"Arman Financial Services Limited
Q2 FY '24 Earnings Conference Call"
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Moderator: Ladies and gentlemen, good day, and welcome to Arman Financial Services Limited Q2 FY '24 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 now hand the conference over to Mr. Mayank Mistry. Thank you, and over to you, sir.

Mayank Mistry: Thank you, Sagar. Good evening, everyone, and welcome to the Q2 FY '24 Earnings Conference Call of Arman Financial Services. First of all, I would like to thank the management team of Arman Financial Services for giving us the opportunity to host this call. From the management team, we have Mr. Aalok 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 can open the floor for Q&A. Thank you, and over to you, sir.

Aalok Patel: Thank you, Mayank. Hopefully, I am audible to everybody. On behalf of Arman Financial Services Limited, I warmly welcome all of you to our Q2 and H1 FY '24 Earnings Conference Call. With me today, we have Mr. Jayendra Patel as well, Vice Chairman, Managing Director; and Mr. Vivek Modi, Group Chief Financial Officer; and of course, our Investor Relations team.

I hope you have reviewed the Q2 and H1 '24 results, press release and presentation available on the stock exchanges and our website. This year marks the start of Arman's fourth decade in operations. I'm proud to share that for the majority of the last 30 years, we've been at the forefront of serving the underserved regions, promoting livelihood and providing small or micro credit to economically backward individuals, who lack access to formal banking and financial services.

Turning to Q2 and H1 '24 results. Despite a lot of global geopolitical tensions, the Indian economy has shown remarkable resilience. This highlights the strength and potential of our economy, resulting in positive growth indicators. The Reserve Bank of India's recent guidelines have created a favorable environment for the microfinance industry, offering regulatory support and a conducive atmosphere for microfinance business. This has opened up new opportunities leading to significant growth and business prospects in the microfinance segment.

During the period under review, our company's assets under management or AUM stood at INR2,304 crores, registering a year-on-year growth of 60.5%. It took us 3 decades to achieve an AUM of INR1,000 crores, but we doubled our portfolio to INR2,000 crores in just about 24 months. This is, of course, the power of compounding. Stand-alone AUM increased by 46% to INR359 crores this quarter compared to INR246 crores in the same quarter the previous year.

Our microfinance subsidiary, Namra Finance registered a 63.4% AUM growth, reaching INR1,945 crores this quarter.

Our emphasis on sourcing, underwriting and technology led to strong growth in our MFI and MSME lending business. Consolidated disbursements for H1 FY '24 stood at INR1,075 crores, registering a growth of 63.5% year-on-year. Our stand-alone disbursement stood at INR165 crores with MSME disbursements amounting to INR134 crores. The MFI segment disbursed INR909 crores compared to INR540 crores the same period last year.

This strong growth can be attributed to favorable credit cycle, positive regulatory policies and our geographical expansions. Furthermore, our expansion into new contiguous territories has generated substantial traction in the regions where we operate.

The company is currently operational in 10 states with a branch network of 385 branches. We've expanded our footprints further by adding 42 branches in the last 1 quarter. We hope to get significant traction from these new branches by Q4 of this fiscal. Last year, we entered into untapped geographies of Bihar and Haryana. Building upon this in the first half of this year, we have expanded our presence to Jharkhand and Telangana as well, where at present, we have operationalized 9 and 6 branches, respectively.

In addition to this, we have inaugurated a zonal division with a new zonal office in Lucknow, UP. While staying committed to our core strategy, we expanded into new states as an essential and strategic growth lever for the future. Regarding our asset quality, we continue to see an improvement. Our gross nonperforming assets or GNPA have decreased to 2.48%, a drop of 99 bps compared to the same period last year. At the same time, our net nonperforming assets or NNPA, are at just 0.23%.

Now coming to collection. Efficiency for the month of September '23 in our microfinance business stood at about 98.3%, MSME was 98.6%, and Two-Wheeler stood at 96.3%. In addition, our overall collection efficiency in H1 stood at 98.2%, demonstrating stringent underwriting, risk management and collection processes. Our digital solutions have automated most of our business processes and have been immensely useful in enhancing customer experiences and also driving efficiencies.

