"Suryoday Small Finance Bank Limited
Q2 FY 23 Earnings Conference Call"

November 11, 2022

MANAGEMENT: **MR. BASKAR BABU RAMACHANDRAN - MD AND CEO**

MODERATOR: **MR. JIGNESH SHIAL FROM INCRED EQUITIES**

Disclaimer: E&OE - This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 11th November 2022 will prevail

Moderator: Ladies and gentlemen, good day, and welcome to the Q2 and H1 FY'23 Earnings Conference Call of Suryoday Small Finance Bank hosted by InCred Equities. As a reminder, all participant lines will be in listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Jignesh Shial from InCred Equities. Thank you, and over to you.

Jignesh Shial: Yes. Thank you, Shree, and good evening, everyone. On behalf of InCred Equities, I welcome you all to Suryoday Small Finance Bank Limited 2Q and H1 FY'23 Earnings Conference Call. We have along with us Mr. Baskar Babu Ramachandran, MD and CEO, along with the top management team of Suryoday Small Finance Bank. We are thankful to the entire team for allowing us this opportunity.

I would now like to hand over to Mr. Baskar Babu Ramachandran for his opening remarks. Over to you, sir.

Baskar Ramachandran: Thank you, Jignesh. Good evening, everybody. On behalf of Suryoday Small Finance Bank, I extend a warm welcome to our Q2 and H1 FY'23 Earnings Conference Call. I have with me my colleagues, Kanishka Chaudhary, who is our CFO; Narayan Rao, who is our Chief Services Officer; Shashi, who leads our Analytics Function; and Himadri Das who is our Head of FP&A. I hope everyone has an opportunity to go through the presentation for the quarter and half year ended September 30, 2022, uploaded on the stock exchanges.

The global economy is facing multiple headwinds such as inflationary pressures, rising interest rates, energy crisis, currency volatility. Global central banks have announced aggressive rate hikes in the past 6 months, except for only a few major economies, the rate hikes are complemented by a contraction in global currency in circulation, the size of the Central Bank balance sheet and money supply measures. On the positive side, however, the Indian economy has shown resilience and has been growing on a steady-state business with all the growth levers in place.

The credit offtake is clearly visible in the economy with bank lending growing at double-digit rates in FY 2023. In September, non-food credit growth crossed 15% year-on-year for the first time since 2018. A sustained rise in the bank credit usually signals an economic recovery. The growth momentum is intact despite rising inflation in the economy. The inflation has necessitated RBI to increase the repo rate by 190 bps to 5.9% so far in the financial year. We are delighted to report that the bank had demonstrated steady performance in H1 FY'23. As the inclusive finance and connected lines of business have almost recovered back to its pre-COVID levels of growth.

The bank's gross advances for H1 FY'23 grew by 20.3%, which stood at INR5,378.4 crore, while the disbursement for the period grew by 50.3%, which stood at INR2,130 crore compared to INR1,417.8 crore in the same period last year. Along with the growth in disbursement, the bank has also witnessed a healthy customer addition of 4.7 lakh customers in the last 1 year, taking the total customer base to nearly 20.9 lakhs, a growth of 29% on a year-on-year basis. We are committed in delivering a monthly pre-provision operating profit of approximately INR40 crore per month. On the profitability side, the bank has turned profitable and reported a profit of PAT of INR20.8 crore in H1 FY'23 as compared to a loss of INR49.7 crore in the corresponding half year last year.

Now let me give some light on the key operational and financial metrics as on H1 FY'23. On the business performance front, our disbursements grew by 50.3% to INR2,130 crore compared to INR1,417 crore in H1 FY'22. The disbursement, particularly in inclusive finance business, stood at INR1,491 crore during the half year period, resulting in a growth of 37.3% against H1 FY'22. The bank has ramped up its disbursal in the Inclusive Finance segment as well as in the Micro Home Loan segment and has commenced 2-wheeler business loans recently. Our collection efficiency is improving gradually on the back of the business and economy nearing pre-COVID levels. The overall collection efficiency were up 94.6%.

On the gross advances front, we grew by 20.3% to INR5,378 crore on a year-on-year basis. The Inclusive Finance business currently comprises of 64.4% of the asset book, while affordable home loans, commercial vehicles and secured business loans comprised 9.3%, 6.2% and 5.5%, respectively. As a strategy, we have been increasing our share of non-inclusive finance business, gradually over the last few years. Suryoday plans to achieve a secured portfolio book of 50% to 55% by FY'25.

Our focus on graduating the products of Vikas loan to our Inclusive Finance customer currently comprises of 83,000 customers in individual lending, constituting a portfolio of INR626 crore as on September. The entire repayment is to the standing instruction in our own bank account and currently, 95% of the repayments are through the bank accounts on the due date. The current collection efficiency stands on this portfolio at 99.2%. We have introduced End-to-End Digital Processes for the segment and are hopeful of accelerating business in the Vikas loan portfolio.

On the deposits front, our deposits stood at INR4,207 crore as compared to INR3,129 crore in H1 FY'22, an increase of 34.5% year-on-year. Retail deposits currently constitute 71.9% of the total deposits and the balance comprises of bulk deposits. CASA currently stands at 17.3%, which is in line with our plan of the retail strategy. The borrowings as of September end constituted 28% of the total liabilities, majority of which 90% is from refinancing institutions.

On our distribution side, Suryoday currently has 567 branches, of which 92 branches are liability focused, while 362 branches are asset-focused branches, but the balance comprises of rural centers. Through this branch network, the bank currently services 20.9 lakh customers, of which total asset customers are 16.7 lakhs. On the asset quality front, the GNPA, NNPA and PCR currently stand at 9.9%, 4.8% and 77.5%, respectively. Delinquency in the portfolio has declined sequentially on the back of improved collection efficiency. The collection efficiency on the restructured book stood at 65% and 26% of the NPA customers are paying customers. We are continuing our efforts to recover the overdue from the restructured portfolio.

