"Equitas Small Finance Bank Limited

Q4FY'23 Earnings Conference Call"

May 06, 2023

MANAGEMENT: **MR. P. N. VASUDEVAN – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER**
MR. SRIDHARAN N. – CHIEF FINANCIAL OFFICER
MR. MURALI VAIDYANATHAN – SENIOR PRESIDENT, COUNTRY HEAD, BRANCH BANKING, LIABILITIES, PRODUCT AND WEALTH
MR. ROHIT PHADKE – SENIOR PRESIDENT AND HEAD ASSETS
MR. NATARAJAN M. – PRESIDENT AND HEAD TREASURY
MR. RAHUL RAJAGOPALAN - DEPUTY VICE PRESIDENT, STRATEGY AND INVESTOR RELATION

Moderator: Ladies and gentlemen, good morning and welcome to the Earnings Call of Equitas Small Finance Bank Limited Financial Performance for Q4FY23. We have with us today Mr. P. N. Vasudevan, MD and CEO, Mr. Sridharan N., CFO, Mr. Murali Vaidyanathan, Senior President and Country Head, Branch Banking, Liabilities, Product and Wealth, Mr. Rohit Phadke, Senior President and Head Assets, Mr. Natarajan M., President and Head Treasury, and Mr. Rahul Rajagopalan, DVP Strategy and IR.

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 telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. P. N. Vasudevan. Thank you and over to you, sir.

P N Vasudevan: Good morning and thank you for dialing in on a Saturday morning. At the macro level in many parts of the world, we are witnessing turbulence in the financial sector. However, the Indian banking system seems to be far more resilient and outlook as things stand today look quite positive.

The banking sector credit growth has been on a high at around 15% last year, while the deposit growth has been around the 10% level. Clearly, the scramble for deposits is set to increase in the current financial year.

Moving on to Equitas, I believe that the initial years of building a brand, raising liabilities, building systems, embarking on technology journey, adding people, all have come out well and we feel that we are on the right path in our journey of building a stable, sustainable and scalable bank.

On asset quality, I'm happy to share that the overall asset quality has improved significantly over the last year. Our GNPA as of March '23 at 2.6% is at the same level of pre-COVID days. Last year, we had guided for a 1.5% credit cost and the actuals has turned out to be at the same level. Since our opening GNPA for the current year has come to the normal level, we believe credit cost also would get back to its normal level of around 1.2% to 1.25%. On advances growth, we had recorded a 35% growth last year. For the current year, we expect advances to grow around the 25% to 30% level.

We have not been guiding on ROA, but since we became a bank, we have been saying as a model, Equitas should be geared for a 2% to 2.25% ROA, assuming that there are no heavy headwinds from the market. We became a bank in September '16 and the demonetization happened in November '16, which led to stress in the microfinance book. It took us nearly three years for this to come to an ROA of 2.1% for the quarter ending December '19. With COVID hitting us in March '20, we faltered on the ROA again, and it took us about one and a half years to come back to the 2.2% ROA for the quarter ending December '22. After becoming a Bank six years back, this is the first time that we have been able to deliver an over 2% ROA consecutively for two quarters. I hope that with God's grace, we should be able to maintain consistency on this trend going forward.

Our balance sheet continues to remain robust, and we are well capitalized with capital adequacy at 23.8%. I am also happy to report that the Board of Directors of the Bank has recommended a maiden dividend of RS. 1 per equity share for the financial year '23. Our landed cost of money has been coming down over the years after becoming a Bank. For the next five, six years, we expect this to play out further because of the kind of robust retail liability franchise that we have been able to build over the last five, six years. This should help get our cost of funds very close to the larger banks as we move into the next five, six years' phase of the bank.

The full benefit of having become a bank would be visible over these five, six years. With a good retail liability franchise built up, a wide range of retail lending products in place, and probably the best of governance standards in the industry, I believe we are entering into the best phase of the Bank. And in this journey, I look forward to all of your continued support to the bank. We look forward to your support in this exciting journey.

I thank you once again for dialing in on a Saturday morning. Thank you so much. And I now hand the call over to Rohit.

Rohit Phadke: Thank you, Vasu sir, and a very good morning to everybody. Advances have grown by 35% year on year and 12% quarter-on-quarter to Rs. 27,861 crores. Quarterly disbursements at Rs. 5,917 crores grew by 80% year on year. This is the highest ever quarterly disbursement. Collections too have been strong and the GNPA in absolute terms has come down from Rs. 837 crores in March 2022 to RS. 724 crores in March 2023. SBL advances have crossed RS. 10,000 crores. Buoyed by strong demand in the retail sector, small business loans lead pipeline remains strong. SBL disbursements grew by 56% year on year. Quarterly disbursements for SBL too were the ever highest disbursements in a quarter. Merchant OD disbursements continue to gather momentum and the portfolio is showing an increasing trend month after month. X-bucket collection efficiency in SBL continues to be at 99.6%.

CV sales have grown by 38% year-on-year on the back of strong demand, low availability and higher freight rates. Passenger vehicle sales have hit an all-time high with sales of 36.2 lakh units, a growth of 23% year on year. Vehicle finance also delivered their highest ever disbursements in a quarter. Improving cash flows of customers have resulted in improving collections. X-bucket collection efficiency for vehicle finance was at 99%. The overdue pool, GNPA and 1 to 90 DPD for the vehicle finance businesses all have reached pre-COVID levels.

