



“AU Small Finance Bank's Q2’FY23 Earnings Conference Call”

October 19, 2022



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Moderator: Ladies and gentlemen, good day, and welcome to AU Small Finance Bank Q2 FY'23 Earnings Conference Call.

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

I now hand the conference over to Mr. Aseem Pant from IR Team. Thank you, and over to you, Sir!

Aseem Pant: Good day to everyone and welcome to AU Bank’s Earnings Call for the 2nd Quarter of FY'23. We thank you all for joining the call and we hope you are well.

As usual, for approximately the first 30 minutes of the call, we will have brief remarks by few members of our senior management, followed by 30 to 45 minutes of Q&A. Firstly, we will have our MD and CEO – Mr. Sanjay Agarwal, share his thoughts on the performance and overall outlook for the bank. He will be followed by our ED – Mr. Uttam Tibrewal, who will share his thoughts on the Assets and Liabilities performance. And finally, we will have Mr. Gaurav Jain - Head of Tech Initiatives and Distribution Strategy, who will talk about our progress in Digital Initiatives. Besides them, we will also have few other members of our senior management to answer any questions you might have.

For the benefit of everyone, we would humbly request that the number of questions per participant be restricted to two and to join back in queue or mail us in case you have any further questions.

We would also like to take this opportunity to announce that our third AU Insights session is scheduled for the 3rd of November and will be held virtually. We will share further details in due course and we look forward to your participation.

With that I will request our MD and CEO, Mr. Sanjay Agarwal to share his thoughts on the bank's performance and outlook.

Sanjay Agarwal: Good evening, everyone. Namaskar. Thank you for joining in. Hope you are doing well. To begin with, I just want to wish everyone a very ‘Happy Diwali’ and a very happy festive season.

This quarter makes us 22 quarters old in our journey of banking and I am amazed to see the progress that we are making as a team. In these five and a half years, we have been extending our foundation for building a scalable and sustainable bank. And we are on course of course.

We have managed to grow the bank to a net worth of more than Rs. 10,000 crores and both asset and deposits have crossed the critical milestone of Rs. 50,000 crore by serving 30 lakh plus customers.

I would like to express myself that each passing quarter increases our confidence that we are on the right path, going the right way, with the right purpose, right strategy and right attitude. I am very excited about the road ahead of us, as a banking system we will see tremendous opportunities in the coming decade as India prepares to become \$5 trillion economy.

In terms of macro, global economic activity has been slowing down due to the adverse impact of geopolitical tensions, tightening global financial conditions, persistently high inflation and sharper than expected monetary tightening by Central Banks globally.

Consequently, India too is facing intensified pressures due to the global interest rate trends, weakening global demand and high volatility in portfolio flows. Despite these headwinds, India has emerged as a bright spot with GDP expected to grow 7% this fiscal. I am very hopeful about a decade ahead as India stands to benefit immensely from the tailwinds of reforms implemented over the recent years, favourable demographics, ongoing digital revolution and realignment of global supply chains.

Based on the recent data banking system credit growth looks healthy at 16.4% year-on-year, and we continue to see growth in digital transaction too. Notably asset uncertainty over rates and liquidity has risen significantly in recent months, while inflation still remains above the comfort zone of policymakers.

Coming to the AU, the last quarter was amongst the best quarter as a bank, where we got most of the things right. We have launched 27 touch points in this quarter. We grew our deposits by 49% year-on-year. Our CASA ratio reached 42% and CASA plus retail deposits mixed reach 73%. Our cost of money was 5.78% for six-month period. I would like to congratulate the team for doing such a wonderful job of raising the deposits during the quarter without any increase in our deposit rates.

The credit market also saw good pickup with festive season coming a bit early this year.

The asset business saw disbursement of ~Rs. 9,200 crores, growing 68% year-on-year and disbursement yield continues to see improvement.

Similarly, the collection efficiency and asset quality continue to hold with average collection efficiency at 108% for the quarter, and gross NPA coming at 1.9% and net NPA at 0.56%.

Our asset quality which is one of our core strengths has remained resilient across cycles. And we are committed to maintaining pristine asset quality. The pandemic days reinforced our faith in our customer segments and we are convinced that we are serving the right customer segment. In fact, the asset quality of post-pandemic book is even better. 77% of our book was originated post-pandemic where gross NPA is around 0.55%. Meanwhile, our balance sheets size grew by 46% year-on-year. Net worth grew by 49% year-on-year and our capital adequacy is around 23.4%.

In August, we raised capital of Rs. 2,500 crore with Rs. 2000 crore for Tier-1 and Rs. 500 crore of Tier-2 bonds. QIP was launched amid challenging market conditions and I am overwhelmed by the support that we received from all the participants. I would like to convey my heartfelt gratitude to everyone who supported us. Thank you so much. This has enabled us further strengthen our balance sheet and allow us to continue investing for the future.

