"Northern Arc Capital Limited
Q4-FY2025 Earnings Conference Call"
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MODERATOR: **MR. KISHAN RUNGTA – EMKAY GLOBAL FINANCIAL SERVICES**

Moderator: Ladies and gentlemen, good day and welcome to the Q4 and FY '25 Earnings Conference Call of Northern Arc Capital Ltd. hosted by Emkay Global Financial Services Ltd. 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. Kishan Rungta from Emkay Global Financial Services. Thank you and over to you, sir.

Kishan Rungta: Thank you. Good morning, everyone. I would like to welcome you, welcome the management and thank them for this opportunity. We have with us today Mr. Ashish Mehrotra, MD and CEO, Mr. Atul Tibrewal, CFO, Mr. Pardhasaradhi Rallabandi, Group Risk Officer and Governance Head and Chetan Parmar, Head Investor Relations. I shall now hand over the call to the management for the opening remarks. Over to you, sir.

Ashish Mehrotra: Thank you Kishan. Good morning, everyone. Thank you for joining. My name is Ashish Mehrotra. I am going to talk about what we are seeing in terms of the performance and then pass it to my colleague Atul Tibrewal, who is the CFO, to take you through the numbers. So, as we begin, thank you for joining us today on our conference call to discuss Northern Arc Capital's performance for the fourth quarter and for the full year of financial year ending March 31st, 2025.

We are very pleased to report that FY '25 was a year of resilient and disciplined execution at Northern Arc Capital despite the operating challenges, macro headwinds and sectoral landscape. We delivered strong and stable performance, reinforcing the strength and agility of our diversified, adaptable business model.

The key highlights worth talking about are our Gross Transaction Value grew by about 23%, taking to an overall credit flow of INR 35,058 crores. Our assets under management grew by 16% on a balance sheet to about INR13,634 crores. Our revenue grew, that means including interest, income and fee, grew by 23% to INR2,071 crores. Our pre-profit before provision or PPoP rose by 46% to INR791 crores. Our operating ratios, like we spoke about earlier, improved by 39 basis points to about 3.64%.

While in the midst of all of this, our net profit remained flat year-on-year. This was primarily due to two exceptional items. One is a one-time provision of INR68 crores made in accordance with the regulatory guidelines on default loss guarantee. This is a conservative accounting-driven adjustment, does not reflect an actual loss in the portfolio and is more prudent to ensure that you have more provisioning as per the regulation.

The second is a management overlay of INR51 crores, taking the total management overlay on the ECL of INR60 crores, again a prudent step to reflect our continued commitment to maintaining resilient balance sheet and sound risk management principles and practices.

Excluding DLG-related provision, our net profit for the year would have been INR356 crores, representing 15% year-on-year growth. I think it's a strong testament to the strength and momentum of our underlying business model.

Our ability to navigate in the year FY '25 effectively was driven by a series of proactive and well-calibrated strategic actions, such as recalibration of our exposure to the microfinance sector, adopting a measured approach in growing our MSME business, especially on the smaller ticket, leveraging growth potential in our consumer finance. These steps, underpinned by robust risk management framework, enabled us to manage the sectoral shift dynamically while staying focused on sustainable high-quality growth.

Over the years, Northern Arc has consistently demonstrated resilient performance, navigating multiple external headwinds, including demonetization, IL&FS crisis, COVID pandemic 19 and recent challenge in the microfinance sector. Our ability to emerge stronger from each of these events reinforces our confidence in the strength of our diversified business model, underpinned by the foundation of a forward-looking strategy.

Throughout the year, we have received valuable feedback from each one of you and many people who may not be on the call, to seek a deeper understanding of a diversified business model. Today, I will take that opportunity to walk you through our approach and how does Northern Arc consistently deliver risk-adjusted better returns across the credit cycle.

At Northern Arc Capital, we are committed to addressing the diverse retail credit need of India's underserved households and businesses through following a two-pronged approach. One direct to customer lending business, a customer-centric philosophy combined with product and channel agnostic approach enables us to craft personalized financial solution that addresses the unique needs of a diverse customer base, including small businesses, individuals, rural households. To effectively serve this segment, we operate through a robust technology-driven platform and our own branch footprint of 360 branches, plus partnering with more than 50 retail lenders.

The second line of business is a credit solution business, what we call as an intermediate retail. We collaborate with 360 Financial Institution to provide comprehensive liability solution enhancing their capacity to meet the diverse credit need for their customers.

This hybrid model allows us to scale efficiently while maintaining superior risk-adjusted return even in the challenging environment.

Let me briefly talk about our direct to customer business and credit solution business with you. In a direct to customer business, our omnichannel approach across key focus sectors has been instrumental in expanding our direct to customer franchise from INR986 crores in March '21 to INR7,064 crores as of March '25, achieving compounded annual growth of about 64%.

