"U GRO Capital Q1 FY20 Earnings Conference Call"

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MODERATOR: **MR. SHREEPAL DOSHI – EQUIRUS SECURITIES**

Moderator: Ladies and gentlemen, good day and welcome to the U GRO Capital Limited Q1 FY20 Earnings Conference Call hosted by Equirus Securities Private Limited. As a reminder, all participant lines will be in 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, 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. Shreepal Doshi. Thank you and over to you sir.

Shreepal Doshi: Thank you, Rayo**.** Good evening everyone and a warm welcome to you all. We thank the management of U GRO Capital for allowing us to host this Q1 FY20 results update call. On behalf of the company and Equirus Securities, I would like to thank you all for participating in the company's earnings conference call. On the call from U GRO management, we have Mr. Shachindra Nath – Executive Chairman & MD, Mr. Abhijit Ghosh – CEO & Director, Mr. Kalpesh Ojha – CFO and Mr. Vivek Seshadri – Head of Strategy & Investor Relations. We will start with opening remarks from the management followed by a question and answer session. Over to you, sir.

Shachindra Nath: Thank you, Shreepal and very good evening to everyone on the call. I am Shachindra Nath, Executive Chairman of U GRO Capital. It is a pleasure connecting with you today on U GRO Capital's quarter one FY20 earnings call.

The last quarter saw us make further strides on our vision of solving the unsolved. As you know, the change of control of Chokhani Securities Limited was completed last year on July 4th, 2018 and the company simultaneously raised equity capital of more than 950 crores from a diversified set of private equity, public market and family office investors. Over the last 12 months, the focus of the new management has been on building a strong second layer team, developing a technology platform and building the distribution channels. I am very pleased to inform you that we have successfully achieved all our stated objectives. We have built a fully integrated technology platform which enables us to deliver specialized credit for both secured and unsecured loan products within 60 minutes. Our platform is also at the core of our origination model with the ability to easily integrate into multiple distribution partner using APIs.

Our distribution system is fully online. The company's disbursals increased from Rs. 64 crores in quarter 4 FY19 to 218 crores in quarter 1 FY20. The company exited the quarter with an annualized disbursal exit run rate of INR 1200 plus crores. The company's AUM at the end of June 30th 2019 stood at INR 276 crores with a total client base of 561 customers. A total of 130 employees have now been on-boarded across 8 locations, with Mumbai being head office, Delhi, Kolkata, Bangalore, Chennai, Hyderabad, Ahmedabad and Jaipur.

The company is in the process of building a 4-pronged distribution network which is scalable, technology enabled and highly specialized. In the short span of 6 months, the company has

started 8 branches and on-boarded 131 channel partners who are operating at an industry leading productivity of 5 files disbursed per person per month.

For our ecosystem-led channel, the company has built a separate vertical headed by the Chief Growth Officer to build partnerships in prioritized segments and tap into our partners' network of distributors, dealers, suppliers through an ecosystem-based lending strategy. This strategy has already started yielding results. Within 4 months, the company has on-boarded 11 partners and 42 customers.

For the BFSI-led channel, the company is in process of creating a partner network of specialized NBFCs with a view of entering into co-origination and assignment partnerships with them. The company is also planning to launch a direct to customer digital channel in the second half of the year and supplementing the same by partnering with multiple Fintech and payment platforms. The partnerships can help us serve the entire SME ecosystem from an INR 5 lakh ticket size to an INR 5 crore ticket size across cities and towns in India while managing our operating expenses.

On the liability side, the company is happy to announce that we have been assigned a long-term rating of A with a stable outlook and a short-term rating of 'A1' by Acuité within 7 months of starting its commercial operations. The rating, achieved in a turbulent time for the segment, is a testament to the strong business model that we are building here at U GRO. The company has initiated conversation with multiple banks for debt and for co-lending partnerships. The company expects some of these discussions to conclude in quarter 2 FY20.