Notably this quarter also we got the upgrade from the third-rating agency. So, now we are AA stable for all three, CRISIL, India Rating and Care. Thank you so much.

Our margin for the quarter expanded at 6.2% from 5.9% quarter-to-quarter. Profit rose by 23%, to Rs. 343 crores with ROA of 1.8% and ROE at 15.3% despite a higher capital base in Quarter 2. This makes our business model very sustainable.

We have always been a customer centric bank build on first principle of simplifying banking with a strong focus on delivering customer delight. I am happy to say that we have added over 3.4 lakh customer (the AU family) in the last quarter. Our bank campaign 'Badlaav Humse Hai' is furthering our reach. More on quarter highlights will be covered by Uttam.

Further our tech led business, to further our customer convenience, I am very happy that way our credit card, video-banking, UPI QR and AU digital team are shaping up to stitch together our tech priorities. We continue to invest in our tech led businesses. Simultaneously we are keeping a close eye on the tech infra to run the bank where cybersecurity is important priority too. Gaurav will cover this in further detail.

In our sustainable journey of building the bank, robust governance mechanism has been the backbone of our growth since the beginning. I would like to say that the reappointment of Verma Sir, our Chairman, has been recommended by the Board and has been sent to RBI for approval.

Two of our veteran board members Mr. Rathi Sir and Ms. Narang Madam are due for retirement in March 2023 after a long fruitful and very impactful inning at AU, for which we are deeply grateful. The Board will be joined by more Independent Directors in times to come.

We have built a strong leadership team at various levels and continue to invest in them, while attrition remains a challenge. But SBU structure has further followed us to attract talent and facilitate our leaders with ample space to express themselves and build cohesive and motivated team which also helps in succession planning. We are increasingly becoming an 'Employer of Choice' and continue to do more every quarter on our employee engagement proposition.

The journey of last five plus years have cultured us towards pursuing holistic growth and development. We are working on every aspect which makes us more purposeful from focusing on ESG to embracing diversity, from furthering financial inclusion to building a Digital First bank, which I think is a great equalizer for all us.

Furthermore, the way we have grown in last five and a half years has given us hope that we are able to manage the current uncertain environment and navigate through the unknowns. I would also like to share you our key learning from last 22 quarter as a bank. First of all, we strongly believe that this platform is a public good which we deeply respect and are building carefully. We are imbibing the key principles of banking of Samajdari, Zimmedari and Imandari in every rights. We are not working with a quarter-to-quarter mentality, instead focusing on the long term horizon which is required to build a bank of substance and predictability.

Governance is first, always first. We have put in place robust mechanism to manage our risks which makes us more sustainable and trustworthy. More importantly, we are ready for short term pains for long term gains. And we try not to heed to short term noises for long term voice.

And the way forward in my opinion, the journey of AU for next five years would be more exciting as we not only implement the learning from these early years but also benefit from newer growth opportunities.

We are giving impetus on scaling the Current Account channel and focusing on SMF (Small and Marginal Farmers lending). To cater the growing demand of wealth products in the coming times we are building our wealth management verticals. We have also decided to add ICICI Lombard as our newest bank assurance partners, I welcome them.

The way the regulatory landscape has evolved in last six months around digital and cryptocurrency will only be benefiting the banking industry. Recently, the regulator also has allowed SFB to apply for AD-1 License and government agency business, and we are evaluating both as it will be a significant boost to our platform.

In the near term, we navigate this uncertain environment, we will remain focus on executing our strategy, leveraging our strengths of understanding the borrower's cash flow, and assessing their business resilience amid challenging landscape. The current environment is not as severe as a pandemic, but we are keeping a close eye on the evolving situation, we and will calibrate our approach according to growing in a sustainable manner.

Specifically, we will be prioritizing, optimizing our cost of funds, consolidating our deposit franchise, preserving risk-adjusted yields and continue towards our growth trajectory in a sustainable way. Overall, I can assure you that as in the past in everything we do at the bank, the endeavor is to build a highly sustainable and credible bank which is predictable, consistent.

In cricket analogy terms, which is near to my heart, we have managed to bat well in the initial over despite some initial swing and seam movements and we are now in the middle over where the team needs to consolidate the innings to play long and to build a sizable score.

And in the end I am very thankful to all stakeholders, government, our regulators, our board, our customers, our investors, the analyst community, my team and all the unsung heroes for supporting and believing in us.

Thank you so much. I hand over to Uttam for the operational highlights. Thank you so much, pleasure.

Uttam Tibrewal:

Thank you Sanjay. Namaskar, and good evening, everyone. We are amidst the festivities, and I hope that the auspiciousness of this period rubs off on all of us. I wish you and your loved ones a very Happy Diwali and Prosperous New Year.

