"Arman Financial Services Limited Q1 FY2024 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Q1 FY2024 Earnings Conference Call of Arman Financial Services Limited 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Akshay Jain from JM Financial. Thank you and over to you.

Akshay Jain: Thank you Yuvasri. Good afternoon everyone and welcome to the Q1 FY2024 earnings conference call of Arman Financial Services. First of all, I would like to thank the management of Arman Financial Services for giving us this opportunity to host this call. From the management team, we have Mr. Jayendra Patel, Vice Chairman and Managing Director, 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 can open the floor for Q&A. Thank you. Over to you Sir!

Alok Patel: Thank you Akshay and welcome everybody. On behalf of Arman Financial Services, I extend a warm welcome to our Q1 FY2024 earnings conference call. With me on the call, we have Mr. Vivek Modi, Group CFO and representatives from the investor relations team. I hope everyone has had an opportunity to go through the results, press release and presentation for the quarter ended June 30, 2023 uploaded both on the stock exchanges and the company's website.

Over the past decade, the microfinance industry has experienced noteworthy expansion and changes across dimensions including consumer engagement, technological integrations and regulatory frameworks. Serving as a catalyst for advancing financial inclusivity objectives, this sector has taken on a pivotal role and extend in financial services to the underserved or unserved low income class in India as well as extending microcredit support to small and medium size enterprises all while aiming to foster economic and social progress within the nation.

During FY2023, the microfinance industry has demonstrated remarkable resilience and determination despite global and economic challenges. This indicates complete rebound from the challenges posed by the COVID pandemic with substantial growth of the industry and positive first quarter, it highlights the path of progress supported by well established regulatory standards that foster a fair and balanced competitive landscape. As on June 30, 2023, the assets under management of the company stood at Rs.2143 Crores resulting in a growth of 54.5% year-on-year and 10.3% quarter-on-quarter.

Of this book of Rs.2143 Crores, our microfinance business continues about 84%, MSME about 13% and two-wheeler about 3%. Interestingly, it took us 30 years to achieve an AUM of Rs.1000 Crores, but remarkably we managed to double our portfolio to Rs.2000 Crores in just 18 months. As we often emphasize, we have fairly well navigating through the different kinds of crisis and emerged with increased strength and resilience. Our disbursement grew by 41.6% year-on-year to Rs.537 Crores. This expansion can be attributed to positive credit cycles, favourable regulatory policies and our geographical expansions that we did in the first quarter and also the last quarter of previous year.

Last year, we ventured into untapped geographies of Bihar and Haryana both of which yielded positive outcomes. Building upon this, we are also now expanding into Jharkhand for the MFI division and Telangana for MSME division. In addition to this, we have also inaugurated a new zonal office for North India which will be located in Uttar Pradesh, in Lucknow. In the quarter, we opened seven new branches bringing the total branch count to 343 with workforce of about 2900 employees and customer base of almost 7 lakhs across 10 states. We had dedicated to further expanding our presence within these new states and plan to open several new branches before this fiscal year ends. In continuation with our branch expansion, we are committed to the ongoing technological investments through digitization, automation and process enhancements.

Last year we integrated new LOS and LMS system and also transitioned to fully paperless operations and this has improved our efficiencies and also more importantly enhanced our customer experience. We are also graduating MFI customers to cashless e-NACH collections in the new IBL segment. We will be rolling out Aadhaar-based digital signatures for all our customers in the coming to next quarter. We are positive that these efforts will make our company poised for the next stage has strong growth. In terms of asset quality, our gross non-performing assets demonstrated a notable decline of 115-basis points year-on-year and a contraction of 26-basis points sequentially and stood at about 2.5%.

Simultaneously, net non-performing assets stood at 0.14% or 14-basis points as on Q1 FY2024 signifying 20-basis points year-over-year decline. As of June 30, our collection efficiency reached about 98%. This diligent collection endeavor of our team coupled with rigorous underwriting procedures and advance technology are collectively contributing to enhancing our loan portfolio quality nearly restoring it to levels almost comparable to pre-COVID period. Collection efficiency for our microfinance business stood at 98.2%, MSME at 98.1% and for two wheelers stood at 96.6%.

For the quarter cumulative provisions stood at Rs.72 Crores, which is about 3.4% of the total book. Of these provisions, for Arman stood at Rs.15.5 Crores and Namra stood at Rs.56.5 Crores. We also have management overlay of around Rs.28 Crores included in our cumulative provisions which is over and above any regulatory or ECL required provisions. Of this overlay Rs.7.7 Crores is for Arman and Rs.19.9 Crores is for Namra.

