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"Equitas Small Finance Bank Limited

Q1 FY '26 Earnings Conference Call"

August 08, 2025

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Moderator: Ladies and gentlemen, good day, and welcome to Equitas Small Finance Bank Limited Financial Performance for Q1 FY '26 Earnings Conference Call.

We have with us today Mr. P. N. Vasudevan, MD and CEO; Mr. Balaji N., Executive Director, Technology and Operations; Mr. Sridharan N, CFO; Mr. Jagadesh J, Head of Assets; Mr. Murali Vaidyanathan, Senior President and Country Head, Branch Banking, Liabilities, Product and Wealth; Mr. Gopalakrishnan G, Head, Treasury; Mr. Dheeraj Mohan, Head, Strategy.

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 this conference call, please signal an operator by pressing star then zero on your touch-tone phone. Please note that this conference is being recorded.

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

P. N. Vasudevan: Thank you. Good evening to all of you, and thank you for taking your time out to attend this call. I would also like to take the pleasure of inviting our Chairman, Mr. Anil Kumar Sharma for this con call. We had a Board meeting in Chennai today, and he was here. And so he's agreed to participate in this call. So he is also present in this room today. Welcome, and thank you, sir.

Now let me give a brief of what happened in the first quarter and how do we see it moving forward. We had a PPoP of INR316 crores for the first quarter and the provisions as per the existing norms were INR281 crores, which would have resulted in a PAT of about INR26 crores for the quarter.

However, we have made 2 extra provisions, namely one being increase in provisions in various NPA buckets to strengthen the PCR ratio and the other being a management overlay in terms of standard asset provisioning for microfinance.

This has led to a loss for the first quarter. This is the first time since 2008 that we have reported a loss and hopefully, the last time too. The thought behind creating a management overlay provision and increasing the provision norms was to speed up the credit cost cycle and showcase the new Equitas going forward without the current drag on the system.

In microfinance, it was expected that the stress levels might taper down in the beginning of this financial year. However, it now looks like that the collection efficiency may come back to reasonable levels only by the third or fourth quarter of this financial year. This is what has led us to take the call to upfront provision buffer so that we can look forward to a more normal quarter in the later part of this financial year.

We have started calibrated lending in microfinance, balancing the long-term goal of reduced dependency on microfinance and the short-term goal of improving collection efficiencies. The discipline in lending based on the MFIN guardrail is expected to improve the quality of new portfolio getting created.

While a separate team for overdue collections has been put in place, case-loads for X bucket also is being reduced to improve both collection efficiency and servicing of existing clients. We had implemented the MFIN Guardrail 2.0 from Jan '25.

Out of the portfolio created between Jan to June of '25, the X-bucket efficiency is about 99.6%, which is more or less what we used to have before this whole crisis started sometime in the first week -- first quarter of last year.

We have been in the MFI space now for about 2 decades with a high vintage staff right from branch manager and above who have seen multiple good and bad times over these years. The initiatives taken both at our bank and industry level should help reach acceptable levels of normalcy in the months to come.

Karnataka and Tamil Nadu have passed acts to prevent coercive recovery practice by lenders. These acts are not applicable to banks. However, at the ground level, there has been a spillover effect on banks too, in the lower end of the small ticket loan against property. This was visible a few quarters back, and we had taken certain proactive measures.

We don't anticipate further stress to build in the segment we operate, especially given that we don't operate in the below INR3 lakh LAP segment, which we stopped sometime last year, I guess, somewhere around November or so, we stopped less than INR3 lakh loans. And we've also taken some proactive steps in terms of tightening our norms for certain segment of borrowers.

Our diversification strategy, which was started back in 2011, holds good and has helped us achieve a secured advance book of about 90% as of first quarter. The secured book is also fairly diversified in terms of different product categories. With new products turning profitable and MFI likely to get back to normal soon, we expect to deliver decent return on equity in the quarters ahead.

On the deposit front, we have revised our rates across products and slabs, both in savings and TD. We should see cost of funds moderating in the coming months. The INR500 crores of Tier 2 that we raised in July '25 will, of course, dampen this a little bit, but directionally, we will see cost of funds coming down over the rest of the year.

We have about 90% of our fixed -- our loan book under fixed rate loans. In a declining interest rate scenario, we expect to benefit. We have registered a growth of 8% in advances for the first quarter and expect to end the year with a growth of about 15%, 16%. Jagadesh will go into further details on his plans of how he will go about achieving this.

As we know, one of the SFBs has got an in-principle license to convert into a universal bank yesterday. This augurs well for the SFB industry as it lays down the direction in which SFBs could potentially proceed going forward.

