"Equitas Small Finance Bank Limited Q2 FY25 Earnings Call"

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Moderator: Ladies and gentlemen, good evening and welcome to the Earnings Call of Equitas Small Finance Bank Limited Financial Performance for Q2 FY25.

We have with us today Mr. P. N. Vasudevan – MD & CEO; Mr. Sridharan N. – CFO; 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 & Head (Treasury) and Mr. Dheeraj Mohan – Head (Strategy and IR).

As a reminder, all participant lines will be in the listen-only mode, and there'll be an opportunity for you to ask questions after the presentation concludes. Should any assistant in the conference call, please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded.

I now like to hand the conference over to Mr. P. N. Vasudevan. Thank you, and over to you, sir.

P. N. Vasudevan: Good evening to all of you and thank you for logging in today.

The first six months of the financial year has been quite turbulent as we witnessed deterioration in the microfinance portfolio at an industry level. Before we discuss in detail about how the portfolio has behaved and steps the bank has taken to ensure we get back on track quickly, I would like to highlight a few good things which have happened during the year.

Our strategy on the liability side is taking shape well. We continue to see strong growth in retail deposits. The overall momentum in mobilizing deposit has been quite healthy during the quarter. About 74% of our deposits are retail and incrementally, we are seeing this holding up. During the first quarter, we had changed the slab for savings bank interest rate. In the first week of October, we have done one more tweaking of the slab for savings account rates and also reduced the peak interest rate for retail TD from 8.5% to 8.25%. While the cost of savings accounts has come down by about 13 basis points in the second quarter compared to the first quarter, the impact of TD interest rate reduction may be visible over the next few quarters.

Investments in products like personal loan, credit cards, and forex services have largely gone as per plan. Some of these products are being piloted and we aim to see it getting rolled out for our existing customers by end of this financial year.

Our investments in technology infrastructure like CRM, super app and customer app for borrowers have also progressed very well. This year our treasury desk has contributed well so far and have actively participated across asset classes taking advantage of the opportunities that the market has been giving us. The cost of funds of the bank has largely remained stable and within anticipated levels. Talking about our asset business, our flagship product small business loan continues to perform quite well. Our strategy to focus on micro lap has started to show results. As you can see, the disbursements in micro lap is picking up, the overall disbursement in small business loans has also remained robust, and we hope to see a good second half for this product. Similarly, we are seeing affordable housing segment and the used car loans growing well, while new commercial vehicle loans remain subdued as per our plan.

Vehicle finance, which showed some weakness in the first quarter, is recovering, and we are confident the second half of the year will be even better. The disbursements in used commercial vehicle and used car loans have been the highest during the second quarter. During the quarter, the team in vehicle finance has increased the focus on recoveries and improving collections across all the buckets. In October, for example, our X bucket collection efficiency in vehicles has moved up to 97.1% which is in the comfort zone and traditionally the second half of the year has been stronger for vehicle financing both in terms of collections and disbursements. The realignment of our loans to healthier yields has helped us keep our yield on advance stable despite the fall in microfinance as a proportion to overall advance during the year.

Now coming to the stress we are seeing in microfinance. The situation continues to be a concern as fresh slippage and flow from SME 0, 1 and 2 continues to be elevated. We have been working with our customers to see how best we can be of help to them to overcome the present stress. One of the new norms being introduced rewards customers by way of reduction in interest rates for loyalty and better repayment behavior. Similar measures for center attendance and group behavior are also being extended. Structurally, we have strengthened the branches with dedicated teams to improve customer engagements, collections and DPD resolutions. These initiatives we expect will help improve resolution percentage of various DPD buckets. We need to see slippage into NPA reduced by half to bring microfinance portfolio to a stable level. We see some of the positive trends further strengthening in October. Disbursements in October crossed Rs. 1,900 crores which is after a gap of six months. X-bucket collections in vehicle finance has improved while in microfinance October saw stability in X-bucket collections.

Lastly on provisions, we have made extra provisions of about Rs. 146 crores in microfinance during the quarter. Out of Rs. 146 crores, about Rs. 100 crores is in the form of stress sector provision, which translates to about 50% of 31 to 90 DPD in microfinance. This is a buffer provision and is over and above the PCR. The balance Rs. 46 crores was done by strengthening the IRAC norms for microfinance NPA book. We now provide 100% for loans above 180 DPD in microfinance. Our intention is to try and upfront some of the provisions proactively and take the credit cost pain upfront.

To sum up, deposit growth is comfortable. FD rates are moderating. We'll wait and see the results of our latest rate reduction in FD. Treasury is doing well. Disbursements are picking up quite well. Vehicle finance collections have improved in October and should see a good second half. The credit cost of our non-microfinance portfolio, which is 84% of our total advance, is at 1.04% for the first half which is very comfortable and could see further improvements in the second half. Microfinance stress is likely to remain for possibly another two quarters, given that the stress started about three quarters back and it's a two-year loan product. As mentioned last quarter, we are not providing guidance on credit cost and growth for the year, so please do bear with us. Our journey of building a robust and scalable bank is on track, supported by focus on secured loans, declining percentage contribution of microfinance, high asset quality and a strong liability franchise enabling us to reduce the cost of funds difference with other banks over a period of time.

Thanking you once again for dialing in, I now hand over to Sridhar.

Sridharan N.: Good evening to everyone.