On the earnings update, on the earnings side, our net interest income stood at INR353 crore compared to INR270 crore, an increase of 30.4% year-on-year. Net total income stood at INR390.8 crore as compared to INR326 crore, an increase of 19.8% year-on-year. The net interest margin improved from 8.4% in H1 FY'22 to currently 9.1% in H1 FY'23. Cost of funds reduced to 6.6% compared to 7.3% in the corresponding quarter last year. Cost to income currently stands at 55.9% as compared to 58.3% in H1 FY'22, primarily due to increase in income. The company reported a profit of INR20.8 crore against a loss of INR49.6 crore in the corresponding period.

We continue to hold a floating provision of INR91.3 crore on our books. On the capital adequacy front, we continue to remain well capitalized and the capital adequacy of our bank is currently 35.9%, as compared to 37.9% as on FY'22. Of this capital adequacy Tier 1 comprises of 33.1% and Tier 2 comprises of 2.8%.

I would now like to highlight some of our other updates. Our Technology Transformation Project Pragyan has been successfully completed in August 2022. The bank has successfully migrated its Core Banking Solution to Finacle. The bank has partnerships with 3 payment banks, Airtel, Fino, and Paytm for end-to-end Digital Process for Sweep Accounts and currently Fixed Deposit arrangements with Fino. The bank is engaging with various technology partners for its assets and liability products. We are strengthening our distribution channels to promote small ticket fixed deposit as low as INR1,000 distributed through our customer service points as well as through our Inclusive Finance branches for amount as low as INR1,000. The turnaround time for delivering this product is currently 100 seconds.

The focus continues to be on retaining existing customers and graduating them to Vikas loan products. Vikas loan enables end-to-end servicing. Vikas loans collections currently stand at 99.8%. And this book currently forms 23% of the overall Inclusive Finance portfolio. The secured business portfolio of the bank currently stands at 36%, and the bank intends to scale this to 50% to 55% by FY'25. We are graduating our Inclusive Finance customers for home improvement loans and working capital needs to secure business loan financing.

Finally, to summarize our endeavor is to grow the loan book by 25% to 30% every year. The bank plans to achieve INR400 crore of disbursal per month from Q3 FY'23 and increase the share of secured lending in the overall product mix. On the deposit front, we foresee great opportunity in leveraging our Inclusive Finance segment, but offer them liability products and also other asset products to graduating customers. We aim to expand our presence cautiously in new states and strengthen our foothold in existing states. Going forward, we target INR40 crore of PPoP on a monthly basis from Q3 FY'23 onwards, along with targeting NNPA by 3% for the year-end.

These are updates from our end. Thank you. Over to you.

Moderator: We have our first question from the line of Renish from ICICI. Please go ahead.

Renish: Congrats on a great set of numbers. So 2 questions. So one is that, what is the total write-off for this quarter?

Baskar Ramachandran: The write-offs for the quarter is INR93 crore, Renish.

Renish: Okay. And sir, related to that in PPT, we are saying we want to reach net NPA of 3% by March '23. But when we look at the current quarter trend, even having the credit cost side upwards of 5%, our net NPA went down by only 20 basis point. So sir, what kind of a credit cost we have to take to reach the targeted level of net NPA of 3% by March '23? So sir, my question is related to our net NPA target of 3%. So to achieve that target, what kind of credit cost we are assuming for second half?

Baskar Ramachandran: Renish, our entire moratorium portfolio has come to a payment pattern from July 1, so which means that whatever were not kind of under moratorium has the payment track record in terms of repayment has commenced. So we have seen the reasonable peaking during the month of September. And the first spillover happens in the month of October and a very, very small spillover of non-paying portfolio of restructured finance happening in November.

We are kind of assuming a credit cost from a provisioning point of view around close to INR100 crore to INR125 crore through the remaining period. And if needed, probably another INR25 crore of additional is what we'll be providing. Our targeted PPoP for the next 6 months, is approximately around INR225 crore to INR240 crore. So we're assuming that around INR225 crore to INR240 crore will flow towards the provisioning as required. We're also having around 30% of our NPA book, which is paying. The intent now was the entire peaking out is really kind of a pullback of the paying portfolio into the non-NPA fold as well.

Renish: Got it, sir. So sir, just last question on the interest income on the yield side. So sir, we have seen that post the new MFI regulation, the lending rate for the microfinance loans have actually gone up vis-a-vis is now, we have seen 20 basis point decline in the yields and which is what actually reflected in 1% sequential interest income growth versus the 5% AUM growth. So sir, what explains that? I mean why there is a decline in the yield on sequential basis?

Kanishka Chaudhary: Yes. So Renish, last year same time, the retail asset portfolio, secured book was around 30% of my portfolio. We have now grown it to 36% of the portfolio. So there's a mix change, which is really causing this minor compression.

Renish: I'm actually talking about the sequential numbers, not the Y-o-Y. So let's say, if we look at our blended yields, okay, it has actually contracted by almost 30 basis points from 19.1 to 18.8 this quarter, right? I mean this is 30 basis point sequential decline. Vis-a-vis when we look at the industry trend, post the new regulation got implemented from April 1, the more of the pricing cap the lending rates for the micro finance loan have actually gone up, and that is what we have seen for the other MFI players. So I was just wondering why there is a decline on sequential basis when industry rates are going up?

Kanishka Chaudhary: So see on the microfinance side, we have not increased our rates even though in this particular quarter, the cost of funds have increased, right. That extends part of the reduction that you see of 30 basis points, and that's offset by the corresponding increase in the retail asset book.

Renish: Okay. And would you have a fixed versus floating rate book split?

Kanishka Chaudhary: So our floating rate book is something that we offer only in the home loan and LAP portfolio. As things stand today, around 40% of our home loan book is on fixed and rest is all floating.

Renish: Okay, got it. 60% of home loan LAP is floating typically.

Moderator: We have our next question from the line of Anil Tulsiram from ContrarianValue Edge. Please go ahead.