This has led to a direct to customer segment share of 52% of assets under management, up from 19% in FY '21. This shift underscores our strategic focus on building a granular customer-centric portfolio reflecting our commitment to discipline and sustainable growth.

Direct to customer business essentially comply focuses on three primary sectors or three key segments. One is MSME. We operate in seven states with our 69 plus branches offering a secured small business loan product to predominantly self-employed customers. This business has grown at a CAGR of 35% from FY '21 to '25 to reach AUM of about INR 2,574 crores, underpinned by strong credit standards and prudent underwriting.

MSMEs are the backbone of Indian economy contributing approximately 30% of country's GDP employing over 110 million people. Despite the significant role, many MSME face this challenge in accessing the organized capital market which has led to an estimated trade gap of about INR28 lakh crores in the sector. We anticipate significant growth in MSME sector and are poised to become a key driver to Indian economy in the coming year and expect to grow our MSME lending business at an upward of 30%.

The second is consumer. Our India's evolving consumption pattern has led to heightened demand of credit prompting us to collaborate with multiple partners and to offer a tailor-made solution to the end customer. We serve these customers through multiple partners using the first loss default guarantee model which covers 5% of risk.

This book has grown multi-fold from FY '21 to '25 to INR3,390 crores and model is mature. We partnered with both financial institutions, non-financial institutions and other people to enable the convenience of financing for them to build a strong direct to customer business.

The third segment we focus on is rural. We have been operating in the rural segment for the past 15 years. We understand this business and have seen multiple cycles of stress. Following the recent stress on rural finance business on account of over leveraging, we have proactively reduced our assets and management by approximately 27% on a y-on-y basis bringing it down to about INR1,100 crores.

We believe the MFI sector will take a couple of quarters to stabilize. We stay sharply focused in ensuring better quality customer selection in this segment.

The consumer and rural segment remain pivotal to our growth strategy along with MSME. We continue to strategically dial up and dial on our exposure in these sectors based on prevailing opportunities and stress level we witness.

The second prong of what we spoke of is a credit solution business addressing the retail need through our intermediate partners. Beyond direct lending, we play a pivotal role as an ecosystem enabler of collaborating with over 350 plus financial institutions and over 1,300 investors to facilitate comprehensive financial solutions.

Our multifaceted approach encompasses our fund management business, i.e. performing credit business, which we have been running for 9 years. We have deployed over INR12,000 crores. We have successfully exited six funds, all on a compounding basis would have given a return of about 14.25% on our performing credit funds.

The second line is a placement business and which has both the institutional solution and a retail platform called Altifi for fixed income opportunities for institutions and retail customers. And third is to support it through our balance sheet. This integrated approach is powered by a proprietary technology platform called Nimbus, nPOS, NuScore and Altifi, enabling the seamless and efficient delivery of financial solutions across the ecosystem between originators to investors, whether it's a retail investor or an institutional investor.

The first, let me talk about fund management business. The fund management complements intermediate retail business by selectively investing in the corporates which meet the thematic criteria of the fund. We manage about INR3,158 crores of assets under management across six performing credit funds. Five have closed, and all have outperformed. One is open-ended fund. We make about 100 and 110 basis point of management fee.

With upcoming launches, we are trying to focus on three things. One is the emerging business fund, which we will launch later this quarter. There is a climate fund for which we are raising and begin the deployment by next quarter. And there is India's first 2X fund. With these new launches, we expect to double our AUM in the near term.

The placement business has been key to our intermediate lending business. We help financial institutions to raise almost two to three times of amount we disburse and have about 20% share in their overall liability franchise from external investors.

During the FY '25, we did placement volume of over INR12,393 crores with a placement fee of about 20 to 25 basis point. A dedicated team is focused on high touch and looking at the quality of the portfolio selection and risk principles. About 80% of investors have been buying these from us for over 3 years.

The third part is the lending from our balance sheet. We also fund institutions directly via balance sheet. The Assets under management as of March 25 stands at about INR6,570 crores with a yield of about 13%-13.5%. The lending capability synergizes with the fund and placement platform creating a very high quality butterfly effect that amplifies both impact and return across the ecosystem.

The most part of what we do is essentially the risk management business function, the way we enable the flow of credit both directly to the customers and through the intermediary and their intermediate finance businesses, the risk management principles and practice are integral part of business we do. Over the years, we have seen multiple credit cycles and crisis, which has helped us to build the robust risk management framework.

Our risk framework is based on four pillars and it's important to talk about it and I'll also get my colleagues to talk about it in greater detail. Our four pillars include **data and analytics**, which is the core for you to underwrite any individual or an institution. The **proprietary model** we built over a period has been tested over a decade and a half.

