Ugro Capital

Operator: Good evening, everyone, and thank you for joining us today. This is the second day of the Bharat Connect Conference, September edition. I welcome you all to the call of Ugro Capital Limited. Today, from the management, we have Mr. Anuj Pandey, the CEO, and Viral Shah from the investor relations team. Before I hand over the call to management, I will lay out the flow of the event. We will first begin with opening remarks by management, and then we will move to the Q&A round. First, we will take up questions from the participants who have raised their hands, and then we will move to the chat box. If time permits at the end, we will take up questions from participants who were not able to join the call. Without delaying anything further, I will hand over the call to Anuj sir.

Anuj Pandey – CEO: Thank you, Juhi, and good evening, everyone. Thank you for joining this update call with us. The way we have thought about conducting this call is to share a small presentation with you, which will tell us a little about the history of the organization and the recent strategic realignment that we undertook. After that, I will discuss how we foresee the future. Without wasting any more time, we will start. I am assuming that some of you know a little about Ugro, but for those who do not have much background knowledge, I will start with the overall history of the organization.

We came into being in 2018 as a listed company when a set of investors led by four large private equity players, together with our founder, Mr. Shachindra Nath, acquired a listed company called Sukhani Securities and rechristened it Ugro Capital. When we started, our aim was very clear: to be the leading MSME lender in the country. At that point in time, MSME lending was considered somewhat difficult because the underwriting problem had not been fully solved. We saw a very large opportunity to use data science and a technology platform to improve underwriting for MSMEs. We described this in our mission statement as “solving the unsolved,” where the unsolved problem was underwriting.

Once we acquired the listed platform called Sukhani Securities and renamed it, we clearly defined our target segment. While MSME is a very broad definition, within MSME we chose to focus on entities with turnover between 20 lakh and 15 crores per annum. We were capitalized in July 2018. We spent about 6 months building the team and establishing the systems and processes, and we disbursed our first loan in March 2019. We did approximately 79 crores of disbursements in the first month. We had started with a large capital base of approximately 950 crores, and the idea at that point was to build an institution that would make a real difference in our chosen target segment.

Our first full year was 2020. From April 2019 to March 2020, which was our first full year, we achieved approximately 860 crores of AUM. March 2020 was when COVID emerged, so we had to recalibrate our plans. In fact, even before we started, the original NBFC crisis had emerged. Our original hypothesis was to build a classical NBFC by growing slowly, lending at relatively prime rates, creating a large secured portfolio, and then, as the company and its rating grew, reducing the cost of borrowing and increasing ROAs. That was the classical way in which we had thought we would establish the business. However, even before we started, the liability side had completely changed. After COVID, the asset side also started changing.

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We recalibrated ourselves after 1-1.5 years of the COVID-related disruption. We redesigned all our systems and returned in March 2021. By March 2022, we had started delivering good numbers. The overall approach during that period was to become as granular as possible, use digital lending platforms, and make our processes more efficient. Since then, we have been adding approximately 3,000 crores of AUM every year. In March 2023, we were at 6,000 crores; in March 2024, we were at 9,000 crores; in March 2025, we were at 12,000 crores; and in June last year, we were at approximately 15,000 crores.

During this process, we completed 2 acquisitions. The first was in 2024, when we acquired a fintech company called MyShubhLife in Bangalore, which was a cutting-edge technology platform for embedded finance. Through that acquisition, we have now created a very large embedded finance business. I will discuss that in detail shortly. Last year, we acquired an NBFC called Profectus Capital. It was more of a tactical acquisition because Profectus NBFC was also in a very similar space, was approximately one-fourth of our size, and we saw an opportunity to acquire and merge it in order to reduce the opex of the combined entity. Both decisions have performed exceptionally well. I will discuss both in more detail when we reach those stages.

Viral, next slide.

This is our current shareholding. Our largest shareholder is the Government of Denmark, led by a fund called IFU, which is the impact fund. It currently holds approximately 15.5% of the shares. Samina Capital, ADV Partners, and TPG Newquest are our original founding private equity firms, holding approximately 12% and 9% each. Arjens is a hedge fund based out of Singapore. It holds slightly less than 6%. The Patni Financial family office holds approximately 6%. The remainder is distributed among the public. A few insurance companies and Sachin, who is our designated promoter, hold approximately 2.8%.

