



ARMAN FINANCIAL SERVICES LTD.

“Arman Financial Services Limited Q3 FY18 Earnings Conference Call”

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**MANAGEMENT: MR. JAYENDRA PATEL - MD, ARMAN FINANCIAL
SERVICES LIMITED**

**MR. AALOK PATEL – ED, ARMAN FINANCIAL
SERVICES LIMITED**

MODERATOR: MR. DIGANT HARIA - ANTIQUE STOCK BROKING



Moderator: Ladies and gentlemen, good day and welcome to the Arman Financial Services Limited Q3 FY18 Earnings Conference Call hosted by Antique Stock Broking. We have with us today on the call from Arman Financial Mr. Jayendra Patel – MD and Mr. Aalok Patel – ED. 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 the 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. Digant Haria from Antique Stock Broking. Thank you and over to you, sir.

Digant Haria: Very good evening to all of you who have joined and good evening to the management also. It is a pretty busy evening there are more than 150 results more than 20 concall. So, I appreciate the time everyone has taken out for this one. Arman is reported all time high profits, probably it looks like demonetization is firmly behind. So, without wasting any further time I will hand it over to Aalok and Jayendra Bhai Patel for opening remarks after which we can do a question and answer session. So, over to you Aalok and Jayendra Bhai.

Jayendra Bhai Patel: Thank you Digant. Ladies and gentlemen, thanks for joining the concall for the third quarter of FY18 results. After the last 3 odd quarters of muted performance, thanks to the lingering effects of demonetization. We were quite pleased with the 3 months result announced last Friday. Overall, our hard work is starting to payoff and I can say with relief that the worst is behind us and the new challenge is to continue our growth trend in the most conservative way possible and break into new markets. That said let us spend the next one hour trying to answer your questions regarding the overall state of affairs of the company and the industry as a whole.

Starting with the profit and loss account, consolidated income from operations for the 3 months ended was 22.5 crores that is about twenty-two and half crores compared to 14.3 crores the same quarter the previous year, a 57% growth. Additionally, income from operations in the second quarter of fiscal 2018 was 17.7 crores. Therefore, there is a 27% increase from the previous quarter of the same year. Profit after tax is or PAT for the 3 months ended is 3.14 crores compare to 1.72 crores the same period last year an 83% increase year-on-year basis. I am pleased to report that there is the first time we have crossed 3 crores in PAT in any quarters. So this is the period, this is the record quarterly profit for Arman. Also for the first time we have crossed a ROE Return on Equity of 22% in any quarter on an annualized basis.

For the 9 months ended consolidated disbursement have reached 389 crores of which 282 crores is in microfinance, 71 crores in two-wheeler and 36 crores in our newly formed MSME division. In comparison, disbursement total 140 crores for the same 9 months ended the previous year. Let me repeat that we have reached 389 crores disbursement in this 9 months as compared to 140 crores in previous 9 months that means almost 180% growth. Assets under management, total 362 crores at the end of December of which about 240 crores were in microfinance, 89 crores in two-wheeler and 34 crores in MSME. Post demonetization we ended last years at an AUM of 192 crores in 9 months. We have shown an 89% growth in asset under management that is AUM.



I would like to stress that these growth is not a departure from our usual conservative nature. All of our conservative policy is remain intact including ticket sizes, rural lending, static centers EPC. We had spent the better part of our year to develop our infra-structure and branch network to be in a position to expand rapidly. Additionally, post demonetization there was a sort of competition vacuum in certain areas which we were well positioned to capture. Going forward we have almost finalized our fiscal 2019 business plan and we will be on track to touch 1,000 crores sometime in FY2020 with the diversified product mix and geographical spread. Portfolio quality remains excellent post demonetization in our microfinance division repayment rate of the post demonetization disbursement is almost 99.7% across India.

