"Fusion Micro Finance Limited
Q2 FY2022-23 Earnings Conference Call"
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MODERATOR: **MR. SAMEER BHISE – JM FINANCIAL**

Moderator: Good morning, ladies and gentlemen, and welcome to the Q2 FY '23 Earnings Conference Call of Fusion Micro Finance Limited, hosted by JM Financial. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded I now hand the conference over to Mr. Sameer Bhise from JM Financial. Thank you, and over to you, sir.

Sameer Bhise: Thank you, Michelle. Good morning, everyone, and welcome to the 2Q 23 Earnings Conference Call of Fusion Micro Finance Limited. Firstly, I would like to thank the management of Fusion Micro Finance for giving us the opportunity to host this call. Today from the management team, we have Mr. Devesh Sachdev, Managing Director and CEO of Fusion Micro Finance; Mr. Gaurav Maheshwari, Chief Financial Officer; Mr. Tarun Mehndiratta, Chief Operating Officer, Microfinance Business and Mr. Deepak Madaan, Company Secretary and Compliance Officer.

Without much ado, I would want to hand over this call to Mr. Devesh Sachdev for his opening comments and overview on the quarter, post which we'll open the floor for Q&A. Thank you, and over to you, sir.

Devesh Sachdev: Thank you, Sameer, and I'd also like to thank JM Financial for hosting us. Good morning, everyone, and thanks for joining Fusion's first conference call to really discuss our H1 results for financial year '23. I am here along with my colleagues; Tarun Mehndiratta, Chief Operating Officer for MFI; Gaurav Maheshwari, my CFO; Deepak Madaan, Compliance Officer. At the outset, I would like to thank all the investors who have reposed faith on Fusion by making the IPO successful.

I would also request you to keep the presentation, which we have uploaded handy, because I may refer to some slides. We had a strong Q2 and first half with company continuing to take a good progress. In the backdrop of robust and consistent credit demand in our client segment, we have delivered good portfolio growth and client acquisition with strong profitability, return ratios, operating metrics. In the midst of interest rate environment, persistent inflation, tightening liquidity and global uncertainty, we had very nominal impact on cost of funds due to robust stability management and confident of similar trend in future now that our credit rating has been upgraded by case to 'A / Stable'.

We are confident of a strong financial year '23 subject to market conditions. What you see today is an outcome of all the work we have done over the last few years in putting the right building blocks -- we set up close to 400 branches in the last 3 years, invested in people, strengthened our processes with focus on digitization and very consistent and focused approach even during COVID times with an eye on future. Now I will take to take you through our quarterly and H1 performance, which you will see clearly reflect our strong focus on Fusion's building block, which have been our key strength across the years.

If I can take you to Slide #17 in the PPT, which has been uploaded, diversification is one of our key strengths. We have grown from 12 states in 2017 to 19 states in 2022. The top states, they are UP, Odisha, MP and Tamil Nadu having a concentration of around 66.48% as of September 22 versus 74% as of financial year 2017. You can see that we are a rural-focused MFI and our composition of rural is around 93% over the last few years. It would be pertinent to add here that under the new harmonized acquisitions when we have to look at household level indebtedness, our client household level retail overlap is only around 12% to 14% against semi and urban overlap closer to 30% to 35%.

Staying on the same page, I would also like to take you through how we built a solid distribution network of branches in all these 19 states across the last few years. If you can see in H1 '23, we have now 1,031 branches versus 934 as of financial year '22, which is a growth of around 10%. We have opened 400 branches in the last 3 years with a CAGR of around 29%.

If you see the overall our branches, which were there in financial year '22, 934, around 400 branches, which we talked about, where -- which have come up in the last three to four years, their contribution to our portfolio is around 25%. 75% portfolio contribution is coming from the branches, which are mature, which have a vintage of more than three years.

Now when -- going forward, our strategy is that while we may add one or two more states, otherwise, now we are well diversified. Our -- we have a well -- distribution is more or less complete. We would now focus on mining deeper in the existing states. We have opened 170 branches. Overall, we have planned to open 170 branches in financial year '23, out of which 97 have been opened. I would also like to mention here that if you look at our branches per district is still very low. It is around 2.5%. So we have a scope to really mine deeper in the geographies where we are present.

You will also see that if I can take you to Slide number 18, it depicts the resultant outcome wherever AUM as of H1 '23 is INR 8,047 crores, registering a year-on-year growth of 54% and 18% in H1 over financial year 2022.

You can also see consistency in disbursement over the last three years, including Q2 financial year 2023. We disbursed INR 1,983 crores in Q1, and we have disbursed INR 2,051 crores in Q2. This was made possible by early implementation and execution of the new harmonized guidelines, helping us achieve consistent disbursement numbers in both quarters in the financial year 2023. Also, I would wish to add here that if you look at our portfolio sourced prior to pre-April ‘21 and post April '21, around INR 7,347 crores portfolio of the MFI book, which is around 93.5% of the total MFI book is sourced post April 2021.

Pre-April portfolio is now outstanding is INR 508 crores, which is 6.5% of the total MFI book. If I can take you now to the Slide number 20, it clearly highlights that while maintaining a consistent growth, we have not gone away from our fundamental prudence. Let me briefly cover the key metrics. If you can see the borrower addition. So in Q2 financial year 2023, we ended September at 3.2 million borrowers versus 2.9 million in Q1 financial year 2022. And year-on-year, it is a 42% growth quarter-on-quarter, it is 10% growth, and 5-year CAGR is around 30%.

If you can see, I think one of the key things, which Fusion has been very focused since peaking is a team modernization where we are very focused towards a very broad basing our coverage and leveraging the diversified network by adding new customers to the portfolio. If I can talk about our new to credit customers in the Fusion book, this is hovering around 25% to 26%. The customers who had no formal financial, any loan from any lender. But if I also add, there are around 16% customers which are unique to us because they have closed their loans from other lenders so that it comes the unique customer comes to around 41%.

