Arman Financial Services Limited

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Dear Sir,

SUB: TRANSCRIPT OF THE INVESTOR CALL HELD ON AUGUST 23, 2022

Pursuant to Regulation 30 of the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 and in continuation of our letter dated August 21, 2022, please find attached herewith the transcript of the conference call held on Tuesday, August, 23, 2022 for Q1 for the Financial Year 2022-23.

Kindly take it on your record.

Thanking you,

Yours faithfully,
For, Arman Financial Services Limited

Jaimish Patel
Company Secretary

ARMAN FINANCIAL SERVICES LIMITED AHMEDABAD

"Arman Financial Services Limited
Q1 FY2023 Earnings Conference Call"

August 23, 2022

ANALYST: **MR MANJITH NAIR - EMKAY GLOBAL FINANCIAL SERVICES**

MANAGEMENT: **MR JAYENDRA PATEL - VICE CHAIRMAN & MANAGING DIRECTOR - ARMAN FINANCIAL SERVICES LIMITED**
MR. AALOK PATEL – JOINT MANAGING DIRECTOR - ARMAN FINANCIAL SERVICES LIMITED
MR. VIVEK MODI – GROUP CHIEF FINANCIAL OFFICER – ARMAN FINANCIAL SERVICES LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the Q1 FY2023 Results Conference Call of Arman Financial Services Limited hosted by Emkay Global Financial Services. We have with us today Mr Jayendra Patel, Vice Chairman & Managing Director, Mr Aalok Patel, Joint Managing Director, and Mr Vivek Modi, Group CFO. 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr Manjith Nair, from Emkay Global Financial Services. Thank you, and over to you, Sir!

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

Jayendra Patel: Thank you, Manjith. My name is Jayendra Patel, Vice Chairman and Managing Director. Good evening, everyone; it is a great pleasure to connect with you again and thanks for taking time out of your busy schedule to join us over this call to discuss our financial performance for the first quarter of FY2022-2023. I apologise for the delay in scheduling this call, but it was unavoidable. As usual, we have issued a detailed press release and investor presentation for the quarter, and I hope you had a chance to review it.

Q1 of FY2023 was a fitting start to the fiscal year, which I am glad to tell you marks our 30th year in operations. I am pleased to inform you that we have achieved some great results in the first quarter of this year despite aligning with new microfinance underwriting guidelines announced by the Reserve Bank of India on March 2022, which involved significant background operational changes and extensive training for our large field force. The last two years were challenging to say the least, but I am glad to say that things are back to normal. Everything is now streamlined, and Q1 FY2023 is a great indicator of the situation rapidly returning to normal. With the normalisation of the macro environment, the credit demand has also returned to normal, and so has our customers' ability to repay. Furthermore, with the new RBI regulatory framework for microfinance loans, the NBFCs will get a level playing field while allowing us to price the increased riskiness of microfinance loans. However, the new regulation is targeted more towards bringing different categories of lenders, that is, MFIs, NBFCs, banks, and SFBs, under one regulatory umbrella. The NBFC and MFIs stand to gain the most. Let us now go over our financial performance for Q1 FY2023 and, post that, touch upon operational numbers in more detail.

Coming to the overview of our financial performance for the quarter, it gives me immense pleasure to inform you that as on June 30, 2022, our Company's consolidated AUM stood at ₹1,388 Crore, higher by 77% year-on-year. Our expanding branch network helped cater to new customers and geographies aided by our organic demand growth from existing geographies, which not only led to great AUM growth but generated high quality-assets with repayment rates of 98%, which is incredible. As of June 2022, our total operational branches stood at 308, and more than 50000 new customers were added during the quarter. Consolidated disbursements during Q1 2023 stood at ₹380 Crore, up by 212% year-on-year and 12% quarter-over-quarter despite adopting the new MFI regulatory framework keeping the company ahead of the curve. An increase in post-COVID loan demand further aided increased disbursement within the rural economy segment. Segmental AUM for microfinance stood at ₹1159 Crore higher by 84%, and the AUM for MSMEs and the two-wheeler segment stood at ₹229 Crore higher by 49%. Our total gross income increased by 59% year-on-year to ₹78.9 Crore, and the total net income increased by 71% year-on-year to reach ₹50.3 Crore. The increase in gross and net income was due to strong secular growth in all the categories within the portfolio. Our profit after tax increased sharply to ₹15.7 Crore in Q1 FY2023 compared to ₹3.6 Crore in Q1 FY2022, registered a growth of 336%. This was also aided by strong growth in the portfolio and significant improvements in the asset quality of our post-COVID disbursements. Our consolidated GNPA stood at 3.6%, and our net NPA stood at 0.3% as on June 30, 2022. The company has steadily created adequate provisioning to take care of the unprecedented impact of the COVID pandemic, and the worst is over in terms of NPA provisioning. The debt-equity ratio stood at 4.75 times as of June 30, 2022, and shareholders' equity stood at ₹228 Crore. We have sufficient capital for growth in the short-term; for the long-term, we have announced a fund raise very recently, which is proposing to raise both Tier-1 and Tier-2 capital amounting to approximately ₹115 Crore. Pending regulatory and shareholder approvals, this is, of course, the regulatory and shareholders' approval. This equity fundraise is extremely important to the company to fund its growth and meet capital adequacy guidelines. This fund raising will allow us to reach at least ₹2500 Crore in AUM in the coming years.