Microfinance has also seen a strong comeback with growth in advances and improving collection efficiencies and GNPA reduction. X-bucket collection efficiency in microfinance was at 99.6%.

Affordable home loans continue to gather pace. In addition to Gujarat and Maharashtra, affordable home loans are now operational in Tamil Nadu, Andhra Pradesh, Telangana and Karnataka. Based on the strong demand from all sectors and improving cash flows for customers, I do see a good momentum building up for a quality growth in advances.

Thank you. Over to Murali.

Murali Vaidyanathan: Thank you Rohit. Good morning, all. I think, like Mr. Vasu clearly mentioned, credit growth growing across is a very welcome sign and there is a squeeze of liquidity we are seeing it across. And despite that, we can happily say that we have grown on our deposits by 34%. It has been a continuous journey for us as we are looking up to enhancing our acquisition through our sales as well as specialized digital channels through B2C and B2B. I'm happy to say that all those three cylinders are firing adequately.

And we have introduced something called VRM one year back and virtual relationship managers are helping us and that portfolio has grown significantly and so is the physical RM channel. So, relationship management is helping us to grow the core, which we call it as a program book elite. Now elite book has crossed RS. 11,500 crores relationship value, thanks to you know, family-based banking concept. So close to 68,000 families are banking with us. That shows the insight of it.

Second thing is we are seeing a good green shoot on current account. We are getting into transaction centric approach. And current account has been backed up by our acquiring business, where we are, like Rohit rightly mentioned Merchant OD on one side, we also have POS machines, QR code and payment and transaction solution. We are there in top 25 and I think single largest SFB at this point of time in terms of machines as well as transaction value. So that's one good value proposition which is working.

On the issuance side, good to see that our debit card spends in terms of e-com, as well as offshore, we are actually making a good industry benchmark. And we should continue to focus on that side. RTD is looking up, since saver is a key concept for us, we are getting into saver more and more as we get deeper and deeper, shifting of money for temporarily should happen because that's the best value and best emergent need which is happening. So overall, domestic side, we are consolidated and grown well.

On NR side, the growth has been very encouraging. We are now present in close to 100 countries across where we have customers. And our book has crossed RS. 1,400 crores of NR book. And that's another healthy sign of creating a channel and going detailed into it helped us.

In terms of PPP, that is third-party income, our insurance, mutual fund and our third-party distribution of broking accounts and all-in-all put together is showing up very good traction, and that is helping the customers to expand their investment as well as trading requirements.

So increasingly, we see that our continued focus on CASA to gain the acquisition penetrating through RTD as a key approach. And with that note, I hand it over to Natarajan from Treasury, to take over, give us the treasury overview.

Natarajan M.: Good morning, everyone. FY '23 has been a challenging one on the market font as the Russian invasion of Ukraine made things worse for central banks globally and the fight against a higher non-transitory inflation levels.

Crypto currency and crypto exchange meltdowns, Bank collapses in the US and Europe and economic collapse of small countries where second or derivative effects of steep interest rate hike cycle that led to disruption and high time volatilities in markets across the globe. For FY '24, inflation appears to have peaked out globally, but continues to remain elevated. This is resulting in interest rates remaining higher for a longer period and the disrupting growth.

Global consumer sentiment continues to remain strong. And outside of tech, global labour market continues to be robust. With falling energy prices and the reopening of China, global slowdown is not expected to be as severe as feared earlier. India continues to remain better positioned both structurally and cyclically and is expected to be one of the fastest-growing economies in the world with the RBI pegging GDP growth of 6.5%.

This is supported by India's high frequency data indicators such as sustained GST collections, strong manufacturing and agricultural activity output, moderating inflation and the credit growth all pointing towards elevated activity levels. This signals confidence in the Indian economy. Markets continue to look for central banks for cues on interest rates, and the volatility may remain innovative till clarity emerges on the direction of rates as central banks continue to fight inflation.

Coming to Equitas treasury performance for last quarter, this has been another stable performance. Profit on sale of investments was RS. 2.7 crores and M2M depreciation for the quarter stood at RS. 1 crores. Our funding profile has been quite stable with opportunities available to raise funds both in the form of refinance as well as IBPC.

With this, I hand it over to Sridharan.

Sridharan N: Good morning to everyone. We had a good quarter on all fronts including growth in advances, deposits and profits. Our net interest income for the quarter came at RS. 707 crores as compared to RS. 552 crores during the same quarter last year, registering a growth of 28% YoY. Other income for the quarter came in at RS. 215 crores as compared to RS. 105 crores a growth of 104%. Other income for the quarter includes RS. 70 crores of income received from sale to ARC. Net income grew 32% year-on-year to RS. 922 crores as compared to RS. 658 crores during the same quarter last year.

The total operating expenditure came at RS. 536 crores as compared to RS. 374 crores during the same quarter previous year. Cost to income moderated to 58.09% for the quarter excluding the impact of income from ARC sale. The cost to income would have been 62.87% for the quarter. Core pre-provisioning operating profit grew 11% year-on-year and 13% quarter-on-quarter to RS. 316 crores. Core PPOP assets expanded to 3.79% for the quarter from 3.62% of last quarter.

