Ugro Capital Limited
4th Quarter FY19 Earnings Conference Call
07th May, 2019

Moderator: Ladies and gentlemen good day and welcome to the Ugro Capital Limited Q4 FY19 Earnings Conference Call. 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. I now hand the conference over to Mr. Pranav Khandwala from Valorem Advisors. Thank you and over to you sir.

Pranav Khandwala: Good evening everyone and a warm welcome to you all. My name is Pranav Khandwala from Valorem Advisors. We represent the investor relations of Ugro Capital Limited. On behalf of the company and Valorem Advisors I would thank you all for participating in the company's earnings conference call for Q4 FY19 and FY19. To just let you all know the earnings presentation of the company has been published on the exchange as well as the company's website. Also we have emailed the presentation to various institutions. Before we begin I would like to mention a short cautionary statement. Some of the statements made in today's concall may be forward-looking in nature. Such forward-looking statements are subject to risk and uncertainties which could cause actual results to differ from those anticipated. Such statements are based on management's belief as well as assumptions made by and information currently available to management. Audiences are caution not to place undue reliance on these forward looking statements in making any investment decisions. The purpose of todays' earnings conference call is purely to educate and bring awareness about the company's fundamental business and financial quarter under review.

Now, I would like to introduce you to the management participating in today's earning conference call and give it over to them for their opening remarks. We have with us Mr. Shachindra Nath, Executive Chairman and MD, Mr. Abhijit Ghosh, CEO and Director, Mr. Kalpesh Ojha, Chief Financial Officer and Mr. Vivek Seshadri, Head of Strategy and Investor Relation. I will now handover to Mr. Shachindra Nath for his opening remarks. Over to you sir. Thank you.

Shachindra Nath: Thank you. Ladies and gentlemen and a very good evening to everyone on the call. It is a pleasure connecting with you today on Ugro Capital earning call. The last year has been a year of ambition, hard work and fruition. We started the year with a mere powerful idea but today we at Ugro are 95 employees strong with 7 branches and a strong capital base of 950 crore. I would like to thank everyone who has made this journey possible. Financial year 19 marked the beginning of a long journey towards creating an enviable institution on the strong foundation of innovation, technology, data and deep knowledge, and taking a small step towards solving the SME credit availability problem in India. Before we begin, I would like to give a brief overview about Ugro Capital.

Ugro Capital is a highly specialized technology enabled small business lending platform focused on addressing the capital need of SME segment. Our mission is, solve the unsolved: the US $300 billion small business credit gap**.** We acquired control of Chokhani Securities from the erstwhile promoter in July 2018 and renamed the company to Ugro Capital. We have since then completely revamped the management team. As of today, our headcount stands at around 95 employees. Each of our senior management teams comes in within experience of 20 years plus in the industry. Post the change of control, the Board was also reconstituted, and a distinguished majority independent board was set up to supervise the business of the company. The company raised INR 953 crore of equity capital from multiple investors through two rounds of preferential allotments, qualified institutional placement and the demerger of the lending business of Asia Pragati Private Limited in to Ugro Capital. The net worth of the company stood at INR 637 crore, the demerger of Asia Pragati's loan business is expected to be completed by end of Q1 FY20. The warrants are due to be compulsorily exercised by the end of December 2019. Post this, the net worth of the company would be INR 925 crore. Operationally we believe that the need of every SME is unique and therefore we adopted a highly sectoral approach to solve the problem of SME lending with a deep sector specialization to understand, reach and service the customer better. We have shortlisted 8 sectors and 38 sub-sectors through extensive study of macro and micro economic parameters, carried out in conjunction with the market experts like CRISIL and others. The 8 sectors shortlisted are healthcare, education, chemical, food processing, FMCG, hospitality, electrical equipment and components, auto components and light engineering. Our distribution, credit appraisal and products are aligned to these sectors. The company has put in place a new long-term strategic vision to build a technology-led small financing business using sectoral expertise and on the core pillar of knowledge plus technology. To this end the company has launched its new generation fully integrated technology platform to process both secured and unsecured loan within 60 minutes of login for in principal approval. To achieve this, we have established API integration with 20 plus data source. We've also created 8 sectoral statistical scorecards and 25 sub-sectoral expert scorecard - an industry first. We want to leverage the best practices of both the traditional NBFC world and the new digital lending firms; therefore the 60 minutes in principal approval will be followed up with the traditional checks and balances, personal discussion, site visits, etc. This, we believe, is the right strategy to win the Indian SME lending market. Lastly, we want to create a liability-centric organization by creating a granular, diversified, and largely secured high quality lending book. Being cognizant of the ALM mismatches and actively engaging with rating agencies, liability providers to create a diversified lending book. The company's philosophy is also to adhere to the very highest level of corporate governance, so we have a very strong and experienced board of directors and we have inculcated the best practice into our articles of association of the company. I would now request my colleague Mr. Abhijit Ghosh, CEO and Executive Director to take you through the operational performance of our company for the last quarter and the financial year gone by. Abhijit, over to you.