Coming to the collections. Our consolidated collection efficiency improved further during the quarter and grew from 85% in Q1 2022 to 98% in Q1 2023. Collections in the microfinance business have remained as healthy levels and improved further to 99% in Q1 2023. The MSME and two-wheeler segment performed excellently in Q1 FY2023 with 98% and 96% collections, respectively. This disciplined collection efficiencies resulted from a passionate on-ground workforce, continuous customer interactions and a customer - focused approach. As mentioned earlier, our comprehensive branch network, as on June 30, 2022, stands at 308. The expansion has given us deeper penetration by tapering into newer districts in existing States and allowing us to explore new States as well. Due to our asset-light business model, the CAPEX spent on our branch expansion has been minimal, which will allow us to reach branch level breakeven rather quickly. As I speak, we are transitioning to a new LOS and LMS system, which will drive us into a new technology-based growth phase in the company. New transitions are always precautious, and we are committed to implementing them by the end of the second quarter. This technology will fundamentally shift how we do business and service our customers. We will significantly improve our clients' experience and turnaround time. Still, we expect these technologies to bring significant efficiencies and reduce operational risk. The number for Q1 FY2023 seems to indicate that COVID is behind us, but we remain ever vigilant, and the future appears to be bright. With the added capital and new technology, we have all the ingredients in place to take the company into the next phase. With a little bit of luck, the first half of FY2023 will be one of the bookmarks in the new chapter in the company's history while we focus on growth. Our foremost priority remains to maintain the quality of our loan book a key outcome of our outstanding operational excellence is our collection efficiency which remains robust at about 98% for Q1 FY2023. We remain bullish about the resilience of our overall economy, and we endeavour to serve the most unserved and unserved population of India so that they could also be a part of India's growth story. I express my sincere gratitude to all our employees, Board of Directors, customers, investors, and other stakeholders for their continued support during these challenging times. I would request the operator to open the floor for any questions and answers session. Thank you so much.

Moderator: Thank you. We will now begin the question-and-answer session. The first question comes from the line of Shubham Ajmera from SOIC Ventures LLP. Please go ahead.

Shubham Ajmera: Thanks for providing me with the opportunity, and congratulations on a great set of numbers. I have two questions. First is on the new RBI regulations for MFI, where the cap on interest has been ignored, so I would like to know if you have increased your interest margin for the rescue of the (inaudible) customers during Q1 and what is your plan for the future and are we planning to increase it further as well in the upcoming quarter?

Aalok Patel: Yes and no. So yes, during Q1, we increased the rates by about 2.5% to 3%, what it was in Q4. We are watching closely what the competition is charging closely, so this is in with what the industry has increased into. There has been an increase in our overall cost of borrowing and overall cost of borrowing for the entire market due to the RBI raising rates, so maybe in Q2 we have not raised, but in Q3, there is a possibility for us to raise by some small margin by maybe 25 to 50 bps, but let us see we have not made our decision on that yet.

Shubham Ajmera: Got it and my second question is on the impairment losses. Like we have done aggressive provisioning and write-off post COVID so is there any recovery among that, and can we say now the impairment cost will not be much as compared to our previous few quarters post 2021?

Aalok Patel: A lot of the provisioning cost and stuff, which you are seeing, is not only like, for example Q1 provisioning will have standard asset provisioning, it will have ECL provisioning. It will not only be COVID provisioning. So as the portfolio keeps increasing, the provision should increase, but yes, you can say that the quantum of impairment losses, or provisioning will not be as high as it has been in the previous quarters. But as the asset size grows in this business 1% to 2% loan losses is to be expected.

Shubham Ajmera: Yes, I got your point, understood. Thank you.