Our **domain expertise** and coupled with our **on-field surveillance** ensures robust portfolio constructions and early warning systems. We actively monitor exposures and conduct partner benchmarking through field audits, ensuring real-time insights and responsive credit actions, demonstrating the strength of character to take the action as we spoke about dialing up and dialing down exposures.

The third more important part of enabling the flow of credit is the technology. We believe to undertake the business effectively and efficiently. We need to invest in building a strong data and technology platform that helps us scale each of our business. As a result, over the years, we have invested and built our own proprietary technology platform and they've all been delivering. It's not something new. They've been there for some time.

Our first platform is Nimbus, which is a debt platform that has enabled over INR1 trillion of credit flow to financial institutions, between originators to us underwriting and for investors participating in those fees.

Our second platform is nPOS, which is Nimbus Partner Origination System, which is an API-based cloud-native co-lending platform using AIML for underwriting, increasingly seamless with partners. We underwrite anywhere between 20,000 to 25,000 loans on a given day. Last year, this platform would have enabled over 11,000 to 12,000 crores of flow of credit.

Altifi is our third platform, which is an innovative fixed income platform for retail investors to participate on securities predominantly focused on fixed income.

And the fourth most important part of the pillar is our own proprietary scorecards, our AI-driven underwriting model that answers the four key questions which we take, i.e., whom to lend, how much to lend, what price to lend, and in case you take the decision, what will be the probability of default.

Each of these platforms are built for our own use. However, we are witnessing early signs of interest across ecosystem and we see the signs for us to monetize some of these platforms. This gives us the confidence to evaluate whether these platforms have legs on their own and can run as an independent business and will be accretive to our overall fee franchise.

As we look ahead in FY '26, we are cautiously optimistic. Early signs of recovery and easing interest rate environment points to improving economic momentum. We believe this will translate into stronger credit landscape, creating opportunities for sustainable growth.

With a strong fundamental and strategic positioning, we are confident in our ability to capitalize on these tailwinds and continue serving as an enabler to growing India's economy. With that, I am going to request my colleague Atul to walk through the financial. Atul, over to you.

Atul Tibrewal: Thank you, Ashish, and good morning, everyone. Thank you all for joining Northern Arc's Q4FY25 earnings call. Let me take you through the financial performance of the company. The assets under management stood at INR13,634 crores, reflecting a strong growth of 16% year-on-year and 11% quarter-on-quarter. In terms of AUM mix, our direct-to-customer contributed 52% of the AUM. Within the direct-to-customer, the MSME finance contributed 19%, consumer finance contributed 25% and MFI contribution consciously calibrated to just 8%.

Our net interest income for FY '25 was INR1,147 crores, which is up 33%, and for Q4FY25 it stood at INR320 crores, up 39% Y-o-Y. Our net revenue, including fees and other income, grew by 30% year-on-year to INR1,248 crores in FY '25 and grew by 32% Y-o-Y to INR350 crores for Q4FY '25. Fees and other income remained range-bound at 0.8% of the average total assets.

Cost of fund for FY '25 was lower at 9%. Opex ratio also improved by 39 basis points to 3.64%. Our pre-provisioning operating profit or PPoP for FY '25 increased to.INR791 crores as against INR542 crores in FY '24, up 46% Y-o-Y. PPoP during the quarter was INR229 crores as against INR175 crores last quarter of FY '24, showing an increase of 66% Y-o-Y.

As has been highlighted by Ashish earlier, we have taken a one-time provision of INR68 crores on account of DLG guidance and a management overlay of INR51 crores, which led to increase in the credit cost for FY '25 to INR405 crores and for Q4FY25 to INR194 crores. On a percentage basis, the overall credit cost for FY '25 was 3.2%, but excluding the one-time provision on account of the guidance for DLG, the credit cost would have been 2.6%. GNPA and NNPA stood at 0.93% and 0.36% respectively. The PCR is also at 60%.

PAT for the full year ended March 25 was INR305 crores, excluding the one-time provision on account of DLG guidance. PAT is INR356 crores, which is a growth of 15%.

On the liabilities front, in line with our debt strategy and our projected AUM growth, we have further diversified our liability book with a focus on long-term funds.

Liquidity remains quite comfortable for us with a positive ALM across time buckets. We had surplus liquidity of close to INR650 crores as on 31st March and undrawn sanctions of over INR1200 crores from various banks and institutions. Total borrowings at the end of the quarter stood at INR9,860 crores with approximately 75% tied to a variable interest rate.

So, these positions will serve us favourably to benefit from the anticipated lower interest rate regime. Our funding mix is quite diversified with offshore contributing to almost 27% and domestic around 73%. Tangible net worth as on 31st March was INR3,434 crores. We have made significant progress in strengthening our balance sheet with our debt-equity ratio improving from 3.9 times in March 24 to 2.9x as on March 25.