Net NPA in microfinance has gone below 1% which is at 0.87%. The net NPA levels in the two-wheeler portfolio remains almost consistent at 2.45 crores, we thankfully do not have any NPAs at the moment in our MSME division. On my part ladies and gentlemen, the future is looking bright in FY18-19 will be the great year going forward. With your blessings and good wishes I am sure we will continue to strive to our greater heights. I thank you all for accompany in this journey and supporting us during the hard days post demonetization. We hope for you continued support. Thank you and I would like to open the call for questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. We take the first question from the line of Rohan Mandora from Equirus Securities. Please go ahead.

Rohan Mandora: Sir, I would like to understand like what is the borrowing mix as on date and how do you plan to raise the incremental borrowings?

Jayendra Bhai Patel: So, we were making great headway post pre-demonetization of converting most of our reliance from financial institutions to banks. Now, post demonetization unfortunately we have taken half a step back not a full step back. So, about 60% of our borrowing is in the form of financial institutions and about 40% is coming from banks private or PSU. So, overall the scenario is that the interest rates have been going down across but before pre-demonetization we had managed to about get our overall borrowing mix to about 50-50. So, we have fallen about 10% behind but that is being said it is the banks are opening up now. Now that the impacts of demonetization have been fully accounted for in most MFIs books and people are back towards profitability the banks are opening up. So, I do not think it will be very long before we are back on track.

Rohan Mandora: And sir, what is your average yields on the two-wheeler and MSME portfolio and what is our incremental cost of borrowing right now?

Jayendra Bhai Patel: Average yield on our two-wheeler portfolio is between 21% and 24%. Average you can consider about 22.5 and in the micro finance book it is about between 24% and 24.5% plus 1% processing fee.

Aalok Patel: On the MSME, we are doing between 28% and 30%.

Rohan Mandora: And sir incremental cost of borrowing?



- Aalok Patel:** Incremental cost of borrowing it depends so from a financial institutions we are getting at about 12.5% to 13% plus whatever other additional cost. From the banks it is coming in at about 11% right now plus whatever processing fee and other cost.
- Rohan Mandora:** And sir if I heard it right in the opening remarks it was mentioned that in calendar year 2020 you are targeting 1,000 crores of AUM?
- Aalok Patel:** Correct.
- Rohan Mandora:** So, how would be the mix of growth like among the 3 divisions?
- Aalok Patel:** So, right now about two thirds of our portfolio is in microfinance and one third is in micro and MSME. Going forward I would like to keep micro at about 50% or lower that is the wish but definitely under 60%.
- Rohan Mandora:** And between the other 2 like MSME would be the faster growing piece.
- Aalok Patel:** , so my guess is that about two-wheeler and MSME will be about the same in the about 6 to 9 months as far as portfolio and we had also working on right now expanding the MSME division to include lap loan as well. So, right now we are doing about 50,000 to 150,000 but these are unsecured. We can also do loans over 200,000 that will be on the lap side loan against property. So, will be starting a pilot on that in about March and hopefully we can see some more numbers coming out of our MSME branches with that.
- Rohan Mandora:** And any new states where we are planning to enter over the next one year?
- Aalok Patel:** Not at the moment. We are already did in Uttarakhand in small way that is part of our UP operations. We have about 2 or 3 branches in Uttarakhand, and Rajasthan we are planning to open another about 3 or 4 branches next year in our MP operations. But definitely we are starting to think about other states.
- Moderator:** Thank you. We will move on to the next that is from the line of Riddhesh Gandhi from Discovery Capital. Please go ahead.
- Riddhesh Gandhi:** Given your large increase in execute disbursement can you just highlight your risk management an underwriting processes and how you think about it?
- Aalok Patel:** Underwriting process you are talking about which division because that will be a very long answer otherwise.
- Riddhesh Gandhi:** Sure, look we are just likely new to the company, so would be great to get just an overview on each of the division, how you are thinking about risk management and how you are thinking about growth and expansion for each of the business lines?