The company has recently welcomed Mr. Navin Puri – the former Head of Branch Banking at HDFC, who has joined as an Independent Director; and Mr. Kanak Kapur, Managing Director of Pacific Alliance Group Private Equity, who joins as a non-Executive Director on the board.

Governance is one of the key pillars of our business. We are of the firm belief that the current liquidity crisis has primarily been propagated by egregious breaches of corporate governance. We have from our inception believed in implementing a watertight governance framework and in pursuit of that, we have incorporated key parameters within our articles of association. This includes that our board is to comprise of majority independent directors. Promoter's power is limited to appointing only 2 board members. Every shareholder which owns more than 10% of the company is automatically granted board representation. The company only has the ability to disburse loans of more than 1% of its net worth with majority board approval and key managerial personnel are to be under the direct supervision and oversight of independent directors. With the addition of Mr. Puri as an Independent Director, we now have experienced professionals drawn from diverse backgrounds including RBI, SEBI, SIDBI, Central government, private sector banks, rating agencies as well as investor nominees who have been on the boards of other financial services companies in India and abroad.

During the quarter, the company also received NCLT approval for the demerger of the lending business of Asia Pragati into the company on June 28th 2019, following which 1,35,65,891 shares worth INR 175 crores were issued as a result of the demerger.

In terms of the company's capital structure, only a set of warrants are currently outstanding. These are to be compulsorily exercised by December 2019 pursuant to which the company will receive an additional INR 98 crores of equity. The company's AUM grew from INR 80 crores in Q4 FY19 to INR 276 crores in Q1 FY20. We are happy to report that the portfolio as on June 30th 2019 has no overdues, is highly diversified and granular with an average ticket size of only Rs. 53 lakhs.

The company as of FY20 transitioned into Ind-AS and also restated its number to include the lending business of Asia Pragati. The net worth of the company stands at 832 crores and its total income has increased from 17.44 crores in Q1 FY20. The PBT was negative 2.2 crores. This was mainly due to Rs. 1.3 crores of noncash ESOP related expenses and Rs. 1 crore of cost relating to the initial setup. We have invested deeply in management team that will drive the company's growth over next few years. We expect operating leverage to kick in over the next few months and we expect to be profitable for the year. We at U GRO are benefiting from the current crisis as our equity capital was raised prior to the crisis and thus, we could focus our entire bandwidth towards building our unique platform aimed at struggling the needs of the small businesses in India. Thank you. Over to you, Equirus team.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Utkarsh Shah, who is an individual investor. Please go ahead.

Utkarsh Shah: So, since these are challenging times for the NBFC sector and you are trying to build a book in this environment, so can you please comment on how is your experience, what is the quality of the portfolio build so far, what kind of sectors we have primarily lent to and what is the strategy for the year to grow in this kind of challenging environment?

Shachindra Nath: Since it is a long question I will try attempting your answer in 3 parts. As far as the challenging time is concerned, the majority of the challenge with the NBFC sector relates to the liquidity side of the balance sheets of most NBFCs. We have not seen across the board any asset side challenges to increase many fold. So, these are unique cases of breach of trust in the market starting from IL&FS and culminating to a few other large NBFCs failing to meet their liability side while the asset side continues to remain stable for most of the NBFCs and as well as banks. So, I do not think there is anything to do with the asset side. In terms of our strategy, we are deeply focusing on small business financing and we continue to build our business towards that. Fortunately for us, as I said in my opening remarks, we raised a significant amount of equity capital last year July prior to liquidity crisis and that gave us an opportunity to keep our heads down, build our entire credit underwriting strategy, analytics and technology platform. And once that was completed, we opened our 4-line distribution channels and now we are growing our

book gradually and carefully in all the 4 lines. So, we would continue to build the way we have planned, and I do not think so that the current crisis is affecting us largely. The people who already have existing books had leveraged their balance sheet completely. For us, we are insulated from most of those challenges.

Utkarsh Shah: And which sectors have you lent to, any data on that?

