



“AU Small Finance Bank Limited
Q3’FY24 Earnings Conference Call”

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Moderator:

Ladies and gentlemen, thank you for holding for the AU Small Finance Bank's earnings conference call. We would like to provide you with a few instructions. To ask a question, you may enter star and one on your phone. An operator will check your connection before announcing your turn. All participants are requested to use only handsets while asking a question. Please ensure that there is no background noise while addressing your questions to the management.

You may be asked to return to the question queue if you do not have a clear connection. Thank you. The conference will begin shortly. Please continue to hold.

Ladies and gentlemen, good day, and welcome to the AU Small Finance Bank Q3 FY '24 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 opening remarks is concluded. Should you need assistance during this conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Prince. Thank you, and over to you, sir.

Prince Tiwari:

Thank you, Sagar. And good evening, everyone, and a warm welcome to AU Small Finance Bank's Earnings Call for the Third Quarter of FY '24.

We thank you all for joining the call on a eve of the Republic Day. And the format for today's call will be similar to last few quarters, where we will start with the opening remarks from the senior management of the bank for the first 20-25 minutes of the call. And we'll then follow that with 30 to 35 minutes of question-and-answer session from all the participating analysts and investors.

To start the call, we'll have our Founder, MD and CEO, Mr. Sanjay Agarwal, share his thoughts on third quarter FY '24 overall performance of the bank. He'll followed by our Executive Director, Mr. Uttam Tibrewal, who will also share his thoughts on the business highlights for the quarter. And besides them, we also have some senior members of the management on the call today to answer any questions that you may have.

For the benefit of everyone, and so that we can all have a active participation, I'll request everyone to kindly restrict the number of questions per participant to 2 and join back in the queue in case you have additional questions.

With that, I'll now request our Founder, MD and CEO, Mr. Sanjay Agarwal, to start today's call by sharing his thoughts on the bank's performance and his strategic outlook for the bank.

Sanjay Agarwal:

Thank you, Prince. Good evening, and namaskar to everyone. I'm pleased to speak with you on the eve of 75th anniversary of our National Republic Day, and I want to express my sincere gratitude to all of you for your presence today. Before I share my thoughts on the bank performance and strategic outlook, I would like to take the opportunity to thank each one of you for your unwavering support and confidence in our bank, which motivates us to continue every day, as you know, building up a truly retail bank is so difficult.

I'm sure by now, all of you have heard everything about the global macro economy on multiple calls. So I will not go much into the details. However, I will share my perspective on the whole India euphoria and the opportunity that it presents and then why I think this era belongs to India. Our honourable Prime Minister's vision of "India @ 2047" by when we complete 100 years of independence and aspire to be Viksit Bharat, is truly inspiring for an entrepreneur like myself and the opportunity and scope for execution it provides to an institution like AU. I'm really excited about this period of growth and it coincides with our own philosophy of building AU forever.

The first phase of our forever journey, that is AU @ 2027 is the foundational period of first 10 years of our banking journey. Post that I strongly believe that AU will be a significant contributor and beneficiary of this India story. Coming back to India story, there are lot many trends that are available. But in my opinion, 5 significant trends, which we are witnessing in the Indian economy and the social environment has the potential to have a fundamental impact on our journey.

First, the recent structural and regulatory changes and growing adherence to the rule of the law will have long-lasting impact on the overall governance and transparency in this country. Second, as the world becomes more digital, the tech acumen and knowledge that we possess as Indians has the potential to change the Indian dramatically in the next 25 years. Third, the entire MSME space will create their own niche, and we are already seeing some initial trends of how the formalization of MSME is helping entrepreneurship.

Fourth, the capital market is poised for long-term growth and with a wider participation. Financial projects are new high but can innovate a lot more on the back of penetration. Fifth and most importantly, India is a vibrant democracy and the way we are handling ourselves and resettling our issues one at a time is commendable, bringing harmony and acceptance at all levels.

As India redefines itself and becomes more purposeful and gets characterised for its democracy, knowledge, execution, and consumerism, I'm very confident that AU will be one of the institutions that will play a lead role in this journey. The first 7 years of banking journey has remained absolutely on track and completely seamless, guided by strong regulatory framework, which we followed in letter and spirit.