Abhijit Ghosh: Thank you Shachin. A total of 7 branches were opened during the quarter at Delhi, Chennai, Bangalore, Kolkata, Hyderabad, Jaipur and Ahmedabad. 76 channels partners have been onboarded. The company started disbursals in January 2019. The company has disbursed loans to SMEs totaling Rs. 82 crore and the total loan book as of March 31st, 2019 stood at INR 80 crore. This comprised of three products secured business loans that contributed to around 78% of the portfolio, unsecured business loans that contributed to 7% of the portfolio and supply chain finance that contributed to 15% of the portfolio. The portfolio is fairly well diversified across seven states and fairly granular in nature. Total income for FY19 stood at INR 41.81 crore on a standalone basis and at INR 49.88 crore when consolidated with the lending business of Asia Pragati on a pro forma basis. Total profit before tax excluding exceptional items for FY19 stood at 4.76 crore INR on a standalone basis and at 12.8 crore INR when consolidated with the lending business of Asia Pragati on a Pro forma basis.

Shachindra Nath: Thank you. We will now open the main room for questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Parth Patel an Individual Investor. Please go ahead.

Parth Patel: Sir my question would be largely from the NBFC sector as a whole, so looking at the current scenario the NBFC sector with respect to the liquidity what are your views on the same for the next year FY20 and specifically for the SME sector?

Shachindra Nath: So, if you look at our earnings presentation, we have given an overview – our view of how the market would span out. If you go on slide 8, I will point you to our presentations our view on how the market will span out. That the spread between AAA rated companies, AA and A rated companies will increase. So, which means that next year what you will see that the large well capitalized and well governed AAA rated company would benefit from the current market. What you will see is that the rating agency will become very conservative with respective to existing ratings and with respect to granting fresh ratings. NBFCs which have managed the asset liability mismatch will now be looked at more seriously. Traditionally and historically in the last five years, both SFCs and NBFCs have created at the long-tenor-end asset liability mismatches and that is why they have to reset their asset strategies to align that. And to some extent, if the refinancing or provision of fresh credit to the NBFCs is not available you will see a tightening of credit availability to SME market. In all of that our view is that for an NBFC like us which has entered at a time when the liquidity is so tight, it is a boon that we are sitting on so much of cash equity liquidity which will be beneficial to our build out.

Parth Patel: Great sir, that is helpful. Sir, any targeted cost of borrowing for us in this market, just to understand?

Shachindra Nath: As you know that for foreseeable future, we are only funding the loan book out of equity capital itself until we get our first rating. We are waiting and we are discussing with rating agencies regarding a platform like ours which has a very strong capital base, a very experienced management team and very high quality governance and a very predictable loan book and granularity of loan book - how should it be perceived in terms of the rating. Depending upon what rating profile we get, our cost of borrowing would set accordingly.

Moderator: Thank you. The next question is from the line of Rohan Mandora from Equirus Securities. Please go ahead.

Rohan Mandora: Sir on the presentation you had talked about a sample, a card based on restaurant business. So, where you have done partnership with a large food aggregator. So sir if you would run through how is this score card or the model working, where in what kind of data are fetching from the food aggregator or what is the facility are we showing and what kind of terms are we giving to the restaurant like it's a two, three loan, working capital loan. Some color on the lending rate we are doing?