Over the last 5.5 years as AU Small Finance Bank, we have charted our course carefully. I am happy to share that in Q2'FY23 we continue to deliver consistent business growth while keeping our margins intact. As Sanjay said, the focus is to implement the learnings of our years as a bank. To maintain our credit filters and quality of book, focus on granular customer acquisition, customer engagement, cross sale and CASA growth. We continue to be optimistic about opportunities and align our strengths for keeping our market position intact.

To start with, I would like to cover some key operational highlights for the quarter. In line with building a diversified presence, the bank has made deeper inroads with 27 new touch points added this quarter, out of which 15 are liability branches, eight of them being in our emerging markets in UP, South and East India. With a view to bolster customer acquisition in urban markets, 13 out of 15 liability branches are located in metro cities like Chennai, Bengaluru, Hyderabad, Kolkata, etc.

Maintaining our pace from the first quarter we have expanded our deposit book by 7% in this quarter and increased our CASA ratio from 39% to 42% on a quarter-on-quarter basis. Similarly, our CASA plus retail TD mix now contributes 73% of total deposits. CASA deposits have grown 109% year-on-year, and 16% quarter-on-quarter against a repo rate increase of 190 bps our incremental costs of funds increased by ~70 basis points during H1'FY23, and our overall cost reduced by 17 bps during the same period.

After avoiding raising rates for entire of last quarter, with effect from 10th October '22, we have increased the FD rates by up to 60 basis points for retail deposits, taking our peak rate to 7.5% for regular customers and 8% for senior citizens. With this hike, the bank is offering one of the most competitive FD interest rates, thereby providing an opportunity to customers, particularly senior citizens to get inflation beating returns from their fixed deposits.

We have been focusing on improving the product mix and cross-sell to our customers with an aim to increase average balances. Our product per customer has reached 1.63 for saving accounts customers and 1.97 for current accounts customers excluding dormant and BSBD accounts.

Our cross-sell efforts include disbursing 10,000 plus life and insurance policies, adding 8600 plus three-in-one trading accounts, and adding 12,000 plus Mutual Fund, SIPs during Q2'FY23. Additionally, during the quarter we disbursed Rs. 728 crores via cross-selling of asset products to our Branch Banking customers, a growth of 64% quarter-on-quarter.

Another key aspect of our Branch Banking strategy is sourcing of quality customers, and in the last quarter, 66% of all savings account sourced by branch team, excluding salary accounts were from premium category of Royal and Platinum accounts up from 59% in Q1.

We have just launched our newest product for our current account customers called Platinum Business Account. This is a premium product with industry leading features designed to provide a lot of flexibility to our small business customers, with plug-and-play features around Cash, QR Codes, Digital Solutions and Pricing. This will provide added momentum to our current account journey, where 37% of our CA customers already hold high value variant of our current accounts.

Our Digital Initiatives, AU 0101 App, Video Banking, Credit Cards and UPI QR have played an important part in improving customer experience and engagement. On saving accounts, our transacting customers have increased to 56% with an average of 28 transactions in a month. Further, approx 72% of the current account customers were active on Internet and Mobile Banking in Q2. This reflects the shifting preference of customers for primary banking with AU.

Another engagement tool, AU Shopping Dhamaka is now in its fourth edition and is currently live, with very attractive offers, across platforms for this festive season, helping us engage more with our customers.

Moving to our Asset SBUs let me start by updating you on our wheels business. As an industry, vehicle sales in Q2'FY23 has grown by 16% year-on-year with more segment displaying major growth particularly the passenger and commercial vehicle segments. Our average ticket size is around five lakhs on disbursements, and Rs. 2.6 lakhs at portfolio level excluding two-wheelers.

This quarter, we disbursed Rs. 3,542 crores with an IRR of 14.29% which was an increase of 35 bps sequentially. This also illustrates the ability and strength of our business model to transition price volatility.

I am pleased to share that as of 30th September 2022, the wheels portfolio hit a milestone of Rs. 20,000 crores through 7.81 lakh live loans, comprising of 53% new vehicles, 35% used and refinanced, 10% tractors, and 2% two-wheelers. Out of this Rs. 16,000 crore is contributed by the new book generated post April 2020, which continues to display robust asset quality at GNPA of 0.65% in line with our expectations. Overall collection efficiency for wheel business was 107% for the quarter. This also led to improvement in GNPA to 2.24% from 2.30% sequentially and from 4.31% a year ago.

Moving on to Secured Business Loans, as on 30th September 2022 our SBL portfolio stands at Rs. 17,471 crores with weighted IRR of 15%, growing 22% year-on-year. We have 1.74 lakh unique customers with a GNPA of 2.8% as on 30th September. This quarter, we added 12,000 plus customers with 76% new to bank with an average ticket size of 11.2 lakhs. For a total disbursement of Rs. 1,459 crores, which has increased 49% year-on-year and 14% quarter-on-quarter. Collection efficiency for SBL business continues to be robust at 112%.