As of 30th September '23, our total borrowings amounted to INR2,245 crores, comprising the diverse mix of financial products -- excuse me, diverse mix of financial instruments. We maintained substantial liquidity of INR269 crores in cash and bank balances, liquid investments and undrawn CC limits with a debt-to-equity ratio of 3.4x and a healthy capital adequacy ratio of 35.15% on a stand-alone basis.

For the quarter, cumulative provisions stood at INR77.1 crores, which is 4.01% of our on-book portfolio outstanding or POS. Of this, provisions for Arman stood at INR15.9 crores and for Namra stood at INR61.2 crores.

Now let me run through the key consolidated financial numbers for the quarter and the half year ended 30th September '23. Q2 FY '24 -- so for -- this is for the quarter, the gross total income stood at INR160.3 crores, registering a 73% year-on-year growth. Net total income amounted to INR93 crores representing a substantial 64% year-on-year growth. Pre-provision operating profit or PPoP witnessed a robust increase of 90% over the same period, which stood at INR69.3 crores. Profit after taxes stood at INR40.8 crores, reflecting a significant year-on-year growth of 105%. Yields for the quarter stood at about 26%. Net interest margin stood at about 14%. Cost to income for the quarter stood at about 25%. Return on average AUM stood at about 7.3%. And return on equity stood at 34%.

For -- now turning from the quarter to the first 6 months or half year, the gross total income stood at INR309 crores, registering a growth of 81% year-on-year. Net total income amounted to INR179 crores, representing a substantial 67% year-on-year growth. Preprovisioning operating profit or PPoP witnessed a robust increase of 94% over the same period, which stood at INR132.6 crores. Profit after taxes stood at INR80.8 crores, reflecting a significant year-on-year growth of 127%.

In summary, we are on the right track to achieve our long-term goals. We believe our prudent lending practices, unwavering commitment to the customer experience and our dedication to the digital innovation will help us achieve sustained growth in the coming years.

With this, I would like to request the operator to open the floor for any questions. And thank you so much for your time.

Moderator: Thank you very much. The first question is from the line of Amit Mantri from 2point2 Capital. Please go ahead.

Amit Mantri: Congratulations on great performance in this quarter. So a lot of branch expansion has happened in this quarter. So can you talk about how you're seeing the demand environment because I think the branches have been opened across the board. It's not like only in a few states you opened, you also opened in the older states, Gujarat, UP, where you have a large presence, but also in new areas as well. So how is the demand environment overall?

Aalok Patel: Yes. So it's -- so Bihar has been doing really well in terms of demand. Lot of the branches with -- not lot, some of the branches, I would say, half of the branches that you see in the older states are -- a lot of them are split branches. What we mean by split branches is once the portfolio of branches reaches INR7 crores, INR8 crores, INR9 crores or it reaches a certain threshold where it crosses our risk, we'll typically split the branch into a new branch, and that has numerous benefits for us overall. Demand is -- at least in the last couple of months, it's been somewhat stable, so that -- so it's not bad per se, but slightly lower than expected, if I can put it that way.

Amit Mantri: Okay. And in terms of asset quality, are you seeing any deterioration in early indicators in specific geographies?

Aalok Patel: I -- again, it's too early to tell at this point. Yes, there has been some pressure, especially there's been a lot of coverage on the small ticket side, the retail loans. There is a few basis points of collection efficiency drop, which you will be able to see in the converts for us as well. But it's too early to tell whether this is just random fluctuation or whether this is an early indication or anything like that.

Amit Mantri: Okay. But even if this a few basis points drop that has happened, that's well within the model of what is required for the business to absorb, right?

Aalok Patel: Yes, yes, of course. I mean our long-term expectation is about a 3%. So we are nowhere close to that. In a sense, it would make sense if it slightly increased in the next couple of quarters or so. I mean the fingers are crossed that it doesn't, but I really won't be surprised. And I'm not just saying this today, I've always said it that microfinance is no longer the 1% or the 2% kind of loan lost business. So let's see how things progress.