Now if you can see our -- while keeping a very high focus on -- we are growing. But if you -- also, if you look at how we have been very calibrated in our average ticket size and our average disbursement. Over the last year-on-year, last average growth over the last 4 years in the average ticket size in the Microfinance has been ranging between 8% to 11%. Even you can see from financial year 2021 where INR 32,113 was the average ticket size, which moved to INR 35,668 in financial year 2022, and we ended INR 23,000 and INR 36,158.

This also reflects in the outstanding for borrowing our portfolio across the year. So year-on-year, our outstanding average growth in outstanding for borrowers in the range of 12% to 13%. So from INR 21,713 in financial year 2021, we moved to INR 24,451 in financial year 2022. And now as of 30th September 2023, it's INR 24,650. So you can see that we are growing, we are diversifying. We are adding new customers, but this addition is very calibrated and it is one of our key strengths, which is that we actually marry risk and growth.

Another aspect, which I want to talk about you, if I can take you to the Slide number 19. In spite of being present in 19 states, well spread, -- we have now more than 1,000 branches. We have not lost sight on productivity numbers. If you can see the GLP per branch has been consistently growing from -- now if you see, it is around INR 7.95 crore the portfolio per branch.

And similarly, if you see the gross loan portfolio per RO, has been also growing. It is now INR 1.25 crore as of 2023, which was INR 1.14 crores in Q4 of 2022. We also are optimizing in terms of our reach and customer coverage. Our borrowers per RO, if you can see very consistent growth -- it was in 2022, Q2 of 2022, it was INR 501, moved to INR 505 in Q3, INR 488 in Q4. Now in Q1 2023, it is INR 502 and 534 as of 2023.

So if I can -- yes, so the borrowers per branch was -- in 2022 was 3020. Now it is 3,220 in FY '23. So the point where we want to drive here is that we are keeping a very key eye on all these metrics.

Now coming to our collection efficiency. As I mentioned earlier, our portfolio, which is 93.5% portfolio is sourced post April 2021 and the portfolio sourced before April 2021 is only 6.5%, which is INR 508 crores. And if you look at the Slide number 7, it clearly reflects the portfolio which has been sourced post April 2021, it is mirroring more or less the performance pre-COVID where our collection efficiencies hovering anywhere between 98.5% to 99%. Similarly, if you look at our portfolio, which has been sourced before pre April '21, it has been now -- we are still seeing some kind of stability in the collection numbers.

But overall, if I include prepayment collections, it is hovering more than 100%. I also want to really touch upon the slide on our credit ECL and our provisioning policy, where we are very clear that if I can take you to Slide number 8, as our policy provisioning policy as soon as the client enters 90-plus, we do 100% provisioning. If you can see that now in our -- in this particular slide out of the total provisioning which we have done, we have done around 174.74 million as a management overlay.

The strategic thought and this is that we want to build some extra buffer in the quarters where we will have a good profitability so that in any quarter or any time when there is any pressure on the profitability because of the credit cost, we can dig into this buffer. So that's the thought behind building the management outlook.

I can -- I would like to now take you to Slide number 24 and 25 in -- all our -- so very quickly, I will talk about our tech. So our tech strategy is very clear. We very strongly believe because of the customer which we serve, we believe in a Touch & Tech strategy, how we have been early adopters of cloud. What we have done is, I think we have kept two, three things in mind: one, our customer segment. So the interface, which is used to onboard the customer is very, very simple today. And then second thing which we have kept in mind that every technology has to make a business sense. If you can see from a customer experience, now 100% onboarding is happening digitally.

Our cashless disbursements have gone up to around 97% our efficiency level in terms of reduction of the turnaround time, which was early around 13 days in 2016 has moved -- has now come down to four days. We have -- and similarly, we are now able to handle the scale. We have been also very, very focused on building a very safe and secure IT platform. That is reflecting in the fact that we have -- whether you look at EMS security, device encryption, data classification, we were awarded ISO 27001 very recently.

So we are wanting to -- as a company, we are very focused on building for future. And you will see that we will continue to invest and build for future so that we are able to grow in a very sustainable bank. Thank you very much.

Gaurav Maheshwari: Thank you, Devesh. This is Gaurav. Good morning, all. Now I would like to give you some key highlights on Q2 for financial year '23 and H1 financial year '23. So, interest income has increased to 74% on a Q-on-Q basis. And on a half yearly, it has an increase of 52%. The total income has also increased to 69% on a Q-on-Q basis. And on a half yearly basis, it has seen an increase of 53%.

On the opex side, if you see that there is an increase of 4 bps from H1 of last year to this year. But on a quarter-on-quarter basis, there is an increase of 10 bps from Q1 to Q2 of FY '23. And that is largely because in Q1, we have increased. We have just opened 28 branches. And in the Q2 quarter, we have opened 65 branches. The cost-to-income ratio of the company has declined from 49.25% of the H1 of last year to 40% this year.

As far as the company has done direct assignment of some more than INR 400 crores in Q2, and we are going to continue with the same spirit and same range. The company has seen an increase in NIM from Q2 -- from Q1 to Q2. Q1, we have seen 10.21% of NIM in comparison of Q1 at 9.38%.

Now I would like to highlight certain portion on our liability mix. So we are going to continue with the liability mix, which we were continuing. As of today, more than 80% of the money is coming from the banking system. Near about 10% is coming from non-banking financial companies and rest is from a foreign portfolio investor and ECB. Going forward, maybe down the line a year or two, we are going to explore some capital market exposures, external commercial borrowings and certain set of bond issuance, whether internationally or a domestic market.

Apart from that, we have got a sanction from US DFC, over $25 million transaction at -- which is a A-Tier money at a cost of 9.65% fixed price loan. As far as on the financial is concerned, so there is a write-off which we have done in the Q2, which is amounting to INR 20 crores. In totality, in H1, we have done a write-off of INR 156 crores.

On the strategic thought, we would like to wait for FY '23 for a strategy to come into future where the interest rates are on a rising scenario, we will see after FY '23, that what kind of international environment or the interest rate scenario built-up. And we will see and develop the strategy accordingly to that.

Moderator: Sir, shall we open the floor for the Q&A session.