I would like to conclude by saying that we have tried to be prudent in terms of upfronting possible stress of the next few quarters. And with most indicators trending better, we expect to get back to our normal levels of performance soon.

I now hand over to Sridharan, our CFO.

Sridharan N.: Good evening, everyone. Thank you for joining us today for the Q1 FY '26 Earnings Call of Equitas Small Finance Bank. Our net interest income and other income for the quarter was INR786 crores and INR286 crores, respectively. Our yield on advances, adjusting for securitization and other off-book items dropped by 44 bps on Y-on-Y basis on account of drop in microfinance mix.

Our net interest margin stood at 6.55%, down from 7.9% last year, largely due to contraction in the microfinance portfolio. It is currently at 9% in Q1 FY '26 as against 17% in Q1 FY '25. Treasury income has majorly contributed to other income segment with Y-o-Y increase of 321%, resulting in net income of INR1,071 crores with year-on-year of 8%.

The total Opex increased by 16% Y-on-Y on account of employee expenses related to bonus and annual increments. This quarter, we reported a loss of INR224 crores, primarily driven by the additional provision which we have made. While this affects our short-term profitability, it strengthens our balance sheet and prepare us for a sustainable growth. Despite these challenges, our PPoP remained healthy at INR315 crores on Q-on-Q basis, reflecting the underlying strength of our core operations.

Our GNPA stood at 2.82% and NNPA at 0.95%. The provision coverage ratio remains robust at 67.03%, and we expect the credit cost to taper down by Q4 FY '26. Gross advances grew 8% Y-o-Y to INR37,610 crores, while microfinance contracted by 41%, our non- MFI book grew 18% Y-o-Y, led by 22% growth in small business loans and 50% growth in used car finance.

On the liability side, total deposits grew 18% Y-o-Y to INR44,379 crores. Our CASA ratio remained stable at 29% and retail deposits now form 73% of our deposit base. We launched FCNR deposit this quarter, garnering over USD 3 million and continue to deepen our retail franchise.

As of June 30, 2025, CRAR stood at 20.48%. During July '25, we have raised a second tranche of INR500 crores of Tier 2 capital. This additional Tier 2 capital will improve the CAR by about 1.7%, taking the overall CAR to about 22%. Our capital adequacy remains strong, and we have received shareholder approval to raise INR1,250 crores in Tier 1 equity to support future growth. Thank you once again for your continued support and trust.

I would like to hand over to Mr. Jagadesh, our Head of Assets, for his commentary.

Jagadesh J: Thank you, Sridharan. Good evening, everyone. We have closed the quarter with gross advances of INR37,610 crores, reflecting a year-on-year growth of 8 percentage. Importantly, our secured book contributes 90%, which is our non-micro finance portfolio, has grown healthily by 18 percentage year-on-year and now stands at INR34,073 crores.

Among the secured book, our small finance -- small business loans, which is our flagship product, reached INR16,067 crores with 22 percentage year-on-year and 2.5 percentage quarter-on-quarter growth. Within our small business loans, our micro LAP product has shown an exceptional momentum growth of 51% year-on-year growth.

And coming back to vehicle finance, we have grown by 12 percentage year-on-year to INR9,510 crores. Among the vehicle finance, used cars grown by 50 percentage year-on-year and used commercial vehicles grown by 26 percentage. We continue to focus on used commercial vehicles and used cars while strategically reducing the exposure to NCV, New Commercial Vehicles.

Our housing finance book stands at INR4,868 crores with a growth of 12 percentage year-on-year and 2 percentage quarter-on- quarter. And our MSE finance assumed strong traction, growth of 37 percentage year-on-year to INR1,696 crores. And microfinance portfolio is at INR3,537 crores with a decline of 41 percentage year-on-year and 22% quarter-on-quarter.

On the digital front, our selfie loan app has gained good traction with INR437 crores disbursed in quarter 1. The yield on gross advances declined by 29 bps quarter-on-quarter, primarily due to the elevated delinquencies and contraction in the microfinance portfolio.

Looking ahead, the July disbursements have already reached INR1,582 crores, well above the quarter on monthly average of INR1,170 crores, indicating a strong start to Q2. To support the growth in secured advances, we have planned to add 50 new branches and also to add more manpower to deepen the penetration in the existing branches.

And for the current financial year, we are looking at a growth of close to 15 to 16 percentage year-on-year growth in the overall asset book, including MFI. This can be done. We are already growing at 18 percentage in our non-microfinance book. So we are looking at a growth of 20 percentage plus year-on-year growth from our secured book.