Amit Mantri: Okay. And final question, now most of the rate increases that have happened post the RBI new regulations, that has been pretty much passed through the entire book, right? So now I think majority of -- 90% of the book would probably be at the higher rates post March 2022?

Aalok Patel: Yes. Vivek?

Vivek Modi: I mean, 85% or 90%, I mean slightly anybody's guess kind of a thing. But yes, largely, majority would have in the post...

Aalok Patel: Yes, so it's been about 1.5 years. So whatever residual portfolio we will be having will be probably 10%, 15%, not more. Exact numbers, we cannot be sure..

Moderator: Thank you. The next question is from the line of Ayush Agarwal from Mittal Analytics. Please go ahead.

Ayush Agarwal: Sir, I just have one question. And firstly, congratulations on a good set of numbers. Sir, I want to understand more about the MSME business. And what are our plans here to scale up? And what kind of approach do we have in the MSME business? Is it juster based? Or how are you targeting the new customer space? We don't have any -- mostly it is in-house sourcing, all of it is in-house sourcing. So if you can talk a little bit about the strategy on the MSME side that will be great.

Aalok Patel: Yes. So the primary strategic purpose of MSME when we opened it in 2017 was that microfinance was basically there to increase household income. I mean we were serving exclusively women. And the idea was that if you give them a cattle or the money to buy a cattle or a tailor machine or whatever it may be that they can supplement the household income. But what we found was in the rural area, of course, there were lot of people who are engaged in these small kind of micro enterprises, the small or the kiranas or the dhabawalas or the tire shop owners or the marketplace kind of people sitting there.

And so the idea was that can we instead of relying on JLG model, can we service these customers. That was the -- essentially what we were trying to do. And so the strategy was just that is that to service the customers who are 1 step or 2 steps above the JLG bottom of the pyramid. And as you said correctly, it is all self-sourced.

As far as the growth and everything is concerned, we are on track. It's just that it takes time to find that specific kind of customer and the rejection rates are very high in this business. They are 70% plus is what our rejection rate stands at right now. So you cannot expect a very, very quick growth that people are kind of used to seeing in microfinance. The ticket sizes are slightly larger. It's an individual unsecured loan.

And so the growth is probably in line with microfinance, even with a smaller asset base. But the thought process is that as microfinance matures and the penetration continues to increase, over the long run, our expectation is that these individual-type micro products will start gaining more popularity and traction in comparison to the JLG type model. And so we are a sort of future proofing in that way as well.

Along with that is, of course, it's a fantastic product with good margins, high safety. We've been improved a couple of -- or at least one large credit cycle, which we had during COVID, where it has performed very well all said and done. And so our confidence has increased quite a bit. And we'll see how best we can scale it up in the coming quarters and years.

Ayush Agarwal: So that's a very detailed answer. But just one follow-up on that. What we also see in the Northern and Western region, in fact, there are -- these dairy farmers who have more than 4, 5 cattle, let's say, and they want a larger ticket price now. So do you also see a shift from the existing MFI loans mostly from the dairy portfolio that we have who have a larger farm shed and want to avail these loans, do you see a trend there as well?

Aalok Patel: So that is -- so I think that's very astute, and that's a lot of insight. In fact, that is our largest customer base are the large cattle owners who -- our sick of borrowing from 3 or 4 JLGs and things like that, and they want to just get individual loans. So yes, absolutely, you are correct, that is also a large part of the market that we are seeing in certain geographies like the milk belt of Gujarat, Sabarkatha, Banaskatha, Aravalli, Panchmahal, Dahod areas, those areas, yes, absolutely.

Moderator: The next question is from the line of Prachi Sharma from Ace Capital.

Prachi Sharma: I just have a couple of questions. I'll just shoot them all together, if that's okay?

Aalok Patel: That's fine, as long as I can remember it. Please go ahead.

Prachi Sharma: No problem. Okay. Can you just throw some light on the Two-Wheeler financial business like I just need an outlook on the same. And similarly, I want to know if like since the yield as in -- is 26.2% when the NIM is 14% now. So what is the outlook on that?

