"Suryoday Small Finance Bank Limited Q1 FY 23 Earnings Conference Call"

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Moderator: Good morning, ladies and gentlemen, and welcome to the Q1 FY23 Earnings Conference Call of Suryoday Small Finance Bank Ltd., hosted by Elara Securities Private Limited. 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Shweta Daptardar from Elara Securities Private Limited. Thank you, and over to you, ma'am.

Shweta Daptardar: On behalf of Elara Capital, we welcome you all to the earnings conference call of Suryoday Small Finance Bank Ltd., to discuss the Q1 FY23 earnings performance. From the esteemed management we have with us today, Mr. Baskar Babu Ramachandran, MD and CEO; Mr. Narayan Rao, Chief Services Officer; Mr. Kanishka Chaudhary, Chief Financial Officer; Ms. Radhika Gawde, Investor Relations.

Without further ado, I now hand over the call to Mr. Bhaskar Babu Ramachandran for his opening comments, post which we can open the floor for Q&A. Thank you and over to you, sir.

Baskar Babu: Thank you, Shweta. Good morning, everybody. On behalf of Suryoday Small Finance Bank, I extend a warm welcome to everyone to our Q1 FY23 earnings call. I hope everyone had a chance to go through our investor presentation for the quarter ended June 30, 2022.

The fiscal year 2023 has begun as the dawn of the new beginning for the world, as the effects of pandemic are receding, and people are experiencing normalcy in the post COVID era. The global economy is witnessing a paradigm shift in terms of macroeconomic factors, such as inflation, interest rates etc.

The central bankers across the globe are worried about increasing inflation, which is primarily due to rise in crude oil and other commodity prices. The sharp inflation has further impacted interest rate scenario, which could impact growth in the near future. The Indian economy, however, has been intact and amidst all these hurdles, the demand in the economy is intact and consumer spends in terms of festive spend, travelling etc is growing.

The country is expected to have a normal monsoon which augurs well for the rural economy. India is an integral part of the global financial ecosystem and cannot be immune from the macroeconomic problems revolving in the world economies. The surge in inflation has forced RBI to increase the repo rate and withdraw accommodative policy stance. RBI has recently increased the repo rates by 50 basis points to 4.9%. And accumulative hike now stands at 90 basis points from 4% to 4.9%.

We are happy to announce that our AUM growth has increased by 28.2% over the last year to INR 5,132 crore in Q1 FY23 on a year-on-year basis. There has been a healthy customer addition as well with total customer base reaching 20.1 lakh, a growth of 31.5% against the numbers in Q1 FY22.

On the profitability side, the bank has done profitable and reported a PAT of INR 7.8 crore during the previous quarter, as compared to a loss of INR 47.7 crore in Q1 of FY22.

Let me give some highlights on our operational metrics for the quarter Q1 FY23. The disbursements for the quarter has grown by 180% to INR 1,012 crore as compared to INR 360 crore in Q1 FY22. The bank continues to disburse loans to new customers throughout emphasizing more in disbursing loans to our existing customers with regular repayment cycles and healthy credit history. The focus is on retaining our existing inclusive finance customers, while also onboarding new customers in the micro as well as in the non-micro loan sector and expanding the affordable housing market portfolio.

Our collection efficiency is improving sequentially on the back of opening of the economy and nearing normalcy. The banks one-EMI adjusted collection efficiency stood at 89% as on 30th

June compared to 87% for the month ended 31st March '22. The collections vertical is one of the most important verticals for the bank and hence we have created a special team of 400 collection officers on a Pan India basis to focus on recovery from distress and restructure book.

Our gross advances grew by 28.2% to INR 5,132 crore on a year-on-year basis. As at the end of June, inclusive finance comprises of 66.9% of the asset book for an affordable home loans, commercial vehicles, and secured business loans comprise 8.8%, 6.7% and 4.7%.