Moving on to the older but newest kid on the block, our Home Loans SBUs. Currently operates out of our eight major states and our total HL portfolio was Rs. 3,365 crores as on 30th September 2022, a growth of 12% quarter-on-quarter. Our disbursement in Q2'FY23 was Rs. 498 crores, comprising of approx. 34,000 loans with an average ticket size of around 11 lakhs. Our GNPA on this portfolio continues to be stable at 0.44%.

Notably, being an Affordable Housing book, much of our book is also eligible for long-term refinance from NHB. Geographically we are seeing greater demand from both urban and semi-urban / rural areas which remain strong with the onset of the festive season.

Commercial Banking is a franchise business, which we started on the banking platform and our two main product lines under this our Business Banking and Agri Banking. On Business Banking, the portfolio has reached Rs. 3,837 crores as on 30th September, a growth of 18% quarter-on-quarter with disbursement of Rs. 938 crores during the quarter. Further the portfolio is 98.5% current, and GNPA was reduced to 0.17% on September 30th 2022, from 0.34% as on 30th September 2021.

Agri Banking business has reached Rs. 3,000 crore portfolio mark, and is growing with stable asset quality. This quarter we saw an incremental disbursement of Rs. 486 crores due to several conducive factors including growing our footprints in newer geographies, newer product initiatives like Financing to FPOs, which is Farmer Producer Organizations, have started contributing to the small and marginal farmer book of the bank.

Summing up, we are in the rising interest rate where inflation is proving to be more resilient than initially estimated. We shall continue to monitor our competitiveness and calibrate deposit rates accordingly, with focus remain on garnering low-cost CASA and retail deposits.

The festive season historically accounted for good business in second half of any financial year, and we are witnessing increased demand across most of the business segments this year as well. We continue to focus on growing our asset business sustainably with yield optimization and keeping our credit filters intact.

While we are bullish on India, we are conscious to not get carried away by return of the credit demand post that two years of pandemic. Till we ascertain if it is a pent-up or a sustainable demand, we will continue to focus on our strengths and reinforce processes -- to prepare for the next promising period of India, yet being watchful of the demand situation. As always, we

remain highly engaged with customers on ground to gauge demand and dynamically calibrate and optimize ourselves. I remain confident that our business model and execution capabilities, optimistic about the opportunities and potential and yet watchful.

I look forward to sharing more with you in the coming quarters. I now invite Gaurav to share his thoughts on our different initiatives. Thank you and take good care. Thank you.

Gaurav Jain:

Thank you, Uttam. Good evening, everyone. I will now provide an update on our tech initiatives including Credit Card and UPI QR. Tech remains an the area of key focus for the bank and we continue to execute on our tech strategy with the objective of growing our deposit franchise, developing unsecured lending capability and building out our digital distribution.

We soft launched AU 0101 in June '21 and did a full commercial launch in August '21, in the middle of the pandemic, since then, our digital capabilities and key metrics have progressed significantly.

I will take a moment to talk about three key highlights around Digital Adoption, Acquisition and Engagement:

I) On Digital Adoption - Our Digital Adoption is 3x of June '21 levels with 14 lakh digital customers of which 8 lakhs are monthly active. 98% transactions and 90% of service requests are being executed digitally.

II) On Digital Acquisition - Customer acquisition through digital products has increased significantly accounting for 42% of total customer acquisition in Q2 versus 0% in June '21. Since the launch, we have opened over two lakh accounts using video banking, issued over three lakh credit cards, disbursed over Rs. 500 crore of digital personal loans, and installed over eight lakh UPI QR.

Digital Acquisition is also helping us lower our cost of acquisition, for example, digital savings accounts were acquired at 50% lower cost of acquisition compared to our branch channels. These digital savings accounts accounted for 38% of total savings accounts acquisition in Q2.

III) On Digital Engagement - Our digital proposition has also increased customer engagement meaningfully. We have extended pre-approved offers to over 1.5 million customers since June '21 off which over two lakh customers took up the offer. Monthly transacting customers, as a proportion of total savings account customer, has increased from 47% to 56%. An average monthly transactions per transacting customer has increased from 17% to 28%, an increase of 65%.

I will now give a brief overview of our three digital units:

1) Video banking - Video banking as a distribution and service channel, continues to improve with the aim of making 0101 plus video banking a complete replacement of a branch. In

Q2, video banking team opened over 50,000 savings accounts, received around 80,000 servicing and engagement calls and increased total relationship value of digitally sourced savings account customers to Rs. 870 crore, an increase of 21% quarter-on-quarter.

