THE UPSIDE of DOWN

ARMAN FINANCIAL SERVICES LIMITED

ANNUAL REPORT 2020-21

Content

"When life gives you every reason to be Negative, think of all the reasons to be Positive."

Headwinds push us back when we least expect it . Sometimes, the forces of nature seem to be at war with us. More often than not, they strike when things are cruising just fine.

The challenge then, is not about what will befall upon us …but how react to them. The negativity that tries to drown us is not as important as the positivity that we rely on to stay afloat!

Remember school days … we were engrained with the fact that two negatives make a positive. Actually, we were being shown that there is a potential positive in every negative. There's a fortune in every misfortune. An adversity, sometimes, is only a misplaced opportunity.

Setbacks are often opportunities turned upside down.

The pandemic presented a rare but narrow window of opportunity to reflect and reimagine our world – and new possibilities therein.

A probability to

up the ante

Covid 1.0 was a turmoil for the entire world. And India.

It was an emergency of unthinkable proportions to which we had no immediate remedy. Overnight, the health scare became and economic calamity as lives and livelihoods were impacted. Large businesses remained shut; its impact percolated right down to micro establishments.

For microfinance customers, who are largely hand-to-mouth, their ventures remained shut for 2-3 months. This reality was worse than their worst nightmare. Most onlookers were almost sure that the unprivileged rural masses would buckle under pressure.

Interestingly, that did not happen. Most microfinance customers repaid their dues, some directly, while others with some help. But they did. The industry recorded collections in excess of 90% by March 2021. At Arman, our collection efficiency scaled to 94%.

This showcased the grit and resilience of the most vulnerable segment of the Indian diaspora, considered unbankable, only a decade ago. They endured and sailed through, possibly the toughest phase in their journey of life.

It also brought to the fore that these are the proven lot with whom you can increase your business exposure. They are the ones who will drive growth over the coming years – for the economy, the microfinance sector.

And for Arman!

A paper with

promising prospects

In the midst of the pandemic-related pandemonium there appeared a ray of hope.

In 2012, when the RBI came out with regulations for the microfinance sector, ~95% of the MFI sector comprised of NBFC-MFIs. The initial successes of this segment attracted banks and other institutions into this space. Despite the growing competitive intensity in this space, the stringent rules of RBI remained applicable only to the NBFC-MFIs, not others. This created a regulatory arbitrage for the non-NBFC-MFI players and gave them a clear advantage.

Recently, RBI has published a Discussion Paper that proposes to change all that. 1) It sets out rules and policies that will apply to all microfinance practitioners – creating a level playing field. 2) It removes the cap on the interest rate charged to customers – this will allow MFIs to charge variable interest rates based on competition, risk, and operating cost. 3) It prevents customer from getting over leveraged – it uses 50% fixed obligations to income ratio (FOIR) for all loans.

Today, when close to 80% of the microfinance portfolio is concentrated in only 30% of India's districts[1] , this new document rings opportunity bells for our sector. And us!

[1]*Source : MFIN MicroMirror District Risk Index Report March 2021.*

Agile & Alive

to possibilities

Even as the deadlier Covid 2.0 hit India and its underbelly, opinion influencers are of the opinion that millions in the microfinance space will default.

We, at Arman, firmly believe, that things will only get better from now onwards. Because uncertainty is often the gateway to interesting opportunities. Because the India is fighting back with passion and perseverance. India will resurge… driven by the lowest slice of its social pyramid. Once Again!

At Arman, we are striving to go beyond the now to the next, which we are confident will be a stimulating journey. For this, we have

We managed our cost structure, making us more effective

- Leveraged technology to make our processes future-ready and enhancing people productivity.
- Saved money where we could but took care of our own team; there were no layoffs, salary cuts, or furloughs for the team members.

We solidified the organisation; it allows us to capitalise on new opportunities

- Widened our presence to Haryana even as we entrenched our presence in Rajasthan.
- Strengthened our expertise of assessing cash flows and business prospects of the rural Indians.
- Provisioned for future losses. Wrote off ₹16.47 crore of COVID impacted loans and made ₹38.12 crore of additional provisions during the year. Total of ₹51.55 crore available as provisions for the future write-offs.