As of strategy, we have been increasing our secured finance portfolio gradually over the last few quarters. Going forward Suryoday plans to maintain a portfolio mix of 55% and 44% ratio towards inclusive finance book and other secured loan segments.

On the deposit front. Our total deposit witnessed a growth of 18.2% to INR 4,019 crore as of 30th June '22. Retail deposits form 78.8% of our total deposits and the balance comprised of bulk deposits. Furthermore, 100% of a bulk deposit are non-callable in nature.

CASA ratio improved to 20.3% which is in line with our granular retail strategy excluding CDs of INR 127 crore. On the borrowings front, we had at the end of June '22 we had 31.5% of our total liabilities, majority of which was from refinancing institutions.

On the distribution front, Suryoday is spread across 564 branches of which 92 branches were liability focused, while 359 branches are asset focused and the balance comprise of rural centers. Through this branch network, bank has serviced 20.1 lakh customers of which asset customers were 16.5 lakh and total liability customers were 15.5 lakhs.

On the asset quality front, our GNPA as of 30th June '22 stood at 10% compared to the GNPA of 11.8 % as on 31st March '22. The net NPA stood at 5% as against 6% in March '22. Our provision coverage ratio as of 30 June stands at 75.1%. Our delinquency in the portfolio has declined sequentially on the back of improved collections efficiency. Our PAR 90 Plus portfolio as of 30th June stands at 6.4%. Our total standard restructure pool currently is 6% of the advances, as of 30th of June. Our collection efficiency on the restructure book and on the NPA book has been steadily rising and we'll give the numbers as we go through the presentation.

On the earning side. Our net interest income increased by 9.8% year on year to INR 135.6 crore in Q1 FY23 and net total income increased by 16.5% year on year to INR 169.6 crore. The net interest margins stood at 9.1% for Q1 FY23 compared to 7.6% for Q1 FY22. For other income mainly included income from sale of investments. Cost of funds reduced to 6.4% in Q1 FY23 compared to 7.4% in Q1 FY22 and 8% in Q1 FY21. Cost to income during the same period moderated to 58.3% compared to 63.5% in Q1 of FY22, which was primarily due to the rise in income coupled with lower cost of borrowings.

The company reported a profit of INR 7.8 crore in Q1 FY23. As on June '22, we continue to hold up floating provision of INR 91.3 crore in our books. We continue to maintain a high capital adequacy, as of 30th June. Capital adequacy of our bank was 36.4% as compared to 37.9% as of FY22. Tier 1 comprises of 33.5% and Tier 2 comprises of 2.9% of the overall capital.

There is significant thrust on digital front in Suryoday, our digital transformation program, Pragyan is on the verge of completion and expected to go live in August '22. The bank is migrating its Core Banking Solution to Finacle, the industry leader and digital banking solutions and has partnered with Kyndryl to support and manage the banks data centers, infrastructure, application, security, etc.

The bank has partnership with three payment banks Paytm, Airtel, Fino for end-to-end digital process for current account, savings account, sweep accounts and also fixed deposit mobilization relationship, with Fino payments bank. The bank is engaged with various FinTech's for deposits, loan investments and insurance products, with an entirely digital process and superior customer experience.

Talking about our new initiative in FY23. Suryoday had launched a Vikas loan, to offer an end-to-end digital service for our inclusive finance customers. This forms today 20% of the total inclusive finance portfolio. Collections of the EMI in this portfolio is tied to the customer savings account. 4.5 lakh customers have been identified for the Vikas loan product.

The other offering a Small Ticket Fixed Deposit with a minimum of INR 1000 to customers who are customer service points with a turnaround time of 100 seconds. These products provide a seamless digital experience and saves time to the customer. We have opened as on it 4800 deposits with a value of INR 7.5 crore to this channel.

Just to summarize. Our endeavor is to grow our loan book approximately 25% during the current financial year. The company plans to increase the share of secured lending in the overall product mix. We plan to achieve by INR 400 crore of new business per month, post Q2 of FY23.