And also having a calibrated approach on our disbursement for microfinance, where the degrowth of 41% for the Q1 will be calibrated to a degrowth of close to 15 to 20 percentage year-on-year. And regarding the asset quality, there was a signs of recovery in the month of July. Our microfinance 1 to 90 DPD improved to 7.09 percentage in July and non-microfinance portfolio DPD also improved to 9.29%, thereby improving the overall DPD trend for the bank in July.

And also on the slippages part, our non-MFI net slippage reduced to 2.04 percentage in July from 2.67% in Q1. So we are strengthening our collection framework by establishing a dedicated vertical for overdue and NPL recoveries. With early signs of recovery in the stress segment and enhanced field level efforts, we anticipate an improved credit demand and collection efficiency in the coming quarters.

Thank you. I hand over to Murali.

Murali Vaidyanathan: Good evening, friends. As you would have seen in our presentation, we have a reasonably good quarter in terms of RTD-led retail franchise growing and backed by current account and current account is backed by ASBA as a proposition where we are getting into the Insti-ASBA as a solution.

And then we have savings account, which is predominantly led by mass affluent and NR as a segment. So I think overall, our trajectory of keeping our focus on Phygital is helping us to garner mass affluent, and that is our Elite proposition and to strengthen Elite at this point of time, we are going to launch 2 more products in the coming months, which is to take care of semi-urban and rural setups as well as one onto the HNI plus as a segment, which we are going to call Elite Light and Elite+ and that kept aside, we also have strengthened our AD1 proposition through FCNR now, and we are on the road map towards building our inward, outward as well as prepaid forex during the quarter 2.

Now these are all important proposition at the level of institution and at the level of customer who actually is expecting a range of products. Today, we have an entire range and gamut of liability products ranging from savings account and TD both showing us 18% and stable CASA ratio. Then we have backed with SIP, you see the AUM growth year-on-year, we are at close to 37%, 40% -- and that is also helping us to cater into protection, that is insurance, which is giving us the steady inflow in terms of health, general and life.

So our proposition towards saver in terms of relationship management and investment is actually yielding us. And today, we have close to 40,000 active 3-in-1 accounts through our partner, and we also have 50,000 ASBA, which has actually given us first quarter throughput of INR1000 crores.

Now as we inch up forward, we are focused on product holding as an approach, RV as an approach, getting deeper into the family and most importantly, getting the hook products and PH products as way of life.

So I think our Elite proposition is strengthening, and we are going to enter the digital for mass through D2C, which is called direct-to-customer for SA and TD, which is coming up at this point of time.

Overall, we'll try to sustain the momentum and grow from here on. Thank you. Gopi?

Gopalakrishnan G: Good evening, everyone. The past quarter was relatively favorable in terms of market movements, particularly in government bonds. RBI provided liquidity and monetary policy support owing to relatively softer CPI prints. This allied to the domestic economic relative resilience to geopolitical tensions played out in government bonds with yield on benchmark 10-year softening by roughly 35 bps.

Government bond yields have inched post the recently concluded RBI MPC, which saw the committee decided to hold the repo rates. Various estimates predict the inflation is expected to remain within the RBI MPC's inflation target and the coming festive season will be keenly watched.

Global central banks continue to diverge in their assessment of respective economies as the Fed continues to hold rates while other developed economies such as U.K. have cut rates recently. For equities, currency and broader markets, India-specific tariffs announced by U.S., the full extent of which comes into effect in August, continue to be source of concern with varying estimates as to the exact impact on GDP growth.

These factors will likely cause a bit of volatility across asset segments, and we remain cautious in near term. Coming to treasury, we commenced the FX business in Q1 in line with the AD1 license granted by RBI. This allows the bank to offer various forex products on par with other commercial banks in the country. During Q1, treasury realized profit of INR116 crores on profit on sale of investments. Thank you.

P. N. Vasudevan: Back to the operator.

Moderator: Thank you very much. We will now begin the question-and-answer session.

The first question is from the line of Darshan Deora from Indvest Group.

Darshan Deora: So given the tough macro environment, I appreciate the steps the management has taken to steady the ship, and I'm sure these steps will pay dividends in the long run. Also appreciate the progress we are making on the current accounts as well as the successful Tier 2 capital raise.

My question is regarding the cost to income, which came in at 70% versus 65%, say, for the same quarter last year. Can you give some guidance on what has driven this higher figure as well as how do you think we'll end the year as well as what will be the guidance for the next 2, 3 years on the cost-to-income front?