Sameer Bhise: Yes, please.

Moderator: We have the first question from the line of Saravanan from Unifi Capital.

Saravanan: I mean, there has been money fresh inflow equity infusion into the company via IPO. So what is the current debt equity ratio?

Gaurav Maheshwari: So the current debt equity ratio is near about at three times.

Saravanan: And the capital adequacy, the reported number for the first half is close to 20%. So it would have also gone up, right?

Gaurav Maheshwari: Yes. So the capital because the infusion of the capital has come in November. So obviously, the November numbers are still to be finalized, but it would be in the range of between 28% to 30%.

Saravanan: In terms of the debt equity, I wanted some strategic thoughts from your side. See, in micro finance, over the last 10 years, every two to three years, there is some force majeure event that is impacting the sector. From that perspective, we are comfortable with companies which always maintain high capital adequacy. If you see the market leader also, like typically, they have not -- they don't cross beyond 3, 3.25 or max 3.5x debt equity. So from that perspective, does Fusion also have any strategic thought on the debt equity part?

Gaurav Maheshwari: Yes. We -- if you look at our 12 year history, we have never gone less than 20% capital adequacy, and we would like to maintain the similar strategy going forward of maintaining capital advocacy, though RBI has prescribed 15%, would like to maintain a 20% capital adequacy.

Saravanan: So on debt equity terms, you would even go up to 4, 4.5 then?

Gaurav Maheshwari: Yes, we may go up to that level, but I think we are more focused on maintaining a capital adequacy of 20%.

Moderator: We have the next question from the line of Aditya Bhandari from Incofin Investment Management.

Aditya Bhandari: Just wanted to ask about the AUM to equity. So it's in line with the previous question. We are close to INR 8,000 crores and our net worth is close to INR 2,100 crores. So on an AUM to equity, we are close to almost 4x. So what would be the time line for the company to raise fresh equity in the coming quarters?

Devesh Sachdev: So thank you, Aditya. So as I mentioned, before this capital infusion, we ended September at around 20.97% of capital adequacy. After this infusion, capital adequacy will move anywhere between 27% to 30%. So I will, again, reemphasize the same thing that we would like to maintain a capital adequacy of 20%. Whenever we feel that we are reaching that level, we'll come to the market for raise the funds.

Moderator: We have the next question from the line of Nikhil Rungta from Nippon India Mutual Fund.

Nikhil Rungta: First of all, congratulations on a great set of numbers. Sir, two questions from my side. Starting with the previous question itself. So in terms of growth rate, I mean, you mentioned that at the current capital adequacy, we would be in the range of 27% to 30-odd percent. So what type of growth rate are we planning for next, say, couple of years? And given that growth rate, by when do you think we'll be going towards this 20% and coming back to the market?

Devesh Sachdev: Yes. So thank you, Nikhil. So again, if you see over the last 3 years, we've grown around 36%, 37% CAGR in the H1, we've already grown by around 18%. I think we would like to maintain a similar kind of growth rate. So once the base actually increases, the rate of growth cannot be in the same multiple. But we are looking at -- because of the fact that we are very well diversified. We are -- there is a pent-up demand, and we have many levers in place.

As I mentioned, whether it is a ticket size, whether it is the productivity, the number of branches, which have come very recently. So we have many levers because of the geography where we are present states like UP, Bihar have huge potential. So we are very confident that we'll be able to grow at a very consistent level. And again, coming back to the fact that whenever we feel that we need capital now the capital adequacy is reaching a 20%, we may have to come to the market for raising capital.

Nikhil Rungta: So this can take care of next 2.5 to 3 years?

Devesh Sachdev: So it's some interest also build up, but it's difficult to really give a guidance now. I think let's go step by step. That's what I have been -- we are very focused on. So -- and then let's see. We have us on saying that we give a more consistent performance and then let's see how we take it from there.

Nikhil Rungta: Sir, my second question is, if I look at our cost of funds on a Q-o-Q basis, there have been increase, but if I look post-September events, there have been an IPO we are listed now there is a CRISIL upgrade from A- to A. So going forward, what type of guidance on the cost of shall we take from your side?

Gaurav Maheshwari: Yes. So Nikhil, as you have rightly said that we have been upgraded to from A- to A by CRISIL, and we are anticipating that our cost of fund from a marginal cost of perspective that it is going to be stabilized, and there would not be -- obviously, the money which we have borrowed, it has an incremental impact on Q3. But largely, there would not be any incremental marginal cost of borrowing, which we are going to raise from Q3, Q4 perspective. So more or less, it will get stabilized. So that's the way we are looking at.

Nikhil Rungta: And full impact of rise in yield is still pending, right, because of the RBI norms.

Gaurav Maheshwari: Yes. So basically, what has happened, the new regime has come in the month of -- we have started in the month of May with the new guidelines. So the full impact would be seen from a Q1 FY '24 perspective, the NIM would be at that level, we would see at a stabilized level.

Nikhil Rungta: So there is further scope for margin expansion?

Gaurav Maheshwari: Yes.

Nikhil Rungta: And sir, last question from my side. Do we -- I mean, -- right now, we are flushed with capital and there are a lot of smaller MFIs which are struggling with capital. Do you see any plans for any inorganic thing or no thoughts on that particular side?

Devesh Sachdev: So Nikhil, we are very, very focused on growing organically. We have no such thoughts on table. We do not -- are not looking for any inorganic growth. Right now, there's no discussion on the table.

Moderator: We have the next question from the line of Arun Kejriwal from Kejriwal Research.

Arun Kejriwal: Just wanted to understand that during COVID, you had taken a very conscious decision of pushing the pedal and growing the business significantly. Now that you have done your IPO, you are listed, you have plenty of money to grow. Could this be taken as an opportunity to press the pedal all over again?

Devesh Sachdev: So thank you, Arunji. Let me go back to your question that during the COVID, Arunji, it was not that we actually face the battle. So it was a very calibrated approach, keeping in mind two, three things. One, fundamental belief on our customer, especially during the crisis time, you have to stand with the customer. That was one.