Move on.

Very quickly, I will discuss how our business has been structured for the last 7 years and the changes we made. We had divided our business into 5 segments. What we call emerging markets has approximately 318 branches in 13 states. Within the chosen target segment, we focus only on the micro-MSME portion, where the customers' turnover is less than 3 crores. Here, we provide loans between 7.5 lakh and 50 lakhs, with a yield of approximately 18-18.5% and a tenure of approximately 10 years. We only provide secured loans here because experiments with unsecured lending across the industry and peer group have not been very successful. Therefore, we focus on providing secured loans of up to 50 lakhs through this segment. This is also where the future focus will be after our strategic realignment. We have been doing this for the last 4 years, and we decided that the time had come to accelerate this business.

The second business is embedded finance. I was talking about MyShubhLife, which is now called GroX Technologies. It is our 100% subsidiary. We completed that acquisition approximately 2 years ago, and through that technology platform we are now embedded with all the large payment ecosystem players, such as Paytm, BharatPe, and PhonePe. We are now also getting embedded into e-commerce platforms such as Meesho. The way it works is that we provide small retailer lending through embedded finance. A small retailer who has a Paytm or PhonePe QR code is able to access our embedded offering through the PhonePe app. We are able to read the retailer's daily

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transactions and, based on the transaction history, vintage, and credit bureau score, we run our machine-learning rule engine and provide a daily-repayment loan.

We typically provide a ticket size of approximately 1 lakh, with a tenure of approximately 1 year and a daily-repayment structure. This is a very interesting field. When we started, we were very conservative because we wanted to understand how the portfolio would perform. However, after 2 years of this portfolio and with the portfolio now close to 3,000 crores, we are very confident. Our models have improved significantly, and this business is performing exceptionally well.

In February this year, approximately 2 quarters ago, we decided to discontinue our DSA-led prime business. By prime business, we meant customers with turnover between 3 crores and 15 crores. Remember, our original target segment was customers with turnover between 20 lakh and 15 crores. As part of the strategic realignment, we decided to focus only on customers with turnover of up to 3 crores because that is where the biggest gap existed and where we were able to command the yields we wanted. For slightly larger customers, who were especially sourced through DSAs, our experience was that, although the portfolio performed exceptionally well and we grew significantly, increased competition in metros meant that pre-closure and foreclosure requests were doubling and tripling. It was becoming very difficult to retain customers after 1 year.

Typically, what happens is that we underwrite a customer, take a call on the customer, and after 1 year of repayment, the customer becomes a very prime customer and starts approaching larger NBFCs and banks at a much lower rate. We typically used to provide secured loans at 13.5-14% in this vertical, and we found that after 1 or 2 years, the customer was receiving an offer at 9.5%. Therefore, while it was a good business from the perspective of our underwriting and distribution capabilities, we felt that in the long run it did not make sense in terms of sustained profitability. We said, why not focus all our energies only on segments where we can earn higher NIMs? That is why we decided to discontinue it.

We let go of the teams that sourced these cases, and this portfolio is gradually running down. We will explain how the entire realignment will look over 3 years. Broadly, the idea is to reduce the lower-yielding portfolio as a proportion of total AUM, increase the contribution of the higher-yielding portfolio, and manage credit costs very tightly so that our ROAs can increase from the current 2-2.5% to 3-3.5%.

Move on.

This is a performance-at-a-glance view of the 2 focused portfolios that we are carrying. The emerging market LAP business through our 317 branches is one of the largest franchises for this target segment in the country. There are very few NBFCs with a pan-India presence in this segment. The only large competitor here is SBFC, which started with this segment approximately 8-9 years ago and has performed exceedingly well. We were operating multiple businesses, and this was one of them, but going forward, we want it to be our main business.

At this point, it is close to 4,000 crores, with a GNPA of 2.1%. The main thrust here is to get the process right and improve productivity. We are already at a reasonable productivity level of approximately 80 lakhs of disbursements per month per branch. We want to steadily increase this to close to 1 crore.