Shachindra Nath: As you said that if you look at most of our earnings call or the stated strategy, we lend to a defined segment of small business financing which includes education, healthcare, food processing, hospitality, electrical equipment, manufacturing, light engineering, chemicals, so on and so forth and we continue to focus on those 8 sectors. There are defined subsectors where which we originate and it cut across broadly 3 line of lending which we do across these sectors; secured business financing, unsecured business loans and supply chain financing.

Moderator: Thank you. The next question is from the line of Ishan Daga from Real Spark. Please go ahead.

Ishan Daga: My first question is what is our average loan tenor like?

Shachindra Nath: We lend across tenors. Our book average on an aggregate basis is sub 5 years. As per the board approved asset liability policy, we do not have any leverage on the balance sheet, but whenever we do have the leverage, we would like to have zero asset liability mismatch across the bucket and we would like to use both securitization and other forms of asset refinancing to make sure that no asset on our book is beyond our term liability tenures. To simplify the answer, our average tenures on aggregate basis is less than 5 years.

Ishan Daga: And what would be the breakup of advances between long-term and short-term as in March we were having large part of short-term advances on our balance sheet. So, what is the situation in Q1?

Shachindra Nath: Vivek, would you have that breakup? But broadly, our secured financing has a little longer tenor. Supply chains have shorter tenor and the combined pool gives you this tenor. So, Vivek, if you have more granular data around that.

Vivek Seshadri: So, 40% of the book should be short term in nature and the rest would be long term in nature.

Ishan Daga: And what about the asset quality? What kind of scenarios are we seeing in our loan book? We are very focused in sectors, I know, but are we also facing any kind of pressure on the asset quality front?

Shachindra Nath: As I said in my opening remarks, we have zero delinquencies. There is no large pressure. Our book is very new as you can appreciate that. But just to give you a little bit of color, we did our first ECL exercise and our ECL came below standard provisioning.

Ishan Daga: And just a followup on the debt raising plan with many banks. So, how much do we plan to raise and what tenor would be the debt raising for our book?

Shachindra Nath: As a strategy in my opening remarks as I said that we are in annualized run rate of more than 1200 odd crores. We have already roughly around 500 plus crores of cash on our balance sheet. So, our need for liability is not much, but given that we are building a book which is diversified, which is predominantly priority sector, which is impact driven. We are now starting our discussion with all sources liability side. Some provider from bank**,** private sector bank, most of the DFIs and other form of liabilities. Our objective in the first year of our business is to establish liability lines of all forms so that when we scale, we should be able to scale easily. That is broadly our strategy.

Moderator: Thank you. The next question is from the line of Amit Jain who is an individual investor. Please go ahead.

Amit Jain: Sir, I could see in the presentation that the average yield is around 13.35%. So, once we start taking debt to expand, do you think that we can hold onto this average yield because debt will be at around 9% minimum and then there will be cost of acquisition and cost of operation. So, is 13.35 sustainable?

Shachindra Nath: It is a good question. Amit, you should look at this way. Our belief is that there is a direct correlation to yield versus loss ratios. Our view is that in initial years we would like to operate in the near prime segment. We would like to hold the quality of the book and that eventually would result in a lower cost of borrowing. Simultaneously, we are working hard in building co-lending partnerships so that the quality of our origination and specialized credit underwriting is accepted by large banks and given that there is no capital allocation towards co-lending, we think we can build a very attractive model. So, you should not look at yields as just one factor of where you stand because in every yield curve, there is an OPEX attached to that. So, there are NBFCs which also lend a 24%, 20%, 18%, 16% gross yield, but their OPEX ratios are much higher and their loss ratios are much higher. So, it is probably not right to look at the final value creation or return to shareholder in terms of the gross yield itself. It has to be combined with the OPEX ratio and loss ratios. So, we are very comfortable with where we are and because our first objective is to demonstrate the quality of the book and gradually leverage versus beginning with the trial to enhance the yield on the portfolio itself.

Amit Jain: And my second question would be around our maybe 5-year plan for the book in terms of size, if we have any such plans around that if you are comfortable sharing that?