Average relationship value of a digital Savings Account customer stands at over Rs. 40,000. Combination of video banking and 0101 is also driving reduction in branch visits, which propensity of digital Saving Account customers to visit branches being one-third as compared with customers acquired through branches.

ii) Moving over to Credit Card, we issued over 90,000 credit cards in Q2 and crossed Rs. 500 crore of monthly spend in September. Our credit card proposition is helping us attract new to bank customers with 47% of total cards reissued to new customers. We continue to innovate with new product launches, let India's first customizable credit card which was launched last quarter, continues to be very well received in the market and is now our highest selling card variant. Our key Credit Card metrics are in line or better than industry average, with 86% of our customers having activated their cards, and 53% customers being 30-day purchase active.

Now a brief update on our Merchant Solutions business, during the quarter we installed 1.5 lakh UPI QR taking our installed base to 8.1 lakh. With over 1.5 lakh daily transactions, UPI QR continues to help us drive engagement and deepening of our Merchant customers. 85% of transactions by value were credited to link AU CASA accounts. This has helped increase average monthly balances by 83% post UPI QR installed. We are also cautiously building out our digital unsecured lending program for merchant. Total unsecured loan disbursement to merchants amounted to Rs. 86 crore.

In addition to customer facing Digital Initiatives, which I just spoke about, we are also investing in a number of areas around digitization, core technology stack and cybersecurity. Some of these key projects include upgrade of our core banking platform, which we expect to go live in the next few months, implementation of data platform which would unify all of banks data in one place, and enable development of next level of analytics capability in the bank.

Implementation of a new loan origination system for wheels business on the Salesforce platform, this would better equip our wheels team for faster onboarding of customers. And finally, our Cloud Migration project, which would be an ongoing initiative for next couple of years and include both migration of selected existing applications to Cloud as well as onboarding new applications on Cloud.

To conclude, Q2 was another quarter of solid execution, and we continue to progress in our digital journey. With this, I will now hand over to Aseem for Q&A.

Aseem Pant:

Thanks Gaurav. Faizaan we can start the Q& A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Renish from ICICI. Please go ahead.

Renish: Just a couple of questions, one is on the disbursement number so which has been segmented around Rs. 8,000 crore from last couple of quarters. And when we look at the sequential growth in the wheels and the SBL portfolio, which is almost 70% plus of our portfolio is around 2% growth. So, what is happening on the disbursement side, I mean, why it has been stagnant, and particularly within the segments why wheels and SBL is still sort of showing the muted growth?

Sanjay Agarwal: We don't think that our business disbursement are stagnant, because we have one yearly plan in place and by that numbers we are growing every quarter. And of course, wheels and SBL, both businesses have some size, and we have grown so much well in last five years. So, we just want to take the risk management and the whole controls and all those things to really see that we don't build wrong book in a good time.

So, I think we are absolutely on track because we have lot many books to offer. We do wheels, we do SBL, we do home loans, we do commercial banking, credit cards. So, we need to figure out and that's why we started all those different product so that we have a very balanced growth. So, I think we are absolutely in course of the yearly numbers. I would say that generally in first six months, we do around 40% to 45% of business. So, in that sense, I would say you will see lot much growth happening in next six months, in comparison. So, that's the sense I really want to build where every product want to contribute in the journey of growth.

Renish: And secondly, on the Business Banking and Agri SME, this book has been growing at a pretty faster clip from last six, seven quarters. So, if you can just throw some light in terms of let's say the tenure and the kind of customer segments where we operate, because when we look at the yield on the business banking, it is around 10%, 10.5%. So, I would say it is one notch below then what leading participant banks are tapping. So, maybe if you can just throw some light on the customer segment and the latest maybe the collection trend or any data point which you can highlight?

Vivek Tripathi: So, both Business Banking, Agri Banking, both are primarily working capital books, and the average ticket size for both vertical ranges from Rs. 80 lakhs to Rs. 1 crore kind of a thing. So, it has more component fund based and non-fund based. It's a pretty normal working capital business where most of the facilities are renewable at the one year, it has a smaller component of CAPEX loans which typically are brownfield sort of expansion or some equipment or machinery purchase kind of a thing. But broadly, it's a business where, we also get a lot of cross-sell opportunities with the same customer base, has good amount of deposit from the same customers. And as far as the yield is concerned, we have to look at from the spread perspective because these are low Opex business as well.

And just want to add on like you know these are not one notch below the other private sector bank customers because lot much formalization has happened after GST in last five years, and

here also we are using our distribution because we are more dominating in the core which is the semi-urban rural area where also we have seen lot much formalization happen, people didn't have any kind of leverage on their balance sheet, but in last five years, their business has come everything on a formal side, they require cash credit and all those things, and we are able to price the risk, and we are able to actually price our positioning as a franchise. So, I would say that again, I won't say that it's a below level of any private sector bank because our net NPA in Business Banking book is around 0.16 right at a rate of 10%. So, very comfortable in this kind of positioning and I strongly believe that India in MSME and SME in next decade will do wonders.

Renish: Is there any geographical let's say concentration, maybe a Business Banking, Agri SME, Rajasthan outside Rajasthan, if you can give some data point around that?