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In the embedded merchant finance business, we have also crossed 3,000 crores of portfolio. The portfolio is performing exceptionally well, much better than our own expectations, with current GNPAs of 2.1%. We are currently adding approximately 60,000-70,000 customers per month in this business. We were already approaching this level, and this is the June number; in September, we had already crossed 4 lakh customers.

Move on.

I spoke about that. The broad mathematics of the emerging market LAP business is as follows.

Management: We have 318 branches that are now stabilizing at approximately 240-250 crores of business per month, which is about 75-80 lakh of productivity per month per branch. This is generating approximately 3,000 crores of new disbursals in a year. Because this is an emerging market business and the distribution is our own, the way an emerging market branch is designed is that each branch has 5-6 salespeople, 1 credit person, 1 operations person, 1 branch manager, and 1 collections person, and they source directly.

The advantage this provides is that we are closer to the customers because all our branches are in Tier 3, Tier 4, and Tier 5 towns. Pre-closure and foreclosure activity is also much lower. Therefore, we are able to retain the portfolio and service the customer very well. Move on.

This is the broad distribution of our branches. We are present in all major parts of the country. We do not want to be in eastern India or in Jammu and Kashmir and Himachal because MSME penetration is very low there. Other than that, we are very well distributed across the country, with Tamil Nadu being our largest state, with 56 branches.

In the last 2 years, we have added approximately 200 branches here. In 2023, we had approximately 100 branches. Once we were clear about the distribution strategy and underwriting model, we continued increasing the number of branches. The broad idea now is that we will continue with the same number of branches, focus on improving productivity, and control opex. Once we reach our desired overall AUM numbers, we will probably start expanding again in the next 2 years. However, the next 2 years will broadly be focused on capitalizing on this business franchise.

I touched upon this earlier. Overall, we are performing exceptionally well in terms of productivity. The industry benchmark productivity is approximately 70-80 lakhs per month, and we are already reaching that level. Most of our branches that were opened last year are yet to complete 12 months. A 12-month vintage is a differentiating point as far as productivity is concerned. Once those branches move forward this year and become more than 12 months old in the system, their productivity will automatically start increasing. Therefore, we expect to achieve an exit disbursal number of between 280 and 300 crores per month.

The embedded merchant finance journey is also very interesting, and our technology platform is now well regarded across the industry. Today, we account for approximately 50% of PhonePe disbursals. We also have a significant presence in Paytm and BharatPe. The only reason this has happened is that we have invested substantially in customer experience for small retailers. While lending to small retailers is a commodity business, the only way to win the market is through the speed of the process, the turnaround time, and the customer experience. On that front, the GroX

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platform has performed exceptionally well.

These are a few more numbers on the embedded merchant lending platform. These are the June numbers. I am telling you that in September we had crossed 4 lakh customers. GNPAs are now stable between 2% and 2.5%. We expect the steady-state number to be approximately 2.5%. The commercial structure is that the final customer yield is approximately 30-36%. Approximately 10% is paid out to the originator. We retain approximately 5-6% as a reserve pool for credit costs, and the rest is our margin. This is a business with approximately 4% clear ROA, which is why we are very optimistic about it. Most of our investment and forward-looking strategy is also through this channel. Move on.

These were our Q1 numbers. Overall, this was the first quarter after the strategic realignment, and we are very encouraged by the results. Our total AUM stood at approximately 15,000 crores, with gross disbursals of 2,500 crores. Our cost of borrowing is steadily coming down, although it should come down much faster. That is what we hope for. We had PBT of approximately 61 crores, GNPA of 2.6%, and ROA of approximately 2.6%.

Coming to that, {? Viral ?}, the strategic realignment change. Yes, go back. Yes.

This is what we have told the market in a public document about what the strategic realignment will achieve and what we are working toward. At this point, our older portfolio, which we are running down and which is the lower-yielding DSA-led portfolio, contributes approximately 67% of our total book. Our emerging market and embedded finance portfolios contribute approximately 35%, or 46% in June. This number will move to approximately 85% in FY29. The higher-yielding portfolio, which is now our focus portfolio, will contribute 85%, and by that time the lower-yielding portfolio will continue running down and will come down to approximately 15%.