We see a clear growing opportunity in graduating our inclusive finance customers and the focus in terms of delivering customer experience to digital initiatives. We plan to expand our presence cautiously in new states and strengthen our foothold in the existing states.

Going forward we target INR 40 crore operating profit on a monthly basis from end of Q2 FY23, worth focus in terms of reducing our NPA for the next two quarters. Thank you all so much. Over to you for any clarifications.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Priyanka Shah from KK Advisors.

Priyanka Shah: I just have one question. What are the plans in terms of geographic expansion in FY23?

Baskar Babu: We are currently present in 14 states. And our focus this year is in terms of deepening our presence in existing states rather than opening up newer geographical states. We have very marginal business in states like Telangana, Rajasthan and even Uttar Pradesh. We intend to increase our presence in these states with little more branches than increasing our footprint in newer geographies.

Moderator: The next question is from the line of Raj Joshi from Ace Securities.

Raj Joshi: Sir, what is the overall collection efficiency as on 30th June?

Kanishka: It is 89%.

Raj Joshi: And sir, we had inducted 400 collection officers so how has been the experience so far?

Narayan Rao: Yes, so these collection team was inducted to basically activate all customer accounts with irregular payments, and which had slipped into NPA. We have been progressively activating the customer accounts and started our collections. We do about INR 6 crore of collections on an average. Our endeavor is to be able to reach INR 10 crore per month and above, in about two months' time.

Raj Joshi: And sir, the RBI has increased the repo rate twice in the financial year so far. So, where do you see our cost of funds from 6.4 going forward?

Kanishka: So, if you look at our overall funding mix about half of the funding is coming from our deposits. So, we expect that there will be marginal increase in our cost of funds in the latter half of the year from here on. But to a large extent, we don't expect our cost of funds to go beyond 25 basis points.

Raj Joshi: Sir, you said 25 basis point, right?

Kanishka: That's correct. Yes.

Moderator: The next question is from the line of Devendra Pandey from DB Advisory.

Devendra Pandey: So, I have a couple of questions. So, my first question is on the overall microfinance market. So how is it shaping up?

Baskar Babu: What we're seeing across the industries in terms of new customer addition has come down sharply to the industry, company to company, bank to bank based on our strategy, there has been an increase in customer base. Currently, as reported we are seeing a strong momentum, including in terms of new to bank, not necessarily new to credit customers. While our focus has been in terms of both retaining our good existing customers with products like Vikas loan, at the same time also the new customers in new geographies where we entered last year, which includes Rajasthan and a little deepening in other states.

The portfolio behavior of the new portfolio across the industry seems to be inching closer to 99%, in terms of collection. Predominantly driven by focused funding to existing well paying customers were paid through both COVID 1 and COVID 2, which at the industry level probably constitutes around 84% of their overall customer base, which existed as of say 31st March 2020. This is how the industry is panning out.

Overall, I think with the new norms coming in, the focus will be in terms of retaining, well paying existing customer and we will likely see a reduction in the pricing as the customer starts making even the repayment to the digital mode. We currently have 20% of our portfolio in inclusive finance where the entire repayment is coming through the savings bank account of the customer.

It still requires a follow through in terms of calling them up before the due dates and that's going to remit money, when that becomes digital, the operational costs are likely to also come down. And this probably will be the trend you will see across many all small finance banks and probably even so the microfinance institutions. So, the industry is looking robust, but I think it's cautiously optimistic in terms of growth. And depending on the strategy of each company, the focus will be either in terms of acquiring newer customers, but at the industry level, there is a tapering of new customer acquisition as you can see from the data.

Devendra Pandey: Got it. And do you see and stress in the rural market especially considering the sustained inflationary environment in last two, three quarters?

Baskar Babu: See, always usually any of the impacts happens with the lag in terms of inclusive finance segment. As far as Suryoday is concerned, we have about 35%, 40% in terms of rural, majority of it is urban and semi urban. We had the impact severely in terms of COVID 1 and 2, when the metros and urban centres were substantially impacted negatively. So, probably a balancing, but at this point of time, are we really seeing any stress in our books or in terms of data at the macro level for the new portfolio, it is not yet.