Capital adequacy was quite comfortable at 24.7%, well above the regulatory requirement and this provides us enough headroom for us to grow our balance sheet for the next three years. Thank you so much and with this I would now like to open the floor for Q&A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Digant Haria from Greenedge Wealth. Please go ahead.

Digant Haria: Hi, thanks for the opportunity. My name is Digant. So, firstly thanks for this more detailed disclosure. That Slide 21 gives a good breakup of the credit costs within each of our divisions. So, my question is now on the consumer, we have 6% as credit costs and this is very significant because it comes after two things.

One is we are operating at 15% to 18% yield. We have 5% of the FLDG from our partners and our consumer book has grown 3x, like almost from INR1,100 crores to INR3,300 crores in the last two years itself. So, is this a result of the fast growth? Is it just because of the cycle that we have such high NPAs on a high base or high credit costs on the high base or is it a model which is just stabilizing? Can you just elaborate on this particular part?

Ashish Mehrotra: Okay, I am going to request Pardha to take this and let us walk through.

Pardhasaradhi Rallabandi: Yes, just to explain, the 6% credit cost is inclusive of the one-time increase in Stage 1 and 2 as per the DLG guidance. Excluding this one-off provision, it is 4.2%. The second point that I should highlight is that while this looks like 4.2%, even it is bit higher, the same is priced in terms of our risk-adjusted return.

When we are talking about 15%, 16% returns, it is actually risk-adjusted return that we are talking about. So, to that extent, in fact, of all the lines that are there in that Slide 21 that you mentioned, this is the one where on a risk-adjusted basis we are well covered.

Digant Haria: Okay, that is fine. So, you believe that I do not know, since you said this I want to ask if we make 3% kind of an ROAs in this consumer lending part?

Ashish Mehrotra: We make actually over 4%.

Digant Haria: Okay, fine. So, that is fine. And then, my second question is that we pivoted into this entire direct lending. Our DNA of the past has been B2B. We pivoted to this direct-to-consumer lending around 2021. I just see that we have grown very fast in that, maybe INR1,000 crores to almost INR7,000 crores.

So, now I just wanted to ask if we stabilized in those new businesses, especially MSME and rural, which are the two real direct to consumer lending? Have we stabilized? Do we need to recalibrate our growth rates because I understand that IPO has its own pressures, but now that event is also out. So, what is the need to grow at 25%, 30% when the market is giving you one-time price to book? So, there is absolutely nothing that the market gives you for growth. So, just any thoughts on this part?

Ashish Mehrotra: Digant, I just want to, at the very outset put one thing very clearly. We are a high-quality, high-governance company. We are not driven by any pressure, whether to do IPO or any other compulsion. We do what is right in enabling the flow of money in a very responsible and calibrated manner. All the businesses have stabilized. They have demonstrated. You asked me return on assets, I will give you an answer on return on assets.

The MSME business is very strong fundamentally. We did witness some signs of stress in the small ticket segment, and we consciously took measured approach, as highlighted in my opening remarks. Microfinance or rural finance, we did dial down. We have actually seen almost 27% YoY reduction in our AUM. That was done consciously as we saw the heightened risk activity.

So, actually our big focus is to ensure that we enable the flow of money in a responsible manner. More importantly, focus on the risk-adjusted return we will make. We will not do anything for growth and will not compromise on the quality and principles with which Northern Arc has been built.

Digant Haria: Okay, perfect. Thank you. That's it from my side.

Moderator: Thank you. We will take our next question from the line of Prolin Nandu from Edelweiss Public and Alternatives. Please go ahead.

Prolin Nandu: Hi, team. Again, a couple of questions on Slide 21. Now, see, I understand that the market has been quite challenging in some sense. My question to the team is we talk a lot about our platform and guardrail, and we have been doing this for quite some time now. So, we have rich data. I mean, the question that I wanted to ask is that, especially in the consumer and rural, do you think all our guardrails, all the tools that we use to underwrite better on risk-adjusted basis, have they stood the test of time, especially what happened in FY25?

And what are our learnings, let's say, now that we are probably towards the end of this current cycle in terms of asset quality and we embark upon growth in, let's say, in couple of quarters. What are the changes that we would like to make to our underwriting model, so that maybe the outcomes next time are even better than what we did this time around?

Ashish Mehrotra: I think if you look at the performance and you remove the one-timers, you will see that the quality of performance is significantly better. One-timers is more conservative. One is an accounting principle not translating into an ultimate credit cost. We spoke about that. And the second is an overlay just as conscious to as we were coming out, I believe right to say of the year of challenge or the year of pause which was FY25.