What this will do is that, while the overall AUM journey this year is primarily flat, there will be considerable growth over the next 2 years. Our overall portfolio yields will increase by approximately 100-120 basis points, and our focused verticals of emerging markets and embedded finance will continue to grow at approximately 25-30% CAGR. Within the next 2 years, our total number of customers will be close to 4.5-5 lakh. Move on.

We have also created a scorecard so that everyone can track the changes we have made. From a portfolio mix perspective, the average yield of the new portfolio is coming in at 18-26%. Regarding our overall income profile, one of the reasons for this discussion with many people is our dependence on co-lending in our older model. We used to conduct a significant amount of prime-intermediated business at 13.5%, with our cost of borrowing at approximately 10.5%. On a standalone basis, that business did not make much sense unless the cost of borrowing came down.

Our cost of borrowing did not come down as much as we wanted because we were also growing very quickly. As a result, because we were very good at co-lending, approximately 40% of our book was off-book through co-lending and direct assignment. When you conduct co-lending and direct assignment, under the accounting standards, whatever future income is generated from the co-lent or directly assigned book is discounted and recognized upfront.

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This gives you an accounting ROA that gets realized once the loan is completed. Therefore, co-lending or upfronted income as a percentage of our total income used to be very high. Not many people like this because it was inherently somewhat volatile, as it depends on how much co-lending you are able to do in a particular quarter. We wanted to deliberately reduce that income and increase our annuity cash income. This is also why we decided to wind down our prime-intermediated business.

One of our objectives is that co-lending income, which was 24% of total income last year, should be reduced to below 5% by 2029 so that the element of volatility is eliminated. In terms of cost and opex, all the hard work that needed to be done has already been completed. When acquiring Profectus, we had stated that we wanted to reduce costs, and we reduced approximately 120 crores of opex on that side. When we wound down our own prime-intermediated vertical, we added approximately 80 crores of cost that was subsequently reduced. Overall, from an opex perspective, we have done everything we had set out to do.

Opex is now very stable, and the focus is on continuing to build the higher-yielding portfolio. The reduction in opex and improvement in the yield profile will take us from ROAs of 2-2.5% to 3-3.5%. Move on.

All the steps that needed to be completed have been completed. This is an update on that. When we started, approximately 32% of our total book was the focus group, but in June it had already reached 46%. In the subsequent quarters, you will see the focus products' AUM mix continue to grow every quarter, with the end goal of reaching approximately 85% by 2029.

I spoke about the 25-30% CAGR. That is how it has been developing over the last couple of quarters, and this trajectory will continue. The same applies to embedded finance. In fact, although embedded finance is a large disbursal business, it is not a very large AUM builder. Today, we are disbursing approximately 700-800 crores per month. However, because it is a daily-repayment business, approximately 500-600 crores comes back as repayment. Therefore, it generates substantial fees and income, but it is not a significant AUM builder. That is how we want it to be. From the current AUM of approximately 3,000 crores, this number will increase to approximately {? 4.5 thousand crores ?} over the next 1-2 years. Move on.

Overall, portfolio quality has remained very robust. Our collection efficiencies have been approximately 98-99% for many quarters now. Our overall GNPA was approximately 2.6% last quarter. Because we are now in a higher-yielding business, we expect this NPA to increase to approximately 3% and then stabilize. That is the plan.

Very quickly, from the perspective of our liability profile, it has been very strong. We have more than 65 active lenders. Almost every large private-sector bank, public-sector bank, DFI, and NBFC is on our loan book. From a liability mix perspective, approximately 45% of our total liabilities are from bank loans. There is also a very large component of DFIs, FIs, and capital markets. Approximately 50% of all loans are term loans, while the rest are in the form of ECBs and NCDs. We have worked very hard to diversify our liability profile, and that is progressing well.

The major challenge we have is reducing our cost of borrowing. This is a function of our ratings. Our current rating is A+ with a positive outlook. Given our performance, we hope that our rating will be

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upgraded next year. That is one component through which our cost of borrowing will come down.