Anil Tulsiram: Sir, my first question is what changes you have done or propose to do to your MFI business post RBI new guidelines? For instance, in one of your interviews you have spoken about 3-year tenure loan becoming more common rather than in the near term.

Baskar Ramachandran: That's right, Anil. So what we are likely to see post introduction of that is that, the indebtedness is, in my view, rightly now explained is in terms of the repayment capacity rather than by the size of the loan that they've absorbed. So that enables the funding into the segment of long tenor if it is more secured and certainly for graduating customers. So of our overall customers, we have around 4.5 lakh customers, which has been through COVID-1, 2, demonstrated substantial ability and intent to pay, not just to us, but to across other lenders, including retail asset financing that they've taken. They have exposure to that.

So earlier, it was all restricted to 1.5 years max, 2 years. Now our Vikas loan portfolio is offered for a tenor of both 2 years and 3 years. But however, what we see from our customers and Inclusive Finance segment for unsecured loans, even for a value of INR1 lakh is to prefer 2 years broadly. Around 80% of our portfolio is still, even given a choice of 2 and 3 years for a INR1 lakh loan, happens to be at around 2-year curve. But gradually, as the ticket has increased or we kind of extend products, which are more like secured business loan against their property for business purposes, they're likely to see over around 4 to 5 years, the installment amount continues to be the same as it is for a INR1 lakh loan for a 1.5-year period. So we're likely to see all of those innovations or extensions of tenors in the coming months because of the new micro finance regulations.

Anil Tulsiram: Yes. And sir, second question is, can you elaborate more on your Micro LAP and Micro Housing Loans, this loan I'm talking about between 3 to 5 lakh ticket size? And how big this segment can become in the next 3 to 5 years? And will it be more focused on MFI customers or non-MFI customers?

Baskar Ramachandran: Anil, it will be more focused on the Inclusive Finance customer segment, not necessarily our existing micro inclusive finance customers alone. So as we kind of realize that because of one getting a holistic view of the household, which is coming from 1 October, even at the lady of the household who happens to be a customer, the retail asset penetration currently stands at closer to 30% to 35% out of the track, which is available for our core customers. Either she is the borrower or a co-borrower in a loan. There are multiple loans at the household levels, including, say, probably a 2-wheeler loan or a car loan or a small ticket CV loan, which the lady of the household who's our customer is not part of the deal structure. The new microfinance regulations allow us to get a comprehensive view of the household. And to that extent, which is not a 3 lakh to 5 lakh. What we call as Micro Home Loans, is between INR4 lakh to INR10 lakh max and above that it becomes affordable home in a different segment.

The Micro LAP segment plays out between INR3 lakh to around INR7 lakh and INR3 lakh to INR5 lakh is a sweet spot for the customer, including easy documentation. Currently, approximately around 2 lakh of our customers' minimum will be targeted for the Micro LAP. But however the process has to be really convenient in terms of not looking for a full legal documentation to the dot. But as long as there is an ownership and there is a business, visibility of the household doing around INR2 lakh to INR5 lakh will be the sweet spot. We believe that it will be around closer to 50,000 customers, what we'll target in FY'24.

Anil Tulsiram: Yes. And sir, my last question is you have started OD facility for MFI customers and CV customers. So 2-part question on this. So what is the rationale? And how has been the experience about the acceptability and credit cost in this product?

Baskar Ramachandran: We had introduced this product during the COVID when customer is exhibiting, kind of displayed behavior saying that we are really hesitant to pay though we have the money because we're not sure what will happen in the subsequent couple of months. So we introduced small ticket OD completely digital means for approximately 3 lakh customers. The experience of around approximately 2 lakh customers was as good. For another 1 lakh customers, invariably either by circumstantial or partially by intent, it became not a great performing loan, including their main loan. So that was probably around 30% in terms of really didn't play out well.

So also the learning out of that clearly for us was that the first nudge would be to kind of the customers to start operating the bank account they have with us meaningfully and build products around that. So purely introducing OD product without inculcating that behavior is not proved to be very successful. So our entire Vikas loan business today, what we've built around 12,000 to 80,000 customers as of September from INR600 crore portfolio, 95% of that money comes through our own bank accounts, but the customer deposits the money before the due date.

So on the exact due date, we only apply a standing instruction and consistently, it has been hovering around 94% to 95%. Now that this becomes a reasonable operative account, introducing a OD product will be very beneficial both for the customer. It means that the customer pays interest only for the number of days that she uses, but more importantly, from an bank point of view, we get visibility in terms of the usage pattern, the credit behavior of the customer when the limit is available when they can use it. And we do believe that we'll reintroduce that in a more robust manner. And the potential of that, we see pretty high are at least an approximate of around 10,000 per customer for 10 lakh customer of ours.

Moderator: We have our next question from the line of Priya Verma from NR Securities. Please go ahead.

Priya Verma: Sir, I have 2 questions. Firstly, are we focusing on any new product launch in H2 FY'23? And the next one is looking at the balance sheet, the fixed assets have jumped from INR41 crore in last September to INR158 crore this September. So what is the reason for such a steep hike?

Baskar Ramachandran: Sure. In terms of the new products, the one which we are really doing is an end-to-end for our Inclusive Finance customers through clear visibility of data analytics around closer to 10 lakh customers seem to be of good quality both by intent and ability to pay. So we introduced a digital mapping exercise for the household called Sarathi app, where we capture both the details of the house and household as well as in terms of their business. So this is the first step that we're introducing Vikas loan where the customer makes the payment to the bank account.

Over a period of time, we would like to reduce our dependence of cash collections, going to the doorstep of the customer and dealing with it. While prima facie it looks a little more riskier to deal with the customer one-to-one. There has been a clear breakout post-COVID, where customers are also equally comfortable in dealing with the institutions on one-on-one for the requirement than standing guarantee throughout beyond even second, third, fourth cycle.