I shall quickly give an overview of our "Financial Performance" for the quarter. Most of this is already covered in our presentation. Our net interest income and other income for the quarter was Rs.802 crores and Rs.229 crores respectively. Treasury income and asset fee income majorly contributes to other income segment, with YoY increase of 156% and 37% respectively, resulting in net income of Rs. 1,031 crores with YoY of 11%. Our yield on advances adjusting for securitization and other off book items remained flat on Y-on-Y basis despite a drop in microfinance mix. The yield on disbursement remained at 17.83% and was under pressure due to slow down in microfinance. Microfinance disbursement stood at 20% during Q2 FY25, vis-à-vis 28% in Q2 FY24.

On the cost side, operating expenditure came at Rs. 682 crores, clocking a growth of 14% over last year. Over the last two quarters, we have been tightening our non-employee related costs, which is visible in our cost, that is flat on Q-on-Q basis. Cost to income increased to 66.09%, vis-à-vis 64.37% of last year. PPOP grew 6% year-on-year to Rs. 350 crores and PPOP to assets remain stable at 2.94% for the quarter. With disbursement picking up, we should see these ratios to improve. Credit cost for the quarter came in at Rs. 330 crores. As explained by Vasu, as a prudent measure we have provided 146 crores of provision towards microfinance. The bank carried a total GNPA of Rs. 1023 crores and NPA provision of Rs. 693 crores.

Our PCR now stands at 67.71%, up from 57.72% in the previous quarter last year. PCR for individual product segments are given in the PPT for a granular view. As of September 30, 2024, the total CRAR has stood at 19.36% and we expect to raise the tier 2 bonds soon.

Thank you. Over to Murali.

Murali Vaidyanathan: Good evening. Thanks for joining this call.

I just want to give some "Key Thematic Insights" than the absolute numbers. I think current account as a proposition, which is highly invested and more focused by the institution started giving some good yields. If you see, we have grown by 66% year-on-year. That's a very healthy sign, which brings us into the new segment of SEMP, as well as businessman community. And we have doing few things right there, actually focusing on the last leg of supply chain and also using acquiring as an objective tool to get that aspect right.

Next part is our savings account:

Our continued focus on affluent as a segment is helping us in two fronts. One is to grow the elite as a book, which is now getting into close to 50%-55% of our book, as well as sourcing. So, our relationship management structure from virtual to real is actually facilitating the real progress there. Second is one of our four pillars is family banking. We are happy to share that close to 30,000 families are now banking with us at the affluent space. So, I think that's one natural progression which is happening. And fourth important thing is RTD as a mix. For example, retail deposits today is close to 79% of our book. In that 444-day rules rose, 55% of my RTD comes from there. So, retail focus and retail poll is helping us to granularize and we have close to 70,000-80,000 new to bank customers who have been onboarded through this product. Now with this family bank as well as elite proposition, one good thing that has happened is MF AUM has grown by close to 70% year-on-year and I think 22% quarter-on-quarter and that's one good trajectory. This is predominantly built through SIP as a route. And ASBA as a proposition is helping good trajectory in terms of savings account as well as qualified family coming in. NRE is another thing we have crossed 140 countries, we have customers now across close to 15,000-16,000 good customers where we are coming in.

Now with AD-1 coming up, our remittance as well as FCNR should facilitate which we should go live very soon, maybe in quarter four. So, overall things are challenging, but I think our team at the front end as well as products, which we are differentiating and the relationship management structure overall is paying it off.

So, I'll hand it over now to Mr. Rohit Phadke to give insights on assets.

Rohit Phadke: Good evening everybody. Advances at Rs. 36,053 crores, grew by 15% year-on-year and 3% quarter-on-quarter. Advances for SBL were at Rs. 14,678 crores grew by 28% year-on-year and 7% quarter-on-quarter. X-bucket collection efficiency was at 98.8%. Micro LAP has been growing very well and the focus on micro LAP has been seeing increasing disbursements month-on-month. The merchant overdraft order book grew to Rs. 1222 crores with 46,827 customers. In the second quarter, Rs. 350 crores of loans were disbursed through our newly launched Selfie Loan app.

Vehicle finance in the CV segment grew by 14% year-on-year and 15% quarter-on-quarter. The vehicle finance advances stand at Rs. 8,877 crores. Used cars have grown by 53% year-on-year and 12% quarter-on-quarter. Used CV business grew by 14% year-on-year and 7% quarter-on-quarter. The new CV disbursements de-grew by 36% and advances grew merely 2%. The focus in vehicle finance is to grow the used CV and the used car book and de-focus on the new CV segment. The affordable housing finance book continues to grow well. Advances grew by 23% year-on-year.

The MSE portfolio is at Rs. 1,366 crores and which has grown by 32% year-on-year and 12% quarter-on-quarter. The MF book de-grew by 4% year-on-year and 6% quarter-on-quarter. We are making efforts to ensure that delinquencies come back to normal. Generally, the second half of the first financial year is stronger than the first half and I am quite confident that we should be able to do well in the coming quarters. Thank you. I am handing over to Nataraj please.

Natarajan M.: Good evening. From the treasury side, Q2FY25 has been good on the market front. Our view on Indian bonds was that once the Fed started cutting benchmark rates, Indian yields also would rally, although with a lag and in smaller measure. This played out in the quarter gone by. US yields rallied by 60 basis points quarter-on-quarter on the back of US Fed cutting benchmark rates by 50 basis points in its September meeting. While the Indian 10-year yields rallied by 25 basis points and closed around 675. Indian bonds continue to see good buying on the back of inclusion in global Morgan Stanley bond index and the expectation of eventual withdrawal of accommodation stands from RBI.