The second component is to change our ALM profile and obtain lenders who can provide longer-tenure loans. That is why our ECB mix has been increasing, because DFIs provide 5-year loans compared with a domestic bank providing a 3-year loan. We are also changing that mix. In addition, our embedded finance business has a very fast repayment cycle, so our overall liability profile is now quite tight.

Overall, from the way we started—

Management: Today, the recalibration and reset of our P&L that we started and have undertaken is now almost complete. We have successfully transitioned our income to be more cash-generated rather than co-lending-generated. From this year and this quarter onward, every quarter you will see substantial improvement, with co-lending income coming down and asset annuity income increasing.

That was a very brief background on how we have progressed, particularly over the last year, and on our history and how we have developed. We are at a very interesting juncture today. We feel that our share price does not reflect our potential at all, and hence we have become very attractive in a way. The idea is to continue focusing on operating performance, continue delivering results, and hope that the market starts recognizing that. That was all. We are now open to questions.

Operator: Thank you so much, sir. That was quite a detailed overview. I would like to request participants who would like to ask questions to raise their hands or put their questions in the chat box. We will first take up questions from participants who have raised their hands. Sir, we will wait for 1 minute.

Management: There are a few questions in the chat box. We can start with those.

Operator: Okay. The first question is—should I narrate the question and you will answer, or will you—

Management: I will narrate the questions. It will be quicker. The first question is: What is the cost of borrowing for our recent capital raise from FMO?

The net cost is approximately 10.1% because it is an ECB. There is a proportion of hedge cost, and we undertake 100% hedging on both the interest side and the exchange-rate side. That is why the landed rate is almost similar. The hedge rate has increased because of the war-like situation, but overall, it remains quite reasonable.

The second question is: What is the expected ROE in 1 year's time?

For the end of this year, our expectation is that our ROAs will broadly remain the same, but the profile of the ROA will be very different. Over the last 2-3 years, most of the ROAs were accounting ROAs because of co-lending income. Now the ROAs are more cash ROAs, and that is why, for the next 2-3 years, we do not need any equity because profit accretion will take care of our expansion plans. Our ROEs will be in a similar range, close to the double-digit mark.

The third question is: Is there any impact from the recent IRDAI regulation? If yes, how much is it?

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The recent IRDAI regulation will mostly affect brokers. We also provide insurance as an attachment for our customers, but the proportion of that income is very small. Therefore, we do not foresee much impact. Whatever cap on commissions is introduced can be compensated for through increased penetration. Unlike typical broker commissions, we do not foresee much impact on our income.

The last question was: Can you give your broad view on MSME sector growth in India if the RBI decides to increase interest rates going forward following Federal Bank?

You are right. One of the issues with MSME lending, and with lending in general, is that there is a possibility of an increase in rates. However, we have to wait and watch whether this will be transmitted to the ultimate borrower. It depends on how our rates move. My personal expectation is that rates will eventually harden this year and then come down. However, I do not foresee this affecting MSME sector growth because the credit crunch is significant and there is substantial demand for credit. Therefore, it will not matter to that extent.

The next question is: What is going to be the impact of a likely rate hike? I think I have just addressed that.

What is the likely impact of the RBI's proposed rule on revolving credit? What is the exposure as a percentage of AUM and as a percentage of interest income?

We do not offer revolving credit at all. We used to have a supply-chain business 2 years ago, but because the yields and NIMs were very low, we stopped it 2 years ago. Today, we do not have any revolving credit product. We only have term loans. Therefore, there is zero impact from the RBI's proposed rules.

The last question is: Is there any update on some of the PE firms reaching the end of their fund life, and what strategy is being adopted here?

You are right. Our original 2 funds, TPG Newquest and ADV, were reaching the end of their fund life. ADV has taken an extension. The fund life of TPG has ended, and it is also selling in the market. We will have to determine a way forward. Although, at current prices, no one will sell, a resolution is required because the funds have reached the end of their life.

The last question in the chat box is: Are you planning to focus on other income? If yes, how much do you expect it to be?

No, other income is not a focus area. Since we acquired MyShubhLife, our embedded finance platform, we transitioned our data science team there. As part of that package, many people approach them for technology support when they want to establish something. Therefore, we provide a small amount of such support, but it is not a core area at all. It is not a focus area, and other income as a percentage of total income is likely to remain the same.