Maintained a solid liquidity base to provide comfort against the unknown

- Created strong liquidity - Cash & Bank balance and Liquid investments stood at ₹ 132 crore and undrawn CC limits.
- Maintained healthy relations with 30+ banks and other financial institution. If cash is our raw material, we have a diverse set of suppliers and sources, including lower rate DFI funds from NABARD, SIDBI & MUDRA.

About Arman

Arman Financial Services Ltd (NSE: ARMANFIN; BSE: 531179) is a category 'A' Non-Banking Finance Company (NBFC) active in the 2-Wheeler, MSME, and Microfinance Lending business. The Microfinance division is operated through its wholly-owned subsidiary, Namra Finance Ltd, an NBFC-MFI.

The Group operates mostly in the underserviced segment of the economy, invests in the small dreams of the large unorganised sector residing in rural and semirural locales across seven states. Arman's big differentiator with a Bank and other NBFCs is the last mile credit delivery system. It serves areas and clients where it is simply not possible for banks to provide financial services under the current market scenario.

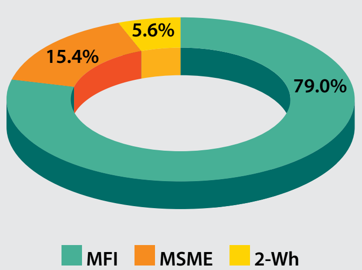
1,889
Team size

239
Branches

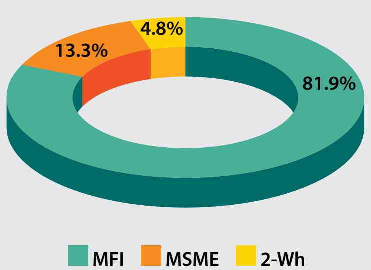
517.8
Market Capitalisation
(₹ crore)

Business – vertical-wise

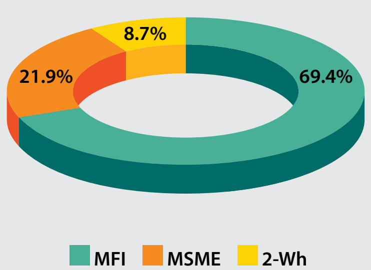
814.4
Assets under Management
(₹ crore)



509.7
Disbursement
(₹ crore)



190.9
Income from Operations
(₹ crore)



Vision

To attain globally best standards and become a world-class financial services enterprise – guided by its purpose to move towards a greater degree of sophistication and maturity.

Values

- To help those who are at the bottom of the pyramid.
- To work with vigour, dedication and innovation to achieve excellence in service, quality, reliability, safety and customer care as the ultimate goal.
- To earn the trust and confidence of all stakeholders, exceeding their expectations and making the Company a respected household name.
- To consistently achieve high growth and the highest levels of productivity.
- To be a technology-driven, efficient and financially sound organisation.
- To contribute towards community development and nation building.
- To be a responsible corporate citizen nurturing human values and concern for society, the environment and, above all, the people.
- To promote a work culture that fosters individual growth, team spirit and creativity to overcome challenges and attain goals.
- To encourage ideas, talent and value systems.
- To uphold the guiding principles of trust, integrity and transparency in all aspects of interactions and dealings.

Our Competitive Moat

1) Genesis

- Arman Financial Services ("Arman") is a diversified NBFC focusing on the large underserved rural & semi-urban retail markets.
- Strong management team with 100+ years of experience led by Mr. Jayendra Patel.

2) Wide Distribution Network

- 239 branches; 55+ 2-Wheeler dealerships.
- 94 Districts, 7 states.
- ~3.74 lakh live customers.
- Contiguous geographic footprint for geographic diversification and cost efficiencies.

3) Robust Risk Management Framework

- 29-Year track record of consistent profitability; never reported an annual loss.
- Complete in-house operations with bottoms up driven credit appraisal models and rigorous collections practices – tailored for the areas of operations.
- Consistent rating upgrades backed by strong financial & operating performance; currently rated BBB+ by CARE Ratings.