Dheeraj Mohan: Hi Darshan, Dheeraj here. So the cost to income, as you know, the income side, we have not grown fast enough because of largely interest reversals coming from microfinance and also disbursements being muted. So as it has passed by and if you look at July numbers, I think growth momentum is back. So items like fee income and interest income will start growing faster. So largely on the income side, we will see a lot of positive correction.

On the operating expense side, we are looking at opex growth of close to 19% this year given that growth momentum is there. And like Vasu said, we're adding people to -- on the front line. So you will see some bit of opex movement because of those, but they're again, largely revenue linked. But I feel that we may be at the peak of a cost-to-income cycle given that most of it has got factored in, and we are seeing growth coming in.

So I think from a cycle cost to income, we would have peaked out. Looking a little ahead, even in our projections, we are looking at, let's say, 2 years from now, our cost to income to be between 60% to 65%. And that will reflect the last part of our investments we are making as a bank, and we've got some slides about the investments we are doing which are long term in nature. All of that should -- that the last phase would capture that.

So from a short term, I think we have hit the peak. From a medium term is 60% to 65%. Long term, we are still -- I think we'll take some time before we give where we would be from a long-term cost to income.

Darshan Deora: Thanks Dheeraj. Got it. I appreciate the elaborate answer. My second question was regarding the housing finance. So obviously, there's a large opportunity out there. I know the company has been thinking about making some changes in our strategy. I wanted to know any updates in terms of the team or the strategy and whether we're seeing any early signs of success there?

Jagadesh J: This is Jagadesh. Regarding the housing finance, yes, currently, we had a growth of around 12 percentage, but we are looking at a growth of close to 20% plus in the current financial year and upwards in the long term.

In the current term, we are looking at adding close to some 18 to 20 branches and another 30 spoke locations among our existing set of branches. So this will help us to show the desired growth. And also, we are focusing more on the semi-urban and rural locations, which will also help us to increase the yield.

Darshan Deora: Got it -- and any additions we have done to the team in terms of the senior leadership on the housing finance side?

Jagadesh J: No, we have not done that. We are only adding the branches. We are not going into the new geographies.

Sridharan N.: Yes. Leadership, everybody is there. So I mean, the people are in place. So the whole addition is all about branch expansion and more people in the same branch.

Moderator: The next question is from the line of Priyank Chheda from Vallum Capital.

Priyank Chheda: I hope I'm audible. Sir, it has been a stressful time. And in such times, what as a minority shareholder, we require is something internal to the bank, which we can control. And I'm coming back to the same question, which was in the earlier participant, which is cost-to- income ratio. It is going up to the roof.

That is question one, when -- how do we take care in the interim when there is so much of pain on the P&L? Why don't we take some calls to cushion up the profitability? That is question number one? And then I'll come back to the question number two.

P. N. Vasudevan: Yes. I mean it's a good question, no doubt. Can we double down on the cost and reduce the cost at a time when there is a stress in terms of provisioning. But if you look at the way the bank is set up, we do not really employ DSAs or collection agents for sourcing or collection of installments. And in liabilities, of course, we don't -- we are not even allowed to have DSAs for deposit anyway.

So most of the costs that we incur are of a fixed cost in nature, be it people, be it branch rental cost and things like that and the IT cost that has been invested. So the variable cost is actually very little. There are some businesses where we pay connectors for certain lead referrals for businesses.

Only a very small part of our cost becomes a variable cost. So if there's a drop in business, automatically, that cost will go down to that extent. But the rest is all actually of a fixed cost in nature.

And if you look at business also, while, of course, the results are not very good, and there is a loss that we have reported in the first quarter because of higher provisioning, etcetera. But if you look at the fundamental platform of the bank, we have a 90% of our loans in secured book, and the secured book is doing quite well, whether it is in terms of growth, in terms of collection efficiencies, etcetera.

We don't see really any issue in that, except that in Karnataka and Tamil Nadu, as we have mentioned, there was a spillover effect of the microfinance stress because of the ordinance, which got passed in these 2 states. There was some spillover effect in terms of the lower end of the LAP book. But that again was a short-lived effect.

And even in July, we have put out our net slippage for non- MFI book, which has come down to 2.19% from the first quarter slippage of about 2.6%-odd. So basically, the business is very strong from the non-MFI side, which is 90%. And the microfinance, which is, of course, 10%, but causing a lot of pain is the factor that we have to deal with.

And we all felt that the microfinance will improve sometime by the beginning of this financial year, but it has not turned out to be so. And -- but with the guardrail settling in and all people getting more disciplined in lending, we do expect that the third, fourth quarter should improve in microfinance also.