With US Fed paving the way for further cut but the smaller doses in the near future, as evidenced by the decision to cut rates by 25 basis points in their last night meeting. We feel there is room for Indian yield to soften once inflation and crude stay within comfortable levels.

On the equity side, Indian equities were quite volatile for a better part of the quarter, but ultimately closed higher as market participants continued to react favorably to sustained economic activity. China's decision to announce stimulus measures to boost their local economy led to flight of capital from India to China with the heavy selling by FIIs. FIIs continue to remain net sellers in Indian equity markets for several weeks now on anticipation of announcement of follow-through measures from China. Globally, the geopolitics continue to be an issue as escalations continue in Ukraine and the Middle East. Despite India's economy continuing to stabilize, consolidate and grow, considering the global nature of trade and supply chain, we can expect bouts of volatility going ahead despite a strong local economy. Hence, our view on the market is cautiously optimistic in the near term. We continue to remain positive on the India growth story over the medium to long term as domestic economic activity continues to be resilient. Now we're open to questions.

Moderator: Thank you. We will now begin the question and answer session. We have the first question from the line of Renish from ICICI. Please go ahead.

Renish: Sir, I have two questions. Sir if we look at the SMA buckets for MFI and bank separately, it is very clear that your SMA 0 and 1 for bank is actually higher than SMA 0 and 1 in MFI, which essentially means that apart from MFI, there are other products segment as well, which are going to some sort of stress. Could you highlight which all products are going to some stress apart from MFI?

P. N. Vasudevan: So, basically, the SMA book for other products such as the vehicles or SBL, they will have some SMA book. But the resolution percentage in those are quite high. Typically, the resolution percentage for, let's say, SMA 0, 1, and 2 in vehicles or small business loan typically will be in the range of around 85% to 90%. And that is why, even though you will have some SMA book, but the ultimate slippage doesn't really happen because the resolutions tend to be very high.

Whereas in microfinance, the resolution percentage in the buckets are actually much lower. And that is why we have created this extra buffer for the SMA book of microfinance and not for the others. Because for the others, though, it is normal, it's actually quite normal and standard situation. Whereas in microfinance, this level of SMA was not there in the past. And the resolution percentage being lower, that's where we thought we should create that buffer provision.

Renish: Got it sir. But even if you look at on the standalone basis right, the SMA 0 in 1 for Q2 is actually highest in last 4-5 quarters, so of course I do understand the retention rates are higher but what is leading to this elevated stress?

P. N. Vasudevan: You mean to say that 4.13, which is the one you are referring to?

Renish: Yeah, 4.13 and 2.7 both. Both the numbers are highest in last 6 quarters, 7 quarters.

P. N. Vasudevan: Yeah, I mean, that's the whole point, no? Because, largely the vehicle book had some stress in the first quarter, and it's improved in the second quarter, but still it is not completely normal. October, of course, I think we have mentioned in my opening comments also, that October slippage was, I mean, the October X bucket was the best in the last few months. And the second half of the year, typically vehicles should see a much better performance. So, that 4.13 is a combination of the microfinance as well as the vehicle finance. But the concern in those cases are not much because our resolution percentage as I mentioned is very strong. So, the concerns are generally not that much.

Moderator: Thank you. We have the next question from the line of Vatsal Shah from Knightstone Capital. Please go ahead.

Vatsal Shah: Sir, a similar question. So, you said that the resolution numbers are 80% to 90% for the bank SMA level. So, can we expect that like 20% of that flows into NPA? Is that understanding correct?

P. N. Vasudevan: Yeah, I mean, so if in the third bucket, that is the SMA-2 bucket, if we have a resolution in a month, let's say in a given month resolution is say 85%, 15% will flow into NPA. But what also happens is that there will be some resolution of the previous NPA accounts. So, at the end of the month or end of the quarter, the net NPA increase would be the net of what flows into NPA and what gets resolved from the opening NPA. So, that is the net NPA that we'll end up having.

Vatsal Shah: Got it. And for MFI, this will be like what percentage the flows from SMA bucket into the NPA pool?

P. N. Vasudevan: So, the for microfinance in our SMA-2 bucket, the typical resolution is in the range of around 40% to 45%, which means nearly half of them flow into NPA. And there will be of course some resolution of the opening NPA which helps to net it off and bring it down, but the resolution itself is only in those ranges. Whereas for other secured loan products as I mentioned, it's typically around 85% to 90%.

Vatsal Shah: Got it. And the last question is on cost to income. So, you like cost to income as you have mentioned in previous quarters as well is likely to remain elevated for the next 2 to 3 years. But what do you expect over the longer term like five years like where it will stabilize according to you?