4) Efficient Liability Management

- Comfortable Liquidity Position: Positive ALM.
- Average lending tenor at origination: ~24 months; average tenor of debt at origination: ~36 months.
- Diversified Borrowing Profile with Relationship across 30+ Banks & other Financial Institutions.
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5) Strong Financial Performance

- High Growth Trajectory (FY2016-21CAGR)
  - AUM: 36%
  - Net Income: 36%
- Consolidated debt to equity ratio of 3.9:1– Sufficient Capital to drive growth going forward.
- High Return Ratios except for COVID impact for FY21: ROE: 5.9%; ROAA: 1.3%.

From the Vice-Chairman's desk

As a sustainable business, everything we do is inspired by a deep sense of purpose. Our values have held us in good stead at this time, and they are the foundation on which we have built our success. It is heartening to see Arman rise to the challenge and continue to make a positive impact on the lives of people, especially during these tough times where our customers need us the most.

Dear friends,

I consider myself fortunate to be expressing my thoughts after having endured a rather challenging period.

FY21 was a rather tough year. Problems appeared across the horizon. Systemic fractures in the business ecosystem, hitherto overlooked in the aggression for growth, became more apparent. But a resilient India Inc., albeit with some slippages, overcame the headwinds and scripted a remarkable recovery that silenced many naysayers.

The story is equally applicable to the microfinance industry too. Once we let the initial dust of the pandemic and lockdown settle in, realities became more apparent and the doom and gloom estimates during first quarter for FY21 became largely unfounded. The writing on the wall shone bright – survival over success was the clarion call for our customers and us.

This is exactly how we tempered our resolve. Even as we provided a moratorium and other benefits to our customers, we focused on recoveries – the rates of which scaled every month. We prioritised liquidity over growth. Our numbers may have contracted but the organisation's liquidity swelled. Our AUM dropped marginally but our NPAs remained manageable. We survived well, but at the cost of our plans being deferred by a year at best.

For me, that is literally no cost for enduring one of the most catastrophic health emergencies of several generations.

The upside of this downturn was that we got precious moments to reinforce our strengths and draw the contours of our blueprint for a post Covid world.

1) We realised that in the penchant for growth and numbers, somewhere the softer aspect of our business – relationships – were getting compromised. We undertook a disciplined drive to build on existing relations with our people – customers and employees.

2) We worked aggressively on strengthening our IT network and solutions which became a 'must have' mandate from the earlier 'good to have' priority. Our technology solutions will support our expansion strategy even as it promises to optimise costs. It will facilitate agility in decision-making and field operations even as we widen our operating canvass. In FY21, we made considerable progress on this front.

3) We piloted a flanking vertical - 2-wheeler loans for the rural markets. The pandemic brought to the fore the need for personal transport over public transport in rural areas. It was something that appeared to be a good fit in our business strategy. The numbers are small at present. We hope to build this piece to a reasonable size over the medium-term.

4) No matter how strong your belief system is about the strength of your company, your strategy and your own abilities, it is difficult to prepare for and face a crisis like a global pandemic. There are no manuals that teach you about leadership in times of a global pandemic, no notes to help you form

decisions, no experience base to fall back on and no guides to suggest a course of action. Crisis management is tough! Its during times like these that you must rely on the judgement of your team and entrust them to think on their feet; use their creativity and innovative ideas to find solutions. I am incredibly privileged and lucky to find myself working with one of the finest teams in the industry.

I whole-heartedly welcome RBI's announcement to harmonise the regulatory frameworks for various regulated lenders in the microfinance space.

FY22 & beyond…

Interestingly, the start of FY22 mirrored that of FY21. The second wave was increasingly painful as it hit India's underbelly – the rural masses. Loss of lives was significant. My heart and prayers go out to all the families who have endured the pain and suffering.

The difference this time was that India Inc. was not completely shut. The aggressive fight against this invisible enemy by the health system, corporates, NGOs, other agencies and institutions, and individuals was an extraordinary effort. The entire country was glued to the television watching the numbers rise every day as the crisis unfold. As I pen this letter, it seems that we have successfully flattened the curve in a shorter time span and a resurgent India, yet again, has bounced back with vigour.

Our business remained subdued in April and May of 2021, but the recovery in subsequent months is better than our estimates. We hope to sustain our business momentum even as we endeavour to strengthen the organisation's asset quality and liquidity. Our estimates could face some headwinds from a possible third wave, which is not expected to be as brutal at the second… I am keeping my fingers crossed!