So we want to build Vikas Loan as the first product. Again, reintroduce a small ticket OD over and above that. And the usage of UPI is near 100% at the household level. And the lady of the household is still not substantial, at least in the Inclusive Finance segment. But when you start operating OD product, we believe that we will build that as well. And probably take the account to the household level. And then the product is not a new product we introduced, but preapproved 2-wheelers were approved for the customer, and they can simply kind of go to a dealership and take it and we introduced similarly secured business loan. So all of that can happen once they have a comprehensive information without reaching out to the customer, every time she really needs it. It's more of an execution is what we'll be focusing for the Inclusive Finance customer in FY'23 remaining period as well as in FY'24. And on the balance sheet, we will fix it as an increase with KC too.

Kanishka Chaudhary: So we got done with our Transformation Project called Project Pragyan in the month of August. So we have capitalized the cost of the project, which is what you see as an increase in the assets.

Moderator: We have our next question from the line of Akash Mehta from Capaz Investments. Please go ahead.

Akash Mehta: Sir, my first question was that how do you see the trajectory for cost of funds and the cost of deposits going forward, given the backdrop of the rising interest rates?

Baskar Ramachandran: So we believe that for our requirements, currently, we have a surplus of around close to INR750 crore, which will kind of get utilized. And we'd like to maintain a surplus of around at least INR300 crore, INR350 crore. So this does not be increase in the excess liquidity which we'll be utilizing. However, the new deposits are coming at an incremental cost of approximately 50 basis points to 75 basis points over a current cost of deposits. So approximately 25% of the buildup that will happen even at 75 bps, 80 bps likely increase in the cost of funds overall is likely to be around 20 bps to 30 bps during the remainder of the year assuming that there is no substantial increase in the interstate environment from here on.

Akash Mehta: Yes, sir, surplus of INR350 crore, right, sir?

Kanishka Chaudhary: Our current surplus is closer to INR700 crore. We would like to maintain INR300 crore to INR350 crore at all points in time. So that's how the liquidity is being managed by us.

Akash Mehta: Okay. And can you briefly elaborate on the collection efficiency level product-wise, which is in the product that is witnessing challenges in terms of collection?

Kanishka Chaudhary: So overall, our collection efficiency is 94.6% as we have indicated. And so far as Inclusive Finance business is concerned, our collection efficiency is around 87%. And when it comes to the mortgage business, we are on an overall basis at 117%, while one EMI capped is 95%.

Moderator: We have our next question from the line of Devendra Pandey from DP Financial. Please go ahead.

Devendra Pandey: So my first question is on GNPA which is still at the elevated level. So is there any behavioral issue by the customers in the repayment or there is any structural issue we face within the markets where we operate?

Baskar Ramachandran: A couple of things. One, Maharashtra has been substantially impacted by the overall level. At the credit bureau level, it indicates that around close to 20% of the portfolio is in 90, 180-plus or in the write-off. So it's broadly a reflection of that. And we have kind of completed all our moratorium by June end. So what has to flow through has flown through. Currently, while we stand at around close to 98% collections in the portfolio which we built post June '21, we have also been cautious in terms of not increasing the ticket sizes, which is we wanted to kind of watch it over completely before it all plays out. So as you really see then we are focusing on the 4.5 lakh shortlisted customer who have been through COVID 1 and 2. So our base per se has not increased substantially to the extent that post June '21 portfolio still comprises only approximately around 80% of our overall portfolio.

So the pressure that we currently see is overall coming in from the pre-June '21 portfolio, which is around approximately INR700 crore, of which around 50% is still not paying. And if you have to explain in terms of the collection efficiency, we have around 9.9% as the GNPA, 35% of the customers are paying, which means that 65% of 10%, approximately 6%, which is not paying, which is translating into 94%. As the base of post-June '21 portfolio keeps increasing, we kind are going to see that the percentage of collection is going up. There's a challenge in terms of the portfolio, it is in terms of the INR700 crore of pre-June '21 portfolio where we are 50% to 55% not paying and only 45% to 50% paying.

Now that the elevated ones is done with, there was an increase quarter-on-quarter in terms of the moratorium customers, restructured customers coming in. We have seen all of that behind at this point of time, including a peaking out happening in October, beyond even September. And the focus now would be to get back customers who have been paying. Other institutions are not paying us probably because we are not in touch with the customers or customers we have been in touch and kind of loss their touch over the last 3, 4 months. So get it back, we're confident that around close to 35% of the GNPA will be recovered through the next 5 to 6 months' time. The challenge will continue to be on the remaining 65%, which is around 6% of the portfolio, which is approximately around say INR425 crore to be precise, is where we see a challenge in terms of recovery. Current provision that we have against that is INR320 crore.

Devendra Pandey: Got it. And since now we have returned to the profitability part, so what kind of ROAs and ROEs would we be targeting in H2 and FY'24 onwards?

Baskar Ramachandran: Before really kind of getting into ROA and ROE we are looking at clearly around INR40 crore of PPoP we used to be clocking that around close to INR30 crore to INR32 crore, pre-COVID. So we are kind of back as the disbursement where we would have seen. It was a little tempered growth in the first 6 months of just about 20% growth. And now on the back of the 10.5 lakh good customers, which we're really kind of deepening through Vikas loan products. We believe that we'll end the year with closer to 25% upwards. And the PPoP will return back to around close to INR40 crore is what we're aiming on a consistent basis for 6 months. As a base does it's likely to kind of stretch our results to INR45 crore, of which kind of indicated that of the INR425 crore of non-paying portfolio, whether GNPA or regular but around INR425 crore to INR450 crore non-paying.

We have covered around INR320 crore of provisioning. So assuming that we'll have to provide INR100 crore over the next 6 months, that's approximately around closer to INR15 crore to INR20 crore per month. So around INR20 crore of PBT visibility is what we want to really work on. So that will convert itself in approximately mathematically, extrapolating, 20x12, we were assuming that it remains the same, around INR250 crore of PBT run rate is what we'd be expecting.

Devendra Pandey: Understood. And sir, lastly, on our asset side. So as a percentage of AUM, how much AUM is the floating rate loans?