P. N. Vasudevan: So, two things on that. We have been saying that our cost will be higher because we continue to remain as a very developing and evolving banks, so there is a level of investment that needs to keep happening in products, people and technology. So, to that extent from an overall perspective, yes there will be some increase in the cost, but if you see the first quarter to second quarter on page #14, if you see employee cost has gone up from Rs. 375 crores to Rs. 402 crores between first and second quarter. However, if you see the operating other expenses, Rs. 243 crores to Rs. 245 crores, so consciously what we are trying to do is try and see how do we control our operating cost to other expenses to the extent that is possible. We are trying to see how do we control that cost and some effort was put in the last quarter and we have seen kind of a flat other expenses and that's one area where we are trying to see how do we keep our cost as much as possible down, while employee cost will go up because we are putting more people on the field, whether it is in terms of sales or collections, that number of staff will go up, so to that extent employee expense may go up. And other expense we are trying to see how best to control it and whether it is in terms of controlling cost or trying to avoid any expense that is possible to avoid. So, that is that effort which is going in. That is from an immediate perspective. But your question from a longer term perspective, if you ask me, I think we have mentioned in the past also that the next three years will be an area where there will be some level of investment, because we are introducing three new products, which is our personal loan credit cards and AD-1 products. And so we have been expanding on those new products. There'll be some little bit more of expenses on that for the next few quarters after which they should stabilize. So, I think from a longer term perspective, you should see our cost to income actually maybe declining after a period of maybe three years.

Moderator: Thank you. We have the next question from the line of Darshan Deora from Indvest Cap Group, please go ahead.

Darshan Deora: Can you throw some light on the MSE product? I see that disbursements have grown in that particular loan product. So, historically, our asset quality has not been so great in that product, just wanted to get some insight?

P. N. Vasudevan: Yeah, so that has grown. During this quarter, it's shown a good amount of improvement. In terms of asset quality in terms of GNPA, there is an increase in the GNPA from 7 point, it's now gone to 9.35 from 7 point something in the first quarter that was largely because there was one account of around Rs. 30 crores which slipped into NPA in the second quarter. But that account has actually got upgraded to standard in the third quarter. So, that should come back by end of this quarter that NPA should come back. But otherwise there is some old NPA accounts which are there in that MSE book, which is causing that elevated NPA. But otherwise the book is performing quite well. And so we are able to see that there is no credit quality concern in the MSE book which is being created over the last maybe 2-3 years.

Darshan Deora: In terms of microfinance, what is going to be our strategy going forward? I mean, we have brought it down from 18% to 16%. Once credit cards, personal loans gets launched, when you see the microfinance loan mix moving to?

P. N. Vasudevan: In terms of microfinance, as we have been saying, it will keep coming down over a period of time as a percentage contribution to the total portfolio. And personal loan and credit cards, which are also unsecured loans as they start filling up. Overall, we have an internal policy, that our total unsecured book should not exceed 20%. So, at any point in time, all the three products should put together should not exceed 20% and they should be within the 20% contribution. However, microfinance, in the beginning of the year, we had some plans in terms of disbursement in microfinance and disbursement in the other products. However, during the year, the disbursement in microfinance has been lower than whatever we had budgeted, given the fact that we are seeing some level of stress. So, obviously, the disbursement has slowed down in view of that. So, the planned reduction in microfinance percentage contribution that we had a plan, it might change because of the current scenario. But otherwise from a little bit medium term perspective if you look at it, I think in a 3-to-4 year timeframe microfinance should be in single digits while personal loan and credit card should fill up the balance.

Darshan Deora: Just in terms of the credit card strategy, I think in the past you'll have alluded to the fact that it's probably going to be more a hook for the liability customers than specifically a very focused product on the asset side? Is that a fair understanding?

P. N. Vasudevan: Yeah, absolutely. One is it's a hook product for the liability customer. The other is that it is also a product which will be cross sold for our affordable housing and small business loan customers. I think we mentioned this also some time back, if I remember right where we give a loan of let's say five lakhs or 10 lakhs to a borrower secured against their house property. Then we will also try to give them a credit card with a let's say a limit of Rs. 50,000 to such customers where the LTV comfort still remains very high and that credit card outstanding will actually be a secured outstanding because we do have a security from the customer for another product and so that security will kind of run for the credit card also. So, for the asset customers principally focused on small business and affordable housing customer, we will offer credit cards which will be kind of a secured product while for liability customers, we'll offer it both as a secured card against deposit because there'll be customers who will offer a credit card as secured against deposits. And then standalone credit cards offered to customers who fit certain profiles.

Darshan Deora: Got it, so the latter would be a catering model with the elite customers, I'm assuming, right? The elite banking customers?

P. N. Vasudevan: Absolutely, yes. And elite, if you've seen in our presentations also, the elite base has been continuously going up, we have been able to add a good number of customers on a quarterly basis to our elite portfolio. And the deepening on the elite account also continues to be quite strong. And that is potentially the segment to which we should aim to cross sell.

Darshan Deora: Got it, and just one last question regarding the credit cards. Given that credit cards usually, from a breakeven point of view, what's the math there, like in terms of, like number of cards required to breakeven on that product if you are having those numbers if you are comfortable with the model that you all have built?

P. N. Vasudevan: Yeah, so for us the acquiring cost is something that we are trying to see that it's kept to the minimum because a significant part of our sales should be to existing customers so we are really expecting our acquiring cost to be at a minimum while the real cost will be not even the technology. The technology part of it actually is not that big a cost on an ongoing basis. There's some initial investment on the system, but otherwise, the ongoing cost on technology is actually not that much. The ongoing cost will be principally contributed by the schemes and rewards programs which will be rolled out. But acquiring cost because we don't plan to acquire through channels, DSAs, etc. in any significant volumes, and so that we don't expect it to be high. Because of this, we will not be able to give a specific number at which we should be able to breakeven, but typically we hear that in the industry a million cards is where you probably start breaking even. I think we will breakeven probably at anything like, let's say maybe one third or one fourth of that is where we will tend to start breaking even principally because our acquiring cost should be low.