Moderator: Thank you. The next question comes from the line of Ravi Jain from 2Point2 capital. Please go ahead. Since there is no reply from the line of Mr Ravi Jain, we will go for the next that is Debashish from Detection. Please go ahead.

Debashish: First of all, congratulations on a perfect set of numbers and also congratulations on the fundraise. I have two questions. One is the net NPA in the first quarter is very good, it is 0.3% compared to all other listed players if there are six, seven listed players if you take the average, it works out for them around close to 2% and the return ratios for us also are significantly better, so we are there pre-COVID times almost there in terms of return ratios and net NPA we are better. Hence, my question to you, Aalok, is-what should we assume the net NPA numbers realistically? Is this an aberration, or should you take a higher number? Second, given the fundraising, we always said that we are going to leverage five to max six times with this fundraise; what level of AUM do you feel we had done for the capital raise?

Aalok Patel: Yes, sure, thanks. Great questions. As far as the net NPA is concerned, I can speak for the industry. Still a lot of the NPA pains we have taken over the last eight to ten quarters, and there was very minimal kind of restructuring or other kind of delaying factors which were used. Hence, I think if you compare our repayment rates or NPA figures in previous quarters, let us say four or five quarters ago, or six quarters ago, they might appear higher than what the industry was reporting, so I think there might be some level of the timing difference. That being said, I cannot say what we can expect in the future because depending on what other kind of black swan events and stuff happens. The goal here is to always maintain sufficient provisioning. Now pricing caps have been removed by the RBI. I think it is prudent to be much more conservative regarding your provisioning requirement. So, I hope to keep net NPA levels to at least less than 0.5% or even maybe even zero in the long run.

Vivek Modi: Pre ECL, if we can regime when we entered into Ind AS before that, generally Arman has been maintaining net NPAs of much lower levels, but are converting into Ind AS accounting and COVID are kinds of they sink-in together and fortunately as Aalok has already explained we did a very aggressive provisioning initially in 2021 and 2021-2022, so primarily as a result of this I think the net NPA has been consistently coming down and now I think if we can maintain it to something like 7.5% that should be a good target to achieve consistently quarter-on-quarter and year-on-year.

Aalok Patel: As far as your question on the recent fundraise, assuming all the regulatory and shareholder approvals goes through, we are confident of at least reaching ₹2,400 to ₹2,500 Crore based on this most recent fundraising. It also depends on your growth pace because there will be internal accruals based on the kind of profits we generate. So it might be higher than that, but most likely not less than that.

Debashish: Thank you, and all the best for the future.

Moderator: Thank you. The next question comes from the line of Srinath V from Bellwether Capital. Please go ahead.

Srinath V: Hi, Aalok. I just want to understand how the business has changed with the new rules. Do we still have group meetings, or how is the collection done? One of the critical pillars of the group meeting was that we could collect the payments in one go for like 20 people, getting some cost advantages from that; that is one question. The other question was that have we started looking at the deeper rural geographies where we did have some cost issues because of the population is less dense, and given the new interest rate structure have we started going into, say, the parts of interior Rajasthan which were not viable at that 10% margin cap, so these were my two questions? Thank you.

Aalok Patel: As far as your first question is concerned, and as far as the groups go, yes, we are still collecting on a group level. Of course, it is at a very nascent stage - we are trying to go for cashless collections in some of our portfolios as well. However, we are still insisting on group meetings because that is following the spirit of the GLG, and also as you said, that it becomes operationally efficient for us to go and collect from a group rather than collecting from an individual person to do it. So that is still happening I do not foresee that going away for at least the short and medium-term, until there is a significant focus that shifts to cashless collections, which I do not foresee happening for a while. Your second question was about moving into deeper rural, yes, that is one of our strategies, and we will consider it. Our hands have been complete tied up in the past one, or two quarters, so we have not executed on that yet, but that is in the works. So we will keep you updated on that.

Srinath V: Just to follow-up on MSME, how is the scale-up going, have we been able to look at a slightly larger ticket size trajectory around 1 lakh or in the current market, have we been able to penetrate to newer geographies, what is your broad growth outlook and AUM outlook over the next one year in that segment because that segment seems to be the one that is not picked up to the same level as what MFI has done?

Aalok Patel: I would not say it has not picked up. I think after doing MSME for like four or five years, I think it is unfair to compare the growth level in MSME to the same benchmark as you can grow in microfinance, because it takes a particular kind of customer engaged in a specific type of business. So the sourcing is a little bit harder, the rejection rates become a lot, a lot harder. That being said, I think we have grown from at a low point of ₹113 Crore I believe in Q1 FY2022 to ₹181 Crore in Q1 FY2023. So quarter-over-quarter, we have grown from 113 to 181, so I do not know what that is in percentage.