So the challenge for Equitas is really not in terms of how to cut cost and control operating cost or reduce the cost. But in terms of how do we just get our growth back, and we have grown by 8% in the first quarter. But as Jaggi mentioned, we should look at about 15%, 16% growth for the full year on the overall book. And that is where the entire cost will get absorbed. And as Dheeraj mentioned, in the short to medium term, our cost to income should come back to that 60%, 65% level.

Priyank Chheda: Okay. I take that. Sir, on non-MFI book, until last quarter, we guided for a credit cost of 1% for the full year. Now -- sorry, I would have missed out what is the changing in the policy provisioning norms that you have undertaken where the credit cost annualized rate is around 2.5% on the non-MFI book. Help me with what is the credit cost that we should look forward for '26? What has changed and transpired versus last quarter to this quarter?

P. N. Vasudevan: So our normal credit cost should be in the range of 1% to 1.2% for the non-MFI book. This quarter, we have made -- we have changed the provisioning norms in certain buckets, which you can see in page -- I don't know which page Page 6, we have made extra provision in certain buckets for the non-MFI book.

The purpose of that or the reason of that was because our MFI book is coming down. And because of that, the overall provisions for the bank PCR from a PCR perspective will start going down. So we needed to increase the provisions in the secured book to keep the PCR up to a reasonable level. So this was a onetime exercise that we have done. But short of that, yes, we should still stick to that 1% to 1.2% credit cost for the rest of the book.

Priyank Chheda: So, this is actually not onetime. It has happened second time in last, whatever, 1.5 years. What we want to really understand is that till what times the provisioning norms will keep getting tightened internal to the bank. I'm sure it is good on the long term.

And hence, we are the long-term shareholders for Equitas Bank, but we really want to understand on the non-MFI book, when would this provisioning tightening ends and then we get back to the respectable PCR norm. So is that something which is yet to come more pain in the coming quarters? Or is this a max pain that we are looking at it?

Dheeraj Mohan: Just to give you one perspective so that you don't think this keeps repeating. This INR112 crores, which is the non-micro finance credit cost, which we have done through strengthening the provision, its incremental impact will not be of the same magnitude because this is why we are saying it is onetime, it's on the stock. So incremental will be a much smaller number.

P. N. Vasudevan: No, no. That he has understood. What he is asking is that is understood. He has understood that this INR112 crores is a onetime because you are doing it on a portfolio basis. Incrementally, only for that extra amount which comes into each bucket, there will be that extra provisioning. That he has understood.

What he is asking is you are saying that this is coming up for that improving the PCR, because MFI is coming down, so PCR will go down because MFI is going down. And what he is asking is in the future also, we'll keep tightening the internal provision norms from the 70% PCR perspective. That's what he's asking.

I think we don't have that answer off the cuff now because I can't really tell you yes or no to that question. What we can say is that we will have to look at this from time to time and time the increase in provision norms properly.

And -- but I think at least for the rest of the year, I'm fairly clear we will not have to do it again for sure. Whether we'll do it in the next year is something I'm not right now able to predict with clarity.

Priyank Chheda: No problem. And just one last question on, again, MFI. For the full year last year, we undertook a credit cost of around 10%. Now in this year, a normalized credit cost, additional upfronting of the credit cost, all put together is another 11% right?

So what I wanted to understand is that the balance now -- so because the book has run down, it's been a 1 year, whatever disbursement that we would have done in last, whatever, 6 months to 9 months, I'm sure we would have taken all the prospects of the pain that overleveraging of the borrower had. Even -- would it be prudent to call out that this is the max pain in MFI book also?

P. N. Vasudevan: Yes. I mean that's the purpose of taking that INR185 crores of standard asset provisioning in microfinance in the first quarter to kind of call out that, yes, this should be the peak of credit cost stress that we should achieve in MFI. And hopefully, going forward, we should see more normalized credit cost for the subsequent quarters. The whole purpose is really only that. That's where we went for that standard asset provisioning.

And in terms of the last 6 months business that we generated, yes, I had mentioned that the collection efficiency in that is actually 99.6%, which is absolutely as good as what it used to be before all this crisis started. And the second thing is -- there's one more question.

Priyank Chheda: Okay. So for the full year, what would be the credit cost for this book that we should think of -- sorry for the balance 9 months, we know that it has happened in Q1. For the balance 9 months, what should be the credit cost on MFI book then?

Dheeraj Mohan: We are expecting another conservatively about INR300 crores -- we have made INR400 crores and conservatively, another INR300 crores is what we are expecting.