Shachindra Nath: Yes. So, I think this is more to give you some sense Rohan in terms of our distribution strategy. In our presentation you see that we have three pivots to our distribution strategy. First is our branch led distribution business where in we are originating business through our own branches, intermediary and channel partner. Second is we are partnering with other likeminded same asset category financial institutions NBFCs wherein they will originate loan and we will go lend with them and third what we call an eco-system financing. Given that we are building deep sectorial expertise our idea is to go to people who have differentiated data which we can use for our statistical score card and credit under writing platform. So, for example, for restaurants we have floated the possibility of providing credit basis the sales data of Swiggy and Zomato e.g. the repeat rate, penetration rate so there is no one unique set about it. Each of the ecosystems have a differentiated value. I think the uniqueness about us is that given that our statistical score card is based about basis 8 million data record which have been analyzed and we have a proprietary score card, that score card can be used to analyze any data set and build in an underwriting model.

Rohan Mandora: Okay, got it. And sir on slide #4 of the presentation we have given approval rate for SBL, UBL SCF categories and it is around 13%, 30% and 39%. So just wanted to understand like are we using 13% kind of an approval rate is slightly on a lower side, if you could give some insights on that?

Abhijit Ghosh: So, basically there are multiple approaches that one can have when one is entering, one is to keep the guards high, and be very clear of what we want. As Shachin was talking about, for the scorecards one of the advantages that we get is a very consistent approach in terms of our risk appetite. So, in that being constant when any new entrant comes into the market, the market will test it on various applications that are coming. So, as on date yes, it is reflective of 13% which I agree with you is little on a lower side but given a period of mixed few quarters you should start seeing a normal throughput coming in that is number one.

Shachindra Nath: And that is also by design as we said there our intention is in the first year of our operation we build a very high quality book and obviously that is why given that there is no manual intervention in most of our underwriting specially our score card underwriting is driven out of the data set this is approval rate which we are giving, but as Abhijit said, we expect this to get improved over a period of time. Without us lowering the threshold of our underwriting but seeing more quality of log ins happening in our system.

Rohan Mandora: Got it. And sir like the yields that we are generating on SBL is 12.6% and most of the disbursements like as I see during the month of March in this category. So while currently we are sourcing the liability of our equity but going ahead as we start raising external borrowings once we get the rating. The spreads that we may make in this business may not be material enough to take care of the OPEX and the credit cost. So just wanted to get your thoughts on this like are you comfortable with this kind of an yield or can we expect the yield to go up going ahead in terms of segment where we would lend to in SCL?

Abhijit Ghosh: So Rohan, I think so, I do not know what presumption of OPEX and what presumption of credit cost you are talking, but what we have our target, I think with our targeted OPEX and credit costs and the cost of borrowing it makes sense. As you know there is a direct correlation in terms of the type and quality of the portfolio your liability side and your cost of borrowing over a period of time. When you look at this business you should remember that this is our first year of true operation. And use our blended yield of the portfolio which will make sense and not just the secured portfolio. So, what we think is that we would build this kind of portfolio and at this yield it will still make sense. We are seeing incremental yield coming into our fold while there is no guidance on that, but as our target is to get the first prime asset from the market. Prime asset yields are like largely in this range itself at the moment.

Moderator: Thank you. The next question is from the line of Rajesh Burani and Individual Investor. Please go ahead.

Rajesh Burani: So basically, from the data points which you have collected are you seeing any stress in the SME lending portfolio?

Shachindra Nath: You are saying spread or stress?

Rajesh Burani: Stress.

Shachindra Nath: So, from the data that we have analyzed when we built our scorecards, we picked up good and bad both customers. And in general, about the view on stress in the SME portfolio, I think that it passes through faster cycles now and there is a bit of stress in terms of availability of liquidity in the market which we have put in our guidance as well, the first question of this call we did attempt on that. So overall, from that perspective it is not as good as few years back when it was on a high but still whatever is present right now, we are seeing in SMEs not such a drastic movement in terms of the credit performance in the market.

Rajesh Burani: Sir basically can you just highlight what we are exactly doing in the co-lending business and with some examples and how much it is contributing to our overall book.