PAT for the quarter came in at RS. 190 crores as against RS. 120 crores during the same period last year, registering a growth of 59% Y-on-Y and the annual PAT showed a growth of 104% to RS. 574 crores from RS. 281 crores in FY '22. As indicated earlier, the bank has completed the sale of microfinance loans through an ARC amounting to RS. 581 crores out of which loan amounting to RS. 501 crores were already written-off and balance were 100% provided. Out of the sale profits of RS. 80 crores, the Bank has recognised RS. 70 crores as other income and reversed the excess provision on NPA assets sold to the ARC amounting to RS. 11 crores. The Bank has also provided RS. 40 crores against the security receipts it held as per the RBI guidelines.

Now, moving on to Asset Quality and Provision, the Bank carries a total provision of RS. 549 crores, NPA provision of RS. 412 crores and provision on standard assets at RS. 137 crores. In order to strengthen the PCR, the management made additional provision of RS. 90 crores and total provision for the quarter is at RS. 85 crores. Details on this are given on slide 10 of our investor presentation.

GNPA improved by 147 bps year-on-year and came in at 2.6% in Q4 FY '23 as compared to 3.46% in Q3 FY '23 and 4.06% in Q4 FY '22. NNPA came at 1.14% in Q4 FY '23 as compared to 1.73% in Q3 FY '23 and 2.37% in Q4 FY '22. Provision coverage ratio improved to 56.9%. As of March 31, 2023, the total CRAR at 23.8% comprising of Tier 1 at 23.08% and Tier 2 at 0.72%.

With this, I would like to hand over to operator and we will be happy to take questions from the audience. Thank you.

Moderator: Thank you very much. We have our first question from the line of Darpin Shah from Haitong India. Please go ahead.

Darpin Shah: Hi, good morning. Congratulations to the team for such wonderful numbers. So, our first question is on cost to assets. We ended the year FY '23 at approximately 6.3%, so where do you see this trending over the next couple of years and what will be the drivers for it?

P N Vasudevan: Yes, hi, good morning. Cost to assets will come down over the next few years, but it will come down very slowly because cost to assets is going to be a factor of the product mix that we have. The existing products that we currently are lending and having, they are all generally very high-touch, high-feel kind of a credit process that we have. And the ticket sizes are at a lower level.

In fact, the average disbursement value per account, if I remove microfinance and the NBFC lending, then the average ticket size comes to anywhere around 6.4 lakhs to 6.5 lakhs per customer.

So, the current mix is that, we have that kind of a mix of portfolio today requiring high-touch-and-feel credit process, and our current cost to assets is where it is today. This is going to come down over the next few years as we introduce newer products where the touch-and-feel might be a little less required, the ticket size might be more than an average of RS. 6 lakh. All that will lead to a reduction in this, but that's going to be a very slow process. It's not going to happen in a hurry. So, over the next maybe three, four years, we might see it coming down slowly and marginally.

Darpin Shah: Okay. So, we'll have to put a number for FY ‘25, FY ‘24-FY ‘25, both the years?

P N Vasudevan: I don't have a number for FY ‘24. FY ‘25, though, I think you can broadly take it that it will be remaining very much close to where it is today because the new product that we'll introduce is largely going to be a personal loan, but it will come only in the second half of the year. And so, it will not have material impact for the current year. So, it may not change. The current year may not change much, but FY ‘25 may change, but it will be very marginal. I don't have a number, but it will be marginal.

Darpin Shah: Okay. Thanks. And the second question on growth trends, so you already mentioned the 25%-30% kind of growth. So, your microfinance, again, will be forming the same proportion as it is today, or we'll see some, it's winding down?

P N Vasudevan: Yes. Microfinance is currently around 18.7% or so, and over the next five years, we should see that coming down by maybe approximately about 4% to 5%.

Darpin Shah: Okay. Thanks. I'll come in the queue for other questions. Thank you.

P N Vasudevan: Sure. Thank you.

Moderator: Thank you. We have a next question from the line of Shreepal Doshi from Equirus. Please go ahead.

Shreepal Doshi: Sir, we have taken an additional provision of RS. 90 crores during the quarter, and it is mentioned that this was due to change in policy, the provision policy for March ‘23. So, what is the tweak in the policy? Just wanted to understand that.

P N Vasudevan: Okay. So, these are basically, some kind of provisioning changes on the various NPA buckets. So, when the NPA is 90 days, it becomes NPA, then, at various stages of the NPA, we have certain provisioning percentages. So, we change some of that by increasing the percentage of provision at an earlier stage of the NPA. So, it's basically that. And this has to be consistent, so whatever we change will remain consistent going forward.

Shreepal Doshi: Okay, I'll take it offline in that case. Just wanted to understand that during this year, during the last 12 months, we've added 3,000 employees. And so just wanted to understand what function or business segments this recruitment would be in. And going ahead, what is our branch expansion strategy? Because we have not really added many branches in the last two years, three years. So, from that point of view, I wanted to understand this aspect.

P N Vasudevan: See, on the branch part of it, we do have a pretty good network of branches today. And the first focus is going to be to leverage the existing branch network. There will be approximately an addition of maybe about 15 liability branches and maybe another about 30 asset branches to 40 asset branches for the current financial year. But by and large, the focus will remain leveraging the existing branch network that we have. In terms of the staff, I'll ask Rahul to brief you.

Rahul Rajagopalan: Shreepal, from last quarter to this quarter roughly around 550-odd employee additions have happened. So, 300 is on the asset side and 200 is on the liability side. And from this 300 again, 50 is largely towards collections. So, rest all are business. So, it largely towards frontend roles.

Shreepal Doshi: Got it, sir. And sir, we still have this approach of having asset and liability branches. We don't have, I mean, don't we just have one branch wherein both asset and liability would be done?