P. N. Vasudevan: Yes. And the percentage is not the right thing because, as you mentioned, the denominator has been going down. But as Jaggi mentioned, we started disbursement again in microfinance on a calibrated basis. So that will obviously reduce the percentage. But yes, to some extent, the percentage is a little appreciated.

Priyank Chheda: So the INR300 crores is for the balance next 3 quarters for this year?

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

Priyank Chheda: Hopefully, we come back more stronger in the coming quarters.

Moderator: The next question is from the line of Ronak Chheda from Awriga Capital.

Ronak Chheda: My first question is, again, going back to credit cost. You said that we are kind of up-fronting the credit cost in the current quarter and also kind of improving the PCR. For the full year, if I were to assume, if it's a INR600 crores to INR700 crores ballpark for MFI and 1%, 1.5%, should your credit cost for full year of F '26 be higher than F '25, if the math serves right?

Dheeraj Mohan: Yes, it will be higher.

Ronak Chheda: Okay. And my second question is in terms of your cost to income. In terms of our readiness to apply for your universal license, do we have to now add -- is there something from a readiness point of view where we will have to invest in processes, tech, people or that investment is largely done and we are kind of gearing up for our application?

P. N. Vasudevan: There is no fresh investment required from that perspective at all. We should be able to apply next year. If we can continue to keep our GNPA and NNPA less than 3 and 1 for March '26, then we should be potentially able to apply subsequent to that. But from an investment perspective, there is no further investment required.

Ronak Chheda: Got it. And my last question is on NII item. I understand there is a reversal in this quarter. But given the fixed rate nature of our book, how do you see that growth delta in the NII growth line vis-a-vis an AUM growth over the next 2 years, given the rate cycle is coming -- the rates are coming down?

Dheeraj Mohan: Yes. I'll try to address that from an expectation on NIM rather than NII growth. So we -- what's impacting NIM largely is the portfolio mix in MFI and also the interest income reversal. So these 2 are the large contributors for the NIM drop. And as you've seen, our cost of funds is also moderating quite well.

So I think in our expectation, our NIMs should roughly hover around here for the given year, even though we will get benefit of lower interest income reversal as asset quality picks up. But again, we're stepping on the pedal from a growth perspective.

So we -- at least we expect NIMs to hover around here for this year. On NII, yes, you're right. NII should grow faster theoretically as you start getting income from these assets and you get the full yield. But I think more expectation is NIM to remain where it is.

Ronak Chheda: Okay. Just last thing on DPD movement in the non-MFI book. Despite -- I understand you commented that it is dipping in July, but the way to -- the movement from Q4 to Q1 is a sharp increase. So can you talk about where are we seeing the spreads except for the ones we have already called out?

Jagadesh J: This majorly happens only on the Karnataka market where we had a sudden flow in the DPD. That was the major impact we had it in the DPD movement, which we brought it under control, which we can be able to see in the month of July where the 1 to 90 DPD has come down both in MF as well as on the non-MF book.

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

Ashlesh Sonje: Sir, if I look at the non-MFI book, on a on the basis, it is a gross slippages have not increased as sharply as the increase in net slippages. So it seems...

Moderator: Sorry to interrupt you, sir. Your voice is breaking.

Ashlesh Sonje: I will come back in the queue.

Moderator: The next question is from the line of Saumil Shah from Paras Investment.

Saumil Shah: Sir, what is the X-bucket collection efficiency for microfinance for the month of July?

Jagadesh J: It was around 99.14% on the 1 EMI demand against 1 EMI collection.

Saumil Shah: So in the month of June, I think it was 98.69%. So it has improved compared to the month of June?

Jagadesh J: Yes.

Saumil Shah: Okay. And how about Tamil Nadu and Karnataka?

Jagadesh J: Tamil Nadu, we are at close to 99% and Karnataka has been improved from 96% to close to 97.4%...

Saumil Shah: Okay. So overall, in all the -- I mean, states, it's improved even in Tamil Nadu?

Jagadesh J: Yes.

Saumil Shah: Okay. And sir, in previous calls, I think we mentioned that by end of this year, our ROA should be in excess of 1%. And FY '27, our ROA is to be in the range of 1.5% to 1.8%. So are we on track to achieve that? Or looking at the current quarter performance, we would like to revise our guidance?

P. N. Vasudevan: Yes. So I think we'll still be able to stick to that. The fourth quarter exit ROA for the fourth quarter should be around that 1% level.

Saumil Shah: Okay. And for FY '27?

P. N. Vasudevan: FY '27, it's, of course, early to predict that, but it will keep improving. That's for sure, because we definitely believe that MFI stress can't continue beyond that. And if MFI comes back, then everything is back to normal. So we should see back to normal levels of ROA subsequent to that. So if the fourth quarter exit ROA is around that 1% level, then you should see progressive improvement in the subsequent quarters.