During these foundational years, we have built a safe and sound bank, delivered good results consistently, built robust senior management team and have protected interest of every stakeholder, be it regulator, customer, employee, shareholder, or society at large. Our focus has been steadfast on every parameter needed to build a sustainable and complete bank.

Be it deposit franchise, retail and commercial banking, digital banking, transaction banking, payment infrastructure, tech architecture, leadership development, compliance and governance, asset quality, customer focus, cybersecurity or even ESG. Every aspect has been covered. With operationalization of the recently received AD1 category license and on completion of the proposed merger with Fincare, the bank will be in a position to offer all products to all category of customers, be it domestic or cross-border or be it bottom of the pyramid customer or ultra HNI.

Against this backdrop, I would like to share my reflection on our performance in the third quarter and certain operating highlights of the bank. Our Q3 results remain in line with the anticipated outcomes, driven by the persistent dedication of our team. This quarter makes a significant milestone for our bank with our balance sheets crossing INR1 lakh crores. Our deposit registered a 31% year-on-year growth crossing INR80,000 crores mark.

We have also used securitization on a strategic tool to diversify our source of funds and use our capital efficiency. Gross of securitization, our loan book has also crossed the milestone of INR75,000 crores mark. As you would have recollected, about 6-7 quarters back, we had pivoted our entire strategy to be a deposit-led assets franchise, something industry has started talking about now. We have been good enough in reading the evolving landscape and started by addressing sustenance of the business model, making it more acceptable to our stakeholders.

Over the last 24 months, we have worked on every aspect that the industry is currently debating, be it reducing the CD ratio, calibrating our asset growth to follow deposits, shedding wholesale deposits, avoiding going aggressive on unsecured loans, not partnering with fintech's solely for origination, settling strong governance standards or focusing on farmer financing and financial inclusion. The current quarter saw our deposit book grow by 6% compared to Q2 and CASA deposits increased by 3% quarter-on-quarter. More importantly, our saving account balance grew by 8%, whereas our retail term deposits grew by 5% during last quarter.

Our CASA ratio is at 33%. CASA plus retail term deposit is at 64% of our total deposits. A consistent effort is being directed towards reinforcing CASA and retail term deposits, notably through enhancement in our product offerings, services, and brand, steering away from the sole dependence on interest rates. But let me also admit that our current account franchise built out has not been to that extent we would have liked, partly because limitation of the platform, partly because of excessive competition in that zone.

But now we are working hard to relook at our strategy around the same and expect that operationalization of AD1 and transition banking will support our CA strategy. Elevated interest rate continues to be a market variable, driven by tight liquidity and the regulatory requirement of controlling inflation. This is impacting the overall industry and thus, cost of deposits remains a challenge.

It has led to a 78-basis point increase in cost of funds in the first 9 months and 20 basis points in the current quarter. At the same time, we operate a high-yield customer segment and thus, there are limitation to increasing the disbursement yield without compromising on the asset quality.

We have still managed to improve our disbursement yield by 38 basis points on YTD basis and continue looking for more such opportunities.

This has resulted in our margin contraction by 6 basis points with an overall net interest margin at 5.5% for the quarter and 5.6% for the last 9 months of this year. As observed in past cycles, the presence of fixed retail book and market segment will be advantageous when interest rates undergo reversal. Our loan portfolio demonstrated robust growth, increasing by 6% on a quarter-to-quarter basis. This growth was sustained by surplus liquidity buffers and notable demand for credit. Our emphasis on asset is centered on prioritizing yield and adherence to our underwriting filters. Uttam will provide more insight on this.

Gross NPA increased by 7 bps, quarter-to-quarter reached 1.98%. This marginal GNPA increase in the quarter can be attributed to low base effect as we have securitized approx. INR2,700 crores of loan assets in this quarter. On the overall portfolio, gross of securitization, our GNPA increased marginally by 3 bps to 1.83% from 1.80% in the previous quarter.