Shachindra Nath: We definitely have plans, but given that we are a listed company, we do not make forward projections of that long. As we have given a lead indicator where we would end up the year, but we would not like to comment upon our 5-year plans, but I would definitely like to state that within the small business and micro SME financing business, we would like to be a large scalable

and industry leading platform. We continue to believe that among the non-bank lenders, you have lenders who are either very small and have not scaled up operations or you have lenders which have diversified businesses which combine real estate, wholesale, consumer, SME and that is why we would like to capture the space of a pure play specialized scaled up platform and be the leader and the largest among those. That will give you an indication when I say that we would like to be the largest SME financier in India where we would be.

Amit Jain: And my last question would be around the entire SME lending space. So, as you can see currently a number of NBFCs are coming up in the same sector like Indifi, Lendingkart and all and then there is a bank, DCB, which calls itself an SME focused bank. So, how do you think that the space will evolve in the next coming years and how will be stamped in terms of the contribution in that space?

Shachindra Nath: Again likely so you should divide the market in 3 parts; banks who are doing SME financing, large NBFCs which are doing SME financing and very small players which are either positioned as Fintech or others. So, a few of the names which you have mentioned, I think, are unique platforms and they are doing very good jobs. And we see them as our natural partners. Given our size of the capital, the management bandwidth and our ability to scale, most of the platforms outside the banks, the name which we have taken are either complementary to us or creating a new market. Second, given the extent of under penetration in the market, our belief is that at least 25 more players like us can exist and bring solutions to small business financing. So, given it is $300 billion of under penetration, the size of the market and the number of players which can exist, I do not think it's a constraining factor. It is about being able to figure out a solution, build execution and technology, analytics of how you underwrite a small business in a differentiated way where in you solve any small business problem is the most unique thing to think about.

Moderator: Thank you. The next question is from the line of Shanaya Kothari who is an individual investor. Please go ahead.

Shanaya Kothari: What is the rate of return on equity you all are targeting and also my second question would be what is the debt to equity ratio you are looking in this year or in the next year like since you all are raising debt now?

Shachindra Nath: In terms of your first question of what is the rate of return on equity, I think you asked. So, again, we do not want to give a number because we do not make that kind of a forward projection, but we would like in next 3 years or 5 years of horizon, we would like to be in highly ROE accretive business and delivering one of the best returns in the NBFC industry. Our strategy to achieve that is to be able to be focused lender, focus around our sectors, build a liability side strategy which combines on balance sheet borrowing, combines it with co-lending, combines it with securitization and also build a specialized refinancing line from multitude of diverse sources of liability providers including the development financial institutions and so on and so forth. So,

that is the answer to your first question. In terms of what is our targeted debt equity, philosophically in the first 3 years of our operation, we would like to demonstrate a gradual leverage. We think that without even leveraging our balance sheet with securitization and co-lending, we should be able to start generating and delivering return. What will be our debt to equity? As we said by the end of the year we will have roughly around 900 plus crore of equity and we are at an annualized run rate of disbursement of more than 1200 crore which should give you an idea of what kind of debt should be on our balance sheet, but it should be very much less than our net worth today.

Moderator: Thank you. The next question is from the line of Ashal Shah from CJ Shah & Company. Please go ahead.

Ashal Shah: I had a quick question regarding why you chose to go with Acuite as your credit rating agency as opposed to CRISIL or any of the other ones that are regularly seen, CARE or India Ratings. And my second question was in relation to the reason behind the jump in employee benefits expense as compared to the same quarter in the last year. Just wanted to understand the reason behind that?

Shachindra Nath: So, to answer your first question, as you know the market architecture is in complete dislocation at this point of time. All forms of market participants; banks, non-bank finance companies, rating agencies are currently managing their existing challenges. Large vendors are now continuing to try managing their asset liability mismatches and market architecture participant including rating agencies are spending deep amount of their management bandwidth in justifying or explaining to the market of their existing rating itself. Given that we were a new business and we wanted a rating agency who has deep and depth of understanding of small business in India and also have available quality time to spend with us and should be able to appreciate the depth of our capital structure, depth of our governance, depth of our credit risk underwriting and depth of our distribution, we felt Acuite which used to be the Small and Medium Enterprises Rating Agency who are best suited to appreciate all of that and that is why we went with them. And fortunately, they had the luxury of time to spend with us and come up with their rating which we felt was justified for the size of our business. With respect to your question on employee benefit expenses, Vivek, most of it is because of the ramp up of the teams which we have done. So, we have grown to now 130 people, so that should be the reason why our employee benefit expenses have gone up, but Vivek if you have any additional color on that if you would like to give?