The second, if you see even the government, the policymakers were very, very focused that the liquidity should flow to this segment. And there was a special carve-out for microfinance sector in various liquidity initiatives which were done during the COVID.

Third thing, our network, our risk management, we were very calibrated we tweaked our credit policy. And we have followed the similar strategy in the year 2016, '17, also Arun ji post events after 2016 policy initiative by the government of India.

So I will say that it was a combination of some of these things of very clear focus on -- and on our core vision and mission are keeping the customers in mind. And also, if you could see, we have been growing very -- as I mentioned in one of my slides that it was -- consistency is one of our key features -- if you see even the last two -- these two quarters, Q1 and Q2, from 1983 to INR 2,047 is the total disbursement we have done.

So let me tell you that going forward also, we do not look at as trying to take a market share or something. I think Arunji, will be more calibrated, wherever we will see opportunity. But yes, as I mentioned, we are a company where we have married the risk and growth. So we'll keep all that thing in mind. We will not go very aggressive in just going for market share and all that. So that is the strategy we are going to follow. And that has in the core strategy of Fusion since beginning, sir.

Arun Kejriwal: No, Devesh I fully get what you are saying. And I was never trying to suggest that you were taking any sort of an additional risk, but having seen what you could do with your strategy with your systems in place, now that you have done so much more -- you have so much more in the kitty. Could this be another effort to try and now get the ball rolling for us in a more -- I wouldn't even use the word aggressive, but in a more positive manner. You have everything going for you, nothing left out.

Devesh Sachdev: Yes. No. As, again, right. So look, again, I will say that if you see the overall average disbursements now which we are doing is about INR 650 crores to INR 675 crores. So we are opening new branches, as I covered in my commentary. Some branches have come up in these two quarters. We have another engine, which is MSME engine, where we are now calibrating more towards secured loan.

Yes. So again, I will only say that, sir, wherever there is an opportunity, we will look at that opportunity, but in a very calibrated manner we are not doing very aggressive on the ticket size and all. We're not going very aggressive on the borrower pressure on the field offices. We will be calibrated, and that's how we want to grow.

Arun Kejriwal: Sir, one more question. With COVID now literally behind us things getting back to normal, what's the ground reality? Of course, numbers are very positive in terms of demand from this segment. Do you see any pockets of strength as far as lending is concerned, which would really comfort you?

Devesh Sachdev: Yes. So one -- two, three things which are very comforting, Arunji. One is the fact that this asset class has shown huge resilience. If you see -- look at the asset class and the kind of write-offs even which are happening, I think it is very commendable. That is one which gives a huge confidence that this customer has ability, aspiration to really service loans. The second thing which is comforting is the fact that, as I mentioned in my commentary, 93.5% of my portfolio has been sourced post April 2021 Arunji, where my collection efficiency is more or less mirroring the pre-COVID. So that also is a very comforting thing.

The third comforting thing is that the client behavior. When we look at the attendance center meeting attendance, joint liability, it is every month, we are seeing an improvement. Just to give you some sense here, if I talk about two, three quarters, four quarters back, and if I look at now between the center and the center attendee now is around 75%, which was -- which went down to as low as 50%.

So, and with a consistent effort of the team, telling the customer. So I think all these things are showing a good -- are giving us the confidence and the fact that, as you rightly mentioned, we have all the levers and we have shown resilience in various cycles Arunji, which also gives us the confidence that we are at a certain point to really not only grow but grow in a very calibrated manner.

Moderator: We have the next question from the line of Renish Hareshbhai Bhuva from ICICI Securities Limited.

Renish Bhuva: Sir, two questions. So one is on the ticket size. So when we look at the other industry players who are having much higher ticket size. So are we experiencing any, let's say, customer drop out because of our ticket size and customer would want, let's say, high ticket size, which are available from the other lenders. What is your experience on the ground, sir?

Tarun Mehndiratta: Good morning, Renish. This is Tarun. Yes. So good question, Renish. But I think just kind of picking up from what Devesh had mentioned earlier, the fact that, A, we are in the process over the last few quarters and years mining deeper into geographies that we've set for ourselves earlier. Also the fact that new customer acquisition, including new to credit acquisition has been a very, very focused strategy and the numbers that we shared with you earlier. What are domain understanding and our on-the-ground experience tells us is that, when we kind of go and meet these customers, the customers also help us decide what's the right size of product offering that they're looking at first and the entry level and then more as they graduate to next cycles.

So we collect a lot of inputs from our field offices. And based on that, as we mentioned to you also earlier in the -- during the call, that our ticket size on an average also have grown in the range of, let's say, 8% to 11% to 12% over the last three to four years. So that is how we try and kind of fix the product offering. It also goes by the fact that where we are in this geography in terms of how vintage customers and are how seasoned they are.

To the question that you asked on saying that is there an opportunity loss, I think very clearly about prudence in financing. When we do all these ground level coverage and when we bring those inputs on the table, we see that there is a good balance that we've struck over the years and that the numbers which we have on the table speak for themselves, that there has been a good direction taken when it comes to even having ticket sizes in the subsequent cycles after the first cycle.

From a standpoint of the fact that higher take customers require a little higher ticket size as we had probably shared in the past that when our customers reach cycles of, let's say, Level 4 or Level 5, our ticket sizes are fairly leveled out at about 70,000 to about 80,000 and thereabouts. So I would tend to say that I think we are currently in a place where I think we have a good balance between growth, either in terms of ticket size and about how we manage our risk there.

Renish Bhuva: Sir, just two follow-up on that. So sir, what is our current disbursement ticket size for the first cycle customer?

Tarun Mehndiratta: So Renish, our first cycle customers, the entry-level ticket side is INR 30,000. But what we've also done, like I just mentioned to you, so there are customers who are seasoned with other financers who may be new to Fusion, but not new really to Microfinancing. So there, we have put a differential level of about 40,000. So in first, I think, we have two levels of entry-level ticket sizes, INR 30,000 and INR 40,000.

Renish Bhuva: So new to credit, INR 30,000 crore and new to Fusion will be INR 40,000?