Srinath V: Not that way generally, let me rephrase. It how do you see the growth outlook? It has been one of those things where you need a slightly more evolved labour force to scale up. Rejection rates are high, so working around all these constraints, where are we today, and how do you see the next one, two years in this product line? And the offshoot of that is we had done some pilots to look at differentiated products in this space, may be some durable financing or even slightly the larger ticket loans in MSME, and even say rural two-wheeler, which was coming out of this branch network. So if you could cover all of those initiatives along with what is happening in MSME that would be great?

Aalok Patel: Yes, so the rural two-wheeler, of course, we are still maintaining our focus on, and that is still generating volumes, although it is almost 30% of our entire book itself - it is about one third almost. So that is there. Regarding the other initiatives, they were kind of due to COVID. They were put a little bit on the backburner, but we are reviving them as we speak. We have a new Chief Risk Officer who is taking the initiative of increasing the underwriting for issuing higher ticket loans. Still, as I said earlier, we had a lot on our plate in the last couple of years, so new projects get delayed when you are trying to fight forest fires here and there.

Vivek Modi: Additionally, Aalok, we can also talk about the IBL. Our learnings from MSME in Arman gave us the opportunity to kind of pilot the individual business loans in our microfinance, which itself is about those still in a pilot phase. But still about ₹30 odd Crore - so that gives us at a group level the reach to almost 150 branches, which are more than three years old.

Aalok Patel: That IBL product is 100% cashless, so we are attempting to collect disperse and collect money in 100% cashless method. So few things going on and a lot of lessons learned from a lot of different products.

Srinath V: Perfect fantastic, hopefully over the next two or three calls as these products make it the light of day. It would be nice if you could give an overview in the introduction. A synopsis, because these are very interesting as you diversify your book. Thanks, Aalok, for the fantastic results, and thanks for supporting our shareholders. Thanks a lot. I will get back to the question queue.

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

Amit Mantri: Hi Aalok congratulations on the good results and on the fundraising that solves the growth capital problem, so that is a great outcome for the company. My question is, on the provisioning front, now is the provisioning for COVID impacted book or first wave, second wave impacted book is that complete?. Now incrementally, the provisioning will be the business as usual provisioning, or would there still be a higher run rate of provisioning because even now I think this quarter also we had around 3.5% provisioning on the overall book, so forward into the future, will this now come back to sub 2% levels or will it continue to be inflated on the higher side for some time even now?

Aalok Patel: No, I guess it just depends on how quickly you want to write off, but to answer your first question, all loans which were troubled loans which we had created before March 2020 depend on what you mean by COVID assets, right, because COVID has been ongoing for two years and there was the first wave, second wave, third wave, the most significant issue was pre-COVID assets which is what we call disbursements that occurred before March 2020, so those are all taken care of. There might probably be a few small things related to the third wave, but that will be negligible overall. Broadly speaking most of the impairment of provisioning that you will see from this quarter onwards is on the post-COVID book, the business-as-usual kind of a thing. Now conservatively, I would say about 2% is what you should expect.

Amit Mantri: Now many of the other MFIs, because of how the new regulatory regime is now getting into some of these different geographies where we have been present, so many of them are not talking about getting into Gujarat, Uttar Pradesh, Bihar, Haryana, which are also huge markets for us or new markets so how does competitive intensity looking like now versus earlier?

Aalok Patel: Well, to be honest with you, it has slightly declined. I do not know why but competition intensity has somewhat declined, and I cannot speak of why that is the case, but in a lot of markets, it seems that maybe our competitors are facing more significant issues that they need to tackle perhaps they are I do not know I do not want to speculate you can probably speculate better than I do, but at least in the short-term, we are seeing somewhat of a decline that being said yes I think over the long run you are correct there are south-based MFIs that are planning to move into Gujarat, and there are east based that are planning to move to the west and everybody is planning kind of expansion one of the reasons why we moved into Bihar was for a very strategic reason as well is because if we did make a move today and wanted to move two years later, it would be tough at that point because the market would become very crowded. So competition is something which is always there, and we have been doing it for a while. I do not have an exact answer for you, but obviously, there are multiple reasons why we do get good customers on board, and we provide an excellent service to them.**Amit Mantri**: Okay, thank you very much.

Moderator: Thank you. The next question comes from the line of Gaurav Prakash Mashalkar from ICRA. Please go ahead. Since there is no reply from Mr. Mashalkar, we will go ahead with the next question. The next question comes from the line of Vinay Ambekar, an individual investor. Please go ahead.