Coming to our borrowing profile, our total borrowing for June 30, stood at Rs.2161 Crores including the debt component of OCRPS and CCDs of Rs.48 Crores as per IND-AS guidelines. The debt to equity ratio stood at 3.4x. The company has successfully been diversifying its funding sources. Last year the company raised about Rs.45 Crores through marked linked debentures and during the quarter raised another Rs.49 Crores through listed non-convertible debentures.

Of the total borrowings, about 33% was through banks, 19% through NBFCs, 13% was through NCDs, 11% was through PTCs, 19% was through direct assignments and the rest was borrowed from DFIs like NABARD & SIDBI. On the liquidity front, the company has a healthy liquidity position of Rs.294 Crores, nearly Rs.300 Crores in the cash or bank balance, liquid investments and undrawn CC limits. Additionally, the company has another Rs.42 Crores of undrawn sanctions from existing lenders.

As on June 30, 2023, the company is well capitalized with the capital adequacy ratio for the standalone business at 31.64% and for the subsidiary Namra at 26.32%. After successfully raising equity funding last year, we are confident that these resource will play a pivotal role in achieving our targeted growth in the coming quarter.

Now throwing highlights on the key consolidated financial numbers for Q1 FY2024, the gross total income stood at Rs.149 Crores registering a growth of 89% year-on-year and the net total income stood at Rs.85 Crores in the back of AUM expansion and improvement in yields.

The NIMs for Q1 FY2024 stood at 13.4%. Profit after tax grew at 154% year-on-year to Rs.40 Crores, this was again given on account of improved interest income optimization of operational cost and of course lower provisioning requirements and improved asset qualities. Cost to income for the quarter stood at 26% as compared to 37% over the same period last year. Yields for the quarter stood at 25.9% registering a growth of about 170-bps over the same period last year. As on June 30, 2023 annualized return on average AUM stood at 7.8% and return on equity stood at approximately 37%. To summarize, we are positive that the current credit cycle and regulatory environment is favourable to the industry and the company and this growth momentum will continue. Our strategic emphasis remains on the technological advances and expansion of our branch network to drive the next phase growth. With this, I would request the operator to open the floor for any questions that anybody may have. Thank you so much for your kind attention and we can open the call for Q&A.

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

Amit Mantri: First of all, congratulations to the entire team on a great quarter. My question is Q1 tends to be seasonally weak quarter in the MFI business, yet Arman had a very good performance in terms of even sequential growth, so what is driving this strong growth that we are seeing even in an otherwise weak quarter?

Alok J Patel: As far as the profits and stuff are concerned that is in line with lot of the business you have done in previous quarters very rarely does impact specifically whatever disbursements we do in any single quarter, largely the income that we earn will be in the following seven or eight quarters. So as far as disbursement of course we had small decline from Q4 to Q1 if you consider that and that is for couple of reasons as you said that historically of course Q1 is slightly slower, demand is slightly slower of course on top of that you are doing a lot of housekeeping items, lot of transfers, lot of new branches, lot of system changes and other aspects, but largely also the impact this quarter on the disbursement was due to the fact that renewals were much, much lower and there is very good reason for that, so during the second wave of COVID which was in March of 2021, so stopped disbursements in March, April and partially May and so the renewal that you would expect as loans and then people come in for fresh disbursements those were largely absent during the last quarter. So, of course that would also have an impact in the total disbursements.

Amit Mantri: Okay and in terms of the geographic expansion into newer states and now you are already fairly diversified for the current AUM that you have, so now would the focus be on just increasing presence in the states that you are present in or would you still continue to enter new states in the next one, two years?

Alok J Patel: The plan is to continue both expanding in existing states and also consistently valuating when it is a right time to jump into new state right, because specifically microfinance, now we are reaching the stage where you can visualize that in four, five years the growth might be tapering off and the penetration levels will increase, so I think it is important to strategically kind of plant seeds before it becomes very difficult to enter into new areas, it is probably a good idea wherever you can expand into, you do make that call for the long run and go into, so that being said, we are usually very, very careful about where we are going to. Usually there are large discussions and lot of analysis and data and visits that we do. It is not that we only go any place on the wish, these things are very sort of well planned before we do it and lot of discussions happen around it. So, I think to answer your question in short it will be a combination of both.

Amit Mantri: Okay and third a data question so of the disbursements that have happened post the second wave what has been the collection efficiency on them like you mentioned from say May

2021 onwards post that the disbursals that have happened which are roughly around Rs.2000 Crores plus so what has been the collection efficiency on that?