- Aalok Patel:** I will give you a very quick 100 mile an hour answer because that is the whole subject all by itself. So, we have three divisions – our primary division is our MFI sector, which we are doing JLG lending that is group borrowing and we mostly concentrated on rural areas about 85% of that book is in the rural area and they are spread across in 4 states Gujarat, MP, UP and Maharashtra and our portfolio is at the end of December was about 240 crores-250 crores somewhere in between that. Then we have an old book which is in two-wheeler financing, we had a regional player in that operating in Gujarat. Our book size is about 90 crores in that and that is the dealer-based model where our sales associates sit in the dealerships and fund whatever customers that would want to come in and finance them. So, that is the mostly urban financing and it completely cash less, otherwise micro is the completely cash-based business and then somewhere in between we have an MSME which is an extension of microfinance. So, these are individual non-group loans unsecured but although we do take PDC and it is a cashless disbursement although we collect at the door step in cash and that is slightly covering people who are slightly larger than, so one step above the bottom of the pyramid. So, microfinance is bottom of the pyramid and we are covering couple of steps above that; people with well-established business although they are in the rural with lower paper work. So, that is but as far as the underwriting it is slightly a complicated process but at a very basic level it involves cash flow analysis, credit bureau cheques, field investigation those kinds of things.
- Riddhesh Gandhi:** And the individuals who are actually can disbursing and approving the loans are also responsible for the actual collections or you got independent teams that handle actual ...
- Aalok Patel:** So, we have a dual model, so the branches the first step of underwriting and then the final authorities at the head office but yes basically at least in the MSME and in the micro side the guy who does the sale is responsible for the collection. In the two-wheeler it does not work that way unfortunately. So, we have a separate collection team for that.
- Jayendra Patel:** Sir, you had any question you can always e-mail us and will try to answer it to you to your satisfaction.
- Moderator:** Thank you. The next is from the line of Sneha Ganatra from Subhkam Ventures. Please go ahead.
- Sneha Ganatra:** Any capital raising plan?
- Aalok Patel:** Yes, we are working on it right now. So, we have about enough capital to take us to about the first quarter of next year. So, yes, we are actively talking to couple of people at the moment but nothing that required any kind of disclosure at the moment but hopefully you should hear something soon.
- Sneha Ganatra:** My second question is on outlook on the growth side and ...
- Aalok Patel:** Outlook on the growth for next year?
- Sneha Ganatra:** Yes.



- Aalok Patel:** Yes, so historically we have been comfortable growing at about 40% to 60%. So, our target for next year will be about 60% to 65% growth on a consolidated basis. But some divisions might be a little faster than others like for example the MSME as a pretty low asset based. So, that should grow lot faster. On the other hand, two wheeler being limited by competition might be in around 15%, 15% to 20% ballpark area and micro we can target somewhere around 60%, 60% to 65%.
- Sneha Ganatra:** Any asset quality risk are we seeing in MSME and SME segment?
- Aalok Patel:** It is a little early we will have to wait for the entire cycle because this is sort of a newer product that we are doing that and doing it differently that lot of other people. Fortunately, so far we have not seen any asset quality issues but it is a little early to tell. Overall, we have accounted for about a 3% loan loss into the pricing. So, that been said we are covered in the event it does come but it is rather early to say until we get through entire one cycle.
- Sneha Ganatra:** And in the microfinance how much is your collection efficiency at 90 DPD, 30 DPD and 60 DPD also?
- Aalok Patel:** So, our overall repayment rate is about 99.7% of amount post demonetization. Our PAR 30 plus is about 2% at the moment, NPA which is 90 plus is I believe about 0.87 and PAR 60 plus will be about 1.35%.
- Sneha Ganatra:** And what is your medium-term outlook on your ROA and ROE would like to maintain?
- Aalok Patel:** ROA if you can target north of 4% that would be fantastic if you can do an ROE of 20% to 22% consistent with overall, I think that will be great. That being said we always target higher than that but about 20% to 22% ROE something that we should be happy with although there is no limit to that so let see.
- Moderator:** Thank you. The next question is from the line of Alok Shah from Centrum Broking. Please go ahead.
- Alok Shah:** I had a couple of questions across segments. One was in the microfinance side and I was looking at the way our presence has extended particularly in the last two quarters. What is our strategy in the UP market, it is kind of more than doubled in last 5 quarters. Is it kind of trying to play an area where not many people look to go into it? How are we looking at that market? One from as on date point of view and two is incrementally.
- Aalok Patel:** So, UP we were well positioned pre-demonetization. I think we entered the market in somewhere around July of 2016 and then in November is when demonetization hit. So, there was a little bit of vacuum created post-demonetization with the competition when they had reduced or stopped their disbursement so we were in a good position to kind of gain market share a little on the quicker side and I know lot of people fell into issues in UP, we did not experience any of that. We had a good team, we were in locations that were not very deeply impacted in the first place to begin with and we have some 28 branches right now. Overall, I do not think we are planning