Vinay Ambekar: Good afternoon, Jayendra bhai, Aalok, Vivek. We are delighted with how Arman has come through these troubled times, and how you have put levers in place for future growth. While finances are an essential element of this, can you kindly elaborate a little bit on how do you plan to take the organisation through in terms of what growth you would need at the organisational level to be able to reach the desired AUM of ₹2400Crore -₹2500 Crore that you mentioned and if possible indicate some broad timeline by which that can be done sustainably? Thank you.

Aalok Patel: Yes, thank you,. That is a good question. So, yes, financials are essential, of course, but a lot of ingredients have to come together. I think as Jayendra bhai mentioned in his opening remarks, for the growth to go, a lot of things have to fall into place, as you said, so number one is of course we needed capital which is there in a capital adequacy requirement of 15% or a debt-equity ratio of somewhere around 6x that is stipulated by the RBI but typically speaking it will be challenging to have a debt-equity ratio of more than 5x so that we are solving by raising equity and hopefully that goes through,. We will get the money in a month or five weeks of time. The second thing which we needed of course is a software so I think as we speak we are upgrading our LOS and LMS system, LOS is Loan Origination System and LMS is the Loan Management System, so everything pre-disbursement is LOS and everything post disbursement is your LMS system and this is a very state-of-the-art kind of if I can use the term Fintech or Fintechish kind of a program completely mobile-based, a lot of APIs to verify their IDs, voter cards, Aadhaar cards, KYC validation, direct interfaces with the credit bureau, mobile phone verifications, you can use UPI as well, there are penny drops for bank account verifications, going completely paperless we have signed with legality to do digital signatures I do not know we are using geotagging for every one of our customers so finding them becomes a lot easier, you can generate heat maps based on those geotag informations, get village level information to all kinds of analytics, as far as collections and stuff also that helps categorization of centers. There is a redshift for big data analytics that we have put on our server. There are tons of things which we have cool things that we are doing with technology, and we are going to start doing them. The third prominent main ingredient, so one was capital, second was technology, and the third and the most important is HR, so we need the right people for the right job, and I think I have said it many times that essentially, we are in a business of selling a commodity which is money. When you go down with the nuts and bolts of our business it is more of an HR business than anything else. So hiring good talent and retaining good talent is getting more and more complex, but we are up for the task. We have a fantastic team of about 2800 people with the right kind of culture that we have created that are doing a fantastic job on the ground so I have complete confidence that they should be able to grow.

Vinay Ambekar: Thank you for that very detailed answer. So do you think that at an employee level, we will need to also double our employee strength to approximately double the AUM, or do you think we can manage with slightly less work?

Aalok Patel: So it will be slightly lesser there are economies of scale that you can do, but it is always a risk versus reward kind of a situation with the staff because you can push your field officer to have anywhere between 400 to 800 customers that he is managing so 800 would be highly efficient and during the good days that would reflect very well on the balance sheet, but when you run into situations like COVID or demonetization that single FO is not able to handle 800 customers, all of a sudden he has to go door-to-door to collect from all of them. So. it is all about like finding the right balance between risk and efficiency, but yes, there will be some economies of scale and especially with this technology and stuff at least the back office and things we would not see a very, very large order, exponentially increase in back office kind of office level people, but unfortunately our business is very much dependent on people, so for every few hundred customers you need one FO and then, you have layers upon layers. Over that you have a BM and an area manager and a regional manager and a state head, the zonal head. So there are multiple layers that you have to create to keep control of everything.

Vinay Ambekar: My next point was around the provision. While you indicated that the approximate provision requirement could be 2% going forward, is it possible to give a rough idea of how much you think could be related to standard asset provisioning and how much could be related to stressed asset provisioning and within standard asset are you taking anything extra over and above the regulatory requirement and similarly for the stressed asset provisioning also whether you are taking any extra provision?

Aalok Patel: No, I think I was generally speaking in very simplistic terms, more in terms of loan losses. So there will be, of course, standard asset provisioning and another asset provisioning that you will have to do. What I basically meant was that if I am lending Rs.100, how much of it will not come back to me in terms of the bad debt? Or you can call it NPA provisioning or impairment. Maybe four or five years ago, in microfinance, we were getting away with 1% kind of a loan loss situation. Given how the market is evolved I think in the long run you have to expect a 2% kind of a loan loss. So that is what I was referring to as far as standard asset provisionings and ECL provisionings, and stuff like that. Vivek can explain it.

