COVID. We are taking all necessary steps and have launched several initiatives to encourage cashless payments from customers. And so we are happy to announce that the launch of the Namra app, which is an Android-based smartphone app, that the customers can use for as a payment gateway and also get account-related information. And of course, we'll keep expanding on the functionalities slowly as time goes on.

We are also using better technology to help branches and middle management to monitor field activities, including live geo-tracking of field force and data mining by a specialized HO team. We have recently hired a special cell at the HO level called BIMS, business intelligence and monitoring unit. And the idea is that we'll have about 25 people who are constantly monitoring field activities through geo-tagging and through BIs, business intelligence reports to make sure that people are using their time effectively.

I don't know if I'm getting anything with it. We are -- so we have a lot of -- we have noticed a lot of the overdues are related to instances of KYC manipulation. And so what happens in that case is that customers who have bad credit or are defaulters or over-leveraged, there has been strong evidence that there has been KYC tampering to kind of deceit credit bureau checks. And so we have successfully launched in all of our branches a biometric eKYC verification using either fingerprints or iris scanners. So many smaller initiatives are underway. So we are attacking this from all fronts as much as possible. And of course, I'm always open for more ideas from anywhere, really.

Anil Tulsiram: Great. And sir, one related question is like in the opening commentary, you mentioned one of the main reason is the leverage -- increasing leverage. And then the RBI came up with the household income assessment and the 50% FOIR, the idea about that to avoid the leverage. So why those measures have failed to control the over-leveraging? Is it because industry is not doing the income assessment and the debt assessment properly or the customers are taking more debt after the disbursement? Or what has failed to, let's say, this specific measure of RBI failed to control the leverage?

Alok Patel: See, when you talk about -- forget about rural customers for a second. If you are talking about assessing income of people who don't file tax returns or don't keep accounting books...

Vivek Modi: Who do not have very qualified bank statements...

Alok Patel: Or qualified bank statements, or even urban players, even in our two-wheeler, income assessment is no more than a guesstimate. So now, especially in the MFI space, that problem is bigger, ,(Inaudible 52:37) right? It's very difficult to assess income. And even if you can assess income, their income levels change drastically from quarter-to-quarter or month-to-month or year-to-year depending on overall macroeconomic scenarios and numerous other factors.

So what I was trying to say that this FOIR rule was a great rule. But earlier on, there was a very conservative hard limit that was put in place, which is about INR1.25 lakh or something close to that per customer. Now it has changed to 50% FOIR. Now let's say, if I assess a customer at a INR2 lakh income, right, and I lever him accordingly, what is stopping another MFI from coming in and assessing the same customer at INR3 lakh income and giving him money, right?

The second issue also is the fact that there are multiple institutions now that are targeting the same customers. So earlier on, rural customers were the domain of the MFIs, people like me, right? 80%, 90% of the loans were serviced by companies like mine or SFBs or largely people's focused on microfinance. Today's scenario is changing where there are many institutions who are targeting the same customers and not specifically in the MFI way, right? I mean you have tractor loans, for example, you have LAP loans, you have gold loans, you have many other kind of...

Vivek Modi: In terms of consumer -- the Tier 4 cities now have lifestyle showrooms and white goods are being sold there as well to a similar customer, right?

Alok Patel: Now those guys are not really restricted by any MFI FOIR guidelines, right? I mean, typically, they have to make a decision on the spot. And usually, that's done by a credit bureau check. And a lot of these customers will have very clean credit bureau even though they might be over-levered. The problem will occur 6 months down the road when they reach a tipping point where they cannot afford it.

Alok Patel: So again, I don't want to paint a bad picture here. This is -- I mean, 92%, 93% of my customers pay me on the dot, right, whatever is coming to me. So -- but my job is not to worry about the 90% or 92% that pay on time, it's to worry about the 8% that don't. So overall, whenever we make broad statements like this about over-leverage, I'm not talking about 100%, I'm talking about 10%. And so that is what we need to solve.

Anil Tulsiram: And my last question is industry-wise, another thing is geography-wise, the experience is different in the default. So are we planning to implement district-wise or state-wise different rate of interest for customers?

Alok Patel: No, that's a good question. We did consider it. Right now, we have not gone ahead with it given the scrutiny of -- about interest rates and other factors from a regulator inside. But that obviously remains a trump card available to us in the future that if the situation is to worsen, then at least some of the costs, you could potentially pass on to the customers, although I would hate for it to come to that.

Moderator: The next question is from the line of Pranav Gupta from Aionios Alpha Investment Management.

Pranav Gupta: A lot of my questions have already been answered. But -- so just to get a sense on -- you mentioned certain geographies that are seeing higher stress than others. My sense that I wanted to get from that, is this specific to -- is this because of specific factors in the geographies, obviously, keeping aside the over-leveraging of it, but any specific micro market factors that are leading to this? Or is it just a general deterioration largely because of over-leveraging and then those customers are being pushed over the curb because of heatwave and elections? That's the first question.

Alok Patel: No. So it's really -- so deterioration, as I mentioned to a previous question before that deterioration is across the board in every state. So there is no state that has been immune to the overall deterioration. Some cases are -- some states are worse than others, such as Rajasthan, Maharashtra and other. Bihar has been behaving well, but there has been signs of over-leverage.

And I think it really differs from player to player because where I'm sitting, I see the southern geographies are a lot better right now, at least some of them. And then I talk to some players that they say that Tamil Nadu is facing a lot of difficulty. Gujarat is one of our best-behaving states, but then there are other players who have made statements saying Gujarat is -- so I think it just kind of depends in even on a district level where you are. So for example, Gujarat, if you are in Saurashtra area or the southern parts of Gujarat, near Surat and stuff, those are behaving quite badly. But...