Operator: Okay. I would like to repeat that if any participant has another question, they can raise their hand or put it in the chat box. If time permits, I will take up questions from clients who were not able to participate. As no participant has raised a hand, I will take up questions from clients who were not able to participate in this call.

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Sir, the first question is about GNPA. GNPA rose from 2.2% to 2.5%, attributed to the denominator effect. At what GNPA level do rating agencies or lenders start becoming uncomfortable?

Management: It is a function of the target segment in which you operate. In our emerging market business, we provide loans between 7.5 lakh and 50 lakh at an 18.5% rate. There, GNPAs can reach 3.5–4%, and that is the industry norm. In the embedded finance business, while many players are above 4%, we are at approximately 2.5%. That is also likely to increase slightly. Broadly, for our type of business, our own estimate is that 3% GNPA over the next 1 year is a good benchmark, and all our lenders and rating agencies are very comfortable around that level.

Operator: Okay, sir. The next question is: Every MSME NBFC now uses GST and bank-statement scoring. What is the measurable edge of GroScore 3.0 versus peers?

Management: Almost every major NBFC and bank uses GST and banking-scoring models. What we have done is to constantly improve our model. We reached that stage approximately 4 years ago. Now, with embedded finance, we have added daily revenue streams to our GroScore. Therefore, for customers for whom GST is applicable, we not only conduct a GST analysis, but also conduct a daily sales analysis through the QR code and juxtapose it with banking data.

We are constantly improving. There is no single defined rule for what the differentiator is. It depends on how much of the portfolio you have underwritten, what learnings you have already obtained, and how much of those learnings you are able to incorporate to improve your version. As each year passes, our scoring systems become better, and we continue adding new parameters.

Operator: Okay, sir. Thank you. One more question is: Vintage branches disburse 68 lakh per month against an 80–85 lakh target. What is the break-even level per branch?

Management: Typically, a branch breaks even at an AUM of approximately 5 crores. Our average operating expense for a branch is approximately 4 lakhs. For a branch to reach an AUM of 5 crores, it used to take approximately 15–18 months, whereas it is now taking approximately 12 months. Typically, a branch will break even between 9 and 12 months if it continues disbursing 80–85 lakhs per month. Approximately half of our branches are already at the break-even level. The other half is likely to break even during the current year.

Operator: Okay, sir. The next question is: Emerging market LAP targets Tier 3 and Tier 4 towns. How do you bridge the gap between secured on paper and realizable on default for property collateral in these markets?

Management: That is a very good question. When we provide secured lending, this is why we do not provide secured loans below a 7.5 lakh ticket size. All our secured lending is undertaken only after we have completed independent title due diligence, legal diligence, and a technical valuation. Although the loan amounts are small, from a process perspective, we approach them in the same way as we would approach any secured loan.

In our view, land is not merely moral collateral. We must be able to repossess and sell it. That is why, for all loans, we undertake an independent third-party valuation.

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Operator: Okay, sir. I think I have completed the questions from the other clients as well. There are no more questions in the chat box, and no other participant has raised a hand. We also have our next slot from 5 to 6 PM. Would you like to make any closing remarks?

Management: Thank you for your patient hearing and for taking the time to listen to us. We are at a very interesting juncture. We have recently undertaken a strategic realignment, and the entire company is now focused on achieving sustainable cash ROAs. We strongly feel that our current market valuation does not do justice to what we are doing. However, people who are able to understand these changes will be able to appreciate the nature of the changes we are making and how they will reflect over the next 2–3 years.

We are open to questions. Virel will be available in case you have any future questions or want to understand any particular point better. Hopefully, we will have a great year ahead. Thank you.

Operator: Okay. I would like to thank Anuj sir and Virel for joining this call, and all the participants for sparing their time. It was a pleasure hosting this call. I am Juhi Manwani, and I will sign off. Thank you, everyone. Have a nice day. I look forward to more such events and opportunities to connect with you. It has been my pleasure. Thank you. Thank you, everyone. Bye, have a nice day. Goodbye.

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