Vivek Modi: In terms of the ECL,, this may not be the forum to have this kind of discussion, as to how much is provided on each of the standard assets. Because that would have multiple factors involved in terms of the staging of these assets between stage one, two and how these assets perform. But if we talk of our ECL provisioning as compared to the statutory or compliance requirement by RBI, I think that is multiple folds higher than what is required by the regulator. So from that aspect, I think our provisioning is much aggressive and much higher than the requirement.

Aalok Patel: I mentioned standard asset provisioning because I am used to it, but there is no such thing as a standard asset. I think you are providing ECL coverages on all buckets, whether that is a zero bucket, or a 30, 60, 90, 180 plus whatever buckets. Different layers of provisioning get provided, and so long as less than 90-day provisioning is more than what RBI stipulates for standard assets, then we are good to go.

Vinay Ambekar: Fair enough. I got that. Thank you very much—all the best for the future.

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

Kuneh Ghelani: Good evening; I am very keen to understand what the impact of the guidelines have been on an operational basis, so potentially with the changes that have come in, we will see the FAQ as well. How would you probably say at what level of the journey that you have been able to progress so far in terms of pretty much what the guidelines asked us to do in terms of aspects. because income estimation, the monthly EMI estimation, family household level assessments. So that the systems, processes, policies, the workforce, right, so where would you rate yourself to be in the journey of being able to adhere to those guidelines truly and broadly your sense, what challenges you are facing?

Aalok Patel: FOIR based kind of evaluation is something that we had been doing in our MSME for a long time, so we had some level of experience of doing that. Broadly speaking, a lot of the EMI-based data and things like that depend on the credit bureaus. So we pull credit bureaus for the entire family at this point, for the customer and the spouse. There is an automated system. For any unmarried children over the age of 18, there is a manual process involved because our system is not ready yet. But with this new system, it should be entirely family-based. The credit bureaus are also coming out with a family level credit bureau check where they will give a consolidated kind of credit bureau report for the entire family. So things are evolving to that point. The only place where you have to use a large-scale judgment is the income side, which is not always easy. I do not think RBI intends to make it difficult for people to borrow money. I guess what they are looking for is just a systematic approach to get a reasonable estimate around their cash flows, and this is what most people are trying to do. That being said, if two people are assessing the income of one individual customer is there a chance of getting completely different answers. The answer is yes. Still, if you do a good enough job, hopefully, it will not be too far off, and I think most people in the industry and including the RBI, are hoping that they do not want a solution on day one,. They want the processes and the systems to evolve continuously. The MFIs system to evolve continuously to assess that income, and I think the spirit and everything are absolutely in the right place. I wholeheartedly agree with whatever RBI has come up with. as far as income verification is concerned. Yes, it is challenging to do but just because it is difficult, that does not mean there should be a long-term endeavour to get us to a place where it is possible to go. So, I think that is all I have to say on that topic. Now, as far as the other methods are concerned, I do not know what am I missing. Something as far as the RBI regulations Vivek, those are the main ones.

Vivek Modi: Those are the main ones. The other is in terms of the qualifying asset criteria, which was earlier 85% which has been brought down to 75% for the total assets. Mainly, if you look at it, it probably turns out to be almost the same equation the 85% only, depending on what are the other assets that the organisation might have.

Aalok Patel: It does not impact us that much because we have two NBFCs, so the NBFC MFI is basically for micro-loans only. I think we are doing IBL.

Vivek Modi: IBL also qualifies for largely 99% of the IBL, which is less than ₹3 lakh of household income, so they all qualify for microfinance loans.

Aalok Patel: Also, one thing to add, and maybe this is turning out to be too long of an answer, but I think the other intent of RBI was to make this as broad as possible. So while the earlier regulations were very targeted toward a specific type of customer, that has to be urban or rural, and less than a certain amount of income. The only criteria they have now is essentially to say that the loan should be unsecured. It should be given to a household with less than ₹3 lakh of income, so that comes out to be ₹25000 a month. Now, most families in India, if you exclude, let us say, the metro cities most families in India would be making, I would venture a guess, less than 25000 a month. So they have made it extremely broad overall, and I think that is the right thing to do, I think instead of putting everything in black and white, let the industry make a judgment call on what is considered as microfinance or a personal loan, or any other kind of loans.

Kuneh Ghelani: I understand. I still appreciate that for one to say that level playing field and the expansion of the segment is something that is quite rightly, but just a follow-up to that broadly. For ,like you said, there is subjectivity involved and there is some elements of doing more cognitive work really in trying to assess customers more and with that you will also probably need more controls. And your policies will also need to be strengthened and systems will also need to be stronger. Right? So. historically, we have tracked very well we have managed to keep opex in a calibrated fashion about making 6% and 6.5% maximum in terms of average AUM basis. So how are we looking at that number really in terms of seeing this organization at the AUM level, that you are targeting just on a employee plus other expenses sort of basis? What is the sort of opex rollout that you are looking at given that you may have to invest more in systems, processes with people, etc., etc. So that would also be very helpful.