to grow that market much faster than any other state at the moment, but the UP market is performing quite well for us and asset quality is also quite good. The market is behaving well, and we are well-diversified because we have good spreads. So, even within UP we have 2 separate divisions. We have, in Northern UP is there and then we have a Central to East UP as well around Lucknow area and in the Northern side we have Saharanpur and then areas in Uttarakhand as I mentioned earlier. So, our team is pretty good we have a good team there. People who have worked in the UP market for 15-20 years. So, other than that yes the UP market is being working out quite well for us.

Alok Shah: And what the AUM mix be more or less the same as the case in terms of branches or what proportion of our AUM would be from UP, the MFI AUM?

Aalok Patel: So, right now it is about 22% around, Gujarat is about 50% and then there is 20% each in MP and UP give or take a few percentage, about 10% in Maharashtra. I think we can push the UP to about 25% but as I said I do not have a plan right now to grow UP faster than any of the other states. We have given equal consideration for our projection for next year to all the states. Besides Gujarat where we want to sort of reduce our geographical dependence. So we will not be opening too many branches in Gujarat other than that we have given equal consideration to all 3 states but that being said once we start into execution let see how it turns out.

Alok Shah: On this line sir, as you grow bigger in terms of a scale and you talked about 1,000 crores as an overall AUM and maybe MFI which is closer to 70%-80%. Would we kind of try and deal ourselves by having in place something called as state wise zone exposure not more than x% something like ...

Aalok Patel: Unofficially those things are already there but you mean like on a board level or something that state exposure is not more than a certain percentage.

Alok Shah: Right, I mean also from the fact that some of the rating agencies at times end up taking things on a wrong sense that even if you do in great in certain markets but because your loan exposure in certain market is high we are not comfortable there.

Aalok Patel: I mean geographical diversification is one of our strategies in the first place. While we do not have a written policy on it just to give you an idea that about a year and a half ago or slightly more than that 80% of our portfolio was in the Gujarat market. We have already made considerable headway. We were a regional player trying to break out as a national player. So, we have made considerable headway already to reduce those kinds of geographical risk. But yes, as we grow larger, I am sure we will have to formalize some of these things and I am open to keeping a cap on state proportions.

Alok Shah: And maybe the last question from my end. On the MSME side you talked about our presence in 2 to 3 states, the Uttarakhand, Rajasthan, right? is that right or?

Aalok Patel: MSME?