Tarun Mehndiratta: New to fusion will be INR 40,000, but a certain level of experience with some other finances.

Devesh Sachdev: Also Renish, it will also depend on the geography. So there are geographies where we even do a 25,000. So we look at -- so the -- this is -- so this is something I'll just take a minute to really talk about this that in Fusion, some of these aspects are decided by risk and audit.

Because when we open a branch, when we have to set up our product in a particular branch, the huge input comes from audit and risk to which when they look at various data, look at the geography, look at the economic activity and look at the customer segment and decide whether we should start with a 25,000 loan or should start a 30,000 loan or we start with INR 35,000 or INR 40,000 loan. So I think it depends on geography, area, stake, districts or all these parameters.

Renish. Bhuva: And sir, what is our top-up loan policy internal?

Tarun Mehndiratta: So Renish, the top-up loan policy internally is giving to existing customers with a decent level of track record. And of course, we all know that the fact that last few years have been fairly eventful. However, our overall top-ups in our entire portfolio. So our portfolio is about 3.2 million customers. Our top of accounts are only about 48,000, 49,000, right? So I think the number speaks for itself that we look at very, very carefully and also assess a customer for our top of needs right at the branch level. And then it suggests if the criteria are met, more on track record and customer behavior and existing customer is offered a top of product.

Devesh Sachdev: But our top-ups are very, very low. I think since beginning, we have never been very aggressive on top-ups out of 32 lakh customers. There's only 48,000 customers have top-ups and those customers which really need money. So we do not do life cycle management. We don't do some of these things.

Moderator: We have the next question from the line of Piran Engineer from CLSA.

Piran Engineer: Firstly, a clarification on one of the earlier questions on when will we see the full impact of the increase in interest rates due to the new regulations? And you had said first quarter of FY '24. But shouldn't it be like first quarter of FY '25, because our loans are typically two years. So something that was disbursed in end of FY '22, it will get refinanced only in end of FY '24 or beginning FY '25?

Devesh Sachdev: So Piran, so there are two aspects to see that how my portfolio is being built up and what is the average maturity of my book. So average maturity of my loan book is between 18 to 20 months. And if you see that the loan which we have disbursed from May onwards, they have a near about at 40% to 45% of the book by March.

And whatever we are going to disburse new that would be replenished the order book which we have created in the month of -- in the year of FY '21, '22. So that impact because you have also started witnessing from Q1 to Q2, it has already expanded by 9.3% expanded to 10.1%. So we are in line with that, that it is going to start from Q1 FY '24 onwards.

Piran Engineer: And just in terms of expense ratio, which is around 5.6% this quarter, how should we think about how that trends over the next two years? And typically, how long does a branch take to scale up to the average of INR 8 crores, INR 9 crore loans per branch?

Devesh Sachdev: So Piran, on the opex ratio, as Gaurav mentioned in his commentary that in spite of opening branches, it has -- the opex has really increased very marginally. We are -- and also, if you look at our cost-to-income ratio as now is less than 40. So we are very confident that you will -- even though we will be opening branches, but there will be an impact of the -- also the portfolio going increasing. So we are very confident that this will be hovering around this or coming down. It will not be going up in the next two quarters.

And coming to your second point…

Tarun Mehndiratta: So, this is Tarun. Average when we start a new branch, we see that the ramp-up on productivity levels comes in phases, like we mentioned to you earlier. So the first year of a brand typically sees an average sourcing of anywhere between, let's say, 140 to 160 customers. So at an average ticket size of about, let's say, INR 30,000, INR 35,000, we're looking at disbursements close to about, give or take, about INR 4 crores in a year.

So about INR 45 lakhs, INR 50 lakhs, about INR 4.5 crores to INR 6 crores in a year. So my sense is that at a fast level of about INR 8 to INR 9 crores, 2, 2.5 years is typically what it typically takes a branch to reach that level, given that the product levels will go up as we go along over the months, so 140, 150 will look like 170, 180 and so on and so forth.

The second cycle ticket size only start sitting after, let's say, 20-odd months, 18 to 20 odd months of our branches existence.

Devesh Sachdev: Just to add a rent our branch breakeven depends on where the geography is, what is the overall net of population. So we have seen that the branch breakeven happens anywhere between 6 to 9 months. 6 to 10 months where a branch is a breakeven.

Moderator: We have the next question from the line of Samir Rachh from Nippon India AMC.

Samir Rachh: So like three questions from my side. One, since the IPO thing is over now and we are well funded for the next couple of years, what are the top three, four priorities, which you have to make companies found an even stronger than they are so that we can sustain the growth rates?

Devesh Sachdev: Yes. Very good question, very strategic question, Samirji. So you're right. So I think I'll say three things, Samirji. There are -- one is the fact that, as I mentioned in one of the slides, which is on the IT, where Slide number 25 that we -- how are we building for future. There are certain trends on digitization, whether we understand our customer well, how are we making sure that we serve our customer well. I think -- and then the opportunity which is available, especially in the rural areas and the rule itself is coming out as an asset class.

So how we are better equipped to really move with our customer, grow with our customer. I think that's one big item we are very focused on. The second remedy is the fact that it's a people business. If you see today, one of the key strengths Fusion brings on the table is a very stable core team and a very -- even the middle management team is very stable and it has come up the later.

So investing on people is another aspect of where we are very focused because as we go along. The third thing is the data. So Samirji we have now 3.2 million customers. How do we look at data to -- so as I mentioned in one of the slides that we are looking at data analytics, how data analytics will be used both for business decisions and also for risk. So if I can tell you, I think, there are -- these are the three buckets. And there are other sub buckets under these three items, but we are very focused on these three buckets, Samirji.

Samir Rachh: My second question was on our like states breakup. So out of the top five states, what will the share of UP and Bihar if you can share that?

Devesh Sachdev: Yes. UP and Bihar is around 19.75, 19.8 each this thing. So we are -- let me tell you, in UP and Bihar, there is a huge potential, especially in UP because INR 20 crore population overall Microfinance penetration is hovering between 6% to 20% if you compare this with other states in Southern India or Eastern states, which is already at 30%, 35%. So we will see that this will be hovering anywhere between 19% to 22%, but we would like over the period of time to maintain less than 20%, even though there is a potential for other states will come up.