Saumil Shah: Okay. Okay. And sir, my final question, since our 100% of MFI disbursements are now covered under CGFMU. So can we expect from now on from here, I mean, we'll be stabilizing at this 10% MFI book or we can even increase this book?

P. N. Vasudevan: Yes, it is unlikely to increase because MFI growth will be always a little lower than the rest of the book growth. And to that extent, it may not increase, but the sharp reduction that we have seen in the last 2 quarters may not happen.

Saumil Shah: So I mean, for us, the ideal level would be what 90 secured and 10 MFI?

P. N. Vasudevan: Around that, around that.

Moderator: The next question is from the line of Anil Tulsiram from Bestpals Research Advisory.

Anil Tulsiram: My question is more to understand the strategy of the bank from next 3 to 4 years perspective and not looking for any number guidance. See, first on microfinance, my question is whatever little I have understood, the JLG business -- the JLG model has broken and now that group collections and group underwriting is not working anymore, and we have to do individual underwriting.

And individual underwriting is definitely not possible for ticket size less than INR1 lakh. And JLG loans are definitely less than INR1 lakh. So my question is why we want to be present in this MFI segment at all when the business model has broken? Or is my understanding wrong? That's the first question.

P. N. Vasudevan: Yes. Your understanding is correct. I'm not going to say your understanding is wrong. The group lending model still exists and the people still assemble in the group. What is really not beginning to work now, which used to work in the past is the willingness of the group members to pay someone else's EMI when that person has not come to the meeting and requesting someone else to pay, they normally used to end up paying. And then they will collect it between themselves subsequent later on.

Now that is the one which is really not happening now, but the rest of the group model still works. And as we keep saying that our own microfinance strategy is very clearly that we will -- that percentage of contribution of microfinance will come down over time, except that last 2 quarters, it was sharply down, which will not happen. It will reduce more marginally.

But otherwise, the rest of the group model still works because even today, we are able to get about 50% of attendance at the center meeting, which used to be under normal circumstance around 70% -- 70%, 75%. So at least 50% are still turning up and making the payment at the group and leaving the rest of the members to be followed up individually.

And we'll have to keep watching this. These are all evolving because now the MFIN guidelines -- sorry, MFIN guardrails have got implemented 2.0. Now people can't borrow more than 3 loans and the total loans can't exceed INR2 lakh and if they have an overdue with anyone, then no one else will be allowed to fund to her. So these are the norms which were not really properly followed in the last 2023 and 2024.

But now from Jan and from April -- from April, everybody has implemented. From Jan, some of us had implemented. And when these 3 norms get implemented strongly by all the players, that is when the members will also start recognizing that they need to repay the money.

If they want to be in the microfinance borrowing market, they need to also repay their money, whether they do it at the group or whether they do it outside the group. So to that extent, I think the collective disciplined lending of the entire industry is what can finally hold this group model going forward.

Anil Tulsiram: Got it. And sir, my second question is on the opex, but I'm not looking for the cost to income or any guidance. Where I'm coming from is -- I don't know my understanding is right or wrong for the size of our bank, I think we have too many products.

So is it that the opex is high because we have too many products and then the products scale up, then the opex as a percentage of assets will automatically come down or is it just that the growth? So why exactly our opex is high as a business model? That is what I'm trying to understand.

P. N. Vasudevan: Yes. So I think we have been investing in a few business lines over the last 3 to 4 years. Used car was one business that we started about 3, 3.5 years back. Affordable housing was another one which has started around the same point in time.

And both of them -- I mean, used car has been quite profitable even last year and this year also. But affordable housing last year was not profit making. This year, it has just turned the corner in the first quarter. So hopefully, it will start contributing more going forward.

And then we had spent money on AD1 and also we have spent money on credit cards. So these 2 businesses, they have not started generating revenue. And this year, they will start generating revenue, but the real revenue should come from these 2 products from the next financial year.

So there is a certain amount of investments we had made. And so that way, the cost to income remained at a higher and elevated level. Of course, the fact that microfinance book was going down and creating a higher level of slippages impacting income reversal was again a major factor.

If that had not happened, if that had not happened and if microfinance had continued under normal patterns, then our cost to income should have been in the range of 62%, 63%, 64%, somewhere in that range is where it should have been, given the investments that we have been making in other products.

Because of that MFI issue, it has gone a little elevated. But once the MFI comes back, naturally, it will produce higher level of income and so the cost to income should come down. But going forward, as Dheeraj had mentioned slightly earlier, in the short term, we should see the cost to income at around this level. But in the medium term, we should see it getting back to that 60% to 65% level.