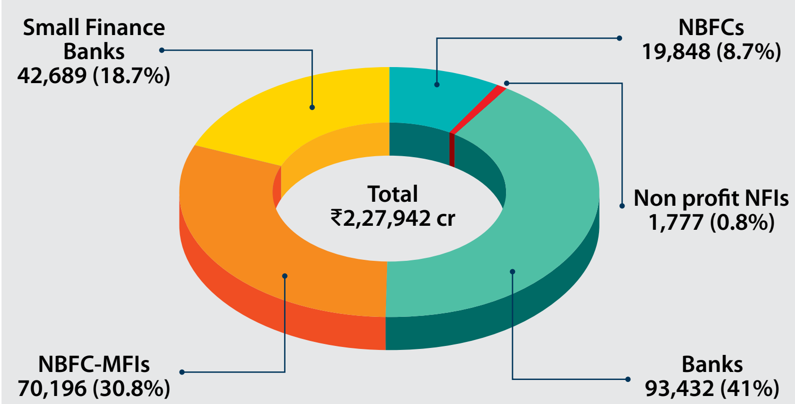
Looking beyond the pandemic, I am particularly optimistic for MFI players like us.

In the past, various RBI and government initiatives to support the NBFCs-MFI have helped the industry. The most recent White Paper penned by the RBI promises great prospects for the NBFC-MFIs operating in India.

The big picture

The primary objective of the RBI consultative paper is to address concerns related to the over-indebtedness of microfinance borrowers and enable the market mechanism to lower the interest rates in the sector.

Loan amount outstanding (₹ in cr)



Source: RI Paper

I whole-heartedly welcome RBI's announcement to harmonise the regulatory frameworks for various regulated lenders in the microfinance space, which would stop the regulatory arbitrage amongst the 'Non-NBFC-MFI' microfinance practitioners and create a more robust industry to prevent overleveraging by microfinance customers, amongst other benefits.

As we have mentioned numerous times in the past few years, there was a genuine need for having such a framework, which would be uniformly applicable to all regulated lenders in the microfinance space rather than prescribing stringent guidelines for NBFC-MFIs alone. These new guidelines, if implemented, will put all microfinance practitioners on a level playing field. The removal of the existing pricing cap will allow MFIs to innovate risk-based products and enter previously underserved geographies, while the 50% FOIR rule will ensure that customers are not over leveraged.

I also feel that there could be systemic change that could playout over the medium-term. While the JGL Group loan format would continue to grow, there could be the emergence of individual loans for the ambitious and the "emerging" rural customers. We have started a pilot to explore servicing these customers.

These possibilities provide considerable optimism for a promising future over the medium-term.

In closing

As a sustainable business, everything we do is inspired by a deep sense of purpose. Our values have held us in good stead at this time, and they are the foundation on which we have built our success. It is heartening to see Arman rise to the challenge and continue to make a positive impact on the lives of people, especially during these tough times where our customers need us the most.

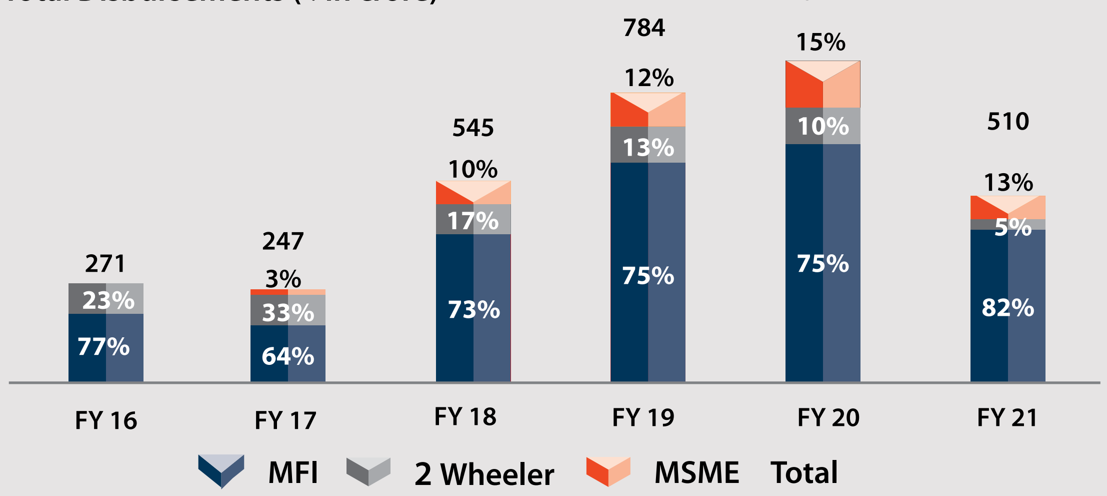
We are determined to come out stronger from this pandemic than we have ever been. I would like to thank the entire Arman team for their unflinching commitment, and our partners, shareholders and customers for your continued trust, confidence and support.