P N Vasudevan: So those are things which will evolve over a period of time. As the customer segments become common, then the servicing outlet also will become common. So that's something that will evolve over a period of time. But it's going to take time.

Shreepal Doshi: Got it, sir. One last question. So, the next project I think in pipeline is the aspiration to become universal bank. So, what's the timeline for the same or what are your thoughts on the same?

P N Vasudevan: So, we have completed the merger of the HoldCo with the Bank. And that was an important milestone that we had to achieve to meet the licensing condition that we had from the regulators. So that just got completed in the last quarter. So, we are in touch with the regulators. And as and when they give us a green signal that we can apply for universal bank, we will do that.

Shreepal Doshi: Got it. Thank you, so much and good luck, for the next quarter, sir.

P N Vasudevan: Yes, sure. Thank you.

Moderator: Thank you. We have a next question from the line of Savi Jain from 2Point2 Capital Advisors LLP. Please go ahead.

Savi Jain: Yes, congratulations on the numbers. One question I had was on the asset fee income that is not in sync with the disbursement growth, which it typically has tracked in the past. So, it is a little muted. Can you explain why that is the case?

P N Vasudevan: Can you please repeat?

Savi Jain: So, the asset fee income, ex of the ARC income, if you remove that, the asset fee income growth Q-o-Q has been tepid despite a significant growth in the disbursement number. Typically, there is a correlation between the disbursement and the asset fee income. So, I just wanted to know why this quarter has been tepid?

P N Vasudevan: Yes. So, it has gone from RS. 95 crores to RS. 102 crores. So, it has increased.

Savi Jain: No. If you look at the disbursement growth has been significantly higher, right? So RS. 4,797 crores have gone to RS. 5,917 crores Q-o-Q. That's a 23.3% Q-o-Q growth in disbursement.

Rohit Phadke: I'll come back offline on this.

Savi Jain: Okay. And another question was on the opex, especially the other opex, which is the one besides the employee cost that has gone up by 14% Q-o-Q. So, is there a one-off there, or what exactly has led to such a large increase this quarter?

Sridharan N: So, there is no one-off actually, it is because of the increase in the business actually, growth.

P N Vasudevan: It's only a growth in the business. Yes, so the other expenses growth is normal only. It's normal business expenses. Along with the business growth, it happens. And as I mentioned earlier, there will be some level of investment that we are committed on the digital side. So, this also includes that cost.

Savi Jain: So next year, will there be a higher than the asset growth? Will there be a higher opex increase or will there be a negative operating leverage as well? Because I think, the trajectory is quite steep for the other expenses also.

P N Vasudevan: Yes, see, our opex growth will continue to remain on the higher side fundamentally because of two factors. One is that our business model is a high touch and feel model. And so, to that extent, the cost will remain sticky. Second thing is that, as we have been mentioning earlier, there are three factors on which we keep investing. One is in terms of our digital. Second is in terms of our brand awareness. We have to put money behind our brand awareness campaign. We have not been able to spend much in the past, but that's something that we will probably increase.

And third is that new product rollouts. We are looking at a personal loan at some point in time. We will look at a credit card at some point in time. And now the Authorised Dealer (AD-1) license has been given to us on Forex. So, there's some amount of investment that we'll do on these three new products going forward, as well as on the branding and in terms of digital, which I mentioned earlier. So, cost-to-income, I mean, people have been asking us whether our cost-to-income will come down from 63% or 64%. Will it come down at some point below 60% and all that?

But our response has been generally that we should be kind of looking at a cost-to-income at a similar level to where it is today, fundamentally because whatever benefit we are able to get out of leveraging our existing investments in various resources will get used to support the future of the bank in the area that I just mentioned. So by and large, you can expect our cost-to-income to remain at similar levels to where it is today, which means that the opex cost increase should be fairly similar to what we are seeing presently.

Savi Jain: Okay. And on the ARC sale, the income that you have recognized this quarter, from what I understand, there's not going to be any further provisioning on this in the future, right?

Sridharan N: Yes, there will not be any further provisioning because the security receipts have been 100% provided for, so any collection which will come on NAV basis as well as realization basis will be accounted as an income.

Moderator: Thank you. We have our next question from the line of Renish Bhuva from ICICI Securities. Please go ahead.

Renish Bhuva: Yes. Hi Vasu and team. Congrats on a good set of numbers. So first, just two questions from my side. So, one is on the margin side. So, if you look at the trajectory, margin has been stretched at around 9, 9.1 despite our cost of fund increasing quarter-by-quarter. Even this quarter, yields are flattish, but cost of fund has went up almost to 20 basis point, and margin has still remained where it is. So, what is the disconnect here, sir?

P N Vasudevan: See, the cost of funds has gone up by 20 basis points during the quarter, but we are also able to recover part of that in the form of increased lending rate and partly in terms of some level of operating efficiency which comes in the system. So while the NIMs are more or less flat, just marginally higher than the last quarter, going forward also we should expect that maybe in the immediate term, when I say immediate term, maybe the next two to three quarter kind of an immediate term, we should broadly expect to see the NIM around this same 9% level, give or take 10 basis points, this way or that way.

But as we have been always saying earlier also, the NIMs will go down over a three or four-year period as both new products get launched and they start taking up a decent size of the book, which will come at a larger ticket size, which means that it will have a lower operating cost, etcetera. So as those kind of get rolled out and they start contributing more, the NIMs should start coming down, but I think that's at least a year plus away.