Slippages during the quarter was around INR403 crores against INR350 crores in Q2'FY24. Credit costs net of the recovery for the quarter normalized to 62 bps with an 18-bps contribution coming from credit card book. As a credit card book attains a size and get seasoned, the credit cost for the same is also getting normalized and coming in line with the industry average.

Overall, asset quality remains within our range as we are not seeing any signs of stress buildup or any specific pockets of warning signals. However, some traditional impact was seen during the quarter in enforcement of collaterals with state elections immediately following the festive season in 2 of our biggest markets, Rajasthan, and MP. This led to a lower resolution and recoveries during the quarter.

Cost-to-income ratio is within our guided range. Our focus on investment to build a full stack bank like credit card, digital initiatives, AD-I license and transition banking, wealth management, brand build-out and upgrading our tech capabilities will remain our key priority and we'll keep investing in them. Merger of Fincare with us is on track, and I'm delighted to inform you that post securing the shareholder approval, we also have now received CCI approval earlier this week. We now await one final approval from RBI. This merger will provide us with a wider distribution and higher-margin products, an opportunity to diversify assets, customer base and geographic presence.

In terms of future outlook, we are focusing on our tech and innovation. We are continuously enhancing our tech ecosystem and digital properties. Migrating our tech to cloud, expanding our data centers, building our data warehouse, and developing analytical workbench remain some key projects that are being progressed. I also believe that our focus on tech is also giving us desired results and creating our own space in this competitive zone. Our pace of customer acquisition has got a significant boost due to our digital product with the possibility to acquire more than a million customers next year.

Our next focus area in the tech segment is AI, which we are excited about and which I think is critical for our next phase of growth. HR and people practice remain key focus area for me

personally as I feel banking is the people's business. I am fortunate that entire senior team has a common vision and it's quite stitched and aligned to the overall purpose. In these 7 years, we put our best foot forward and already working on many initiatives to nurture our talent with partners like Korn Ferry and Aon with a keen focus on their learning, training, motivation, retention, career path, succession planning and other such areas. We are working to build a pool of talent to take forward our forever journey and create a human capital for the bank for generations.

We have focused a lot on efficiency and productivity of people and reorganized the business groups under five businesses with leadership aligned at every level. Similar nature of businesses were brought under one umbrella to align them with a single objective and avoid any transition gap. All this, along with the various automation projects has resulted in a significant productivity lift for our on-ground sales, credit, and opportunity.

This has resulted in a relatively stable manpower over the last 8 quarters despite the business growing at ~25% CAGR on both advances and deposits. In the end, I can assure you that we are committed to build one of the most trusted and finest banking institution in this country. We aspire to be a full-service bank for our customers and need to manage multiple stakeholders. Sometimes that has its own cost, but it brings sustainability to the franchise. And while we are building for the future, we are also delivering consistent results, while also continue to lead by example, as the largest SFB.

Our various investment avenues will start yielding profitably from FY'26 and will help us unlock operating leverage. Our size and scale will give us an advantage beyond 2027, and we are strategically preparing ourselves for that phase.

In closing, I stand before you today, not only as a CEO, but as a custodian of your trust. I assure you that we'll continue to push the boundaries of what is possible to create sustainable value and to deliver on our promises. Our path may be challenging, but I'm confident that with your unwavering support we will triumph.

Thank you once again for joining us. Over to Uttam for the further operational highlights. Thank you so much.

Uttam Tibrewal:

Thank you, Sanjay. Namaskar, and good evening, everyone. Wish you an abundance of health and happiness, and my wishes for the 75th Republic Day of our great nation. I will now share an update on the operating highlights of our key businesses for the third quarter of FY23-24. India story has remained strong despite global headwinds, and Indian economy continues to grow with all leading indicators being in the positive range.

During the third quarter, the festive season provided momentum to consumption and the overall demand remained robust across segments. However, tight liquidity and global risk, including geopolitics continue to pose threats to trade flows and commodity prices and warrant caution. We continue to remain watchful and agile as we move forward.