Alok J Patel: About 98%. Essentially most of the book which you are seeing has been generated post COVID only.

Vivek Modi: In fact Amit if we kind of split the pre-COVID into two slices, first is the pre-COVID before March 2020. There is nothing that is left from March 2020 when it comes to microfinance in particular and between kind of first wave to second wave the overall microfinance portfolio because again microfinance portfolio is typically a 24 month cycle portfolio. What you have outstanding is less than 1% or 1.5% of the entire AUM of microfinance.

Amit Mantri: Okay got it. Thanks. Thank you very much and good luck for the future.

Moderator: Thank you. We have our next question from the line of Akash Mehta from Capaz Investments. Please go ahead.

Akash Mehta: Thank you for the opportunity. I had two questions on individual business loans so we have seen a lot of traction coming in this so in coming quarters how much contribution will this make in our AUM?

Alok J Patel: I think to answer your question it is about 2% of the microfinance book at the moment. So largely on our Rs.2000 odd Crores book presently it is about Rs.40 Crores to Rs.50 Crores so it is not a very, very large book. The idea here is we are basically getting future ready so what I mean by that is that overall the prediction is that as microfinance progresses, strategically it will shift from more on a group based loans to individual based loans and in that case you will have to rely more on cashless collections versus the doorstep collections that we do right now. While it is of strategic importance for us right now it is not of business importance for us. The answer is that going forward in the next four or five years or so, I think if my prediction is true, it will be a very large portion of the book. If not anyway, we are just being future ready at this point.

Akash Mehta: Got it Sir and just on the same front, what would be the average ticket size and what are the kinds of yields you will be charging?

Alok J Patel: So the yield is very similar to microfinance right now. So it is about 27% and the ticket sizes range anywhere from I believe 65%, right now on average it is about 75%. We are going up to 75% but there is a desire to increase that as time goes on and as the experiments goes on.

Akash Mehta: Okay Sir that helps. Thank you.

Moderator: Thank you. We have our next question from the line of Rohit Mehra from SK Securities. Please go ahead.

Rohit Mehra: Thanks for the opportunity. So my first question is, we have expanded in the new states, so how is the response from Jharkhand and Telangana and also how is Bihar performing? What kind of book contribution do we expect in near term?

Alok J Patel: Yes. So I mean, we have just moved into Jharkhand and Telangana. It is too early to tell to be honest with you. I think in the MSME in Telangana we have only made last month, I think 12 or so disbursement if I am not mistaken and in Jharkhand I do not think we have made any disbursements.

Jayendra Patel: Last quarter we have not.

Alok J Patel: Last quarter we have not. July we stated doing it. So it is a little too early to tell to be honest. The ones that we went into before that which is Bihar and Haryana, so Bihar has been performing extremely well and Bihar today now stands at the largest concentration of microfinance in India at this point, so earlier it was Tamil Nadu. Now it is Bihar, so Bihar has overtaken Tamil Nadu and frankly by the numbers it is one of the best places in India to do microfinance I mean going by both demon and COVID and post COVID the asset quality is phenomenal, but we are anytime something is too good to be true you always want to make sure that you pay more closer attention to it and so that is what we are doing right now and while it is possible to open a lot more branches in Bihar, we are kind of waiting and watching at this stage. I know it sounds kind of like I do not have confidence on Bihar and that is not true at all. Just what I am trying to say is that Bihar as a market has grown very quickly and very fast and so it is prudent for us to kind of just take a breather and wait to see what the reaction is going to be so that is Bihar. In terms of Haryana, it is kind of mixed results so the asset quality is good but the volume of business being generated through disbursement is not as high as we had anticipated, but it is what it is.

Rohit Mehra: Okay that is perfect. In the sense right with the current upcycle in a microfinance industry what kind of AUM growth do we target?

Alok J Patel: We do not give out targets except to say that we typically have a CAGR of about 35% to 40%. That will continue to be our long-term target for at least the next three or four years.

Rohit Mehra: Okay thank you. That is it from my side. Thank you.

Moderator: Thank you. We have our next question from the line of Yash Mandawewala from Mandawewala Family Office. Please go ahead.

Yash Mandawewala: Congratulations on a phenomenal quarter. Alok just a few questions from me so firstly one thing that I have noticed is that the average salary cost per employee for some of our peers the larger MFI and NBFC are significantly higher than us almost 50% to 60% more so can you elaborate on why this might be? Our field force employee salary is not competitive with the market or is there something else?

Alok J Patel: I do not think so that is the case. I do not know where you are getting the data on the average salaries.