Anil Tulsiram: Okay. And sir, one follow-up question on the microfinance. Is my understanding right that now that you are saying that the collection cost will go up drastically for the balance for not coming to the growth?

And RBI has been pressurizing that the rates cannot go up beyond the point. And structurally, it looks like the credit cost of the MFI segment has increased. So without going into the numbers, can you say on a sustainable basis, the profitability on the microfinance has come down compared to the before this ceiling?

P. N. Vasudevan: Structurally, I think, again, you are right, structurally. I think the MFI, the profitability, the ROAs and the ROEs that MFI used to generate in the past, I think at an industry level, we will start getting used to seeing it at a more normal level. And over time, the returns on microfinance may be only equivalent to that of secured loan books, just slightly adjusted for the unsecured risk exposure.

So it will get -- it's probably be a little bit more than what a typical MLAP or a secured loan LAP can produce just adjusted for the unsecured credit part of it. Otherwise, the earlier situation of higher levels of ROA, ROE, I think, is something that at the industry level, we'll all start probably getting used to not having that kind of stuff going forward.

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

Ashlesh Sonje: I hope you can hear me better now. Two questions from my side. If I look at the NPA recoveries and upgrades in the non-MFI book, that metric seems to have worsened quite a bit in this quarter. If you can shed some light on which segments or sub-segments and which regions are contributing to this worsening. That is one.

And secondly, I heard you say that the credit cost guidance for the non-MFI book should be around 1% to 1.25% -- this seems very different from what we used to indicate earlier for the entire book. If I go back a couple of years, we used to say that the overall credit cost should be around 1.1% to 1.2%. Now we are giving a similar guidance for the non-MFI book. So what has resulted in this change in expectation? Those are the 2 questions.

P. N. Vasudevan: Okay. I'll leave the first question to Jaggi to answer in terms of geography region-wise, where do we see stress on the non-MFI book. As far as the credit cost of the non-MFI book is concerned and the overall credit cost of the bank is concerned, you are right.

When we became a bank in 2016 and then for the brief while that post demonetization, if you remove that impact for about a year impact, then from 2018 to 2020, where there was no external factors at play, again, our credit cost at the bank level used to be around the same 1.2%, 1.1%, 1.2%, 1.25%, which comprised of more or less equal kind of credit cost between MFI and non-MFI.

But now what we feel is that the non-MFI will still continue to be at the same 1% to 1.25% level. But the MFI could be at a different level. MFI could be different is what we feel. It can be -- I mean, earlier, we used to say long back before all this crisis, it used to be 1% to 1.5% credit cost. Subsequent to demonetization, we thought that 2% to 2.5% is a more normal credit cost for microfinance.

Post corona, we thought around 3% is a normal credit cost for microfinance. Now post this 2024 overleveraging crisis, probably anywhere between 3% to 4% could be a normal credit cost for microfinance.

So if you take that way, and if I assume that 10% of our book will be microfinance, then we are really looking at 0.3% to 0.4% credit cost once microfinance settles down and becomes normal. And then 1% to 1.25% from the other. So you can potentially then look at 1.5% as a credit cost at the bank level.

I'll leave Jaggi to answer the geography wise.

Jagadesh J: Okay. Regarding the non-MFI slippages, there are 2 products which we had slippages compared to the previous quarter. One is on the VF, other one is on the SBL book. But VF, you normally see it's seasonality will be there for the Q1. We cannot make a comparison with Q4. But when you make a comparison with the last financial year Q1, actually the slippages which is much more lower, both for the 1-90 DPD as well as on the GNPA print.

So we don't see much of problems as far as the VF, even though the slippages compared to Q4 were higher. But if you look at the SBL part, as in the -- clearly mentioned in the call that even the -- due to this ordinance, we had an impact even on the mortgage loans on the lower ticket sizes less than INR10 lakhs.

So we have been comfortably having a X-Bucket efficiency of close to 995 in Karnataka, which has dropped down to 96.2% in the month of February. So currently, we brought it down to almost close to 98.4% in Karnataka, but those slippages, which contributed majorly in the Q1.

So the maximum slippages happened from SBL is on the -- from the Karnataka region. And this is primarily on the both less than INR10 lakh ticket size, which is the micro LAP and GLAP products.

Moderator: Well, 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.

P. N. Vasudevan: Yes. Thank you all of you for attending this call and highlighting areas for focus for the bank and for the management. Thank you so much, and see you again next quarter. Bye-bye.

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