Moderator: The next question is from the line of Ashlesh Sonje from Kotak Securities.

Ashlesh Sonje: One question on Slide number 18 of your presentation, where you have given the portfolio at risk numbers. If I subtract the PAR 90 number of 6.7% from the PAR one plus, I get a PAR 1 to 90 of around 6.7%. If you can -- can you tell me what part of it is in the restructured book so, that I can look at it separately?

Kanishka: Which part, part of 1 to 90, is it?

Ashlesh Sonje: Yes, sorry. Just want to look at PAR 1 to 90 ex restructuring?

Baskar Babu: 1% of the overall assets. And in terms of restructure, it'll be around closer to 10% of the restructure book will be in 1 to 90. Let me also give you the full data but as I understand now is around INR 50 crore and which INR 510 crore is the restructured book of which around INR 300 crore is the standard restructured book. So, if you want to take it as a percentage of standard restructure book it is around 15%. We'll take it as the overall restructured book is around 10%.

Ashlesh Sonje: So, about 1 percentage of the PAR 1 to 90 is restructured, is that right?

Kanishka: **No.** 1% of the overall portfolio.

Ashlesh Sonje: Okay. Understood. And secondly sir, on the impact of the new guidelines for microfinance. Just wanted to check where we are in that process and what impact we have seen in acceptance, less rejection rate?

Baskar Babu: The challenge is in terms of combining the entire household obligation which the credit bureaus are working and expected to deliver by end of this month or latest by September mid. So currently we are taking out the credit bureaus reports of the customer separately and we are partially -- and substantial implemented. We do believe that another full implementation will happen well before the month, the end of August, beginning of September. But otherwise today, it's a workaround in terms of we'll have to pull out the various bureau reports, combine it to find out the household obligation. And once the credit bureau start giving a combined report of obligations as well as in terms of income, it will become far more easier in terms of implementation. But otherwise, it's a workaround and almost 90% is implemented.

Moderator: The next question is from the line of Ms. Shweta Daptardar.

Shweta Daptardar: Couple of questions. If I look at our network presence, then it's actually spread across top industrial state be it Tamilnadu, Maharashtra, MP or Karnataka. But if I look at the GNPA trajectory it's remained slightly sticky for a while now. So, could you explain, you know now that the pandemic challenges are behind, what is it that's hampering? That's point number one.

My second question is if I look at your cost of funds, so that's have been improving. You also mentioned in your opening comments that, we do not see much spike from here. So, what are the weighted average cost, and do you see the mix tilting going forward?

And one last question from my side is, so, you've mentioned in your opening comments that you are up for increasing your secured lending base. What is the strategy like going forward to do so?

Baskar Babu: One in terms of stickiness of our GNPA, which is 11.8% and 10%. Almost all completely all of that is coming in from the pre pandemic generated portfolio. We have strong presence in urban markets like Mumbai, Pune, which were far more impacted negatively during the pandemic and what they did also is a little bit of a dislocation of the customer from their kind of residences. So, after pulling back which is where we have put our 400 force, the primary intent of this specially is focus collection force is that it does not really give bandwidth to a regular relationship officer to also follow through, with the customers where their chain of repayment has been broken. It requires more than three or four visits.

But what we're really seeing, which is very encouraging, is that the customers are not even paid for six full months, with the continuous -- just started paying. Once when the microfinance segment, customers start paying even three instalments regularly, even with the one or three or four instalments out of five or six instalments which have fallen due, it is not likely to end up in a credit loss, it is likely to end up only with a delayed closure of the loan.

So, which is why we are really focusing on it and we hope that the broad thing as we guided last time is over. And because the overall portfolio itself has shun to closer to 30%. The main thing we'll have like to look at in our kind of a business or a comparison for our portfolio, is that current portfolio for us only constitutes 60% out of the post pandemic. If this were to be a little higher, it's 70% or 75% or 80%, as a percentage the GNPA, would look lower than what it is looking at this point of time.