Kanishka Chaudhary: So like I indicated, it's only in the HL portfolio where we have a fixed rate loan product. So in the HL portfolio, we have around 40% of the book, which is fixed rate. Rest all is floating. And the Inclusive Finance business is the fixed rate loan. So apart from that, everything else is floating.

Devendra Pandey: So the raised floating rate AUM, are we able to pass on the increase in interest rate cost with those customers?

Kanishka Chaudhary: Yes. So we have been able to pass on the rate hike to a considerable extent, especially in this particular quarter. But one of the advantages that we have is that, if you look at our funding side, we have a mix of borrowings and deposits. And all our borrowings, which are 50% of our overall funding are multiyear, long tenor borrowings with rates locked in. So we do have a bit of a comfort that side. But yes, beginning this particular quarter, tried passing on the interest rate hikes. And on most of the products, we have raised rates by at least 50 basis points.

Devendra Pandey: Understood, sir. And is there any specific number we are targeting in terms of customer addition? Or we are just focusing on increase the wallet share from each customer we already have?

Baskar Ramachandran: In the Inclusive Finance segment, we used to kind of have a very comfortable growth of around close to 25,000 to 30,000 customers per month. So would like to kind of now go back to acquiring closer to 30,000 new customers, mostly new to bank, not necessarily new to credit on a month-on-month basis.

Devendra Pandey: Okay. And sir, my last question is that our deposits have grown at a considerably higher rate compared to our gross advances. So why there is so much difference here between deposit growth and advances growth?

Baskar Ramachandran: As we kind of now became a bank from an MFI, from an asset liability management perspective, we wanted to have closer to 30% to 35% of our liabilities is contractual in nature, so which was a refinancing mechanism and the remaining to be scattered to by net worth. So overall balance sheet broadly at this point of time, we want to have 20% of our balance sheet as net worth. Around close to 35% to 40% in terms of refinance and the remaining through deposits. So currently, we are kind of having been a bank for the last 5 years. The intent is to slowly increase the deposit percentage, and our current CV ratio stands closer to around 125% to 130%. The ideal thing for a bank would be at least be at 100% or a little lesser than 100%. So the focus is in terms of driving deposit to constitute a share I mean of absolute amount, which is equivalent to our overall asset book.

Moderator: We have our next question from the line of Anil Tulsiram from ContrarianValue Edge. Please go ahead.

Anil Tulsiram: Sir, this is the industry-related question. So after this new RBI guidelines on microfinance, do you think the frequent high credit cost events will come down or at least the 10% credit cost event will become much more rare going forward? Credit cost event. Because in the past 5 years, we have 2 credit costs events. De-mon and COVID. So will the RBI guidelines help in reducing the credit cost structurally for the industry?

Baskar Ramachandran: It all depends on the customer segment that each one will choose, while somebody mentioned, Renish mentioned. While there has been a quick increase in interest rate, at least specifically from MFI is what we saw post 1 April, 2022. If the regulations require all the regulated institutions to declare the minimum, max and the average interest rate on the micro finance loans to a point where, then it also state that RBI also may start kind of publishing these rates on their website. So it would mean that, when there is a transparency of rates to be disclosed and which now necessitates us to give us an APR, including any life insurance amount premium, which is detected upfront out of the disbursement. Our overall level, while there was an immediate increase, it is likely to kind of become moderated over a period of time. And as things mature, there will be a clamor for acquiring customers with excellent track record as it will happen in any lending product. And it may become digital at some point of time where the customer will do even a balance transfer out of a new loan directly from the lending institution to the institution we have a loan.

So these are likely to kind of happen. But while there is an increase which has happened now, it gives a view in terms of entire household. So somebody wants to manage the credit cost manageable, which is programmable. They'll have to choose the customer segment accordingly. While there has been a collateral damage out of COVID, on the positive side is at 80% of the household across the state, across overall, assuming the 20% went through pressures in terms of repayment, have demonstrated a great behavior in spite of challenges of an external environment. So and it also made each of the institutions to deal with the customers broadly on a one-on-one with no guarantee getting really enforced. So as long as you deal with the customer one-on-one, you're at risk. Patterns will depend on the customer segment we choose and how you deal with the customer stickiness.

So if it has to be taken forward, the credit cost would be the call of each and every institution. Very important that while the norms do allow the obligations to be calculated based on the installment amortized and the quantity of the loan, anybody pressing an accelerator of an unsecured loan to the existing customer purely on track record may increase the credit risk and consequently, the credit cost. So each one will determine the range at which they would like to do and hence, they pick the customer segment. That's our take.

Anil Tulsiram: Sure. And the second question is on the branches. So it's a 2-part question. So we are converting some of the liability branches in the composite branches. So what sort of assets we are introducing into these liability branches? And the second is we have more than 350 asset branches. So any plan to convert these asset branches or some of the asset branches into liability branches or use this network to raise the liabilities?

Baskar Ramachandran: Actually, we don't have any plans now of converting liability branches into asset branches as well. We may start sourcing affordable home loan and secured business loans, which is mortgages. But what we call as composite branches is broadly asset branches, which then become focused on liabilities as well. So there's a separate team focused on liabilities. So currently, we have around 26 branches, which are predominantly started as asset branches, also do sourcing of deposits. Intent is to increase 26 to 50 branches by end of this financial year.

Anil Tulsiram: Okay. So if I understood correctly, composite branches means asset branches, which are also being used for liability branches, right?

Baskar Ramachandran: Correct.

Moderator: We have a next question from the line of Renish from ICICI. Please go ahead.

Renish: Sir, a small clarification. See, on the portfolio, which originated post June '21 is having a collection efficiency of 98.2%, so this is one EMI adjusted or this is including arrears?

Kanishka Chaudhary: One EMI adjusted.

Baskar Ramachandran: One EMI adjusted. We broadly calculate our collection efficiency on one EMI adjusted and thereafter, look at the overall thing, which includes arrears. But what we're speaking now on post June '21 is one EMI.