The advantage of the amount of rich data we have and the insights and the four principles of a risk management framework, the most important is a field surveillance and due diligence process where we actually cover 250 plus districts in a year where independent risk team goes and meets not only our own branches, but also our partners branches to see how the risk is originated, how the loans are originated.

How the loans are being underwritten, how the loans are being serviced and how the loans are being sunset. That gives us an edge almost a couple of quarters before any risk even crystallizes. I think these principles, if you look at on a 10-year basis, the Northern Arc performance will be significantly superior than any other on a risk-adjusted basis.

So, I think we continue to learn and continue to invest in building our risk management principles and our scorecards continue to get tested and enhanced. Right now, we have a couple of larger institutions begin to use our scorecards to underwrite their own direct-to-customer loans. And I think the more we do, the more we learn, the better, the richer and the better the performance you will see quarter-on-quarter basis.

Prolin Nandu: Okay. The second question, again, is a little bit more granularity on this consumer business, right, where credit cost is 4.2%, excluding one-time provision. So, the previous answer, you mentioned that we are at a decent 4% ROA. So, should we get used to this, at least on the credit cost part, a slightly higher number because that's by design on a risk-adjusted basis?

Or is there something here also, like for example, if I look at your rural, right, and there you have given your branch network and there are two specific states where we all know there are some issues and the cycle there also we are probably aware about where it is.

So, in consumer also, is there something which is related to some state concentration there or should we be, as observers be used to a higher credit cost number because that's more by design and not something which is coming out of the cycle. Can you help me with this?

Ashish Mehrotra: Sure. I think if you read the slide, it says net yield. The word net has been consciously put there. And like I said, because that is a real number, it's a net yield number we look at and we look at these businesses on a risk-adjusted basis. So, obviously, that business will have a slightly different credit cost and that's how it has been designed on a risk-adjusted basis for you to generate 4 plus return on assets.

In a phyigital distribution where you need human beings, you need to focus and create hub-and-spoke model for efficiently delivering the end product to the customers and serving those customers. So, obviously, given that we started a journey in Tamil Nadu, we build that business starting from Tamil Nadu and the acquisition we did three years ago of S.M.I.L.E business. So, our concentration is around certain states. We are expanding both in Bihar and in UP.

So, we will continue to select the right set of cohorts of pin codes where we think we can grow the business in a way we conduct. That's where it is. By and large, a portfolio, if you look at a portfolio of INR13,300 crores of book is actually spread across about 680 districts. So, we have a pretty diversified book.

In case of our own MFI or the micro-entrepreneur's business, there is obviously concentration in geographies where we have a physical footprint of branches and that we will continue to expand. I think we will continue to expand in a calibrated manner.

Moderator: The next question is from the line of Nishant Shah from Emkay Global Financial Services.

Nishant Shah: Three questions. First is, what is the learning from the past, last year's stress? Second, what is the strategy on D2C segment? And third, you have scratched the topic of risk management. So, what measures have you taken to strengthen it further?

Ashish Mehrotra: I think three things. Let me try and take it not necessarily in the same order you asked. The last one is on risk management. I think it's a continuous process for us. And to my mind, it begins with the target client model. And then our four pillars comes into play.

If you are very clear on a target client model, your risk policies, your operation delivery, your governance and control, and the fulfillment of customers is a function of how sharply you define who your target customer is.

And given that we operate in the three different segments between MSME, consumer finance, and in rural, we very clearly define who our end customers are. And that ensures you get a better performance on this segment. The second question was on great learnings and what we have learned. So, I'm going to ask my colleague, Pardha, to take it. He's a group risk head. He's the best person to answer it. But I will do comment once Pardha comments.

Pardhasaradhi Rallabandi: Sure. While some of this would look generic, the most important thing is in building a book in terms of portfolio management is having a granular and diversified book. That is something we have consciously been doing for the last five, seven years. As you can see, the number of clients has gone up significantly. And that diversification in terms of geography, in terms of MSME consumers, in these segments also has gone up, sectors also has gone up significantly. That is number one.

Second, of course, is particularly in an environment like this, focus on collections and recoveries is absolutely essential. That is something for the last six months has gone up significantly and would continue to go up in FY'25-'26 as well. Particularly in H1 '25-'26, we might see a little bit more of stress. But, overall, year '25-'26, we should see with a good collection effort that recovery is being good.

The last thing is, again, it looks very generic. Most important thing in this sort of environment is not to lose your head and focus on the process, I mean, basically the entire group having a process orientation and diligence to just continue to follow the process irrespective of what the numbers are at the operating level.

That focus on diligence in terms of underwriting, in terms of monitoring, and in terms of collections, that is something that we absolutely focus on at this point of time. Without such process orientation, it is very easy to get stressed in this sort of environment instead of recognizing this as an opportunity for subsequent years.