Moderator: Thank you. We have the next question from the line of Chetan Gindodia from PGIM Mutual Fund. Please go ahead.

Chetan Gindodia: Firstly, wanted to understand a little bit about the microfinance book. So, would it be possible for you to disclose what percentage of our microfinance book would have more than three borrowers?

P. N. Vasudevan: Yeah, we have lots of data on that. Four lenders is 14.5%. So, 9% of our borrowers have an exposure of more than Rs. 2 lakhs total borrowing. I can give you Rs. 1.5 lakh exposure also. So, 12% of customers have an exposure of Rs. 1.5 lakh and 2 lakhs is 9% and 14% is having 4 loans and above. Below 1 lakh is 65% in terms of number and in terms of POS is 60%. Actually this is a good point that you are raising. This is where we are saying that we expect somewhere in the third and fourth quarter the stress should kind of start seeing some decline because there is a core set of customers. In our case for example, it is 81% of the customers have less than 1.5 lakh borrowing and so 81% of the book we should really not see much of stress in the future also. It is the balance 20 or 19% of the customers who have more than 1.5 lakhs where some of them will show some signs of stress, but many of them would be already stressed or are going through that stress right now. So, in the next 1-2 months or 3 months or 4 months, some of them who are really not going to be able to come up properly in their thing will probably slip into

NPA, while the rest will kind of recover and come back. So, that's where we feel that maybe in two quarters from today, we should see this stress probably behind us.

Chetan Gindodia: So, still from an underwriting perspective, it seems like just 20% of borrowers being a little on the over leverage side seems a bit high, seems like in line with industry, but seems a bit high.

P. N. Vasudevan: See that 20% is 1.5 lakh and above. Okay, industry doesn't count 1.5, the industry counts 2 lakh and above. If you look at 2 lakh and above, it is 8% in our case. So, 2 lakh and above is 8%, whereas the remaining 12% is 1.5 lakh to 2 lakh. So, that the industry doesn't count that because what happens is at the industry level we have the SRO and the SRO, the guideline is that we should not be more than four lending should not happen and we should not give a loan which is put together more than Rs. 2 lakhs. So, the Rs. 2 lakhs is kept as the kind of barrier at the industry level through the SRO resolution. So, industry talks of overborrowing at Rs. 2 lakh and above and at Rs. 2 lakh and above, we are at 8% whereas 1,50,000 to 2 lakh is 12%, which is not counted by the industry as a stress at all. But we take it as a focus area for us because from this area also people might slip into NPA. So, we put extra focus and extra effort to be in touch with this set of customers also.

Chetan Gindodia: Okay, got it sir. And lastly, so incrementally if I see this quarter our disbursement on microfinance and microloans is total nearly Rs. 950 crores. So, what are the safeguards that we are placing on the incremental disbursements on this side?

P. N. Vasudevan: So, of course there are two things. One is that as per the SRO guidelines we don't lend if we are not the fourth lender or less we don't lend. Second thing is that if the total borrowing is more than 2 lakhs that also we don't. So, that guardrail of the MFIN is something that we have put in place. But second and very important thing is that our own data shows that the behavior of the portfolio for second, third, fourth and fifth cycle borrowers is better than the new coming, new first time customer. And so the focus is to try and restrict our lending as much as possible to existing borrowers. For example, in the month of October, 87% of all our disbursements was to existing customers. So, these are the few things that we are doing on the disbursement to try and ensure that the new disbursements remain healthy.

Moderator: Thank you. We have the next question from the line of Shailesh Kanani from Centrum Broking. Please go ahead.

Shailesh Kanani: Sir, couple of questions from my side. On the MFI side, have we changed any provision policy and if you can highlight any other product as well if you have changed? And secondly once we are out of this MFI cycle and as we introduce new products, so in 3-year to 5-year basis, what do you think our business should generate on a stable cross cycle basis ROA? If you can throw some light on that as well?

P. N. Vasudevan: Okay, in microfinance in the second quarter, there are two things we did on provisioning. One is that we increase the IRAC provisioning norms for NPA accounts in microfinance from earlier we used to have 90 to 180 days was at 50%, 180 to 360 days was at 75%, above 360 days was

100%. This was the position as of June. What we did is that 100% provision from 360 days we reduced it to 180 days. So, at 180 days in the second quarter 180 days plus we make a 100% provision against what was 75% earlier. The second thing is that in the 90 to 180, it was a flat 50% against that 150 to 180 we increased it to 75%. So, these are the two changes we did in the provisioning and microfinance NPA, which accounted for Rs. 45 crores of extra provision for the quarter. This is one. The second extra provision that we did in microfinance in the second quarter is we created a buffer provision on standard assets of microfinance for about Rs. 100 crores. This Rs. 100 crores translates to approximately 50% of our SMA 1 and 2 book of microfinance. So, this is a buffer provision that we created in the second quarter. These are the two things that we created. Now coming to your next question in terms of on a little bit medium to longer term basis like three year plus what could potentially be the ROA for the bank. If the credit cost normalizes at some point in time last year if you remember for continuously for about 5 quarters, our ROA was in the range of 2% when our credit cost was normal. So, that's the model. So, as and when our credit cost should normalize, we should be able to look at that kind of returns.

Shailesh Kanani: The reason I was asking that as we have this newer products coming in, they would obviously take time to mature with personal lending and credit cards. So, just wanted to get some sense. Should we expect on steady state basis lower ROA in that case?