Warm regards,

Jayendrabhai Patel
Vice-Chairman & Managing Director

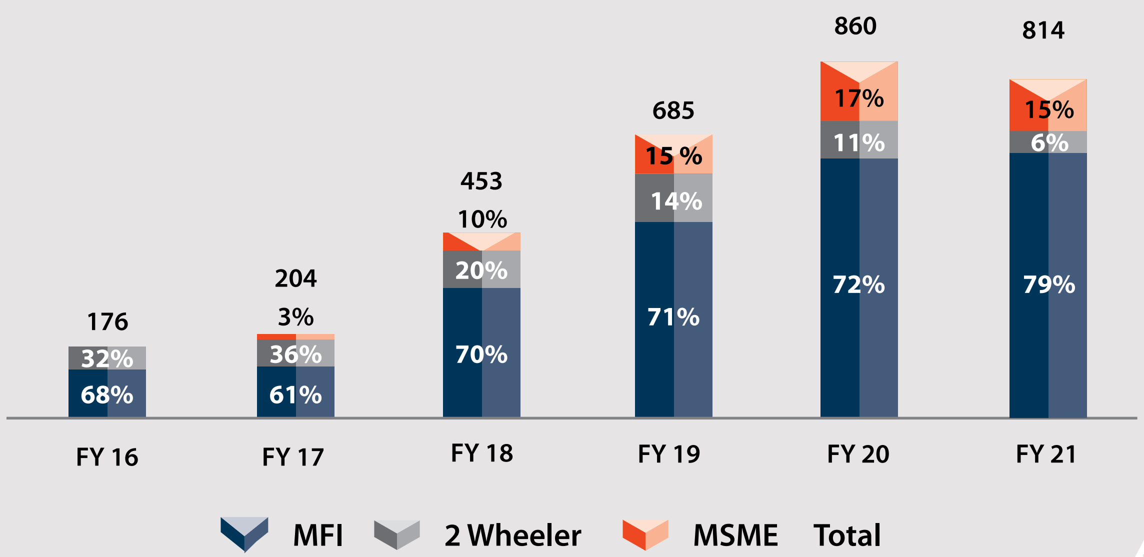
Key performance indicators

Total Disbursements (₹ in crore)