Ashish Mehrotra: I think the first comment was on D2C. As you see, if I exclude rural finance, D2C franchise between MSME and consumer actually grew by over 30%. I think we are consciously building it brick by brick, and we continue to expand on it. At the same time, continue to expand a fee franchise, which is essentially what we spoke of Placement and Fund management business, and all of the tech and data services to create a very compelling proposition and enabling the flow of credit.

So I think that is the power of credit ecosystem. The great power of it comes through the flow over INR35,000 crores of credit. Northern Arc's ability to learn and underwriting is significant three times more than the size of our balance sheet. I think, to my mind, that is the best way to end it saying we have three times more greater degree on the quality of the data we get access to.

Moderator: The next question is from the line of Sarvesh Gupta from Maximal Capital.

Sarvesh Gupta: So, sir, just harping on the same consumer finance part. So, this year we have got a 6% credit cost. What was this number, let's say, in FY '24, and what is the expectation going forward, let's say, in next year, coming years? Should we expect this similar 6% sort of a credit cost, given that our net yield is high?

Ashish Mehrotra: Yes, I will get my colleague Pardha to answer.

Pardhasaradhi Rallabandi: Sure. Again, last year on the consumer side, the approximate credit cost was around 2.5%. Some of the partnerships structures have subsequently changed where there was higher yield on the book, because of which the credit cost also goes up during this year. As I said, again, on a risk-adjusted basis, this is a business which contributes significantly to our RoA. This would continue to stay elevated, but I would not really be too concerned about this on a risk-adjusted basis, as I mentioned.

Sarvesh Gupta: Okay. And for the overall book now, let's say, for the coming year, would you want to give any guidance, given that in MFI, our gross NPAs have already come to almost very little in our credit book? So given that, what should be the guidance for FY '26 credit cost for overall book?

Pardhasaradhi Rallabandi: We would not want to call it as guidance specifically, but the way things are looking, while the current GNPA is at 0.07% in rural finance, that's a consequence of our policy to write off unsecured retail loans at 90 DPD, but we should expect some amount of stress in the portfolios across the country, across all the NBFCs, across all the lenders, for the next three to six months or so, I would think, H2 should be far better.

With all this in mind, I would think that we should, I mean, we should keep the credit cost approximately around 2.5%, by year end FY25-26. That's probably where we would be heading but just don't go by the 0.07% number. There is rural stress, particularly in states like Tamil Nadu and Karnataka. We have to see as to what will be the impact of the regulations coming in states like, on the collection efforts, we'll have to see those sorts of things. So, we should build in some amount of conservatism on that.

Sarvesh Gupta: Sir, I want to be, so this year we did 2.6%. Are you saying next year we should expect somewhere around 2.5%?

Ashish Mehrotra: Yes, I think we're saying around that range. That's the range.

Sarvesh Gupta: Okay. And lastly, sir, on your NIM, I think this quarter we have seen a sharp jump in the NIM percentage. In your ROE slide number 34, it has gone up from 8.4% to 10%. So, if you can give some color here and what should be the expectations for going forward?

Ashish Mehrotra: Yes, Atul.

Atul Tibrewal: So, there were two major contributors to the expansion in the NIM. As we said, our D2C business is being scaled up and the most important contribution, obviously, is the increase in the yields. The yields have improved for us and the interest expense has also come down.

The cost of funds which used to be in the range of 9.3% to 9.4% has now also come down to around 9%. So, both have contributed to the expansion in the NIM and as we scale up the D2C business further in the coming quarters, this NIM should even expand further from here.

The loaded NIM including fee and other income for us was actually close to 10%. So, then actually the expansion in the NIM is from 9.3% to close to 10% this year.

Ashish Mehrotra: As part of our strategy, as you build direct-to-customer franchise, you will see the expansion on the NIM line and as we build the fee on top of it, I think that's where you will get better risk adjusted return.

Sarvesh Gupta: Sir, given this and our credit cost guidance, so in slide number 34, this PBT is 3.1% for the ROA tree. So, given the guidance on interest income, interest NIM increase, etcetera, I think we should be able to touch 4-odd percent in the coming year. Is that a right sort of assumption?

Ashish Mehrotra: I think you have to look at it gradually.

Sarvesh Gupta: Okay. Okay, sir. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Praveen Agarwal from Axis Capital. Please go ahead.

Praveen Agarwal: Thank you, sir. I had a couple of questions on the liability side. I think you all have shared a lot of details in the presentation and our cost of borrowings have reduced from 9.2% to 9%. If you can just share what is the incremental cost as of now? That will be very helpful. Secondly, is there any borrowing plan calendar that we have put in for the current fiscal? And thirdly, is there any lumpy maturities on the borrowing side, which is due in the current fiscal? If you can just share some of those data, it would be very helpful.