Dheeraj Mohan: Yeah, this is Dheeraj here. On ROAs and ROEs, from a guidance perspective, we thought we'll stay away from it currently. Let things improve, let credit costs normalize, then we'll see where we are in terms of ROAs. And you're right, as newer products come in, it will have an impact on ROAs, but like Vasu explained, we are not investing heavily on new-to-bank customers through these products. It's largely to improve stickiness. So, you'll bear with us for some time till we get credit cost normalized and then we'll see where ROAs are or we would leave it to your imagination. You've seen all the line items in terms of NIMs and cost to income and credit cost and we'll see how the bank progresses on it.

Shailesh Kanani: Okay, just last question from my side on MFI. In our opening remarks, sir mentioned that October has been a little improvement. So, can you share some numbers and any reasons per se for this improvement in terms of collection efficiency or in general, what we are seeing on the ground? And if some data points on the state is also available, that would be helpful.

P. N. Vasudevan: We don't want to get into too many details of October, but I'll just give you one ballpark figure which is our X bucket collection efficiency. X bucket collection efficiency was seeing some level of deterioration over the last 3, 4, 5 months, but in the month of October at least that level of deterioration had stopped. So, I'm not saying that it's actually gone improving further. But at least the level of deterioration has stopped in the month of October, which is the first good sign that we saw in the book. And maybe partly contributed by some of the most risk customers already moving to NPA earlier and also the kind of initiative that has been rolled out by the bank, including increasing the number of people available on the field to deal with the customers and spend time with the customers. So, that's the thing that we saw. X bucket does become a crucial factor because if that's where you control the flow and then the rest of the bucket you have a little easier life after that. So, that's what I was really referring to.

Moderator: Thank you. We have the next question from the line of Pallavi Deshpande from Sameeksha Capital. Please go ahead.

Pallavi Deshpande: Just wanted to understand what is the level of attendance we see at these center meetings now and what was it earlier in Q1?

P. N. Vasudevan: Yeah the center meeting long back when we started microfinance way back some 18-20 years back, the attendance used to be anywhere in the range of 90%. That was the best attendance that we used to have long, long time back. Subsequently, after that AP crisis and demonetization, the attendance did come down, but it settled down at anywhere around 65% to 70%. COVID, of course, is the one which is the biggest disrupter in microfinance because during COVID for nearly one and a half years or so, we told the customers not to come for the meeting. And we told them that to hand over the money to the leader and we'll go and collect it from her. So, for more than a year and a half, we ourselves told the customers don't come for meetings. And that I think was the biggest disruptor because even during demon, we never told them don't come for the meeting. We kept telling them come for the meeting. Even if you don't want to pay, no problem, just come for the meeting. But in COVID, we actually actively told them not to come and for too long a period of time and that became a habit. And so post-COVID, the central meeting attendance has really dropped. It's somewhere in the range of 45%, 50% today.

Pallavi Deshpande: Well, sir can we say that some part of this whole problem is coming from here until this improves? We won't see this sector improve?

P. N. Vasudevan: Yes, of course. See this. Attendance is a big indicator of the cohesiveness of the group. And if the attendance percentage is low, then naturally the cohesiveness also reduces, which is not good for the lenders. So, that's why we are rolling out some interest rate discount scheme for customers when they come for the next cycle, which will be based on their attendance as much as on the repayment. It also includes attendance as a parameter. So, if somebody has a higher level of attendance, she will get a lower rate of interest in the next cycle.

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

Ashlesh Sonje: Sir, couple of questions from my side. Firstly, there is one slide where you have shown the power book in microfinance for Equitas versus the industry. If you look at the PAR 61 to 90 book, that has been consistently higher for Equitas versus the industry, at least in the data points where you have shown it. What do we understand from this data, sir? How do we attribute this difference?

P. N. Vasudevan: Yeah, that is true. I mean, it's data. So, that's true. And if you see also another slide, I don't know whether we have put it here. The PAR data of the type of players, SFB, banks, NBFC, MFIs and other NBFCs. I don't know whether we have put it here. We have not put it here, I think, but that's another data available. In that, if you see, the SFBs have a higher level of DPD as a type of lender compared to let's say the banks or the NBFC, MFIs. So, I mean if you ask me to guess why? I can give you a couple of reasons but there are some reasons because of which SFB as a lending type has a higher level of DPD compared to other type of lenders. So, that is why if you see the industry versus Equitas, ours is higher than the industry fundamentally flowing out of the fact that SFB itself as a type of lender has a higher DPD.

Ashlesh Sonje: So, but on the same slide you have shown SFB versus Equitas as well. There if you look at the 61 to 90, that number has been higher for Equitas?

P. N. Vasudevan: Yeah, so we are talking of let's say PAR 60 to 90.

Ashlesh Sonje: For Equitas and the SFB industry which is on the same slide.

P. N. Vasudevan: Yeah 1.19 to 1.27, is that right?

Ashlesh Sonje: Correct, yeah and the trend also for the past two quarters.

P. N. Vasudevan: If you see the first bucket, that is 31 to 60 bucket if you see, SFBs are at 1.13%, this is as of June 24 and Equitas is at 1.05. So, if you see that 31 to 60, they are slightly lower than the SFB industry. Then if you go on to the 61 to 90, we are at 1.27 and the SFB industry is at 1.19. So, we are slightly on the higher side. Now, if you move on to 91 to 180, we are at 1.37 and the SFB is at 1.43. So, in two out of the three buckets, we are actually lower than the SFB industry, while on one we are slightly higher than the SFB industry. So, that is how it is. But the differences are not much, so there's not much to read into this.