Aalok Patel: So in the 2 -- see, specifically on the Two-Wheeler space, the Two-Wheeler market has been somewhat in the doldrums since 2019. If you look at the overall sales, the Two-Wheeler sales in India, which were somewhere around 22 million and around 2019, if I remember correctly. Now I think last year, it was closer to 12 million or something like that or 13 million. So overall, the market has shrunk quite a bit. And simultaneous, the competition has also increased.

And credit quality is somewhat poor -- at least people are -- be competing on underwriting standards. I'm not exactly sure. And so we are sitting -- waiting and watching, right? So certainly, that has been -- Two-Wheeler has been our bread and butter for quite a long time. I mean, before we started microfinance from about '98 to about 2010, that was our primary business for a long time. So we know what we are doing, and there is a lot of competition right now in the field, and the sales are quite low. I think even in the festive season, the dealers were not very, very happy.

So I don't know much about -- I don't think we are going to see much of a difference this year, but let's see things improve there. Of course, electric vehicles are starting to penetrate. And I do see that there might be an opportunity there in the coming years as far as Two-Wheeler financing is concerned. So I don't have -- I don't know if Jayendrabhai wants to add something to that.

Jayendra Patel: All I can say that the electric vehicles -- there are about 3, 4 different reasons why the Two-Wheeler industry is in a shape that it is in. First of all, the price of the vehicle has drastically gone up is number one. Number two, insurance, now the RTO is asking for 2 years insurance. Another reason is post-COVID, lots of schools and colleges were closed. And hence, it has affected the business because parents are not -- or they were not buying the vehicles for their children. Number four, probably is the electric vehicle is a brand-new technology. And the technology is moving so fast that people are still waiting for the technology to stabilize.

The issue is that today, you can buy a vehicle. And I'll just give you an example. Today, you can buy a vehicle, which can give you 160 kilometers on one charge. Tomorrow, 6 months down the road, you might have some vehicle, which is giving you 250 kilometers per charge. So the technology -- until the technology stabilizes, people are reluctant to buy.

Another thing is a charging issue that people are -- where to charge the vehicle, is another thing that you might have seen in the day before yesterday's newspaper that the government is thinking about -- is thinking of removing the subsidiary on the electric vehicles, especially the Two-Wheeler.

So these are all the reasons why -- and the manufacturers are also appointing dealers left and right, and hence, the competition for each dealer is without the volume, it's increasing so much. So these -- all these factors are contributing to affect that the industry is slowing down. Let us see what happens, and we keep our fingers crossed. That's all.

Aalok Patel: What was your second question?

Prachi Sharma: Understood, sir. Sir, the next question, should I repeat that question?

Aalok Patel: Yes, I told you all it's...

Prachi Sharma: No problem. No problem. I just wanted like an outlook on, say, the yield today is 26.2% and the NIM is 14%. So I just wanted some outlook on the same.

Aalok Patel: No. So see, our yields are pretty stable right now, as I mentioned to the first question from Amit that most of the portfolio now is as per the new yields, and we have not really increased the interest rates. I don't think there is a lot of scope to increase the rates any further. Probably more of us likelihood that it might decrease in the future. So I would say that the yields are probably stable or as high as that they're going to get at this point. .

In terms of the NIMs, again, we are -- it's very good NIMs right now. I don't think anybody can argue that at this point. We have the benefit of having high interests, low operating cost, and I guess, cost of borrowing is slightly higher. So should that decrease in the future, maybe we can squeeze out some more NIM. But the credit costs are also low.

To have a situation where your opex low, your credit cost is low and your interests are somewhat high, and so therefore, you are getting good NIMs. There's only one in that equation that we can reduce further is the cost of borrowing. The market rates are quite at this point. But I don't think that it's probably going to be stable or maybe marginally lower in the future.

Prachi Sharma: I just have one last question pertaining to the individual business loans, which at the moment, I think, is around 2% of our AUM. So I just wanted to know, say, an outlook on these loan product?