- Alok Shah:** Yes, MSME?
- Aalok Patel:** No, we are right now mostly in Gujarat and we have about 2-3 branches in MP. So we are only in 2 states. What I said about Rajasthan and Uttarakhand was we kind of divide up the microfinance into state wise units. So, right now we have 4 units or divisions or whatever you want to call it, that is Gujarat, MP, UP and Maharashtra. Within the UP division they have cross the border in a bordering area and open 2-3 branches in Uttarakhand and in the similar fashion next year we are planning through our MP unit we can open up 2-3 branches in the bordering of Rajasthan, just to test the market. Then if Rajasthan turns out to be well, we can expand and then break that apart into a separate unit as well.
- Jayendra Bhai Patel:** But as one said Alok we should say that Rajasthan is on the horizon and do not be surprise in sometimes next year we might expand a little more in Rajasthan.
- Moderator:** Thank you. The next question is from the line of Amit Mantri from 2Point2 Capital. Please go ahead.
- Amit Mantri:** I wanted to understand what is the current leverage levels at a consolidated level?
- Aalok Patel:** Leverage, I think we are at about including sub debt about 6x, I believe.
- Amit Mantri:** This is significantly higher than your historical leverage levels. So does this worry you a bit?
- Aalok Patel:** It worries me until I raise capital but we are working on that. So, hopefully it happens sooner rather than later.
- Jayendra Bhai Patel:** You said that very right as this is not in the culture you are very observant, let me tell you that.
- Amit Mantri:** And last quarter there were several one-off expenses because of the growth and the closing cost of loans that we had on our books. In this quarter are there any one-off expenses or one-off income that we have had in our P&L?
- Aalok Patel:** No, I do think that there is anything really unusual this quarter. Definitely not on the income side. There were lot of expense and cost in the previous quarter this quarter we have not really opened up a lot of branches as well. So, lots of the branch opening expenses are also sort of limited. So, nothing really above the ordinary.
- Amit Mantri:** And can you just, we are now seeing that overall the MFI industry has recovered fairly, and everyone is again back to the growth path. In fact overall, I think MFI AUMs are now already higher than pre-demonetization level. So, how are you seeing the overall competitive intensity in the MFI business both in markets like Gujarat which is large part of your AUM and other newer markets like UP that you have entered?
- Aalok Patel:** I mean, competition has always existed for the last several years and while as I did say there was a little bit of vacuum when we restarted our disbursement now things are back on track. So, the



competition is there but there is enough room for everybody to operate. I think there are still a lot of areas which MFIs have not managed penetrating into and that was some there was a concern that was read it by RBI as well that about 80% of the concentration is in 20% of India's districts, so basically the 80-20 route. And RBI was basically trying to encourage spreading into the less penetrated districts of India. So, those come with a slightly higher operating cost, less density of population maybe a higher loan loss potential, all of those things are there, it just make sense everybody is going after low-hanging fruits at the moment. But I think there is enough opportunities now at least for the next 2-3 years I do not foresee too much of an issue on that side.

Amit Mantri:

And even on the MSME side while you do not have a seasoned portfolio about when we look at lot of others NBFC be it in the affordable housing space or others in the MSME business. They have now started to report some challenges in their book once they have become seasoned. Assuming that eventually even you will have some part of those challenges at least? So, what is the plan in countering and ensuring that when you are growing rapidly right now you do not fall into the same trap as everyone else of getting into asset quality troubles in the MSME space?

Aalok Patel:

So, yes in the MSME space I did hear that people are running into NPA issues. I think lot of those people concentrate on more of the urban side. I am targeting more of the rural and the thing which are not doing that as work so well in microfinance is that doorstep recovery. So, that is little bit expensive and it comes the margins are higher the operating cost is also much higher. But I think that is the sort of the secrets sauce that keeps the microfinance payments coming is that you do not lose the touch with the customer. Once you start going into that **(Inaudible)** 32.57 or ECS or PDC model, 12 months they pay but after that you sort of lose touch with the customer and you do not want to become a faceless corporation with them. You want a kind of maintain a touch and I think that will make a lot of difference but that means that it is a new market, so I am aware of the potential risk side and that is why we are not growing very aggressively either. We are taking our time assessing, making changes along the way, learning lessons if you make and I will be very honest if there was if I saw or we saw collectively that this was a very risky area definitely we will be planning to expand on it, I think we have gotten in and out of businesses throughout our long history, 3 wheeler being an example or even before that personal loans and things. So, whenever we think that an area is getting too risky or potentially very risky will be the first to get out. So, we have a pretty strong risk frame work around that. Yes, so exit is more important than entry. I think that is your motto or an equity investor's motto not ours but yes it works for us also.