Renish Bhuva: Got it. So, I mean, is it right to assume that incrementally whatever pressure we might face on the cost of one side will be able to pass on to the customers?

P N Vasudevan: It's a combination, as I mentioned, of passing on a part of that to the client by way of increased lending rate and also partly in terms of some level of efficiency that we continue to see in the system.

Renish Bhuva: Got it. I mean, when we talk to peers, the commentary has been that it has been challenging to pass on the high lending rate, especially in the vehicle finance business. So, I just wanted to get a sense of what is our stance?

P N Vasudevan: See, by and large, we are not talking of a very large increase being passed on to the clients because, last quarter the repo rate did go up by 25 basis points, but subsequently in the last review, it's remained flat. So, we don't expect that from here on there will be too much of requirement to increase the lending rate. And these marginal increases that we might have to do over the next two, three, four months, it may be very marginal, frankly. It may not be very high, is what we believe.

Renish Bhuva: Got it, sir. And so, my second question is on the retail TD share. You know, so of course, more than 90% is non-callable. But if you look at the trajectory from last six quarters, the share of retail TD actually went down to 60% from 80% a year, year and a half back. So, despite, in most of the calls you've been highlighting that we are focusing on retail TD, but ultimately our bulk TD proportion is going up quarter by quarter. So, I mean, how one should rate this data point, sir?

Murali Vaidyanathan: There are three parts to it. One is retail TD in terms of number of customers we are adding into the book has gone up in last six months, which means average ticket price have come on and then granularity has gone up. That is one side. Second thing, individuals opting for bulk TD has gone up. Earlier, it used to be only institutions. For example, we have a new segment where NR individuals is also started giving. See, for us, we classify exactly what is, given to us by the regulators. So even if you come with, say, 2.1 crores, it makes sense to take it into a bulk TD role.

So, NR has helped us and similarly individuals have helped us. The third thing is there was a space available in the last quarter where we could get non-callable with a reasonably high duration of one year and one year plus. So, we went on to that. So increasingly you will see retail TD in terms of individuals growing and in bulk also individuals as well as NRs coming in. One of the reason is the present debt front taxation also.

So, we are seeing a trajectory picking up there. And in bulk, we predominantly don't focus on RS. 100 crores, RS. 200 crores. It's between RS. 3 crores to RS. 10 crores as a specific bucket, which gives us the arbitrage of costing as well as spread of number of accounts.

Renish Bhuva: And sir, what is the rate differential between retail TD and bulk TD?

Murali Vaidyanathan: See, retail TD is published rate, right? Bulk TD is based on market. So, we normally push for retail TDs only and retail TD rate.

Renish Bhuva: Okay, but not materially high rates?

Murali Vaidyanathan: Today, actually, bulk is cheaper too at the industry level.

Renish Bhuva: Got it. And sir, just last question again, based on the participant which asked earlier. Then if we look at in connection with the asset fee and the opex part, so let's say with the business growing, other opex is growing. But that is not offsetting by the higher asset fees. So, I mean, of course, it means that we are paying higher on sourcing. And at the same time, we are not able to charge the same fees to the customer. Is that the right way to look at it? Or is there some other things which are still happening there?

Rohit Phadke: So, on the fee part that you are asking, one is, as you keep building the portfolio, operating efficiencies will come into play. And as operating efficiencies will come into play, that will take care of the increased costs, the variable costs that will incur. Secondly, you said that with the sourcing costs, I know. In SBL, 92% of our sourcing is direct. In SBL, 92% of our sourcing is direct. Only 8% is through whatever, connectors or intermediaries. So outsourcing is not the issue.

On the fee part of it, what has happened is, we have also gotten into other segments, not merely our traditional segments, but more credit-tested segments where there was an opportunity last quarter. CVs have gone up. So prime CV is a segment. In SBL, secured business loans, which is a slightly higher ticket size customer, that was an opportunity. And that is why the fee income has not grown in proportion to the disbursement. But the disbursement spike is very high. So, the customer interest income and the operating efficiencies itself will take care of the increased disbursement. It will not lead to a negative cost.

Moderator: Thank you. We have our next question from the line of Abhishek Murarka from HSBC. Please go ahead.

Abhishek Murarka: Yes, hi. Good morning, Vasu and team. And congratulations for a fantastic quarter. My question is, first on credit cost guidance, what do you see it as for FY ’24, especially given this new provisioning policy? So just some guidance on that would be helpful.

P N Vasudevan: So, as I mentioned in my earlier remarks also, for the current year, we should be budgeting a credit cost of between 1.2% to 1.25%.

Abhishek Murarka: Okay. Perfect. And my second question is just some color on the business side. So, in vehicles, how much increase have you been able to take in the last, let's say, a year? And currently, how easy are you finding it to pass on? I know you said that there's competition. You replied to Renish also. But just some context in terms of the business dynamics. What's happening in terms of the ability to pass on rates?

Rohit Phadke: So, in vehicles, 50% of our book is on the used CV. Yes, only about 35 to 40% is on the new CV and the remaining 10% in used cars. So, the pressure on margins is primarily on the new CV, which is a limited book. See, we have scaled up used cars in the last year, and we intend to scale up used cars further. So used car and used CV is a high margin product where we don't see a pressure on margins as of now. And the new CV piece is very small. So, the product mix will work in favor of vehicle finance.

Abhishek Murarka: What would be the rate, the blended yield right now, for used versus used?