Yash Mandawewala: Dividing the employee cost? You give the employee number and the employee cost as well and most of your peers do as well?

Alok J Patel: I do not know. I do not think that is the case. It might be some nuances with the numbers and the reporting and other things, but certainly there is not a 40%, 50% and 60% difference. There might be a 10% to 15% difference here and there from different companies, but I do not know. I would be curious to look at the numbers that you are looking at.

Yash Mandawewala: Sure but on the field force there is nothing sort of the salaries are not much different from the industry?

Alok J Patel: I mean so our overall salaries might appear lower but then for older employees we have a fairly generous ESOP program which creates a lot of wealth so I mean it is dollars and cents wise, I think a lot of employees have done much better at Arman than they would have at our peers if you count the complete package. I would say that we are probably right around average or maybe slightly below average of what we pay out but certainly I would not say that we are 50% to 60% below. I do not think that is quite possible.

Yash Mandawewala: Got it. May be we can connect offline and I can share the numbers from the deck and the other people and the other companies deck so we can have a conversation around that?

Alok J Patel: Sure.

Yash Mandawewala: Just another one, so on the board meeting this time there was a provision for a fundraiser as well so if possible can you give some more thoughts on that and when we will look at potentially raising these funds?

Alok J Patel: Yash this is something that we always do every year. Historically if you look at it, it will be the same that we always take enabling resolutions for both NCD raises and also for equity raises so specifically for QIPs only I have to do. For a private placement I think it is not possible to take enabling resolutions. You have to go reach out to the shareholders as and when the time comes, which is of course a very time consuming process. So the purpose of taking enabling resolutions is just essentially that if there is an opportunity usually those opportunities come and go quickly and it is convenient administratively at least to have those enabling resolutions and approvals in place. Now speaking specifically of your question about fund raising or equity fund raising, I mean we just raised as you are well aware, we have just raised about Rs.115 Crores about 11 months ago and we are at a debt equity about 3.7 or so give or take. So we do not exactly need equity at this point and of course we are adding a lot of internal accruals to our net worth, so as long as those accruals can keep up with our growth, we should be okay. Now the disclaimer here is that right now is a good time. If there is an opportunity available, I will probably consider it so I think I learned the hard way in my own experience about that equity is rarely available when you need it. It's only available when you do not need it. So that is the life lesson over there, so we will see but nothing at the current juncture and nothing on the table at this point.

Yash Mandawewala: It makes sense Alok and congrats again on a great quarter.

Moderator: Thank you. We will take our next question from the line of Amit Shah from Ace Investments. Please go ahead.

Amit Shah: Sir I have one question. Sir currently microfinance segment contributes a major chunk of the portfolio so do you have any plans to diversify the order book?

Alok J Patel: So I mean microfinance has become a large chunk as a function of its growth potential. So, I think people who know a bit of our history will know that for the longest time our bread and butter was two wheeler financing, which has now become about 3% to 4% of the book total. We do not have anything too crazy on the horizon right now. We would be considering products which kind of fit our overall rural strategy. So of course I know I have been talking about like stuff like microlap and stuff for a while. So that is something that we can go into and certainly there is a desire to do it if it is feasible. We have tried to do it in the rural in the past to be honest with you, but the paperwork has been challenging. Just it is availability to actually do a mortgage in the rural segment has been a challenging part of starting the business like that. So, let us see. I think as we go on and as microfinance expands what will happen is that the growth will start tapering off and the other businesses like MSME and individual loans will start growing. So in the long run, my guess is that the weightage which you will see in microfinance will naturally start trending downwards and be replaced by other higher growth businesses.

Amit Shah: Okay Sir thank you.

Moderator: Thank you. We have our next question from the line of Savi Jain from 2Point2 Capital Advisors LLP. Please go ahead.

Savi Jain: I do not know if I have missed that, but I just wanted to know about these senior management changes that you have announced, but if you can just tell me something about that?

Alok J Patel: So I mean, I think this was a while back, right, the Chief Operating Officer. The HR head is here only. So Ravi is still here. He is going to be here for a while now for at least the next six months, but he has expressed a desire to relocate to foreign country and so preparing for that. That is it so there is no resignation from Ravi at the moment.

Savi Jain: Okay and then I think there is some internal audit…

Alok J Patel: We have hired, so basically internal audit was a function of the CRO. It fell under the CRO. We have essentially split that now so CRO whenever, we do replace will be a separate function and audit will be separate so it will not fall. So this is the brand new position.

Savi Jain: These ESOP programs, these are aimed at still which level of employees the new programs that we have?