Let me start with an update first on our digital banking business. As a tech-led bank, our core focus is to identify digitally native customers, offer them differentiated products and engage them using state-of-the-art digital application and service platform, providing them convenience

and branch-like experience digitally, thus providing them value along with their entire life cycle with us.

The collective deposit balance of the video banking portfolio now exceeds INR1,500 crores with over 4.5 lakh customers. Our digital savings acquisition saw an uptick of 30% quarter-on-quarter. Additionally, we had introduced digital current account offerings in the previous quarter, and I'm pleased to report that we have scaled to over 3,500 accounts in this quarter. We have also now added corporate salary accounts to the video banking platform in this quarter.

With the help of our all-inclusive video banking solutions available 24/7, we are now serving over 1,000 customers every day with 400-plus services. I'm also happy to inform that we have crossed 26 lakh registered users on our super app AU0101, registering an 11% quarter-on-quarter increase with monthly active users growing by 8% to over 14 lakhs.

Moving to Merchant Acquiring Business. We have added 2,200 point of sale and witnessed activation rate of 50% in this quarter. As the overall transaction value grew 17% quarter-on-quarter to INR575 crores, average ticket size also grew by 15% and contributed to INR37 lakhs transactions in Q3.

Updating on our credit card business. During the quarter, we launched our first-ever co-branded card with a leading travel partner Ixigo, allowing us access to more than 15 crores users, largely based in their Tier 2 and Tier 3 locations. Overall, our credit card business at 8.3 lakh cards has not only helped in doing cross-sell to our existing customers, but has also become a robust channel for customer acquisition for the bank.

This festival season, we continued with our annual shopping bonanza under the brand of Heart-to-cart, which was live across all platforms including Amazon Great India Festival with total spend of over INR2,200 crores.

Now moving on to our liability franchise. Overall deposits crossed INR80,000 crores in this quarter, with 6% quarter-on-quarter growth. We continue to focus on building a retail and granular deposit franchise through high-quality customer acquisition. During Q3, our banking programs, AU IVY, AU Royale, AU Platinum made up 44% of our total customers. Similarly, the share of higher variant current account was 35% of total acquisition in Q3 FY '24. Our PPC currently stands at 1.7 and 2 for savings and current accounts, respectively. With 58% savings and 68% current account customers being transacting with us on a monthly basis, indicating a healthy customer engagement.

Our drive towards customer acquisition and engagement were complemented by the second season of Badlaav Humse Hai campaign with Kiara Advani as brand ambassador. Our latest campaign, Soch badlo aur bank bhi, reached 10 crores people through TV, print, radio, cinema, and digital media. As per Kantar BrandZ tracks our way, the campaign achieved 80% recall among our targeted audience and importantly, a 50% lift in brand consideration.

Our green deposit program Planet First, launched in Q2, has received strong initial support from customers, raising INR200 crores deposits till now. We are deploying this money in green

projects like solar power, electric mobility solutions, etc making a humble beginning in contributing to India's net zero mission.

Last quarter, we created Swadesh Banking Group to strengthen our banking services in India's Bharat. By unifying rural branches, BO/BC, financial and digital inclusion and small and marginal farmer lending under one umbrella. This leads to greater collaboration and innovation to design products and services tailored to the unique needs of this niche segment. In this quarter, we launched three differentiated products for this segment, namely Swadesh saving accounts, Swadesh current accounts and Kisan savings accounts.

Let me touch upon our cross-sell initiatives. Cross-sell of assets to branch banking customers was INR890 crores during Q3 as against INR598 crores in Q2, showing a growth of 49% on a sequential basis. In insurance, our total distribution increased by 23% sequentially with total business growing from INR158 crores in Q2 to INR194 crores during Q3. In our wealth business, our recently added referral offerings like PMS strategies and differentiated AIFs allow us to offer a complete basket of products and helps us to serve our high-net-worth customers better.

During Q3, our investment AUM has reached to INR521 crores, across 1.6 lakh customers, registering an AUM growth of 50% quarter-on-quarter. Moving on to our asset franchise. We maintained sustained disbursements across our retail product segments, which are lease, micro business loans and housing loans. Our total gross loan portfolio, including securitization has crossed INR76,000 crores, and our flagship products, Wheels and MBL have crossed a significant milestone of INR 27,000 crores and INR 20,900 crores, respectively.