Aalok Patel: I think any opex kind of increase will be offset by some level of economies of scale, at least until you get to about ₹3000 Crore, or ₹4000 Crore, where you run into some level of these economies of scale. So that is a hurdle to cross for at a later date. But we are not expecting a huge scale in opex increase. at this point the opposite will probably have a slightly reduced opex, but no promises at this point, but we are trying to reduce opex as well.

Kuneh Ghelani: Understood, thanks for the answer; wishing well to the very best.

Moderator: Thank you. The next question comes from the line of Ravi Jain from 2Point2 Capital. Please go ahead.

Ravi Jain: One question was on the liability side. Are we seeing easy access to liabilities from all the various sources, including banks, NBFCS, etc., because some of these NBFCs that we have spoken to, the larger ones, have kind of decided to temper down this business of lending to smaller NBFCs significantly to so just wanted to understand access to liabilities is that a concern or there is no issue there?

Aalok Patel: There is a concern, I would not call it exactly a concern, that is something that we are actively managing at this point. But it is not only because of the market. There are numerous situations which are happening which have led to kind of a liquidity crunch during the first quarter and the second quarter. Number one, it is first of all, banks are pretty reluctant. I would not say reluctant, but they take it easy as far as disbursements are concerned in the first quarter. The second part is that a lot of the banks and people met their NBFC limits during the CGS schemes and stuff like that. So they have to wait for repayments to occur before making fresh disbursements. The third is the RBI easing rates among other things.

Vivek Modi: So people have been holding back the decision that time. So that might be one of the reasons while some of the NBFCs you might have spoken to have said that we are not probably lending very aggressively. Right now, because every almost three weeks, or every month, you were seeing a 0.25 basis increase for the last three months. But now, I think since everything has kind of stabilised largely, what we are seeing right now from the larger NBFCs, the smaller private sector banks, they all are coming back and lending to the NBFCs, or evaluating NBFCs more aggressively than in the past two, three months.

Aalok Patel: I think Vivek, if I can also mention that a lot of the funding has changed. From like term loans in PTC type of loan or PTC lending. So, for whatever reason, that has been much more popular in the last couple of quarters than straight up term loans. And a short answer is, is it a lot more difficult today to raise debt than it was a few quarters ago? Yes absolutely, but it is nothing that we can't handle.

Ravi Jain: There is still demand for this assignment securitization like we did a very large transaction last quarter. So are you still seeing some appetite for that?

Aalok Patel: We did a DA transaction last quarter with SBI. We are seeing many EPC transactions which is another type of buyout transaction only. But, it is not considered an actual sale. So it is not like an off-balance sheet transaction, at least under Ind AS guidelines, but yes I think we are talking to a few people about DA transactions as well. The problem with DA transactions is absolute without any recourse, so the risk basically gets wholly transferred to the buyer. So otherwise it is a pretty good deal, because it goes directly into the book. It is not considered a treasury instrument. It goes directly into the retail kind of CSL book.

Ravi Jain: What about market sources like NCDs and all - is that something you are evaluating?

Vivek Modi: In Q1, we have raised multiple NCDs as months have gone by, largely to answer your question. More specifically, we have always kind of tried to borrow from various channels, and I think all the channels remain open at this point of time. There is always a bit of a flavour for every quarter. So, as Aalok pointed out, the flavor has been more structured transactions, like PTCs for the last couple of quarters and now, as the interest rate to some extent stabilized, we are also seeing a lot of interest from various lenders, including the PSU, private sector banks and larger NBFCs, coming back to the conventional term loan kind of lending as well.

Ravi Jain: Secondly, did these Gujarat clubs impact your collections?

Aalok Patel: What?

Ravi Jain: Gujarat clubs.

Aalok Patel: No not really.

Ravi Jain: I think people have gotten used to much more extreme circumstances, and these are now like a cakewalk for them.

Vivek Modi: Obviously, we do not lose focus on the collection efficiency, and that is something which I think everybody in the organisation clearly is wired, and DNA is to look at the first thing is having the collection come in.

Aalok Patel: Yes, but you are right, Vivek after going through COVID, it is like being cured of cancer and then if you have a small sneeze, you do not even notice it, right? So, it is one of those things.