Atul Tibrewal: Ashish, should I take it?

Ashish Mehrotra: Please take it, Atul.

Atul Tibrewal: Thanks, Praveen. So, three questions. I will answer the first question first. So, cost of fund, as I said, it has been coming down for us. As I said in my remarks also that 75% of our borrowings are floating in nature. So, as and when the Reserve Bank brings down the rate, the banks will pass on this benefit to us, though it happens with a lag. But I think in the current financial year, we should definitely see good amount of benefit flowing out of it.

In fact, in quarter 4, lot of our borrowings were raised linked to repo rates, where we got the benefits immediately. I think that trend should continue. We expect the cost of fund to even come down further. The incremental cost, which used to be in the range of around 9.6 to 9.7% previous year has now come down to around 9.2- 9.3% and we should definitely see this coming down even further.

On your second point, on the lumpy maturity, we do not have lumpy maturities. The maturity is close to INR400 crores to INR500 crores every quarter, which we replace with incremental borrowings. Most of our loans that get matured are on amortization basis. So, even the offshore funds that we borrow are also maturing in 3 to 5 years' time and we do not have any big maturities. In fact, on the ALM, as I said, we have a positive ALM across the time bucket. So, there is no question of any mismatch.

To your second question on borrowing strategy, as I mentioned, 27% of our total borrowings are from offshore and that strategy will continue going forward as well. In fact, last year, liquidity in the system was very tough for most part of the year, but I think we have been able to navigate this tough time very efficiently.

We had raised close to $115 million at the beginning of the year from offshore DFIs and that helped us tremendously over the last year. I think borrowing will continue to be diversified for us. We will continue the strategy of making a good blend between the offshore and domestic in the current financial year as well.

Praveen Agarwal: Sure. If I may just ask one more point over there. We have seen that the bank borrowing piece has remained stagnant in terms of percentage of overall mix in the last one year, whereas it has increased very aggressively over the last five years. So, is there a plan for an ideal borrowing mix for us?

Atul Tibrewal: We would love to bring down the bank borrowings from the levels. It used to be around 70%-75%. We would like to bring it down to almost 50% and keep the offshore at around 30% and the balance should be from the capital market. That would be the best mix for us and we are working towards it, Praveen.

Praveen Agarwal: And any leverage levels where we would be like top-ish or we will feel it as peaked kind of stuff, which has improved dramatically over the last one year because of capital gains?

Atul Tibrewal: See, the banks and the regulators and the rating agencies, they are all comfortable with anywhere between 4x to 4.5x. We are currently at around 2.9 debt to equity and I think we are good at least for the next three years. We do not see any equity plan or anything in the next three years. So, for the next three years, we are comfortable.

Praveen Agarwal: That's heartening to hear. Thank you. That's it from my side.

Ashish Mehrotra: Thank you.

Atul Tibrewal: Thanks, Praveen.

Moderator: Thank you. We will take our next question from the line of Nidhesh from Investec. Please go ahead.

Nidhesh: Thanks for the opportunity. So, first question is the profitability difference between the direct and intermediate business. How should we look at the ROA differential between the two businesses, which is high ROA? Because if we look at the business, the balance sheet is moving towards direct business. So, is the ROA of that business higher than the intermediate business or it's lower?

Ashish Mehrotra: The way to look at it is that 60% of revenue comes from direct to customer franchise at a revenue level. On a steady state basis, the intermediate retail or the credit solution business should make anywhere between 270 basis points to 320 basis points and that's because you have a very strong fee franchise coupled with it.

On a direct to customer business, we already spoke, since somebody asked specifically on a consumer finance business, we make 4 plus return on assets. As we scale our MSME lending business because it is physical, you need to open branches and so on and so forth. I think that business will actually get to the same range as consumer gradually over the next few quarters or over let's say over 15 to 16 months or so.

So that means eventually your direct to customer franchise should give you upward of 3.5% return on assets growing from there on as the efficiencies of scale come into play. We spoke about that we have invested and we spoke about our operating leverage, we are beginning to see part of it even in a challenging year. So that means as the market stabilizes, our ability to grow from there and getting the leverage and the right sort of return should, I think we are very well poised for it.

Nidhesh: Sure. And second question is on the opex ratio, we have done quite well this year where opex to asset has reduced. How should we think about opex to asset movement in FY '26, '27?

Ashish Mehrotra: I think we will remain range bound anywhere, between 3.7% to 3.8%. Listen, we have invested, in proprietary technologies and it is tested, it works unlike lot of other people. We have already seen improvement in productivity curves and branches even in the period. So as we continue to expand, we know that it will go up marginally, but I think it will remain well within the range bound as you have the productivity gains coming in to offset the expense build-up.