Renish: Okay. And sir, on this 6% of the customer base, which is non-paying as of now. So sir, what is our writing-off policy? I mean is it at par with economics for unsecured loans or we have an aggressive writing off policy?

Baskar Ramachandran: We're little aggressive technical write-off policy, not a full write-off policy.

Kanishka Chaudhary: So what you see is essentially a technical write-off, which means that we are not waving our right to be able to reach out to the customers to recover the dues. And yes, I mean, we have had technical write-offs for the last 3 quarters or so. But at the same time, the recovery efforts in so far as these pool of customers are concerned, they continue.

Renish: Got it. No, so basically, I just wanted to get a sense like, the COVID visited write-off will actually come in FY'25, I mean, not now?

Kanishka Chaudhary: No. Actually, in our case, you would notice that the moratorium that had been provided by us was for a very short duration. And like we indicated a little while ago, our entire portfolio, which was provided moratorium has come out of the moratorium by June 2022. So currently, the entire portfolio is actually getting built and whatever restructured portfolio we had, which is around INR420 crore today. And that portfolio has also come out of the moratorium. So we don't have any part of the portfolio which is not getting built today.

Renish: So basically, I understand that the current collection efficiency is on a total portfolio basis, without any portfolio being under moratorium. But my question is the write-off, I mean, the 6% of pool which is non-paying as of now, this write-off will actually come in '25, I mean not '23-'24 because we have a technical write-off policy. I mean, is that right?

Kanishka Chaudhary: No. Because see, that's not entirely the case because, let's say, the portfolio that has come out of the moratorium now is something that can become worst-case scenario, NPA, let's somewhere between October to November were, right? So which means that the write-off will kick in only 12 months thereafter, so which is December '24 to Jan '25. Yes.

Renish: Yes, yes. So that's what, I mean, '25, right, I mean not, '23-'24?

Kanishka Chaudhary: Yes.

Moderator: We have our next question from the line of Nisha Shah from NM Securities. Please go ahead.

Nisha Shah: I had 2 questions. The first is how many branches are we targeting to open in the second half of this year? And any specific dates?

Baskar Ramachandran: We're kind of targeting to open around closed to 40 to 50 branches predominantly Inclusive Finance branches and probably around 5 to 6 would be deposit focused. So they'll be coming in mostly towards the Q4, which is more in terms of lining up for the business of FY'24.

Nisha Shah: Okay. And my second question was that we have commenced our disbursement in the 2-wheeler segment. So how is that business shaping up? And any quarterly target of disbursement for that?

Baskar Ramachandran: No. Nisha, at this point of time. So we are kind of now testing it out, making sure that we're end-to-end, the customer experience is good. So we are not chasing any numbers out there, not good in at all. It's to really understand the product at this point of time where we, again, are pretty confident in terms of the scale-up of the product is not sourcing the dealership point. But in terms of more to pre-approve our existing, very good customers is approximately around 10 lakhs and pre-approve them and deliver the products. So the initial one is more of a testing phase at this point of time, will continue to be so for the next 1 quarter.

Moderator: We have our next question from the line of Pulavarthi Saikiran from Pulavarthi Advisors. Please go ahead.

Saikiran Pulavarthi: Just one, just clarity. When you say INR425 crore of what I guess non-paying PAR 90 plus, is my calculation right that you're total AUM is INR5,378 crore? And in the presentation, you said that 90 plus PAR at 7.9%, hence, you arrive at INR425 crore, is that the right way to look at?

Baskar Ramachandran: Sai, what we are really looking at is, whether it is a non-NPA account or an NPA account, how much of the customers are non-paying? Usually in an Inclusive Finance segment as long as a customer pays, even if they are in 90 plus is that they're not getting over in 2 years' time, it will get over in 2.5 years' time. And very likely quite a few of them come back to even to be good customers all over again. So currently, we are running at around close to INR450 crore of portfolio, which also includes close to around INR100 crore of portfolio, which is not yet GNPA, not paying for 2 consecutive months. The current provisions that we hold today, including provisions against restructured loans against as of September, is INR320 crore. So the uncovered mathematically at this point of time as is approximately INR130 crore. So if all the non-paying customers there to continue to remain non-paying and has to be provided for the uncovered fees at this point of time in INR130 crore.

Saikiran Pulavarthi: Okay. No, I'm just wondering like with more efforts getting into the collections and also you have hired a lot of people getting in, how do you see this, what I can say, whether the current INR320 crore provisions will be sufficient or would you believe that some more provisions are needed going forward?

Baskar Ramachandran: As I said, currently, the uncovered piece of that between non-paying and what we have provided for is around approximately INR130 crore. So if things were to remain as is, that's the max that we'll have to kind of provide for, for the portfolio at this point of time. The good news is that the existing portfolio, I mean, the portfolio which is built post June '21 continues to be robust, but extremely important. But we'll have to be watchful of it out of our experience, and that's where we are really building in the Vikas loan, which is where we keep dealing with the customer one-on-one, kind of gives you a complete insight, not just of the customer household level. We believe that the challenge of the past has also given an opportunity to kind of graduate and go more deep rather than acquiring more and more customer and building up the entire base purely by looking at the past prepayment track record. So as we're speaking, left as it is non-paying will continue to be non-paying where we always have stated the gap has an uncovered and currently, we stand at INR130 crore.

Saikiran Pulavarthi: Got it, sir. So the priority for the organization, whether this will be remained unpaid or not, is it fair to assume that in the next 6 to 9 months, we will be able to understand as provide accordingly?

Baskar Ramachandran: In 6 months, yes. I think the 6 months is very good time to kind of get a clarity and as needed. We'll kind of, as I said that at around current even run rate of the PPoP around close to INR90 crore to INR100 crore. So you've doubled that it's around approximately INR200 crore. So we'll have to then provide for both from a substantial piece of that INR100 crore over the next 6 months, and that kind of cleans up all that's there at this point of time.

Saikiran Pulavarthi: Got it, sir. So one data-keeping question finally from my side. Is there any accumulated losses at this point of time for us to take advantage in terms of the tax rates?