Samir Rachh: So I think we'll have a very big tailwind because these two states are perhaps one of the fastest-growing states in India and maybe a long growth runway, I guess?

Devesh Sachdev: Right Sir.

Samir Rachh: And then my last question is on this MSME engine, which you touched upon. So can you just elaborate more on what our long-term strategy to make that engine bigger and faster?

Devesh Sachdev: Yes. So Sumit, I think I'll -- so there are two, three strategic thoughts, which were there when we started MSME vertical. One was very clearly, we wanted to build operating credit assessment. We understood that microfinance is more of an operating model. We wanted to build a credit assessment model. So that was one. The second was we were wanting to remain adjusting to our asset class.

So the third was the fact that as there was a question earlier that there are customers which are needing a larger loans and how do we serve that customer because we are very prudent. We don't want to give very high ticket loans in the micro finance vertical. So what we have done is that -- and also we run a 3-year pilot. We have now close to around 43 branches. All these branches have come in areas where we are very strong as the micro finance. So MSME right now is a stand-alone doing a business. But we are also now looking at some of the customers' lead, which are now going to the MSME team on the microfinance customer, which need a larger loan and can provide some kind of security.

So the idea is that I can only tell you that we are more focused on building it very organically. It's a INR 200 crores portfolio as of now. But we are satisfied with our 3-year pilot -- and we are now going to the next stage, but I will resist from giving any guidance on numbers and all, I think we will be very, very focused on growing it as a strong asset class because -- and you will see that's the history of fusion. If you see the history of fusion in from 2010 to 2015, '16, we were building the right blocks, and then the growth came. I think we are looking at it in a similar manner. Right now, we are also recalibrating more towards the secured loan. And that's how we want to build this MSME vertical.

Moderator: We have the next question from the line of Gaurav Kochar from Mirae Asset Management.

Gaurav Kochar: A few questions, sir. Firstly, if I look at the assignment income this quarter was some INR 31-odd crores. So how should we look at this income going forward? And right now, if I look at it, the off-book AUM is around INR 1,000 crores. Your on book is around INR 7,000 crores, and overall AUM is INR 8,000 crores. So which is around 12%, 13% of overall AUM. So going forward also, can we expect the off-book AUM to be in the similar range of 12%, 13%?

Gaurav Maheshwari: No. So Gaurav. So one, the assignment book is as of today, approximately INR 730 crores to INR 750 crores. It is not INR 1,000 crores. What we are looking at, it is net of ECL allowance, so maybe you can add up and then you can work out on the math because that number comes to near about at INR 7,300 something crores as GLP. So second, as far as the direct assignment is concerned, so we are going to continue with the same pace because in Q1, we have seen slightly more less attractive rate what we are looking at.

And in Q2, we have got some larger sanctions from the bigger banks with the pricing that we are looking at. Obviously, there should be a, you can say, advantage to do a direct assignment in comparison to a term loan. And if that opportunity comes into, we are continuing to maintain the same level going forward in Q3 and Q4 also.

Gaurav Kochar: How should we model this? So is this, let's say, of the INR 750 crores, you earned around INR 31 crores in this quarter. Going forward also, can we assume that for a similar quantum on a percentage basis, this seems like a 4% kind of income. Can we model that 4% of the total of book as assignment income goes?

Gaurav Maheshwari: Yes. So you can assume because it totally depends upon the market condition and how it pans out to. So you can assume between 2.5% to maybe 4%, 4.5% of our range.

Gaurav Kochar: My next question is with regards to -- if I look at the disbursement run rate and borrower per branch, both these numbers are broadly stable in the last, let's say, 2, 3 quarters. if I look at the branch number of branches have gone up. So going forward, let's say in second half because microfinance is more a back-ended business in terms of growth. Can we assume that the disbursement, which is around INR 2,000 crores per quarter, that run rate improves in the second half of this year. And as a result, the metric of AUM per branch, borrower per branch, et cetera, that also improves in the second half. Is that a fair assumption?

Devesh Sachdev: Yes. So no, we're of 2 points here. One, if you see the overall stability in terms of the productivity levels is one of the factor is that we have opened new branches. And in the last 400 branches, as I mentioned earlier in my commentary in the last 3 years, and we continue to open more branches. That's why you see that it is the productive level not moving at that level, but still we are able to maintain a very decent productory levels.

Second is that if you see -- look at the disbursement, I don't think we have already done close to INR 4,000 crore in the two quarters, H1. You will see 5%, 10% here and there, but more or less, we will -- because we are more consistent. If you see that historically also Gaurav, we are very consistent. It's not lopsided to the last quarter. That has not been our strategy in the last many years, if you look at our disbursement numbers Q-on-Q. So more or less, you will find a consistency there.

Gaurav Kochar: My last question is with regards to the pre-FY '21 portfolio. Right now, it's only 6.5% of overall AUM. But if I look at the collections, including the prepayments, et cetera, the collection seems to be 107%, 108% for this quarter. So going ahead, let's say, given that you have a 2-year sort of average duration of the loan, can we expect this portfolio to completely run down by 4Q? And if that's the case, I mean, what are the, I mean, write-off or any sort of stress that you foresee in this remaining 6.5% order book?

Devesh Sachdev: So Gaurav, if you look at we have one, we are fully provisioned -- so on wherever we need -- where the customer is a 90 plus, it is fully provisioned. And as I mentioned, we are already creating extra buffer. We do not see some any big slippages in the portfolio, which is sourced pre-April 21. So we are not very worried about it. And there is a team which is working on that portfolio separately also. So I don't think that we have front-loaded everything in the last two years in terms of provisioning. So we are not very concerned that there could be any shock because of the portfolio, which has been sourced pre-April '21.

Gaurav Kochar: So the first half credit cost is broadly where you should be in the second half as well. Nothing more than that? The net worth after the capital raise during IPO, that stands at INR 2,100 crores, right?