Ashlesh Sonje: Secondly, you gave a data point that the four lender portfolio is about 14.5%. Just want to understand this, this is four or more other lenders, right, apart from Equitas?

P. N. Vasudevan: That's right.

Ashlesh Sonje: Understood. And this is the borrower account or the proportion of the portfolio lying with these borrowers?

P. N. Vasudevan: That's a borrower account.

Ashlesh Sonje: Understood, sir. And just lastly, if I look at the non-MFI portfolio, the slippages there have increased QoQ. So, just wanted to understand from you qualitatively what is the reason for higher delinquencies and whether this is coming predominantly from the vehicles portfolio or there is some increase for the SBL portfolio as well?

P. N. Vasudevan: The SBL is under normal levels. So, vehicles, there was elevated gross slippage and which also led to a higher level of credit cost for vehicles in the second quarter, but it's still within an acceptable level. But in terms of the MSE, I mentioned that there was one account of Rs. 30 odd crores which slipped into NPA in the second quarter. So, anyway that's come back to standard now in the third quarter, but that was there in the month of September. But if you see the credit cost, we have given a slide, a separate sheet somewhere in the beginning of the presentation. I think that is Page 7, if you look at it, we have given a half yearly credit cost summary for the bank. If you look at that, the rest of the portfolio, which is 84% of the book, the credit cost for the half year is 1.04%, which is quite comfortable. We don't really have an issue with that level of credit cost at our given our kind of lending. It's really the microfinance which is a 10% which includes all this one time provision etc. but whatever be that it is a 10% and overall for the bank it becomes 2.59%. So, if you look at this sheet, fundamentally what it represents is that at the bank level at the 84% of the portfolio level, we are very comfortable in terms of our credit cost and going forward it should actually improve because second half is always better than the first half from a collections and disbursement perspective. So, we should actually see an improvement on this for the rest of the year. And this microfinance is the one which of course causes the stress and has caused the stress in the first half. And that's where we have put in two things. One is we have put in extra efforts in terms of our products and people on the field etc. to meet the customers and work with the customers. Second thing is we have done some up fronting of the provision so that we are trying to upfront the potential pain in the third and fourth quarter to try and reduce the impact of MFI credit cost for the rest of the year. That's what we have done in the MFI. But rest of the bank we are quite well placed.

Moderator: Thank you. We have the next question on the line of Ronak Chheda from Awriga. Please go ahead.

Ronak Chheda: My first question is on small business loans with the growth continues to be strong in this segment. I just wanted to get your sense on how are we capacitated in terms of branch network and what are plans for the next 2 to 3 years to sustain this level of growth in SBL segment?

P. N. Vasudevan: Small business loan is our flagship product, it is now 41% of our total book and touchwood the credit quality etc. is good from all parameters and so that will continue to be the torch bearer for the bank. In terms of capacitating it for further growth in the future, we have been adding both the sales and collections team in that business over the last few months and we have been increasing the disbursement per branch. We currently operate roughly out of 400 odd branches, I think 415 or so branches and now at our current level we have a per branch disbursement, monthly disbursement of around 1.6 crores. This was of course lower some time back. We have been adding more feet on street into the branches and increasing the per branch productivity. And there is a plan to further improve that number of people per branch and the 1.6 ideally should keep moving up going forward which will help in terms of improving the volume from the existing branches. That's one thing. Second thing is that in the last 2 years we have added approximately about 60 odd branches where we offer small business loans. Next year we again plan to add, I don't know the correct number today, but somewhere in the range of 40-50 branches is something that we should be adding, which will help improve the reach and distribution for all the products, including small business loans. So, I think we are fairly on track in terms of capacitating the bank to support the improved volumes from not just small business loan but the other products also.

Ronak Chheda: My second question is on slippages in the MFI book. You said the slippages, fresh slippages continue in the MFI book. So, how should we think of Q3 and Q4? Will the slippages peak in Q3 or this is more a 6-month thing where we could see the peak slippages coming in Q4 for the MFI book, per se?

P. N. Vasudevan: See, I don't think I'm in a position to tell you whether the peak is behind us at this point in time. I'm really not in a position to tell you that just now. The X-bucket efficiency that we have, that is people who are not having an overdue but who slip into an overdue in a given month, that X-bucket efficiency is currently around 98%. Now that needs to move to 99%. So, it has to move up by that 1% and that 1% will make a lot of difference from a potential further slippage and credit cost into the future. So, that's where the lot of efforts are going in both from us internally as well as from the industry in terms of an improved lending discipline to try and not have over leveraged borrowers. So, I think that the whole thing is hinging on how much we are able to improve the X-bucket efficiency and the more we are able to improve the less will be the potential pain into the future. But right now, I am not in a position to tell you whether we have seen the peak behind us and third and fourth quarter will be normal. I am not in a position to tell you that because we still need to wait and watch for some more time and see the effect of whatever we are trying to do in the field. So, we believe that we may have to be prepared for some level of pain even during the third and fourth quarter and probably somewhere during the fourth quarter I have feeling that we should start seeing some abatement in the pain because the transactions would have run through 5 or 6 quarters by then and it's a 2-year product. So, most of the potential delinquent customers should have fallen delinquent during this period and hopefully the newer loans which are given in the last 2-3 quarters should not be causing as much pain. So, that's where we believe that fourth quarter is possibly a time period by which we should see some level of abatement and maybe the first quarter of next year could be reasonably normal. But this is conjecture only, I am not saying that this is something I am sure about, this is something I am hoping and we'll have to just wait and watch and see how the trend happens.