Abhijit Ghosh: As of today, it has not contributed anything to the book. That is more strategic direction as we said that there are three pillars to our distribution model, our direct branch led intermediated debt origination, partnering with other financial institutions who have similar approach to credit underwriting and who follow our philosophy on the credit underwriting but have a much more deeper penetration and availability of granular portfolio and third is our eco-system financing wherein we partner large ecosystem and provide credit to SME and micro SME in those ecosystems.

Rajesh Burani: Right. And sir so basically are we open to any kind of equity funding if debt is not available in the market at a good rate in the future?

Shachindra Nath: As a listed company I cannot comment on that, as you know that we are total capital availability of 958 crore which is quite significant for us. There are hardly any NBFCs who have surplus liquidity at this point in term in the market. For us it is understandable, given in first seven months of our operation what we have built in terms of the quality of the management team, our credit underwriting processes and physical and technology infrastructure. We generally believe that whatever asset side we want to create this year, the debt side for that we will be able to match it and also there was always an equity route which is available to us whenever we want, but as of today our board has not given us any guidance in terms of any future equity raise.

Rajesh Burani: So, this capital which we have in our books is sufficient for how many years to get an earnings growth rate of 15-20%?

Shachindra Nath: It is very hard to say, I think you have to follow us every quarter and you see what growth rate and what asset book we are getting.

Rajesh Burani: Yes. And sir I have seen in your shareholding patterns mark key investors have invested in the company. So basically is there a lock in or something like that to what they have invested and maybe is there a lock in and when it is going to end basically?

Abhijit Ghosh: As you would have seen that we have raised capital in two formats. We have raised capital through preferential allotment wherein several private equity investors have come in. Investors, from their date of investment, have a lock in of one year and some pool of investment we have raised through a QIP which had no lock in.

Rajesh Burani: Right. So there is a one year lock in.

Abhijit Ghosh: Yes.

Moderator: Thank you. The next question is from the line of Vivek Chauriya an Individual Investor. Please go ahead.

Vivek Chauriya: Do we have any long-term target in terms of how we want to scale the book and with a 1000 crore network what sort of peak leverage would we be looking at and how much time would we take to get there?

Shachindra Nath: We do not comment on any forward-looking statement, but I can give you a general guidance. Philosophically the company, the way we are building our business model is that we want to prove our quality of asset book, credit cost and our technology and underwriting premise, and we want to leverage our balance sheet gradually. In terms of return on equity and return on assets we are looking at multiple other options such as liability pools which include securitization as well as co-lending by other large lenders to us. So, for NBFCs we generally believe that on balance sheet borrowing is not the only solution. Most of the NBFCs have to innovative and create premise around unwitting and asset creation and there are multiple ways of generating liability on that.

Vivek Chauriya: Okay. Just one more question I am sure you read reports that pretty much every big corporate business book is also planning to get into re-financial given the PAT liquidity conditions. So how will we be able to differentiate ourselves, if the market share is moving to the private banks and their cost of funding is which quite loss, I mean is there something which we will be doing very differently in terms of grabbing good assets and also pretty good yield on it. What I am trying to understand from you is, I am sure.

Shachindra Nath: I get your question; I can attempt answering it. So, your question is in three-fold. One, how do we compete when there is, in your judgment there are large corporates, new corporates for entering into NBFC business, the banks' low cost of funds and they are capturing the market. How we would differentiate in that market? To answer your question number one I think, given the current liquidity crises, my understanding is that most of the people who were NBFCs took a very simple and straight forwarded approach to business are rethinking in terms of their strategy. Banks definitely are in advantageous position, but they have been in this advantageous position the entire time. I do not think so that probably this liquidity crises might have opened up little bit more asset gathering capacity. But NBFC businesses and bank businesses have always two different businesses they have two different customer segments. We genuinely believe that for a small business customer the only way to serve it's need is to understand him better. The way we think we understand our customer better is because at the design stage we have committed our self to 8 sectors and 32 sub-sectors. We have built our technology statistical scorecards and expert score card around the sector and sub-sector. Which means that we can differentiate between a dentist and a gynecologist and nursing home and a pharmacy and that is why we can underwrite we can turn it around and we can hold our book and maintain our cost of credit far better than any other generalized lender. I hope this explains.