Let's start with our Wheels business. This quarter, the vehicle industry sold 70 lakh units, showing 10% growth year-on-year and 29% growth quarter-on-quarter. Strong quarterly growth was visible in the 2-wheeler and the passenger vehicle segment with 37% and 10% growth respectively. In Wheels business, this quarter, we have disbursed around ~INR4,500 crores against ~INR3,600 crores in Q2'FY'24, registering a 23% growth quarter-on-quarter at an IRR of 14.6%.

Our average ticket size remained around INR5.3 lakhs (ex. two-wheeler) on disbursements. As on December 31, 2023, the total loan portfolio of Wheels stood at INR27,000 crores. With the increase in seasoning of book, GNPA's maintained at 2.6%. Further, all disbursements were auto loans and 2-wheelers were made through Wheels 1 app, a digitized process based on salesforce platform and FICO BRE.

Moving on to our micro business loans, as on 31st December'23, our loan portfolio stands at INR20,900 crores with a portfolio of IRR 14.80% and the GNPA of 3.1%. During Q3, we disbursed ~INR1,600 crores and a total of ~INR4,400 crores in 9-month period between April to December, with an average ticket size of 12.6 lakhs.

Now let's look at our housing finance business. Loan portfolio of our home loan business at the end of Q3 reached to ~INR5,400 crores with quarter-on-quarter growth of 8%. The average ticket size on this book is 12 lakhs at an yield of 11.6%. And gross NPA of 0.6%. Our total

disbursements in Q3 stands at INR579 crores, with YTD disbursements of INR1,700 crores. Shifting to our commercial banking.

The commercial banking portfolio grew by 47% on a year-on-year basis to reach INR16,386 crores as against INR11,179 crores as on Q3'FY23. Commercial Banking did fund-based disbursements volume of ~INR3,000 crores in Q3'FY24, of which business banking and Agri banking accounted for 61% of business, GNPA for Commercial Banking stands at 0.4%.

Business Banking active limit stands at INR13,500 crores, and the gross advances are INR6,800 crores, showing year-on-year growth of 56% and sequential growth of 11%. Business Banking recorded a disbursement of ~INR1,000 crores in Q3 and GNPA stands at 0.5%.

The Agri banking business has now reached ~INR5,200 crores with GNPA of 0.3%. This quarter, we saw a fund-based disbursement of INR783 crores with a growth of 23% quarter-on-quarter. Under our FPO financing program, we have now supported funding needs of more than 1.5 lakh farmers via 406 FPOs, including 130 new FPOs added during this quarter. Additionally, in the current quarter, we have financed 17 new renewable energy products to farmers under the Pradhan Mantri Kustum Yojana, taking the total renewable energy financing for agriculture to INR177 crores as on December 31st.

Summing up, the liquidity deficiency and competition among banks has pushed deposit rates further up. We continue to closely monitor the competitive landscape and execute our strategy of building a retail granular sustainable deposit franchise. We will continue to consolidate and enhance our inclusive banking efforts and auger digital inclusion. We believe that the unique positioning of the bank to identify white spaces across geographies and customer segments and execute on those opportunities will – help us continue to grow sustainably.

Furthermore, concentrated efforts are being made to enhance the share of wallet through cross-selling of current accounts, saving accounts, QR, personal loans and credit cards to new-to-bank customers and existing-to-bank customers, fostering stickiness. We will continue to exercise a strong level of prudence as we plan for the coming quarters with uncertainty around interest rates and inflation.

The outline strategic initiatives collectively position us for sustained growth and amplified market presence. I'm eager to share many more positive updates with you in the coming quarters.

Till then, stay safe, stay healthy. Thank you. Over to you, Prince, to take it forward.

Prince Tiwari:

Thank you, Uttam sir and thank you Sanjayji. Sagar, we can now open the floor for questions.

Moderator:

Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Bhavesh Ratilal Kanani from ASK Investment Managers. Please go ahead.