Moderator: Thank you. We have the next question from the line of Pritesh Bumb from DAM Capital. Please go ahead.

Pritesh Bumb: Just a couple of questions. First, if you can mention how much will be our Tamil Nadu exposure in MFI?

P. N. Vasudevan: 57%.

Pritesh Bumb: Of the MFI portfolio, 57% is Tamil Nadu?

P. N. Vasudevan: Yes, that is right.

Pritesh Bumb: Second, just wanted to check of the Rs. 143 crore provision which we took Rs. 43 crores is on the existing NPA which has fallen, the slippages which are coming in and there you have enhanced them?

P. N. Vasudevan: That's right.

Pritesh Bumb: And the Rs. 100 crores is type of a contingency provision for the future years.

P. N. Vasudevan: That's right.

Pritesh Bumb: For future quarter basically?

P. N. Vasudevan: Absolutely.

Pritesh Bumb: So, if you exclude the Rs. 100 crores which you may utilize in next few quarters, how much can we see a credit cost perspective only on the overall basis because you gave a color of the non-MFI book. But can you just give a little bit color that how much requirement will be there for a provision perspective in next two quarters?

P. N. Vasudevan: Okay, I am not giving you a guidance, but I am giving you some mathematics. If you look at the non-microfinance book at 1%, let's say that 1.04 is a potential credit cost for the 84% of the book. And microfinance, this 10% credit cost includes all this one-time provision and all that. If you remove that, it will be about 6.5% or so. If you remove that Rs. 100 crore, the credit cost of microfinance from 10% would be approximately around 6.75%. But that's actually a very elevated credit cost. It's not a normal at all. So, if your credit cost starts normalizing, even if not at the pre-COVID level, but even within the current scenario, if it reasonably normalizes, and let us say that we end up with a credit cost of anywhere around say 4% to 5% in microfinance, then if you multiply that with 16% of the book, then you are talking of 4% of 16% would be 0.6%. So, then you have a 1% credit cost for the rest of the book and a 0.6% credit cost for microfinance. So, then you are really looking at a 1.6% credit cost for the bank as a whole, if the credit cost of microfinance can come down to say 4%. So, that's a little bit of math.

Pritesh Bumb: So, this math is in for next year basically just wanted to check because we have given annualized credit cost of 10% will we see like a 6%-7% credit cost for the full year because then the second half gets much better because your commentary was that you wanted to safeguard a bit of the next two quarters credit cost.

P. N. Vasudevan: That's right absolutely.

Pritesh Bumb: And another clarification needed on the MSME book, sir, you mentioned some one-off NPAs happened. That's why the GNPA is opposite, 7% to 9.35%, if you look at the segmental GNPA?

P. N. Vasudevan: That's right, yes.

Pritesh Bumb: That is the one-off there, right?

P. N. Vasudevan: That's right.

Pritesh Bumb: But the SBL book also, we've seen some inch up. Is that, I just wanted to check in terms of customer profile, is the customer profile still the same as the MFI and that the same stress is at the SBL as well? The over-leveraging front or even in terms of cash flow, do you feel that is a little bit spread out in the SBL as well, though it is a secured business but do you see that stress there as well?

P. N. Vasudevan: We would have given you our MLAP GNPA. So, if you look at the overall SBL GNPA, it's at 2.19% in September. 2.03% in June, 2.19% in September. So, there's an inch up on the GNPA, but I think that's normal and it should be within that range only. There is no one-off or there is nothing specific about that. So, it will be moving within that narrow range. And in terms of the profile of the borrowers, for small business loans, the bottom end of small business loan, which is what we call as MLAP, Micro Loan Against Property, where the loan size is typically up to Rs. 7 lakh, now there will be some amount of overlap with the top end of the microfinance cluster. But minus the MLAP, the overlap between MFI customer to small business loan, that overlap will be very nominal whereas it will be much more in the MLAP segment. And MLAP segment, while the overall SBL is at 2.19%, within that MLAP will be definitely at a higher level of NPA. But then since it is secured, generally the ultimate credit cost is generally very low.

Moderator: Thank you. That was the last question. I would now like to hand the conference over to Mr. P. N. Vasudevan for closing comments.

P. N. Vasudevan: Thank you. Thank you all for dialing in and listening in and asking us all kind of queries. Happy to be of service to you. To kind of sum up at a bank level what I have mentioned in my opening comments also, 84% of the book remains quite strong and quite healthy and we should see potentially a further improvement in the quality over the second half which is always traditionally the stronger half. Microfinance, we'll have to take it with a stride and we'll have to just take it in our stride and go along with it and see what best we can do to minimize its impact. On the deposit side we are doing quite well, treasury is doing quite well and our technology initiatives are coming up well. Our new products are very close to launch. Some of them are already gone on a pilot launch. And so I think overall as a bank, many things have fallen into place and we should see the effect of all of this going forward. And microfinance is something that anyway we have been at it for 17, 18 years now. So, we do know what that business is all about. And let's see how best we are able to manage and keep its impact as low as possible. So, that's it from our side. Thank you so much and wish you all very best. Thank you, bye bye.

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