Vivek Tripathi: See typically our asset business are distributed between Rajasthan, MP, Delhi NCR, Punjab, Haryana, Gujarat and Maharashtra. So, that is where it is spread out. As new geographies are very new and wherever the branch banking because this business would be a branch centric so, wherever the branch banking franchises would progress, these business would follow the suit.

Prince Tiwari: So, Renish, two data points, on the first question you have to also understand, we also securitized about Rs. 700 odd crores during the quarter from the wheels business. So, that will also impact the gross advances, and as far as what Mr. Vivek ji said that you know the entire Business Banking, Agri Banking, geographically it would be very similar to the overall book.

Moderator: Thank you. The next question is from the line of Ratik Gupta from Guardian Asset Management. Please go ahead.

Ratik Gupta: So, we have reductions during the period of approximately Rs. 234 crores, so I just wanted to understand how much will be the write-offs or the recoveries from this, if you have the breakup?

Prince Tiwari: This data has been given on Slide #26; we have done a Rs. 23 crore write-off.

Ratik Gupta: And I wanted to understand, if we have a deposit rate being fixed, and with the increase in repo rate, we still don't see cost of funding or that increased level. So, I just wanted to understand a picture of it, so, how is the incremental cost of funds going down and the repo rate has been increasing?

Prince Tiwari: No, so incremental cost of funds hasn't gone down, incremental cost of funds have gone up ~70 basis points.

Ratik Gupta: Cost of Fund

Prince Tiwari: See total cost of funds, there is a base effect, there is an AUM and the overall cost has been coming down for us, if you look at for last two years. So, prior to pandemic, we were at about 7.5%, last full year the cost of funds were about ~5.9%. So, an incremental cost of fund if you

see we started the year at about 5.3. So, to that extent, it has just been an mathematical adjustment.

Yogesh jain: So, lot of old money is still there, because of that my cost is coming down, but if you will see when we started our year, we started from around 5.65, which is now 5.8. So, in six months our overall cost had increased, but it is still since we have low cost old money in system. So, that is why my overall cost is still 17 basis points below than what it was in last year.

Moderator: Thank you. The next question is from the line of Prabal from Ambit Capital. Please go ahead.

Prabal: My question is on the SA deposits, so very strong growth sequentially and year-on-year. But if we see the monthly growth in the balance sheet as well that is also very strong. So, just want to understand what is driving this increase in the balance sheets per customer or we are also able to see mobilization of more customer base.

Rishi Dhariwal: See, we continue to acquire customers in our Royal and Platinum offering products, which is what is finding good traction with customers. The second is that we have increased our branches in urban markets by almost 130 branches over the last two years, which is similar to reach out to customers in newer geographies and the expanded distribution, adds to our ability to source more and more Savings Account.

The third is that the savings customer and the deposit customer are, two very, I mean they are two different groups of people, there are different groups of people who typically keep money in savings. The customers who typically book deposits are the ones who are senior citizens and people who want to save money for slightly longer term. So, we have been able to sort of ramp up our savings accounts acquisition and that is showing the growth in savings.

Prabal: Okay. and what was the cost of SA deposits, if you have the number?

Prince Tiwari: So, 5.5%.

Prabal: The question was that we have seen reduction in employee whereas the employee cost have gone above 15% Q on Q. So, what can explain that?

Prince Tiwari: Obviously, employee cost is more a function of, there is annual appraisals and those things happen predominantly for us, it happens in Q2. So, that would be part of the reason, but nothing extraordinary there. Of course, in terms of overall capacity addition point of view, we had some excess capacity during the COVID days. So, because of that, we have obviously been looking at focusing a lot on productivity and rationalizing some of those manpower, looking at the overall environment, and then inflation has always played a role, right, because the appraisals typically would follow in this quarter and given the inflation that's happening, given the entire talent crunch that's happening across, you would see a natural cost increase. So, that's what it is, nothing else to read into it.