Vivek Seshadri: That is broadly correct. Our employee expenses in fact for the March ended 2019 was around 12 odd crores, broadly this quarter has been in the same ballpark. So, it has not gone up to that extent. But what we have done is really invested in all the manpower that we need right upfront because we are here looking at a 3-4 year horizon for employing people as well and we believe investing in the right kind of people at the right time is very critical to success of the company as well. So, all the employee benefit expense that you see have been incurred upfront, but as you see there is not too much of an increase quarter-on-quarter on this side.

Shachindra Nath: I would just add to what Vivek said, I think we are a unique non-bank finance company which was started in a listed company environment which means that we do not have the cover of a private company wherein information is not disclosed. Having that level of transparency and also given the size of the capital we raised, we decided to invest very significantly into what we call the depth of the management. So, business is led by a CEO who is reported by an hierarchy of CXOs, which is Chief Risk Officer, Chief Financial Officer, two business heads, Head of Legal Compliance and all come with more than 20 years plus industry experience and they are supplemented by a third and fourth layer of management team. So, if you compare our management team, it would stack up vis-à-vis large NBFCs running businesses of at least 15,000 crore plus asset size and we did that because in our long years of experience, we realized that when you are growing the business, if you do not create adequate management bandwidth, managing skills became a challenge and that is why we pre-invested.

Moderator: Thank you. The next question is from the line of Mitul Patel who is an individual investor. Please go ahead.

Mitul Patel: So, sir I wanted to know if you could give any guidelines on the provisions we will create this year and what kind of NPAs we expect in FY20?

Shachindra Nath: So, as we said that we have now moved to Ind-AS accounting and we are following expected credit loss policy for provisioning and that would be done on a quarter-on-quarter basis. Our first quarter ECL came 2.33% and we have provisioned that. I think we will continue to do that exercise. We do not expect these provisioning to go beyond that given that large portion of our business are secured, large portion of our business comes in what we call in most of the near prime segment where most of our borrowers are either have a very high commercial bureau rating or have at least minimum of 5 to 7 trade lines which behaviorally they have borrowed and repaid. So, we continue to be in that segment of the market.

Mitul Patel: Also sir if you could explain a bit more about the ecosystem lending model as per your presentation?

Shachindra Nath: To begin with, we decided to focus on 8 sectors of small business or SME market. We did that 8 sector focus approach because we looked at 180 sectors of the market and we decided that on a macro parameter for the next 5 years, these are the 8 sectors which would continue to be largely insulated with the broader economic distress or slowdown activity, would not have any form of regulatory hurdle, so on and so forth. Now we decided to be in those 8 sectors, we found that there is an opportunity to find unique partners for each of those sectors and use their ecosystem to provide financing and that is what we are doing. So, to begin with, we are looking at mid-market corporates who are all rated and looking at their suppliers and dealers and distributor and bring a financing solution to bridge the working capital gap across all the levels and we are extending that partnership with multiple such players. So, for hospitality, we are building partnership with 3-4 large players. For healthcare, we are doing that. I think once we have proof

of the concept delivered and we will have a book, next quarter you will see some of those names and how we have built those partnerships.

Moderator: Thank you. There are no further questions.

Shreepal Doshi: So, thank you everyone for participating in the conference call and thank you to the management also for giving us this opportunity. With this, we will conclude the call.

Moderator: Sure. Thank you very much. On behalf of Equirus Securities, that concludes the conference. Thank you for joining with us. Ladies and gentlemen, you may now disconnect your lines.