Ravi Jain: But is that more from the customer's point of view that he is now able to manage even under such circumstances, which earlier floods were a reason for the very low collection. So is there a change in the psychology or the ability of the customer to sustain these events because of COVID?

Aalok Patel: I will be honest with you, besides demonetisation and COVID, like flood, earthquake or whatever, those were very localized. You will find a few villages here and there, and we are in hundreds of districts and in thousands of towns. One isolated incident in some geographies is a blip nowadays, and when it comes to stuff like a flood, the money might come in four, five days later, or a week later, or if the place is not accessible. But typically, the customers do pay as long as there is not a considerable lifestyle damage where they have lost their house and their farm and everything like that. If it is just an accessibility issue, they will pick up slightly a little late, but they will pick up. Now, if you are talking about very large-scale floods, where they have lost their livelihood and migrated elsewhere, which is what happened, it is not a concern.

Ravi Jain: Lastly, some of these other larger NBFCs have slowed down the disbursement significantly in the last quarter, and the reason that they mentioned is that they are trying to gear the system for these new RBI guidelines. They want to be entirely sure that they are meeting all the requirements. But from what you say, it seems like there is some bit of leeway in terms of what is required, so that is a slight difference that at least I noticed when speaking to you as compared to the other larger NBFCs?

Aalok Patel: I would not be able to comment on what other people are doing or saying. To be honest with you, as I said that income verification was probably new ultimately due to many organisations we had some level of practice with it through our IBL loan and MSME. So maybe, it was just more confidence driven than anything else that, we can do this we have been doing it for years. If they are facing issues such as that, are they going to solve it in a quarter or two magically? What exactly are they hoping will happen in Q2, that they will manage to do in Q1? I am not exactly sure how to answer that.

Ravi Jain: Great, that is all from my side. Thank you.

Moderator: The next question comes from the line of Sachit Motwani from Param Capital. Please go ahead.

Sachit Motwani: Hi Jayendra bhai, congrats on a great set of numbers and even on the fundraise. My first question is a follow-up to what Vinay was asking about when you are looking at ₹2,400 Crore, ₹2,500 Crore of AUM, so I just want to understand from you your emphasis on the risk management so are you going to build a big risk team or something on how do you look at it?

Aalok Patel: We have a pretty large operational risk team or an audit team if you want to put it that way. We just hired a chief risk officer who comes with a lot of experience in different banks and different NBFCs and also in MFIs as well. So, we have always been conservative. I think that has been a cultural thing for us from the very start and not only for the MFIs. But from the very beginning, in 1992 and that has essentially made us survive all these years. So that is not something that we want quickly to give up on easily. So, there are not very large structural changes to the risk. However, we are starting to formalise it regarding policies and tracking and all those other factors.

Sachit Motwani: Got it. Can you name the Chief Risk Officer?

Aalok Patel: It is Srinivasan Raghavan.

Sachit Motwani: Second, was on other than NCDs, ECBs and securitisation, rest of the borrowings would be on a floating rate basis for you?

Vivek Modi: Usually, all the term loans are on a floating basis.

Sachit Motwani: That will constitute how much of your liabilities?

Vivek Modi: Term loans on the bank borrowings from that route will constitute almost 60% of our borrowings, 60% to 65%, NCDs included around 60%. NABARD, MUDRA, and everything - that also is to some extent MUDRA excluded, but NABARD is generally floating again because they kind of change after one year's reset about 60%.

Sachit Motwani: So what would be your incremental borrowing cost?

Aalok Patel: Well, that again depends mainly on where the funds are coming from.

Sachit Motwani: So let us say we were to take banks?

Aalok Patel: If you take banks right now, the funds are coming in at about 11% to 11.5%.

Vivek Modi: I think the overall increase in the cost of funding for new loans has gone up by about 75 basis points generally. In terms of resetting, the reset would anywhere range between 30 bases to 75 basis points - depending on the lenders, because many lenders have reset it twice. We might have had a three-month reset contract.

Sachit Motwani: I just wanted to get your thoughts on this Prayaas Scheme of SIDBI. Do you think that could be one of the things you can do for MSME lending?

Aalok Patel: I have not considered it yet, but it is a good idea. I think we can think about it.

Sachit Motwani: Fair enough; thanks a lot, Aalok; those; are my questions and all the best.

Moderator: Thank you. That will be the last question. We have reached the end of the question-and-answer session now. I would now like to hand the conference over to the management for closing comments.

Aalok Patel: Thank you, everybody, for your support, and I wish you a pleasant evening.

Moderator: Thank you. On behalf of Emkay Global Financial Services, that concludes this conference. Thank you for joining us. You may now disconnect your lines.