We will do an organic resolution of the GNPA, currently around close to 40% of our NPA customers are paying customers. They're not necessarily paying every month; they're paying what two instalments out of every three months. They'll continue to be tagged as NPA till such time all the instalments are cleared, and the loan comes to a closure, but around 40% of that is what we're really focusing on in terms of getting it, is around of the INR 515 crore closer to around INR 200 crore to INR 225 crore. It is a portfolio which will not end in credit loss, but we recorded the timeline.

In terms of our cost of borrowing, I'll ask Kanishka to take the call.

Kanishka: So, as we have indicated our overall cost of funds today it's around 6.4% and it has held firm quarter on quarter. If you look at our funding book, our deposit and borrowing ratio is around

60 is to 40. So given that particular mix and how we see the rates moving, we expect that our cost of funds will be in the range bound by around 25 bps more.

Baskar Babu: While our current cost of funds is at 6.4, the incremental cost of mobilization currently is around 6.6. So, not likely to kind of shift dramatically much not certainly more than 25 bps overall if at all.

And in terms of secular loan portfolio, who've launched micro home loan which is a space which is reasonably weakened, which is between 5 lakh to 10 lakh of funding given we see many of our affordable home loan companies have moved to ticket sizes over and closer to 8 lakh plus.

And predominantly this is coming out of our inclusive finance customer segment. Not necessarily our existing customers. Currently the run rate is around INR 5 crore per month and it's on an acceleration four crore per month increase disbursement. We are seeing this business as INR 25 crore to INR 30 crore disbursements per month, granular average ticket size probably less than around 7 lakhs. With multi-income streams in the family and in a small portfolio of INR 22 crore. Obviously, this is not a correlation increase, but usually the delinquencies are very closer to zero than anything significant in this portfolio because of the intensity of collections and the customers having substantially good track record in the inclusive finance segment and probably in a little bit of retail assets.

So, we see that as a growth engine closer to around INR 30 crore per month towards the end of the financial year. Regular home loans and secured business loan portfolio currently is clocking around INR 45 crore per month, average of around INR 45 crore to INR 50 crore. The intent is to also increase that disbursement to around closer to INR 75 crore to INR 80 crore in two quarters from now. So, combination of INR 110 crore would come in from affordable home loan, secured business loan, as well as micro home loan. That's how we are and with the same disbursement in microfinance loans that we are on INR 350 crore and that this disbursement we have to be around INR 100 crore not including other products like digital partnership products, the portfolio mix whatever kind of projected in terms of 55 or 45 will happen.

Moderator: The next question is from the line of Mr. Renish, an individual investor.

Renish: Hi Just a clarification, I am not individual Investor. I am from ICICI Securities.

So, a couple of questions from my side. So, one is on the liability fee. Okay. So, I mean, if you look at the deposit profiles, for last seven, eight quarters, it has been a static around 38 billion odd, and even if we look at the liability branch addition, so practically, we have not added a single branch since COVID on site. So, what is our medium-term outlook in terms of the brand expansion on the liability side? And does it make sense after converting into SFB we are still let's say 40% funded by the borrower?

Baskar Babu: Renish, in terms of what we're trying to do now is converting many of our branches into composite branches, which means that including two branches, around 26 are composite branches, we are making more of our inclusive finance branches which are infrastructurally ready for kind of having assets business instead of just focus only on liabilities, they will have the two divisions within that, one focus on liabilities and one on the assets. So intent is slowly increase it to at least by 50 branches during the financial year we will do around 10 per quarter or even including 10 to 15.

In terms of our borrowings, we have a conscious strategy of managing an ALM in the formative years of the bank. While most of our borrowings at this point of time come in from NABARD and SIDBI. And the cost of funds very close to our overall weighted average cost of funds except for the SLTRO, which took at about 4%, other than that it's marginally just about the same. The liability period of around three to five years.