Nidhesh: Sure. And last question is on how do we plan to scale the fee income line item, specifically in the placement business, fund business, how do we plan to scale the fee income? And if you can share what percentage of your fees are coming from placement business and fund business for FY '25?

Ashish Mehrotra: The way to look at the credit solution business, you have funds where we invest. Funds make 100 to 110 basis points with period end AUM of INR3,158 crores, you make INR35 crores of revenue there. Placement, even in a subdued trade environment, we placed over INR12,500 crores worth of volume. You make about 20 to 25 basis points.

The power of that comes in is also on our Altifi platform which is the bonds platform where we are now also seeing higher number of individuals HNI and I am sure you are looking at that as a platform. If not, please download altifi.ai and look at it. It is a great platform for people to participate in the high yield fixed income portfolios. So I think that is the third part of the fee franchise.

The fourth part of the fee franchise which I spoke is saying how do we go about monetizing our tech capabilities. We already have one or two banks who signed up to use our platform. Our platform is very agile. We have done like 20 million loans on that platform.

A lot of people talk of platform. Us is tested. With so much interest, people wanting to do fixed income business, Nimbus platform is also a fee income opportunity for us. Great scores are anyway there. So, you have a SaaS solution which adds to the fee franchise coming from, which is accretive to the fee franchise, historically built between placement business and the fund management business.

And we are conscious to what we have said that over a period of time we would like to double our assets in the management and the funds business.

Nidhesh: Sure. That is it from my side. Thank you.

Moderator: Thank you. We will take our next question from the line of Shreyas Subedar from DC Advisory. Please go ahead.

Shreyas Subedar: Thanks for the opportunity. I have very specific three data queries. On page 30 of Page 36 of the PDF file that came with the results, which refers to the segmented results, there is a INR90 crores loss before tax on a line item called others. If you could just, please help us understand what this line item refers to. And in the same period last year, there was a INR26 crore profit. So I just want to understand the swing in profitability here? That is the first question.

Atul Tibrewal: Sorry, can you just help us with the page number?

Shreyas Subedar: Page 30 of the 36 Page PDF that you had put out on the BSE website, the segmented results, there is a line item called others, which has a INR60 crores revenue and a INR91 crores loss before tax. The same number last year was INR106 crores of revenue and INR26 crores of profit. I just want to understand the nature of the swing and the reasons there too?

Atul Tibrewal: We don't have the data handy. Can we take this offline. We will get back to you on this.

Shreyas Subedar: Understood. The second question is related to the intermediate lending business. So we reported a 1.5% credit cost, which on an average asset of about INR6,000-odd crores is about INR90 crores, INR95 crores of credit cost. I am just doing the math. I am not sure if it is correct. Given the fact that we have been in this business for the last period of time, is it a one-off that has led to that kind of credit cost or this is now a more steady state of 1.5% credit cost on the business?

Pardhasaradhi Rallabandi: This includes an overlay. As with any credit business, there were some exposures in intermediate retail, which went through stress during this year, on which we had to make provisions, including an overlay, though it was not really required at this point of time.

Ashish Mehrotra: Historically, this business has delivered less than 30, 40 basis points of credit cost over the last 10 years.

Shreyas Subedar: Understood. So this is more one-time. My last question is in relation to the consumer finance business. Thank you so much for calling the color. So at 16% risk-adjusted yield, if I were to take a 2-1 debt equity on that business, in my rough-of-the-envelope calculations, we are getting to about 8%, 10% opex on that business.

For a business which looks like, I think again, I'm doing calculations, INR3,300 crores of AUM, 1.5 odd million customers, so give or take INR30,000 average ticket outstanding. Is this opex sustainable or do you think 8%, 10% has room to come down? That's point number one.

And point number two, I'm assuming all of this business is unsecured and therefore is 15%, 16% risk-adjusted path or course or should we look at a number which is slightly higher?

Ashish Mehrotra: So first you need to understand that this is backed by first loss default guarantee, FLDG. I think the business will make 16 plus net yield and will make 4 plus RoA as we look at it. The opex will eventually start coming off as you build around on it. This is fully tech-enabled, like I said, and both platforms on any given day underwrite about 20,000, 25,000 customers.

So, the way to look at the math is that if you have a net yield of 16% minus the COF, which is at 9%, you make 7%. And you get a NIM because of the fee of about 8%. So, I think you will make 4 plus return on assets if you run the math.

Shreyas Subedar: Understood, sir. Thank you.

Moderator: Thank you. Ladies and gentlemen, in the interest of time, this is our last question. I now hand the conference over to the management for closing comments.

Ashish Mehrotra: We just want to thank you all for coming and participating and giving us indulgence to understand our business better. Thank you for spending time today with us and we look forward to engaging with you. Thank you very much.

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