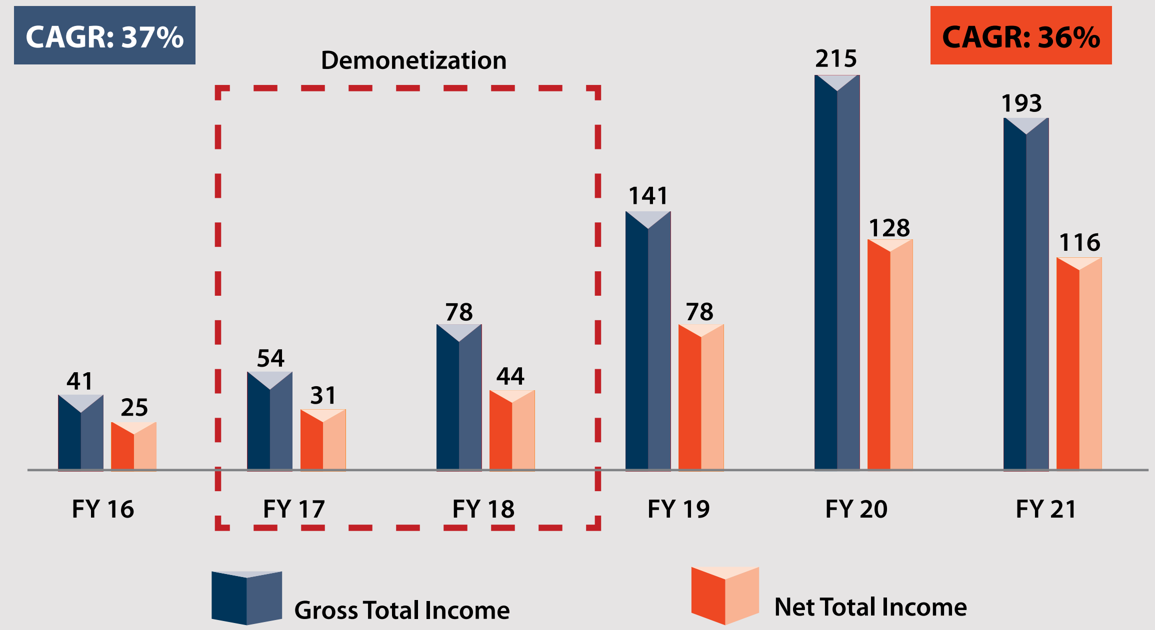
***Note:** FY21, FY20 & FY 19 figures are as per IND-AS, all the figures to FY19 are as per I-GAAP*

Assets Under Management (₹ in crore)

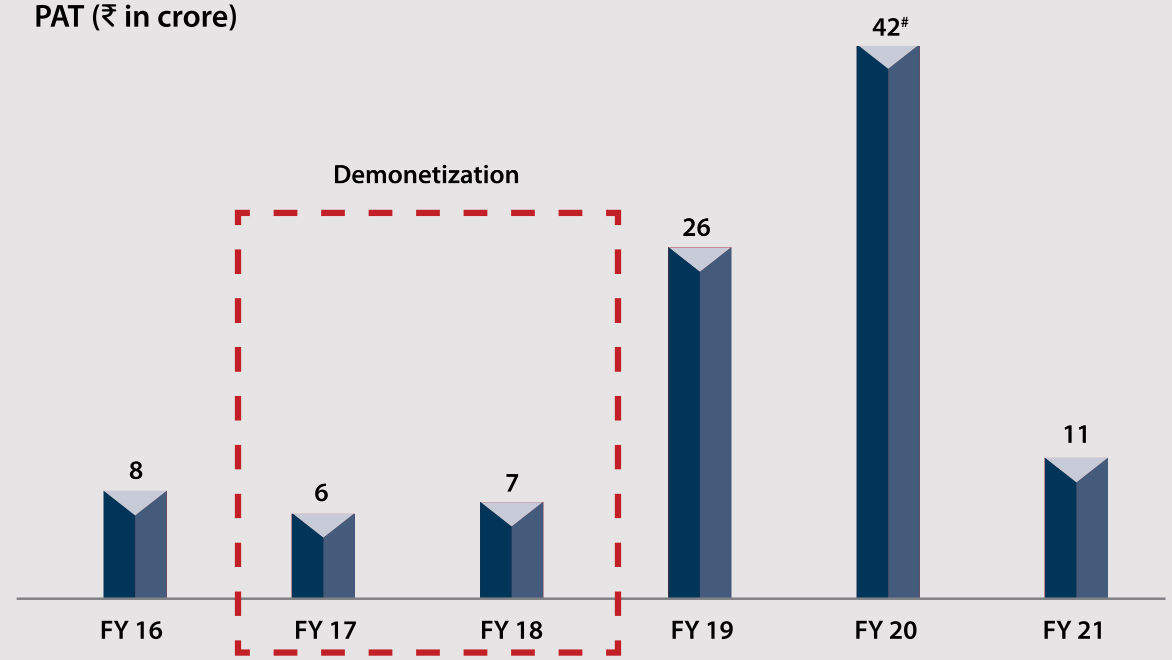


Note: FY21, FY20 & FY 19 figures are as per IND-AS, all the figures to FY19 are as per I-GAAP

Gross Income and Net Total Income (₹ in crore)



PAT (₹ in crore)



Adjusted for the Covid Provisioning of ₹6.68 crore, PAT would have stood at ₹48.2 crore in FY20; and ROE would have been 32.6%