Aalok Patel: Yes. So this is slightly different than MSME. A lot of the things which we do might be similar. But essentially, we are graduating the microfinance customers who have been with us for multiple cycles into individual cashless growth, right? Or -- so what that means is that if a customer's been with us for, let's say, 3 cycles, and they don't want to do the group liability anymore, and they wanted individual loan and they have matured enough, we'll graduate them to sort of a higher ticket individual loan under the condition that it has to be all -- all has to be licensed.

So we are planting seeds for the future. As I told earlier that JLG, we have good 2, 3 years, 4 years left in JLG, but we are thinking that what's next. And I think the next trend is going to be individual loans. Second thing is just going to be the collection, the door step collections will have to sort of reduce. And for that, we'll have to move towards the cashless collection. So we are experimenting.

Moderator: The next question is from the line of Parth Vasani from KK Advisors.

Parth Vasani: I just wanted to understand, is there any -- I mean, are there any background or challenges that we are facing in collections due to upcoming elections in Madhya Pradesh and Rajasthan?

Aalok Patel: No. I mean, none that have reached my table or anything like that. In the Indian context, there's always going to be some election somewhere or some flood or famine or drought or something on there our operations are pretty wide at this point, and we are quite used to dealing with elections.

So I don't foresee any issues. And so far, there have not been any issues that have come to my notice. But of course, it makes sense to be vigilant during the -- especially when the -- when you get to a point that's very close to the election, especially about things like cash carrying and disbursements, is it going to the right places and things of that sort. So -- but we have procedures in place for that. And I don't foresee any problems there.

Moderator: The next question is from the line of Mr. Mayank Mistry. Please go ahead sir.

Mayank Mistry: I wanted to ask on the asset quality. So basically, you can see on the Slide #32, our Stage 3 has shown a little rise as compared to March '23, right? And it has been -- I think it has gone up marginally even in this quarter as against Q1. So if you could some -- just throw some light on where is this more concentrated from? Is it concentrated to some geographies where there are some delinquencies? And secondly, if you could throw some light on the collection, what are we doing towards collections sir?

Aalok Patel: What slide? Slide 32, you said?

Mayank Mistry: Yes.

Aalok Patel: Okay. And you are saying what has increased? The...

Mayank Mistry: Par 31 to 90, if you could see, our par 31 to 90 has increased to 4.6% for Two-Wheelers and other segments are also marginally up.

Aalok Patel: Correct.

Mayank Mistry: Yes. So any specific reasons or -- I mean is it due to seasonality? Or what is the factor that is driving this?

Aalok Patel: So as I said, I think one other caller also was asking about disbursement and collection. And I think very openly, there has been some pressure. See, as far as Two-Wheeler is concerned, that is pretty much with the market right now. And underwriting standards have gone down quite a bit, and there is a lot of pressure there. So yes, I mean, definitely the Two-Wheeler has somewhat deteriorated. I mean it had improved from last year to -- by March '23, and now it seems to be going back a bit.

As far as MSME and micro, and it seems like they are trending kind of very similarly. Overall, yes, there has been some pressure, and that pressure is across the board. So I cannot say that it is only in certain geographies or something like that. Some places might be slightly more than others. So Bihar and UP are slightly lower. Maharashtra and MP are slightly higher. But nobody is really immune to it, right?

So overall, I don't know there is mix. So if you're going to ask me the reason, I don't know. We are looking into it. And -- but there is no one good reason for it. And you are seeing it across the board like that. Clearly, it is more of macroeconomics than any one particular thing.

Vivek Modi: And if I can add to that, largely part, it still kind of does not raise any -- very strong alarms for us because currently, we are expecting it, especially in the unsecured segment, the NCLs to be over a period of time, upwards of 2%. So we did definitely fell down during COVID and after kind of COVID 12 months, but it is well within our range of expectations as we've been kind of regularly talking about.

Aalok Patel: So you can say it's still below it. I mean it's still lesser than our overall expectations, which is good. Another reason could be that just the penetration is increasing, right? So as the overall industry AUM increases, obviously, the indebtedness on a per client basis will also increase that could be putting some pressure, which you are seeing signs of. Again, I would have -- we are looking into it, obviously, keeping a close watch on it but cannot pinpoint any good reason right now.