Kanishka Chaudhary: So we had INR93 crore of loss on a financial year basis last year. That is something that we will be able to take advantage of at least for the next couple of years as we see it.

Saikiran Pulavarthi: So essentially, maybe the next year will be a full tax rate of 25%, is that fair assumption?

Kanishka Chaudhary: Yes. So we will be able to take benefit of the credit losses that have led to the loss in the last financial year.

Moderator: We have our next question from the line of Raj Gopal Ramanathan, an Individual Investor. Please go ahead.

Raj Gopal Ramanathan: Yes. A couple of housekeeping details. Total write-offs that the bank has the total amount of write-offs in the last 24 months. And what percentage of these write-offs do you expect to collect over the next, maybe, say, 2 to 3 years or so? That's the first question. The second one relates to your credit cost assumptions pre-COVID. Obviously, nobody had anticipated an event like COVID or any such sort of fatal events. So what were your pre-COVID credit cost assumptions on the entire book?

And going forward, because some of these assumptions keep getting revisited based on the learnings of it. Going forward, say, over the next 2, 3 years and as the portfolio builds out, what is going to be your credit cost assumption for the future. I'm not necessarily saying for FY'23-'24 as such, but let's say, if you were to budget it for this institution, assuming a steady state scenario, what would that be? What has been the loss given default experience that you would want to build in for the future? And there is one mention in the annual report where you've mentioned that you have a lending or you have tie-up with Lendingkart. So I just wanted to understand what is that tie-up? And is Lendingkart actually originating loans on your behalf, which are housed on your balance sheet? And what is the business rationale for Suryoday to have partner with them?

Baskar Ramachandran: Sure. I think if you look at historically, looks like as if we'll have to build the model of the past, which probably is looking very little different, substantially different now, as we start dealing with the customer with heavy data available and how you build stickiness around your customer. Early, the microfinance model was it in a particular locality geography, if there is a default starts, there's spillover impact was near 80% to 180% . So entire thing kind of breaks out. There's a social pressure as much not to repay as much as a social pressure to repay in good times.

So the credit loss we had to build that would be around closer to might be around 2.5% credit loss per year. But in Inclusive Finance, as you would always see in the microfinance segment, in sequential couple of years, even in 3 or 4 years, the credit cut can be as low as 0.2% to 0.3%, 30 bps and 50 bps, program for 2.5%. You'll have to continue to kind of do that on a year-on-year basis because what we see is, this extreme events take out 10% to 15% of the overall portfolio. If we technically can look like the contingency provisions can go to as high as 8% to 10% portfolio on a sequentially very good years. So if you had to build a shockproof model, I would personally think, not necessarily, probably, this is the view of the bank. Personally, I would think that it has to program for 2% to 2.5% and continuously build it, even if you're not having a credit loss for 3 or 4 consecutive years. And whenever the event ever were to happen, then you have built up an enough buffer to do it and then keep moving. However, that said, it cannot be built as 2.5% model and keep lending.

So earlier model was acquired more and more customer and reduce the risk by keeping the lending size. The first cycle it's 25,000, second cycle 30,000, then 50,000, 70,000. Now we'll have to really look at customer to customer, and we'll have to break out in terms of differentiating the customers clearly.

As far as the Lendingkart program is concerned, we have a very small portfolio at this point of time, which is INR35 crore. The rationale is that in all the products, we may not, for instance, if somebody wants to co-lend with us as of now, there is a little bit of an ambiguity in terms of regulatory allowance for SFBs to co-lend. If microfinance is what I can kind of have an expertise in and somebody wants to also be in the segment, it does not really kind of make any economic sense or a customer point of view. For all of us should lend INR30,000, INR35,000. It's good for some person who's strong to lend INR11 lakh and kind of distribute the risk to 2 more lenders and 3 more lenders.

Lendingkart is especially as one in terms of sourcing small ticket MSME loans ranging between INR5 lakhs to INR25 lakhs. So while it's not an automatic pass-through. We underwrite it finally. They kind of source the customer. They do a preliminary selection and give it to us. So the intent is to really learn that piece of the business. And if it works well, take the partnership even at a strategic level. Any partnership for that matter, is that, they were to use it only to kind of get to a segment without having a direct exposure into that segment. The learning curve can convert itself into a long-term partnership or you can kind of choose to get into the segment yourself at some point of time. But today, all the partnerships are being looked at where it is, a little more long term rather than kind of utilizing it only on a short-term basis.

Raj Gopal Ramanathan: Okay. The total write-offs over the last 2 years?

Kanishka Chaudhary: It's INR540 crore cumulative.

Raj Gopal Ramanathan: Cumulative. And what would you be realistically expecting to sort of collect over, say, the next or maybe during this period and maybe over the next 2, 3 years?

Baskar Ramachandran: 15% to 20%.

Raj Gopal Ramanathan: 15% to 20%. Okay. And steady-state Tier 1 levels. Obviously, you are at 35%, you keep growing the book at 25%. There is a fair amount of runway from a capital standpoint. But what is that level of Tier 1, which you would be budgeting for on a steady-state basis?

Baskar Ramachandran: We continue to be a 65% at the current portfolio mix. We always, as an MFI never wanted to leverage beyond 3x. Whenever we cross 3x, we raised capital. So pretty clear that it can't be a high-leverage business, if you are in the unsecured piece and specifically in the Inclusive Finance segment. So if you carve out that piece of 65% of the book, who think that around 25% to 30% should be the capital adequacy for that segment. And for the remaining 30%, it can be 15%. So net-net around 25% to 30%, 25%, I think, is what we'll be comfortable with at current mix. As a mix transforms itself to more secure, so probably a 20%-plus would be comfortable. I would still prefer a 25% over 20%.

Raj Gopal Ramanathan: Okay. And what would be your aspirational ROAs, around 2% as things normalize?

Baskar Ramachandran: Most of the ROA, are aspirational one is to be a growth steady 16% to 18% ROE.