Rohit Phadke: So currently, the blended yield for vehicle finance is 15%, 16%.

Abhishek Murarka: Okay. All right. And just some similar commentary around SBL. What would be the yield and how much increase has been taken?

Rohit Phadke: SBL blended yield is at 16.5%.

Abhishek Murarka: Sorry, could you repeat that?

Rohit Phadke: About 17%.

Moderator: Thank you. We have our next question from the line of Nidhesh Jain from Investec. Please go ahead.

Nidhesh Jain: Thanks for the opportunity. Firstly, on the liabilities, we have seen a bit of moderation in CASA on a sequential basis. So how should we think about CASA growth in FY '24? And secondly, when do we see CASA, cost of CASA for us to trend downwards? Because that still remains quite sticky. When do we get comfort to reduce the SA rate products?

Murali Vaidyanathan: Hi, Murali here. First, your question is very valid. See, at this point of time, the arbitrage between SA rates and TD is very welcoming for a long-term saver. So, if you look into the segment which we operate, savers as a segment, number of people opting to go for TD within the book, taking existing money and bringing in new money, both are going up. So, I think at this phase, we should leave it to the depositors because it is part of consumption cycle, and we should be optimally priced.

Today on SA rate, there are already most of the banks have crossed 7.25% also, and there are banks which have crossed 6% also. So, the optimum pricing will start seeing once the interest rate starts dipping and giving us a favorable turn. So, at this point of time, if you see our laddering in terms of pricing, I'm sure you are aware, up to RS. 1 lakh bucket, it is 3.5%, 1 to 5, it is 5.5%. If you see, these two buckets are growing because the compulsive proposition of spend which we have put in with debit cards has gone up.

So actually, the higher bucket where you have 7%, those are the people actually shifting towards TD and getting the arbitrage out. So effective cost of, till we keep growing that 3.5% bucket and 5% bucket for us, it will help us to bring the cost of funds down. And CASA, the only way to pick up now is getting the new customers to a continuous opportunity which is available in the market, then keep cross-selling TD for a longer duration. That is going to be our approach and we are continuing in that direction.

Nidhesh Jain: Okay, so can you share some data on what percentage of our SA is from direct customers?

Murali Vaidyanathan: Yes, it is there in the presentation slide number 23. Saving slab wise, we have up to RS. 1 lakh, it is 6%. RS. 1 lakh to RS. 1 crores, 63%. So, 70% of the bucket. Okay, between that, 1 to 5 will be another 8% to 9%. So top 15% of the book, that is up to RS. 1 lakh and 1 to -- it's contributing 15% of the book. So, we need to keep expanding the pie to get the cost of funds down. We need to expand the RS. 1 lakh to RS. 1 crores bucket to get the SA. This is the two strategy through which relationship banking is working for existing book. Digital banking is working to source customers and sales channel is there to get the effective penetration.

Nidhesh Jain: Sure, and how is our success in getting salaried accounts in the market?

Murali Vaidyanathan: Salaried, there are two sets of salaried. One is you create a corporate code and specifically target. We have close to 1,800 corporates with 30% of the employees going through us. We also do a unitary basis because our proposition is for savers. We don't have the range of consumer products. So, in our SA book today, 38% to 40%, 38% to 40% is salaried individuals who are holding balances with us because of the proposition. So, our focus is to get individuals targeted. Second is to co-sell to get the COCOA on. Third stage, work in progress, which UAT is done. We will take through a digital route to target specific corporates of CAT A and CAT B that work is on.

Nidhesh Jain: And secondly, on the asset side, we have written off almost RS. 1,000 crores of loan over the last three years, FY '21, '22, '23. So, if you can share some breakup, how much is microfinance and how much is non-microfinance and what would be the strategy to get recovery from these written off loans?

P N Vasudevan: One sec, let them get the data on the breakup of written off assets. But Rohit, meanwhile, can talk about what is the likely recovery.

Rohit Phadke: So, I'll just give you a sample example of the restructured pool. You'll understand how it has behaved. In the opening of the book, I'll just give you a sample example of the restructured pool. In the opening balance, we had RS. 1,881 crores of assets restructured. Out of those RS. 881 crores, RS. 833 crores worth of customers foreclosed or settled their accounts. So, the live book, there is only RS. 726 crores. And about RS. 491 crores of customers were either written off or in vehicle finance, repo sale has happened. Out of this, microfinance, RS. 123 crores has been written off. And vehicle finance, in153 crores of customers have, the vehicles were repossessed. And current NPA is RS. 219 crores. So, 73% of the customers have really been normal. It's only about 27% of the restructured book, customers who have not been able to pay.

Sridharan N: This is on written of assets. If you look at the microfinance, close to RS. 535 crores, of which we have sold RS. 500 crores. Last three years, around RS. 400 crores in microfinance and 150 crores in CV. Business Loans Unsecured is RS. 51 crores. That totals to Rs. 600 crores.

P N Vasudevan: In the last three years, we have written only Rs. 600 crores. Not more than that. Technical written off. Technical written off, okay. Right, Nidhesh, you got that?

Nidhesh Jain: Yes, so okay. I think I've included both written off and technical write offs. That was amounting to around RS. 1,000 crores.

P N Vasudevan: No, no, no. The technical write off is what we write off fundamentally arising out of microfinance, most of them. The other written off is basically in vehicle finance. You know, when we repurpose a vehicle and it is sold and there's a shortfall, that is written off in the same quarter. And the second thing is that in vehicle finance, when the NPA bucket crosses a certain level, like let's say two years or three years, and we have not been able to repossess a vehicle even after that, then after that point in time, we do again a technical write off in that vehicle finance portfolio also. So that's how it goes normally.