Devesh Sachdev: Yes, it should be in the that range. But Gaurav, there would be an additional profitability, which is going to come for October, November.

Gaurav Kochar: So I'm missing on that INR 600 crores. So -- from a medium-term perspective, what would be the guidance now that the equity base will also go up. On the ROE, ROA and ROE front, any medium-term guidance, let's say, FY '24 or FY '25 that you'd like to call out?

Devesh Sachdev: So I think Gaurav would like to maintain. I mean, we will be more consistent in maintaining the numbers which we have given, especially on the ROA, Sorry, that is the -- after the equity infusion, the ROE definitely will come down. But on the NIMs, on the ROA, you will find a very consistent numbers subject to market conditions. But yes...

Gaurav Kochar: Sure. So sorry, did you mean 5% kind of ROA, if that's what you mean?

Devesh Sachdev: So, I think we will not stop -- not say the 5%, I think anywhere between 4.5% to 4.75%. And as I mentioned that whenever we have a good quarter, we would rather put some -- transfer some money in the management out overlay rather than talking about it saying, talking about a 5% testing will be more concerned about a consistent ROA. And I think we are more focused on this bracket of 4.5% to 4.75% as a consistent ROA.

Moderator: We have the next question from the line of Alpesh from IIFL Securities Limited.

Alpesh: And congratulations to the team for the great set of numbers. First question is on all the yields had by we have discussed a lot on that. But just getting some sense that what would be the expansion possible over the next 4 quarters after the entire repricing is then based on this risk base to pricing mechanism?

Devesh Sachdev: So if I understood correctly, you're talking about NIM right?

Alpesh: No, I'm not talking about the margin because, obviously, the cost of funds will have a good thing in that. But yes, just on the yield on loans. The number that we have reported in this quarter, which is around 20.3%. So what would be where it can settle down?

Gaurav Maheshwari: Yield, you're talking -- so yield, which I am assuming is without considering the processing fees. So we are targeting between 21.5% to 21.75%. And plus, obviously, there would be a processing fees, which we are charging at like 1.25%. So that is what it is to be...

Alpesh: So it would be around 150 basis points kind of an expansion over the next 4 quarters some...

Gaurav Maheshwari: Yes.

Alpesh: Okay. So go over here, my question is, while we are not expecting a significant increase in the cost of considering our rating upgrade plus softer syndication and the capital raise but et cetera. So we will have a further expansion in margins from around 10.2% to 11.2%, 11.5%. And so far as the margins are the spreads, right? -- so is it fair to assume that we should be settling somewhere around 11.2% to 11.5% margin kind of on a steady state basis?

Gaurav Maheshwari: Yes, yes.

Alpesh: So now again, now a related question here, going back to the Gaurav question. If we are going to settle 100 basis points higher margins from here on, there would be some operating leverage playing out and the assignment income contribution is also increasing. So -- and if we are planning to have a 4.5% to 4.75% kind of ROA, are we talking about keeping a credit cost number at around 2%, even though fundamentally, it may not require but the management overlay of almost 1% ever year?

Devesh Sachdev: Yes. So Alpesh, you're right. I think anywhere between 1.5% to 2%, we would like to -- overall, including the provision around 90%, we would like to maintain to build.

Alpesh: And sir, just last question on the growth side. Since we are on a INR 2,000 crore kind of a disbursement on a quarterly basis. Is it -- and most next year, our repayment rate should come down, considering the considering that there have been some backlogs related to the COVID and R&D duration of the portfolio is also slightly increasing. Is it fair to assume that next year around 28% to 30% kind of year growth possible in FY '24?

Devesh Sachdev: Yes, I think we would like to because the base will be much larger from where we are now. So yes, I think anywhere between mid-20s is where we will focus on a more consistent basis.

Moderator: We have the next question from the line of Jigar Jani from Edelweiss Wealth Management...

Jigar Jani: Yes. Just one question, sir, on an absolute basis, we have seen some increase in our GNPA by about INR 30 crores on a Q-on-Q basis, plus we had about a INR 20 crores write-off in this quarter. But if you look at the 30 to 90 DPD number, that hasn't come down significantly. So just want to understand what is causing this increase in absolute GNPA. Is it slippages from the 0 to 30 buckets? Or how -- I mean, just trying to reconfirm the numbers?

Tarun Mehndiratta: This is Tarun, like we had explained earlier, so in our portfolio, when we do the slicing from quality or a portfolio assessment standpoint, we still have about 6.5% of the portfolio which is pre-April 21 source portfolio. And the fact that we have gone through the event over the last few years, there are 2, 3 things that we look at here. A, is the characteristic of the overall book. So there is this new book, which is 93.5%, which has shown to you, there is a very, very good demonstration of behavior like it was in pre pre-COVID.

So the collection efficiency there is now in the zone of 98.5% to 99.2%, 99.3% month-on-month, and this we've seen across all the states. What we've also seen is this is as the phasing out or let's say, the impact of the events has started to slow down a bit or get redeemed a bit we have seen the uptick in the customer kind of behavior towards also resolving their early delinquencies or so on and so forth. And this we've seen across geographies. And that is how we see better collection number than what we've seen in the past.

The other part is that some of the other pockets, like we mentioned earlier, who are probably largely or more significantly impacted in COVID 2. And after that, some of the other natural elements have taken a while to come back to the normalization curve, which we've seen over the last 3 to 4 months. So we continue to maintain our focus on engaging with our customers who had been hit -- so we -- like Devesh mentioned earlier, there is a dedicated set of loan -- our officers on the field who engage with them, and we continue to resolve their fast delinquencies more progressively as we go along.

So these 4, 5 factors give us comfort that we will and we are also going to see a more progressive slowdown of increase in the early buckets, which will help the flow to the 90-plus bucket, and we will see consistency of levels in terms of how the GNPA will look like as we go along over the next 2 quarters.

Jigar Jani: Is it possible to share your 1-plus DPD this quarter and in June quarter?