Vivek Modi: I mean 100 kilometers west of Surat -- I mean, so east of Surat, things are much better in terms of districts like a Panchmahal or Dahod.

Alok Patel: Dahod has been -- I mean you have the same leveraging issue in Dahod, but the portfolio quality is quite good. So I think the tendency for the human brain is to find relationships, Okay, X is causing Y, so let's stop X. But unfortunately, things are not that cut and dry. I mean there are weak correlations and a lot of different ADRs, but there is very little strong correlation to kind of say that if you just stop doing X, then things will improve. I hope this makes sense.

Pranav Gupta: No, absolutely. Just a follow-up on this, sir, I wanted to understand some of that. A lot of players have mentioned that over the last 6-odd months, they have seen center culture deteriorate, members not willing to attend meetings as they were earlier. And some part of the deterioration has also led to that. Are we also seeing those sort of trends play out in some of our geographies?

Alok Patel: Absolutely. And that has not been the case for 3 or for 6 months. JLG culture being diluted is something that I think I've been talking about for the last 2 years or so. I mean, since COVID, that has been the case. And it's to be expected, really. I mean our business model is largely based on discipline and customers coming and sitting in a certain way and they are now tired of that (Inaudible 1:00:33)and stuff.

As competition increases and as people get more used to availability of credit, 10 years ago or 14 years ago when we started microfinance, I mean, it was absolutely green pastures all over the place. And if you made the customer jump through 20 hoops to get a loan and to continue getting a loan, they would be ready to do it. Today's customers are different, and I don't think there's anything wrong with that. I think the market has matured, the country has matured. And we have to, rather than fighting it all the way through, we have to adapt our systems to adapt to the new ground realities. So -- but yes, you are -- it's absolutely correct, attendance levels, JLG culture and everything has been getting diluted.

Pranav Gupta: Right. Sir, just a question on the attrition that you mentioned. Are we -- so typically, attrition in MFI or, in fact, gross lenders over the last few years have been relatively high, mainly on the feet on street levels. Are you seeing this attrition also increase slightly above those levels, maybe a branch manager or area manager level? Or is it still restricted on feet on street?

Alok Patel: It's just restricted to feet on street. And I have many friends in other industries, manufacturing and whatnot, and it's always the -- and they are also facing similar difficulty to find ground-level staff, whether factory workers or field officers or what have you. As far as like middle management and above is concerned or MBAs and other white-collar professionals are concerned, there is little turnover. And in fact, those jobs are available, I mean, candidates for such jobs are easily available. It's the feet on the street which is causing the main issue.

Pranav Gupta: All right. And just one last clarification. The presentation mentioned that collection efficiencies were at 95.8%. Is this including arrears or excluding arrears?

Alok Patel: This is including arrears.

Pranav Gupta: Okay, including arrears. And do you have the number excluding arrears offhand?

Alok Patel: So you mean on-time repayment?

Pranav Gupta: Yes.

Alok Patel: So on-time repayment in June would have been about 93.8%, 93.6% or something like that.

Pranav Gupta: Okay, okay. And this wouldn't have significantly improved directionally in July or probably in the beginning of August?

Alok Patel: No, there has not been any significant...

Vivek Modi: So they would have been almost similar?

Alok Patel: Similar. Maybe a slight improvement, a few basis points, but nothing meaningful.

Moderator: The next question is from the line of Ashlesh Sonje from Kotak Securities.

Ashlesh Sonje: I hope I'm audible this time. Sir, you made a comment around some identification-related frauds. Are these frauds happening in spite of Aadhaar-based authentication?

Alok Patel: So see, what are the basic documents that we check during, let's say, disbursement? So for us, we take 2 forms of ID; and in most cases, it is an Aadhaar card and a voter ID. So earlier, what we found, I'm talking about years ago, people would -- it's easily to manipulate the numbers of an Aadhaar card.

Even many such places available -- illegal places available, but people used to do it. So then what we started doing was using a Verhoeff algorithm to make sure that the digits are correct. Then the problem was that, okay, the digits were correct, but they were borrowing the digits from other places, maybe minors or their children or something. So in that case, we started

OKYCs wherein we would get basic details about gender, location, age, other factors which were available.

Now we have finally bit the bullet and also gone to a level where they have to use an iris and/or fingerprint scanner to get the loan. And so I think we started that about 6 months ago. So a lot of those kinds of at least Aadhaar-based manipulations have stopped. But there are still other documents which are susceptible, right? So like voter IDs. And in many cases, we find that these are not safe voter IDs, but there are multiple voter IDs available for the same customer.

Let's say that we have a rule that we don't give to rented customers, right? Now how do we check whether that they are rented or not? And so there is a list of documents that we can take from them such as electricity bill or other things. Now those can be manipulated as well. Anybody with Photoshop can do it. And so more and more customers who want to kind of defeat your credit bureau checks or defeat your overall credit assessment, they would use such tactics.

So -- and really, this is not just for microfinance, this is for all lending businesses in general. So this is not restricted to microfinance, and it's largely a cat-and-mouse thing, right? You come out with new systems to stop it and somebody comes with something else to defeat it and so on and so forth.

Moderator: Ladies and gentlemen, due to time constraint, that was the last question for today's call. I now hand the conference over to Mayank Mistry for closing comments.

Mayank Mistry: Thank you all for joining the call today. And thank you to the management team of Arman Financial Services for giving us the opportunity. thank you.

Alok Patel: Thank you very much.

Vivek Modi: Thank you.

Moderator: On behalf of JM Financial, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.