Moderator: Thank you. We have our next question from the line of Arvind R. from Sundaram Alternates. Please go ahead.

Arvind R: Yes, thank you for the opportunity. I just wanted to understand the credit growth, expectations in the next few years and what is the mix you are expecting in each of the segments? I just wanted to understand that.

Rohit Phadke: So as Vasu sir mentioned that we expect advances growth to be between 25% to 30% this year. And I think we'll maintain that pace. On the mix between different segments, I think mortgages will be at about 50% of the book. Microfinance will come down from 19% currently to about 15%. And vehicle finance will be at about 20% to 25% of the book. So, this is what the current scenario is. And this is what we are looking at as of now.

Moderator: We have our next question from the line of Manish Agarwalla from Phillip capital. Please go ahead.

Manish Agarwalla: Yes, congratulations to you. And just one question on RBI draft on penal charges. So, any thought, how does that impact the equities?

P N Vasudevan: I don't think we'll have much of an impact.

Manish Agarwalla: Okay. So, to the fact being, the fact that we are in a segment where the overdue are in the regular criteria, we don't see any major impact in our numbers.

P N Vasudevan: Hello, can you repeat your, you're not audible.

Manish Agarwalla: Yes, so the point I was trying to make is that we are in a segment which is self-assessed and the overdue in that segment are very regular in nature, though ideally it might be very low. So, we don't have, we don't see any impact of this draft regulation on penal charges. That's what you want to confirm, correct?

Rohit Phadke: Yes, yes, that's what we are saying, that there won't be any impact on us on that circular, if the circular comes into effect.

Manish Agarwalla: Okay. The other data keeping question I had, can you confirm what is the outstanding standards of provisioning and contingent provisioning in the book right now? Yes. Outstanding standards of provisioning and contingent provisioning, if any, in the book?

Sridharan N: Yes. Yes, the non-NPA provisioning is RS. 412 crores and RS. 136 crores is on the standards provisioning and restructure standards provisioning. So, totaling to RS. 548 crores.

Manish Agarwalla: Okay. And finally, the restructured book which we have, does it entirely pertain to SBL or we have some portion of vehicle there?

Rohit Phadke: No, no, it's across the bank. That number which we have quoted, RS. 234 crores, is across the bank.

Manish Agarwalla: Can you quantify?

P N Vasudevan: See, actually, MFI has become zero.

Manish Agarwalla: Do you have the break-up?

Rohit Phadke: SBL is RS. 109 crores, CV is RS. 80 crores, and MSE is RS. 46 crores. Entire microfinance moved up. So these three totaling to RS. 235 crores.

Manish Agarwalla: Okay, fine. Thank you very much.

P N Vasudevan: See, basically on the restructured book, there was a certain level of worry in the market in terms of the size of our restructured book, when we initiated that in December of ‘21. You know, we had that 10% of our book restructured, 9.7% or whatever, around 10% of our book was restructured. But the reality is that it's played out fairly well, and, today at the end of March ‘23, we are left with only about RS. 235 crores of restructured book. And against that restructured book, we have an NPA of RS. 177 crores, which is all put out in your presentation at page 11.

And against this RS. 177 crores of NPA in the restructured book, we have 88% provision coverage in the system. So, I think we are fairly well covered on the restructuring, and it's actually played out well. And a Bank like ours, which is focusing on a certain segment of borrowers who are from the very, very, the low-income segment, we just got to be a lot more humane and considerate and empathetic to our client base in terms of stress like what we saw in the last two years. We can't just be like any other Bank trying to keep our restructuring or moratorium, etcetera, low. We can't do that.

We just got to be supportive to those customers because, the message that we keep giving internally also to our sales staff and our credit staff when they do a transaction for a customer is that, if they make a mistake, because the customer doesn't, beyond a point, he doesn't even know how much he's actually making out of his business. We got to sit down and create a kind of a balance sheet or a P&L for the customer to determine his level of income and then remove something for his expenses and say what's the balance available for an EMI repayment and use that to calculate the loan that he can actually be able to borrow and service.

So, we do that kind of calculation for the customer. And the message to the team is that you guys make a mistake, what happens is the bank will have a small write-off. The Bank will get on with its own life. We'll never be impacted. But for that individual customer for whom our staff makes a mistake, at the end of the process that the Bank will roll out, the customer will lose his property. And that property is probably the only property he has in his life. And he'll lose his property. So, we just got to be very careful, very sympathetic, and very empathetic with the kind of segment of borrower that we deal with.

And so, we did go for a very large level of restructuring in 2021. But it's played out well. And the Bank has actually come out very strongly after that. And today the restructuring is mostly completed in terms of either payment or in terms of closure or in terms of NPA and write-off or whatever.

Similarly, I'll just give you one more data point. I mean, just to refresh all your memories. In 2020, when RBI came with the moratorium, 90% by value and 97% by number of customers took the moratorium in Equitas Bank. Can you believe that number? 90% by value took moratorium. 97% by number of customers took the moratorium.

But at the end of two years of COVID, the Bank is absolutely back to a very strong financial position. Our GNPs are absolutely back to our pre-COVID levels. Collections are very robust. Customers have been able to come back very strongly and repay their loans and save their property and protect their security, whatever they have given to the bank. And so, it's really played out very well.