So as a strategy we decided to have from a behavioral point of view, all deposits get converted into behavioral contracts, and time bound. But as far as a bank loan is concerned, we said 50% of our book would be in terms of deposits and gradually increase it to 100%. And refinance, we will have consciously the strategy approximately around closer to 30%.

So, now as the deposit base is growing, and we also areThat gave us a space to reduce our reliance on bulk deposits. Currently, our bulk deposits constitute only 20%. If we have to really increase our -- reduce our CD ratios or increase the deposits, one of opportunity will be in terms of tapping the bulk deposits which are gone slow in the last three or four quarters, but our focus would be granular term deposits from the existing inclusive finance customers as well as converting our branches into composite branches. So, you will see around positive 50 more branches becoming liability focus in this coming financial year.

Renish: Yes, but, Sir, I mean, if we look at some of the peer SFBs, we have not yet seen the MFI branches contributing meaningfully to the deposits base. So, I mean, let's say whatever branches we have converted so far, if you can just highlight you know, what is the average balance in those accounts versus the balances in the typical liability branch setup?

Baskar Babu: Every branch, I don't have an overall number, we'll circulate it later. But of the 26 branches, composite branches, there'll be no, significantly difference on only liability focus branches, because the team is separate, which is focusing on the deposits, they just happen to operate from the same centers.

But any branch where you open as a composite branch within a year on average, they contribute around closer to INR 15 crore to INR 20 crore of deposits, around 70% to 80% coming in from term deposits and around 15% coming in from CASA.

Renish: Got it. And the last question again is on the asset quality side. So, even if we let's say keep aside the MFI book wherein, we have witnessed a sequential decline, but rest of the segments, we are still witnessing a sequential increase in the gross NPA number be it SBL, housing loan. I mean rest of all the products have witnessed sequential increase, and it is now like nine quarters after the COVID. So, if you can throw some light, what is happening in the rest of the portfolio?

Baskar Babu: In the other portfolio it has been pretty steady and declining except for a spike in the month of June, out of a few larger accounts, getting timestamped as NPA while they are in the 60 to 90 for the last three, four months, spiked out in terms of June. As of July, there has been a pullback in the other products as in JLG. So, confident that the GNPA levels will be back to less than March levels in the other products.

In JLG we'll have to have a residue portfolio as always guided. So that we are in the process of partial recovery and part of that will go towards trade – but however we currently are sitting on our entire non-paying portfolio so to say is around closer to INR 400 crore which is the customer has not made any payment in the last three months which we are still not written off, against this, we are having a very clear provisioning of INR 325 crore.

The gap on that basis of non-paying to paying, that non-paying could also be customers who are not at NPA, not necessarily they are only NPA customers. The gap is around INR 75 crore is the uncovered provision as you speak. In terms of non JLG products, we do not see any increase that could happen over the March levels by September. There was certainly a spike in the month of June in the quarter of June.

Renish: Just last question, data keeping question. What is the total write off we have done in Q1?

Kanishka: We have done a total of INR 131 crore in this particular quarter. And it's entirely in the JLG book. This basically represent customers who have not been paying us for more than six months.

Renish: And if you if you can share the FY21 FY22 write off number, if you have it with you right now?

Kanishka: We wrote off around INR 218 crore in FY 22 full year.

Renish: INR 218 crore?

Kanishka: Yes, 218.

Renish: And '21?

Kanishka: So, total write offs across the two years will be around INR 340 crore.

Renish: Which is including current quarter number or?

Kanishka: No this is up to March. So, the total is INR 340 crore and another INR 130 crore of the current quarter.

Moderator: As there are no further questions, I now hand the conference over to Ms. Shwetha Daptardar for closing comments.

Shwetha Daptardar: Thank you. On behalf of Elara Capital, we thank all and the management of Suryoday Small Finance Bank, to give us the opportunity to host the earnings call. Thank you so much.

Moderator: Thank you. On behalf of Elara Securities Private Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.