Raj Gopal Ramanathan: Okay. Given that your leverage is going to be not more than, say, 4x, right, 3x to 4x you are essentially budgeting for something like a 4% ROA. Fair to say that?

Baskar Ramachandran: So if we put instead of 4x in terms of the Inclusive Finance segment and the remaining ones can be 7x to 8x, if it's a pure home loan mortgages, it can leverage itself into 7x. So net-net, at the current mix of 65 to 35 capital adequacy of around 25%. I think 5x the leverage is what we can really look at.

Raj Gopal Ramanathan: Yes. So in a way, you're talking about something like 250 basis points to 300 basis points of ROA?

Baskar Ramachandran: Perfect. Yes.

Moderator: We have our next question from the line of Anil Tulsiram from ContrarianValue Edge. Please go ahead.

Anil Tulsiram: Yes. Sir, RBI has removed the limit on the number of lenders, which can then to microfinance customers. But I think still, Suryoday chooses not to be third or fourth lenders for MFI customers. So what's the rationale for that?

Baskar Ramachandran: I mean I would have kind of explained it now. I think it depends, like for instance, you're based on all our kind of data, which we kind of intentionally kept looking at for the last 10 years. We have around 10 lakh customers who have clear credit discipline, kind of demonstrated behavior over a period of years, including substantially through COVID 1 and 2. So if we really look at customers on their own, actually don't want to deal with too many lenders and very, very curated borrowers. Usually take for 1 large loan from 1 MFI, and probably maximum 1 more. So anybody kind of who takes it from more and more institutions, too many loans, we generally kind of get into a behavior which may not really be desirable. So we generally continue to have a conservative cap. But however, where we want to deepen the relationship we would rather increase it to the products as well as in higher ticket loans as long as it's for clear demonstrated business purpose than the distributing purely in terms of open up the cap. So we're still comfortable with a maximum lender cap around 3 in the micro finance segment. So if you've taken a car loan and if you've taken a 2-wheeler loan, we don't really count it out.

Anil Tulsiram: Okay. So if my understanding right that, after the things stabilize, say, after a year or two. We will be comfortable becoming the single large lender to microfinance customer and our ticket size can increase up to 60,000, 70,000 also for at least a good customer?

Baskar Ramachandran: So even today, we do. We do lending up till INR1 lakh for very good customers. So the 77,000 customers broadly, we've give upwards of INR75,000 to INR1 lakh. Currently INR623 crore book as of September and with a collection of not only 99.8%, 95% of the customers make the payment though our bank account well before the due date. And of course, we kind of sweep the money only on the due date, which is 7th and 10th. So intent is to really, as the customers are graduating not to treat them exactly like a group loan customers of the past. So each one kind of you analyze, you kind of appraise them individually, and that can happen when you capture all of the data one time rather than kind of giving a loan without doing too much analysis, which is what we're using on Saarathi app which we introduce to get a holistic view. Very, very we'll be comfortable leaving with the customers for the loans that they require for a particular purpose rather than in same loan for everybody measured by the number of cycles we have been with you.

Anil Tulsiram: Yes. Helpful, sir. And you just mentioned Saarathi App Can you elaborate on that? What is that?

Baskar Ramachandran: It's an app, which now we've kind of moved to Finacle. Earlier we're in a platform called FIS, where there is a substantial dependence on the vendors, one of colleague questions, was also pertaining to why our fixed assets increase. Now we have kind of in-housed all of that. Initially went into the OpEx model for technology. So which it has been meant that our dependence on the vendor were substantially higher for rolling out anything. So after moving into kind of Finacle, we have introduced this app where we capture all the information about our customer at the household level as well as in terms of capture the photographs of the customer at the house as well as in terms of the business place. Many times, it could be attached to the household itself, house itself or it could be independent.

And finally, the underwriting is done at a centralized level here. based on the capability of the customer both by the financial data as well as by in terms of other demographic data. And this rests with us for good. So tomorrow even in the event of wanting to get in touch with the customer, we also take broad details like at least electricity bill, the proof of which, which is beyond just the voter ID, which we used to take earlier. So this app captures all of that and puts it. So along with the analytics, we combine it and then we can choose and calculate an imputed income of the household. And hence, can kind of work out loans, secured as well as unsecured based on their capability to repay in, measured by the number of cycles they have been with you. So that's an app we have kind of laid out in the last 2 months.

Anil Tulsiram: Yes. So sir, my last question is, can you elaborate on your fintech strategy in which areas over the next 2, 3 years, you want to tie up with the fintechs, on particular product asset side, liability side, collection or underwriting anything? The broader strategy for the fintech partnerships.

Baskar Ramachandran: The fintechs have used it, including for sourcing accounts through the partnership which we have with Fino Payment Bank, Airtel Payment Bank and with Paytm Payment Bank. With Fino they also got a regulatory approval to source fixed deposits for us, which will be rolled out in the month or 2. So we would look at that as a low-cost granular fixed deposit and deposit mobilization, specifically in terms of fixed deposits. We'll continue to kind of invest in that in terms of our resources. And when it's scaled, it scales without really kind of adding exponential costs for sourcing. And on the asset side, while we are working with a few partnerships, one is Lendingkart at this point of time. We used to have with Paytm, which are paused because our systems are getting aligned with the new digital guidelines.

We'll still look at the partnership, we'll look at 3 or 4 partnerships in terms of assets and look at equal numbers, including payment banks in terms of sourcing liability. Whenever that breakout happens the way in which liabilities will be sourced will become very, very different from the traditional model. But when that will happen is a question. So while we'll keep exploring that, we'll continue to focus on our usual traditional model through branches and through our regular digital channels. But that's something which a breakout can happen at some point of time.

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

Baskar Ramachandran: Thank you very much. Thank you for participating in the call. In case you have any further on, please reach out to us. And we'll be happy to kind of answer it. Thank you very much. Have a great day.

Moderator: Thank you. On behalf of InCred Equities, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.