So, this kind of an empathetic approach is something that a Bank like us will have to keep in mind all the time. So, I just thought that I'll just give you that background because quite often we tend to, in our own analytics on financial numbers, I think sometimes we tend to forget the kind of customer that we service. And when you forget that, then, I don't think you are doing the right business at all.

Moderator: Thank you. We have our next question from the line of Ashlesh Sonje from Kotak Securities. Please go ahead.

Ashlesh Sonje: Hi, team. Good morning. The first question is on the slippages front. We have seen a meaningful sequential decline on slippages. Can you give some color on what is driving this decline?

Rohit Phadke: So, slippages were down to RS. 190 crores from RS. 286 crores. So, I think slippages are improving because there is enough cash flow with the customer now. Collections are improving in the field. And I think this trend will be maintained.

Ashlesh Sonje: You expect the number to decline further from here during FY '24?

Rohit Phadke: It will definitely improve. It will not be bad. That much I can tell you 100%. It will definitely be better than 190.

Ashlesh Sonje: Okay, perfect. And secondly, on the cost of funds front, we have seen a sequential increase of about 20 basis points. But looking at the liabilities book that we have today, if we assume no further hikes on the term deposit rates and the SA rates which we offer, what is the amount of increase on the cost of funds that we are likely to see at the peak?

Murali Vaidyanathan: See, it is directly proportional to the product mix. Today we are at CASA, which we closed last quarter, 42. And that has actually cost of SA is 6.2 or 6.3. Incrementally, as you saw, TD, the incremental cost of TD is closer to 8.5, which means there is an arbitrage of 23 to 30 bps, to be very precise. So, if we continue to get CASA 45% as a total composition, we can maintain the CASA costing rate. TD is market driven. TD, which was 7.1, has moved up to 7.5. So, 40 bps increase is what has happened in the last three quarters, if you see.

So, if we have to sustain that, we need to increase the CAR to CASA ratio, CASA ratio, and importantly, getting into the TD mix. So, TD is market driven. TD, despite that 250 bps of RBI hike, we have still not gone up to the 250 bps. We are at 150, 160 bps at this point of time. 175 bps post this hike. So, I think today we don't see an increase in SA rate, so which means SA book can be, as we grow, we can maintain the cost of fund on SA. On TD, we are going on duration-centric, so we are looking at certain buckets only. So that is directly driven by the prices. So, I think three to four-bit hike per month over next six months is seen. Then as it cools down, we need to bring it back.

Ashlesh Sonje: Understood. So, when you say 3 to 4 basis points is the hike on cost of funds on a monthly basis?

Murali Vaidyanathan: Yes, yes.

Ashlesh Sonje: Is that because of the TDs getting repriced, or you're talking about...

Murali Vaidyanathan: You are replacing the existing TD. See, there are two types of TD. One is you get from the market, which is open market sourcing, which is directly. Second, you are replacing on maturity a lower-cost TD with a higher-cost one, because that is market-driven again.

Moderator: Thank you. We have our next question from the line of Manuj Oberoi from Yes Securities. Please go ahead.

Rajiv: Yes, hi, sir. This is Rajiv. Congratulations on a very strong set of numbers. Just a few questions. Firstly, SMA 1 and 2 position as of December. What will that be?

P N Vasudevan: SMA 1 and 2?

Rajiv: As of December.

P N Vasudevan: That's basically, you're talking of standard asset provisioning.

Rajiv: No, no, I'm saying SMA 1 and 2. SMA 1 and 2 portfolios as at the end of December. So, you've given as at the end of March in the presentation.

P N Vasudevan: Okay, you're talking of slide 11, where we have given you March '22 and March '23 data. So, what's the December number of SMA? The total of SMA 1 and 2 in December is -- 3.88. 3.88 is the total of SMA 1 and 2 in December. And in March, that has come down to what? 3.19 or something like that.

Rajiv: Yes. And, sir, what happened to those RS. 60 crores of restructured standard provision which we were planning to utilize? So, have they been fully consumed in the current quarter in the form of additional provisions?

Sridharan N: See, this quarter, we have consumed RS. 11 crores, which has been returned back. So, over a period, no, actually, depending on the collections prescribed by the RBI guide, the rest will be utilized.

Rajiv: Yes, so what is the residual balance of those provisions now, which can be returned back, maybe?

Sridharan N: Residual balance of restructured provision is Rs. 48 crores

Rajiv: Just last thing, so I see you holding PCR of 88% on the restructured NPAs, which is significantly higher than the overall PCR on the NPAs. So, why so?

P N Vasudevan: I mean, these are restructured assets because at some point, the customer was under stress. So, basically, we have a policy of having a higher provision for restructured so that whatever trouble that might arise in the future out of that should be reasonably covered up. Our overall PCR on the entire NPA book is 57% as of March. So, we should be looking to increase that 57% over the next few quarters, and our target is clearly to go to the 70% level in the next few quarters.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. P. N. Vasudevan for his closing comments. Over to you, sir.

P N Vasudevan: Yes, thank you. Thanks, all of you, for dialing in and keeping us on our toes with all your questions. We really appreciate it that you're taking your time out and to help us improve our business and keep it going forward. So, we look forward to your continued support. Wishing you all the very best. Bye-bye.

Moderator: Thank you. On behalf of Equitas Small Finance Bank Limited, we conclude today's conference. Thank you for joining us. You may now disconnect your lines.