Alok J Patel: All employees that has been with us for over two years so about 700 plus employees would be eligible from anywhere from 40 shares to 4000 shares at the highest levels. The average would be about 300 shares.

Savi Jain: This includes branch level employees also?

Alok J Patel: Yes it includes field officers also. It includes office boys also.

Savi Jain: Great. Best of luck.

Moderator: Thank you. We have our next question from the line of Karan Mehra from Mehta Investments. Please go ahead.

Karan Mehra: Thank you for the opportunity. A couple of questions from my end. Can you help me with like how many customers are unique to Arman that is new to credit and Arman plus one lender?

Alok J Patel: Yes, so I mean I can tell you that at the time of disbursement about between 20 to 30, let us say about 20% or so, 20% to 25% are either unique to us on new to credit but of course, once you give the loan, I have no idea that who they may or may not borrow from. So I would not know on a portfolio level, but at least from a disbursement level, that is where it stands today, so let us call it about 20%.

Karan Mehra: Understood. One with regards to provisioning, so will we continue with the stringent provisioning policy and what are the total provisions that we have as of now?

Alok J Patel: Rs.73 Crores, 3.5% of the portfolio. This is what our current provisioning is, which is slightly more than we need from both an ECL and regulatory reasons. There is a management overlay on that, so there is a bit of a slush fund and I know people do like and appreciate creating provisions over and above. I know people do like creating provisions over and above what is statutorily or what the CAs kind of require us to do, but even I mean these are all from being an accountant myself when you run into trouble, it is not going to be any accounting accrual reserves that is going to come to your aid, right. It is going to be cash liquidity and it is going to be equity. So I mean to me, I am kind of neutral about creating provisions because, it is an accounting line but then so it is reserved in surplus. You can always use that tool against write offs. Of course the main benefit is that it smoothens out your P&L during crisis, but other than I do not think it helps you much besides that, but of course I am in the minority of this opinion, but will continue to create management overlay also.

Karan Mehra: Okay. Can you help me with the write off number that we took this quarter?

Alok J Patel: The write off.

Vivek Modi: The write off was approximately Rs.10 Crores.

Karan Mehra: Okay thank you and all the very best.

Moderator: Thank you. We have our next question from the line of Jigar Shah from AK Securities. Please go ahead.

Jigar Shah: Thank you Sir. Thank you for this opportunity. I have a couple of questions so what would be the average cost of borrowing for the quarter and in the MSME segment we are 36% plus? Are these sustainable in the medium term?

Alok J Patel: It is sustainable in the short term probably in the medium term as well. It is unlikely in the long term. As competition increases you should expect that to probably come down. With that being said with the few players that are operating in this segment and remember MSME is a very, very broad term. So even like certain loans that we take from PSU banks at Rs.50 Crores is also falling under SME or something so the range is like between Rs.50,000 to Rs.50 Crores people classified sometimes as MSME, but at the level that we are doing it our rates are not very, very different than a lot of our competitors are doing so I do not want you to get the idea that we are an outlier in terms of rates. That is probably around average so this is the kind of a high yield business and it is high yield because it is high opex business.

The operating costs are much, much higher in microfinance for example and you are doing doorstep collections on an individual level instead on a group level so that also increases your expenses. You are doing a much more stringent form of credit from a completely separate team that increases your cost. The type of people you have to hire is obviously a lot more qualified and theoretically although I have not experienced it but at least textbook wise it is slightly more risky also is at least what they claim. So the yields are basically a function of all of that. Number one low penetration and low competition. Number two it is a high opex and number three higher risk apparently, but theoretically.

Jigar Shah: Got it Sir. Thank you Sir. This helps and I just had another question like what would be the other cost of borrowing for the quarter?

Alok J Patel: All inclusive cost will be about 12.5%.

Vivek Modi: In fact this quarter is the larger part of about 70% borrowing was from PSU banks.

Alok J Patel: But the interest rates in the market have been going up. I am sure you are aware of that. What we could borrow at 22 versus what we can borrow at 23 even though our ratings are better overall cost in the market have gone up significantly for reasons that I am sure you guys know better than I do.

Jigar Shah: Got it Sir. Thank you so much.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I now hand the conference over to management for closing comments. Over to you Sir.

Alok J Patel: Well thank you so much. Thanks to everybody for joining. It is a good quarter. I think hopefully we can keep the run going and I thank everybody for their support and very insightful questions. Thank you so much.

Moderator: Thank you Sir. On behalf of JM Financial that concludes this conference. Thank you for joining us and you may not disconnect your line.