Vivek Chauriya: Just one more book keeping question. Right now the total share outstanding is 2.33 crores and in the presentation it is mentioned that the total capital is almost 7.5 crore should we expect that by the March balance sheet, in terms of the expended.

Abhijit Ghosh: Sorry can you repeat your question please.

Vivek Chauriya: Yes, right now the total equity Capital outstanding close to 2 crore 33 lakh share as you have mentioned it in the presentation and the total expanded capital would be close to 7.5 crore right? 7 33 crore something like that. Will that process take about a year for that to reflect on the balance sheet?

Abhijit Ghosh: In terms of availability of capital, which is all compulsory convertible capital with no coupon attached to that for a purpose. This is the net worth available to us. When this capital came in, for regulatory purposes the instruments were structured this way because there were technical issues relating to open offer and so and so forth. What is not available to us is only 100 crore of pending compulsory warrant exercise. The due date of that is December. So, in terms of cash availability, our demerger for Asia Pragati would get completed by end of first quarter FY20 within June end. And that would give us additional cash in our balance sheet of around 175 crore and additional 100 crore would come by exercise of warrants by end of December. In terms of your convertibility of instruments, most of these instruments post July would get converted when the lock-in is over.

Vivek Chauriya: Okay, so I am guessing by the next year March 20 balance sheet the total diluted the **–29:05** will be close to 7.3 growth shares as you have mentioned in one of your slides in the presentation.

Shachindra Nath: It should be by December sir.

Moderator: Thank you. We will move on to the next question that is from the line of Amit Jain and Individual Investor. Please go ahead.

Amit Jain: My question is regarding the yield on unsecured book. Sir as far as the new NBFC goes they charge a little higher rate as high as 24 to 26%. So why are yield so low as compared to NBFC I am not comparing it to bank at 19.6% I believe so any reason for that 19.3?

Shachindra Nath: Sir, it depends. So actually, unsecured credit in India is not restricted to only 24%, it goes all the way up to 45%. So, it depends upon what segment of customer you are chasing. A first-time borrower having no credit history has no repayment behavior, or repayment profile will end up paying anything from 30% to 40%. So, if you are an Uber driver who is lent money to pay your insurance you will end up paying 45%. Our unsecured is what we call is the top end of the unsecured market - it is a borrower who has a credit history who passes through our statistical store card which means that he is not a first time borrower, he has a very good quality score and he is a very strong repayment behavior. So, yield is a function of kind of credit you have capacity to undertake.

Moderator: Thank you. The next question is from the line of Prathamesh Sawant from Emkay Capital. Please go ahead.

Prathamesh Sawant: Sir I would like to know how much of your current business is coming from DA phase and what part from your current your own distribution network?

Shachindra Nath: So, let me reiterate what I said, we have three distinct distribution model, one is what we call our ecosystem-based financing so technically our supply chain financing book is direct. Our branch led business today predominantly services our entire intermediate channel which is DSA led and third is our financial institutional partner which is NBFC led which is again not direct, it's indirect. So, you may presume other than supply chain the most of our business is through intermediate DSA partners. At a book level is on a small base in almost 61% is through DSAs.

Prathamesh Sawant: Okay. And what is your target going forward like one year down the line. You would like to reduce as much as possible reliance on DSA right?

Shachindra Nath: Yes, so as we say that we think that initial year of any company an intermediate channel is more profitable vis-à-vis a mature company so we will be comfortable with the current mix what the way it is shaping out. We have put requisite infrastructure across all three distribution channels, but I think our easiest scale would, in the first few years, come from this channel itself.

Moderator: Thank you. As there are no further questions I now hand the conference over to the management of Ugro Capital Limited for their closing comments.

Shachindra Nath: Thank you ladies and gentlemen for joining this earning call for Ugro Capital. If anyone has any specific questions they may reach out to Mr. Vivek Seshadri our Head of Strategy and Investor

Relations and he will be very happy to answer your questions. Thank you and have a good evening.

Moderator: Thank you. Ladies and gentlemen on behalf of Ugro Capital Limited that concludes this conference. Thank you for joining us and you many now disconnect your lines. Thank you.