Mayank Mistry: And anyway, sir, this Two-Wheeler only accounts for 3% of the book so far. But are there any shift that you are seeing in the AUM going forward from -- between the segments?

Aalok Patel: No. I think they will continue to remain -- in the short term, probably remain pretty stable in the mix. In the long run, probably the individual loans might have more weightage. Maybe in 3 to 5 years, about 1/3, 2/3 kind of a thing. But in the short term, about -- we don't expect the mix to change substantially.

Moderator: The next question is from the line of Mr. Raj Shah from Statheros LLP. Please go ahead.

Raj Shah: Yes. So (voice is inaudible) our company as well in terms of AUM and disbursement growth?

Aalok Patel: This is really strange, but I missed most of your question. Since it was -- anyway, I think the phone reception is a problem. Can we move to the next caller if any. He can try again.

Moderator: Mr. Shah, if you can repeat your question once again.

Aalok Patel: Yes. You're dropping in and out there. Operator, please let us move to the next question, if any. If no more questions, operator, I think we can conclude.

Moderator: We have one question, sir. So the next question is from the line of Mr. Raghav Garg from AMBIT Capital.

Raghav Garg: I think you may have already answered this question, but apologies I joined the call very late. I just wanted to ask why the gross NPAs have increased in Two-Wheeler and the MSME segment?

Aalok Patel: Yes. So I think that was the last question. But yes, I don't have a good answer for that. It is across the -- really across all geographies. Two-Wheeler is a small portion of the book at this point, but -- so let's maybe putting aside Two-Wheeler for a second. But MSME and microfinance have seen maybe a 20 bps kind of a jump in the 30 to 90 buckets, and a very marginal kind of -- flattish to marginal in the GNPAs overall. But I don't know. I mean, I think this is clearly something that all small ticket size retail loans seems to be facing at this point across the board and...

Raghav Garg: Sir, would your customers in these 2 segments, were they existing MFI customers to you or to say, another MFI?

Aalok Patel: So it depends. I mean some of them about 20% to 25%, 30%, depending on what months are, you need to meet at the time of disbursement. Others have borrowed from other MFIs as well in the MFI segment. In MSME also, there could be some level of overlap because remember, MSME is basically somewhere in between mainstream and micro. So you're going to see overlap on both sides. They might have bank borrowings and they might have micro borrowings as well, especially their spouses in case you're lending to a male. But yes, it's --I don't know if that answers your question.

Raghav Garg: Sir, so just specific to your own company, would you say that this increase in both of these segments or either of them has come from the same customers who probably have an MFI loan from you or...

Aalok Patel: No. So there is no overlap in our own customers. What that means is that -- so are you talking about like cross-selling that...

Raghav Garg: Yes.

Aalok Patel: Microfinance loan and MSME both.

Raghav Garg: Or the other way that I wanted to understand is that if the NPAs in MSME are increasing today, were these customers at some point in time MFI customers to you? Because they wanted a...

Aalok Patel: No. There was very little overlap.

Raghav Garg: Okay.

Aalok Patel: No. I mean these are some -- we are targeting a different subset only. So in ideal that might be the case. But in any case, we only do one loan per customer. So we don't try to really cross-sell. Unsecured cross-selling, I don't know like, mean because that's -- you can do it if you are doing like, let's say, consumer durables and stuff, right?

Or otherwise, most customers want as much money as they can get. So after they go through our underwriting process, they get whatever they're assessed at. So if unsecured loan rate, that doesn't make a lot of sense to -- at least for me, a lot of people do it. I'm not going to say that they're right or wrong, but...

Raghav Garg: And sir, any geographical color to this increase in stress? Is it coming from a specific states or a couple of states? Or how would -- how are you looking at it?

Aalok Patel: No, it's across the board. Certain states are higher than others, like Maharashtra and MP are higher. Bihar and UP are lower. Rajasthan, Gujarat and others are somewhat average, but it’s across the board.

Moderator: As there are no further questions, I would now like to hand the conference over to Mr. 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 to host the call.

Aalok Patel: Thank you so much.

Vivek Modi: Thank you.

Jayendra Patel: Thank you.

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