- Vimal Jain:** In addition to that, actually, you are comparing the cutoff date numbers, whereas total cost paid for the employees is (for) around 700 more than average of the last quarter. So, that is why this cost has increased. So, closing numbers, is reduction of 1200 number, but in average its 700 more than last quarter.
- Prabal:** So, is it fair to say that Rs. 450 crore number is not sustainable and can improve quarter-on-quarter from here onwards?
- Prince Tiwari:** No, what we are saying is that ultimately see the employee wage bill would typically follow the inflation cycle and where the entire employee base is going to grow. What Vimalji just mentioned that the reduction in the employee base has happened towards the quarter end number that you are seeing. If this sustains going forward, then obviously you will see some amount of impact. But in case depending on the business requirement and how the overall environment shapes up, if we decide to further increase our hiring, then obviously that will also have an impact. So, we will have to see how we go along.
- Prabal:** And on the other OPEX so any targets on cost to income because now that is almost 4.5% to average assets so I understand....
- Prince Tiwari:** Prabal, if I understood your question, cost to assets is typically something that we don't track. We track cost to income ratios, which we have already talked about in the presentation, and also given a guidance and touched upon in MD's speech. It's definitely outside of our comfort zone and we are working on it, and you would see there has been a reduction quarter-on-quarter. And we will continue to do our best to bring it down to our guidance range of about 62% odd.
- Prabal:** And this 62% odd would be because of improvement in income and not because of the reduction in the cost of the investment --?
- Prince Tiwari:** No, both actually because in the 1st Quarter also, if you see there was an impact on the income right.
- Moderator:** Thank you. The next question is from the line of Anusha Raheja from Dalal & Broacha. Please go ahead.
- Anusha Raheja:** Yes, I am saying over the next two to three years, when you feel that operating leverage will kick in, and you will have material reduction in the cost to income ratios?
- Sanjay Agarwal:** So, again, you know that there were so many unknowns in the last two to three years, right due to pandemic and now also you are seeing a lot more uncertainty around the future growth, but we as a bank need to always capitalize ourselves to really sustain. So, if you ask me that, whether we will have an operating leverage in two to three years, I will say let's give us another three to five years, because in that timeframe we will have a sizable business in place, there will be more loans in place, and I think I would say not 2 to 3 years but maybe in three to five years, you will see operating leverage helping us to build a better ROA.

- Anusha Raheja:** I mean, definitely you are in an investment phase currently and that's positive, but any number to put up over the next three years? What internal number that you are looking at, or any ballpark number to put there?
- Sanjay Agarwal:** So, give us some more time, because it's difficult to predict, as of now, because of this, continued inflation. We are into investment phase, our credit card business, we do banking business, the whole tech business is coming up to a size and shape. So, I think it's difficult to predict to be very honest. But we are not out of the course, we are not running a very high cost around it. If you take our investment cost say around 55% to 56%. So, I would say that, next three to five years we will have some kind of operating leverage there. But it's difficult to put a number around it as of now.
- Moderator:** Thank you. The next question is from the line of Dhaval from DSP Mutual Fund. Please go ahead.
- Dhaval:** I just had one question relating to the PSLC income. In general, like for the first half we have seen a very low number. So, could you just comment, what is driving this run rate. And if you can give some perspective --?
- Yogesh Jain:** So, PSLC is just I think market factor, and every quarter we see how market is behaving, what are the rates, premium available. So, if you will see 2nd Quarter premiums were very muted, micro and general were happening on 2 paisa to 1 paisa. So, we decided that -- and we will see next quarter. So, we have PSLC portfolio available. But since rates were not there, we will figure out in next quarter. But as we mentioned in our presentation, that we securitized some of our portfolio to get some rate advantage. So, we will balance between PSLC and securitization going forward also.
- Dhaval:** And the second half should be significantly better than the first half in terms of PSLC?
- Yogesh Jain:** There is no such benchmark because earlier 2nd Quarter was better, last year. So, there is no benchmark, we will see each quarter and then accordingly, we will figure out.
- Moderator:** Thank you. The next question is from line of Darpin Shah from Haitong India. Please go ahead.
- Darpin Shah:** So, my question is towards growth, now while you are talking about uncertain times and preserving our yields and consolidating deposit franchise, should one assume that even the loan growth from here on will moderate or will still continue the way we have seen AU in the previous years?
- Sanjay Agarwal:** No, so I would say that, that's why we call it uncertain time, because we are not able to predict and there are certain headwinds like inflation, interest rates, liquidity, right. And you know that our asset growth is driven by the deposit growth, we can't grow asset on it's own right. And deposit is pricey now. So, we don't want to raise money at any cost and want to lend it at any kind of rate. So, we really want to protect our NIMs and our ROE and ROA. So, that is why we

are saying that we want to really see that how the growth happens, it has to be profitable, it has to have some kind of numbers around it. As I told you that generally we do 40% to 45% of business in 1st Quarter, that makes a very healthy growth rate in this year itself. So, there is a demand but we just don't want to rush ourselves. Because I strongly believe of my experience of 25 to 26 years that bad books are built in good times. So, we don't want to do anything like that. And so there is growth, but we don't want to say that, we really want to grow out of that right. So, that's our positioning. But we are growing well and we believe in that, that any sustainable, reasonable growth can be manageable and sustainable.

Darpin Shah: Just one last data keeping question, how much was the slippages from the restructured book during the quarter.

Aseem Pant: That was Rs. 58 crores.

Moderator: Thank you. The next question is from the line of Nilanjan Karfa from Nomura. Please go ahead.

Nilanjan Karfa: Just two sets of questions. I mean, it just seems to me being a little more cautious, quite a few times, we heard building bad book during good times, which is a fair comment. But therefore, just trying to get a context of what kind of growth are you actually looking at for this year and maybe in the next year as well?