Tarun Mehndiratta: So we can always do that. We will come back to you. We can probably take that separately and can address that for you. Yes.

Moderator: We have the next question from the line of Bhuvnesh Garg from Investec Capital.

Bhuvnesh Garg: I have three questions. Firstly, on your loan yield. So if I heard it correctly, you said your incremental loan yield is 21.5% to 21.75%. Is that correct, sir?

Devesh Sachdev: Yes. This is without talking about without the processing fees.

Bhuvnesh Garg: And secondly, on geographic breakup. You mentioned that the share of UP and Bihar is about 19% each. So could you please also what are 2, 3 other states from you drive your significant AUM?

Tarun Mehndiratta: Odisha will be closer to about 11.5%. Madhya Pradesh should be closer to 9.7%, 9.6%, followed by Tamil Nadu, which will be closer to 6.5%, 7%, 7.2%.

Bhuvnesh Garg: And thirdly, sir, what would be your customer retention rate?

Tarun Mehndiratta: So our customer rate today is in the range of 70%, 72%.

Bhuvnesh Garg: 70 to 72.

Tarun Mehndiratta: And as we go along, what we want to do is that the balance of our new customers to existing customers, especially in the branches that we've been there for a while, especially the vintage branches. So we are focusing more on looking at how we can meet the growing needs of our existing customers. And that is also really one of the key metrics that we assess ourselves on very closely. So we are always -- so this retention rate 3 years ago was about 48%. So 3.5, 4 years, ago was about 48%. So with focused interventions and orientation of the teams and engaging more with the customers, offering the right kind of products that they were looking at. We've been able to bring this up from 48% to about 70%, 72% -- and we are looking at how we can improve this more.

Moderator: We have the next question. That's a follow-up question from the line of Renish Hareshbhai Bhuva from ICICI Securities Limited.

Renish Bhuva: So sir, sorry to circle back to the ROA journey. So Q2, our credit cost is more than 3.5% on an annualized basis. And going ahead, we sort of we are expecting a margin expansion. And of course, these credit costs will normalize to the steady level of 1.5%, 2%. So sir, cumulatively, there will be a 250 basis point additional P&L benefit is likely to come. So I'm just trying to reconcile why we are restricting ourselves to 4.5 to 4.75 ROA when there is a probable 250 basis point of ticker is lucky to come?

Gaurav Maheshwari: No, no. So as what Devesh has said in the initial statement also, that we will try to create a buffer for any unforeseen event, which are going to come in the future or if it is not to be, then obviously the benefit is going to be for all the companies and all the shareholders on that perspective. So it is something which we are working on to have a consistency on our return ratio. So that is what we are going forward with.

Renish Bhuva: But we are not going to, let's say, increase the management overlay materially, is what I want to get a thing?

Devesh Sachdev: So Renish, as we mentioned, I think we overall want to maintain overall in around 1 point extra buffer of anywhere between 0.5 to 0.75 right now but this will change every quarter and is looking at the environment, looking at the customer behavior and then we may rethink next year. But right now, any quarter, good quarter, we would like to really put -- and then build some buffers of 2.5% to 3% over the next 2 to 3 years.

Gaurav Maheshwari: So to add what Devesh is saying that in the last 2 years, we have already provided like we have front-loaded all the provisioning. So obviously, this year would not be an ideal year to look at a credit cost in that perspective. I think from the next year onward, it would be very clearly visible that what would be the potential credit was what we are talking about.

Renish Bhuva: No, this is very helpful. In fact, we are amongst the one where having this provisioning policy, at least amongst MFI players? Thank you, sir.

Moderator: We have the next question from the line of Darpin Shah from Haitong India.

Darpin Shah: Yes. So my question was in the opening comments, you had mentioned about tweaking some credit policies. So if you can highlight more about it, what you had to beat and what were the outcomes of it?

Devesh Sachdev: Yes. So what I talked about was that Darpin during the COVID time, when we decided to continue disbursing so we had done small tweaks here and there. That was what I was talking about. So those peaks were one, understanding areas where there was a continuous lockdown, not going and where the impact of COVID was more not disbursing there. Looking at some of the geographies like UP, Bihar did very well even during COVID focusing on some of these geographies.

The second was that looking at the client behavior. So when we were sourcing when we were welcoming new customers which had trade lines with other or other lenders -- we actually looked at whether the customer has ever gone in certain buckets, whether the customer is under resolution of 1.0 or 2.0. whether the customer look at the migration this thing. So some of these things we looked at. And what has been the customer behavior over the life. Normally, you look at the customer over the last 1 or 2 years.

But there, we said, okay, let's look at the customer behavior over the last 5, 6 years, if the customer is already existing customer of micro finance. So some of these things, we actually tweaked to make sure that when we decided to grow in the uncertain environment, it is a very calibrated and thoughtful growth.

Darpin Shah: And sir, one data billing question, if you can help us with vintage of your customers. What I mean is all of this 3.2 million customers, how much will be in bucket -- sorry, not bucket, but cycle 1, cycle 2, if you can just help us with that?

Tarun Mehndiratta: Yes. So currently, in terms of number of customers, the breakup is that cycle 1 on an average is anywhere between 51% to 53%. And the remaining is our existing customers. So it's about 46%, 47% will be existing customers and 51% to 53% will be cycle 1 customers.

Darpin Shah: But any further breakup in this 1%, 6% cycle 3 cycle 4 type of a customer?

Tarun Mehndiratta: Yes. So the bulk of this existing customer of about 46%, 47% is made up by get customers followed by 3 and 4 like that. So that is how the breakup is.

Moderator: Thank you -- ladies and gentlemen, as that was the last question for today that the management could answer. I would now like to hand the conference over to Mr. Sameer Bhise for closing remarks. Over to you, sir.

Sameer Bhise: Thank you, everyone, for joining us for this call today. Also I would like to again thank the management of Fusion Micro Finance for giving us the opportunity to host the conference call. Thank you. That ends the conference call.

Devesh Sachdev: Thank you, Sameer. Thank you, everyone.

Moderator: Thank you, sir. On behalf of JM Financial, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.