Amit Mantri:

I hope you put the equity raise behind very soon?

Aalok Patel:

Yes, I hope so too.

Moderator:

Thank you. The next question is from the line of Pranav Singh, an Individual Investor. Please go ahead.



- Pranav Singh:** I wanted to ask this quarter we have not opened any branches, but we are now close to maximum disbursement in microfinance. So, are there any plans for opening new branches in FY19-20 could you get some....
- Aalok Patel:** Yes, we definitely are planning to open a few branches. So, what we did last year we opened up most of the branches in Q1 and a few in Q2 and Q3 and Q4 will be sort of lighter. But Q4 will start thinking about next year and putting up some branches in late this month early next month and the old cycle will start again. So, on the micro side may be about between, I do not know about 30 odd branches is what we are thinking of, but it is a little preliminary, so do not hold to be that. So, I mean we have not really finalize the business plan, so I do not think I can share too much with you over the phone. But as soon as we have the hard numbers will share with you later on.
- Pranav Singh:** And sir, if you could share what is the kind of quantum of equity rates that you are looking at if you have an idea in mind?
- Aalok Patel:** Honestly, I will not be able to comment on that. I do not know, it is a complicated question.
- Jayendra Bhai Patel:** We are tied up with the statutory requirements and the other things and there are certain things that we do not want to disclose that at this juncture which we are bound to do that. So, all I can say that is we are working on it, sir.
- Aalok Patel:** Yes, certainly we do not want to be raising equity every year or anything, so whatever we raise hopefully it sufficient for at least a couple of years.
- Pranav Singh:** I was trying to understand the provisioning requirements it appears and for example in microfinance we have 2 crores of gross NPAs but we have 2.5 crores of provisions for standard assets. So is it, would I be fair in saying that we do not have any net NPAs in microfinance business?
- Aalok Patel:** Yes, so how it works in microfinance is, it is controlled by RBI. So, RBI says you have to take, it is a formula, so you have to take the higher of two things is first thing is 50% of PAR 90 and 100% of PAR 180 or 1% of standard assets. So, whatever is higher is what you have to take. So, in our case the 1% of standard assets is higher than the other one. So, that is what we take on our books which is why the provisioning on standard assets is higher than the actual NPA.
- Pranav Singh:** And sir the last question on my side. I see from filing that now Param Capital has over 10% equity in the company, I was wondering if the management knows whether it is financial investments or do they have any strategic interest in the company?
- Aalok Patel:** You were wondering if the company knows what?
- Aalok Patel:** Param Capital.



- Pranav Singh:** Is this is only a financial investment, or do they have some strategic interest in the company or if you have any idea on?
- Aalok Patel:** No, it is simply a financial investment. In fact, Param was already had a stake in the company previously and they just wanted to increase that stake for financial reasons only. So, we are thankful for that support overall and I met with representatives of Param on couple of occasions previously unrelated to this topic and they are very nice and professional people. So, I do not think that I expect anything negative from that acquisition.
- Moderator:** Thank you. As there are no further questions, I now hand the conference over to Mr. Digant Haria for his closing comments.
- Digant Haria:** Thank you for joining this call and thanks Aalok and Jayendra Bhai Patel for taking this time out and answering all the queries patiently. Thanks everyone and have a great evening.
- Aalok Patel:** Thanks Digant. Thank you so much.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Antique Stock Broking, that concludes today's conference. Thank you for joining us and you may now disconnect your lines. Thank you.