Sanjay Agarwal: So, I am just repeating back, generally we do 40% to 45% of business in H1, and that makes us around 12% or 13% growth itself, we are already delivered. So, if you mathematically calculated, it will be around 27% to 28% kind of growth this year. And my point is not that that we don't want to grow in that aspect anything around 27% to 28% even 30% is good enough. But the idea is to really grow at some kind of strategy, because we can't raise money at any cost and we just don't want to lend at lower rates. So, we really want to protect our NIMs, our ROA and that is why we are saying that there is enough demand available, but demand has to be profitable for us. And in past we have done that, even in my NBFC days, there was a good time, but we never ever gone to the market demand. I always try to build our own strategy and work upon those lines.

So, my, my sense is that we are on right course, we have a very long term vision to build this bank. We need to see the cycles, the team need to understand, team need to hold on and see through every up and downs of the bank journey to really become a more long term franchise, which makes you very sustainable and predictable.

Nilanjan Karfa: If I can just kind of expand the question, I mean, is there something in the environment that you are a little worried about?

Sanjay Agarwal: In my opinion, inflation remains like this, and there is an elevated interest rate and then it will eat up your wallet so how the people will pay the EMI. If suddenly, the crude goes up to \$120 to \$130 per barrels, then what we should do because we are running a vehicle book, we are

running a SBL book. So, we need to be cognizant of the fact that how inflation remains for next six months. The policymakers are doing their best, but the demand is like this. And what I want to say is just that while you grow, let's grow sustainably. So, when you have a lot, much demand, you can pick and choose. So, we are doing that and in that, we really want to calibrate ourselves, let's price rates, let's understand customer more, let's see that even on a high inflation, high interest rate cycle, whether it's okay to pay EMI. So, I think that kind of understanding we are building internally.

Nilanjan Karfa: The second question is, I don't know if you will be able to share, in the 4th Quarter we did that the OPEX movement between '21 and '22, split out between three or four different components, possible to get it in the first half how this has moved?

Prince Tiwari: We have given the data, I mean not in so many words, but the number is definitely there, it's on Slide #15 around Rs. 125 crores of the incremental expenses has been towards investments and the breakup is there on that slide.

Aseem Pant: That's for Q2 and similarly you can find for Q1 in Q1 presentation.

Moderator: Thank you. The next question is from the line of Sarthak an Individual Investor. Please go ahead.

Sarthak: My question is to Sanjay sir. So, can you give me approximate expense towards the fund raised and what ROA would have been barring this exceptional item?

Sanjay Agarwal: Oh, specific data right you want –

Prince Tiwari: So, we have already disclosed that. No, so the exact number is already disclosed in the placement document that is as per requirements of SEBI. So, broadly it was around 1% if I remember correctly, just a tad above 1%.

Sarthak: Around Rs. 20 crores you mean to say.

Management: Yes, Rs. 23 crores, if I remember correctly.

Sarthak: And my question is to Sanjay sir, so I being a retail investor, it's very difficult for me to calculate each and every moving item in P&L. So, I just want to get a sense that what our sustainable ROA would be for like two to three years, and then once operating leverage kicks in, after three to five years, just give a sense, a number, a range?

Sanjay Agarwal: So, I would say that, you have to see our last five year working that gives you enough guidance, because we always remain north of 1.7 to 1.8 of ROA, (RoE) north of 15%, initially, our journey of last five years. So, Sarthak to be very honest there are so much moving items like how the interest rates will play out, we invest in so much of digital capabilities, like pandemic happened. And there are lot much unknowns which happen to us in next five years favourably. So, if you ask me specifically, it's difficult for me to comment, but the last five years, number, data should



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give you confidence that this franchise is very sustainable, because we have figured out, the asset franchise, way to lend, at what rate we want to lend, what our NPAs can be, because what not we have seen in last five years. So, our asset franchise is very solid and very strong. Our deposit franchise in last three years has completely gone through a complete change, from a wholesale franchise to retail franchise. So, that is also enabling us to manage costs in spite of this inflated rate. And then again, our digital properties are coming up. So, I think all put together and I strongly believe that anything what we have achieved in last five years should be there on table. But anything can happen better from here.

Sarthak: So, maybe once operating leverage kicks in, 2% plus ROA is also possible, 2 to 2.2 or 2.3 something like that?

Sanjay Agarwal: Difficult to comment for me, but let's hope for the best.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Aseem Pant for closing comments.

Aseem Pant: Thank you everyone, for joining us and for your support. On behalf of the entire AU team, we wish you a Happy and Healthy Diwali. Please reach out to the IR team for any further questions.

Moderator: Thank you. Ladies and gentlemen, on behalf of AU Small Finance Bank, that concludes this conference call. Thank you for joining us, and you may now disconnect your lines.