Bhavesh Kanani:

Thank you for taking my question. This one is on the disclosures on the 31st slide provisioning summary. Basis the disclosure of net credit cost and excluding credit card credit cost, those numbers essentially imply that probably our credit card business annualized credit cost is around

6.5%. I wanted to verify that. And if that is the case, where do we see it stabilizing? Is 6%-6.5% a level which is comfortable to us? And any directional outlook you want to give.

Prince Tiwari:

So Bhavesh, before Mayank can answer the details around that. First the number is confirmed, you're absolutely right that broadly the credit cost on the credit card book in this quarter is in the range that you mentioned. You will appreciate that the book is getting built out, and it's very early days and credit card is known to be a high credit cost business, but a highly profitable business as well.

Now while we have started seeing the credit cost as the book is getting some sort of a maturity in size, you just understand that it's just less than three years since we have started operations. The profitability have also, in some ways, started showing up, but of course, we are not yet at a level where we can say that the ROE of the book is more than the credit cost. But Mayank, you want to add anything in terms of the future outlook?

Mayank Markanday:

Good evening, Bhavesh. Adding to what Prince said, yes, the credit cost is around this percentage only, which you mentioned. But since we are in the third year only, and we could see the trends coming across. So trends are more or less stating that they are getting stabilized and on the reducing. So we will remain under this trajectory only. And this is what nearing to the industry average also.

So this is on the credit cost. And future aspect is we are building our term book, and we are confident that we will build that to some certain more extent in the coming year. So that will also support us. And in the fourth year, we'll be able to give more guidance on the profitability piece.

Bhavesh Kanani:

Wonderful. Thanks, Mayank, for that. The second one was on the industry level scenario on the term deposit and liquidity as well as deposit mobilization in general. If Sanjay sir could share his thoughts on these aspects.

Sanjay Agarwal:

Yes. So thank you, Bhavesh. So I think I commented in my narrative that this is a very tough environment. Liquidity is a challenge. But overall, we have performed very well. We have done INR80,000 crores of deposit last quarter. Our CASA is around 33%. Our retail plus CASA is around 64%. Cost, of course, it's not actually, in our hand because market is too competitive. Every bank is looking to build their own deposit franchise.

So there is a war on the rate, right? But we have managed it through raising CASA, retail deposits, wholesale deposits, also have done securitization. Overall, we remain in absolute control of things, barring the cost of money. And it's not easy to build INR80,000 crores of deposits on an SFB platform, but team has done phenomenally well in last seven years to be at this stage. We have built lot many hooks like you're talking about credit card. Credit card in the last two years has given us tremendous visibility, a tremendous recall value, tremendous brand build-up, right?

So I think we are doing around wealth, we are doing around credit card, we are doing around our whole payment systems, app. So overall, the purpose of entire bank is to build that deposit, right? And so we are really focused to build a deposit franchise, first, and then, of course, an

asset-led around it. And then we have done it. I'm saying this from last maybe now good two years that we want to be a deposit-led asset franchise.

And you would have seen our CD ratio, which is now touching even below 85%, which is one of the best in the industry. So of course, I'm very happy the way we are building up of course, another three years more where we want to be known as retail bank of this country. So absolutely on course for that.

Bhavesh Kanani: Just one clarification. When we talk about intensity of competition, do you see risk of price hike in term deposits in the industry?

Sanjay Agarwal: You're already seeing that, right? You're already seeing that. You should have read or would have attended every call. So every CEO is looking to build more deposit-led strategy now. So I won't say that I would be surprised that if there would be a hike in rates from here onwards in terms of competitiveness around bank only. But your bank is in very, I would say safe zone because our CD ratio is 83%, and our CASA is around 33%. We are not there on the market for every deal now, right? So we know what to take, what not to take. And Yogesh do you want to add something? Okay.

Yogesh jain: So Bhavesh liquidity side, also, we are pretty comfortable. We have LCR of 128% as on December. Additionally, we have very high-quality non-SLR liquid book, which is also available in the range of INR4,000 crores to INR5,000 crores. So in liquidity also as a bank we have that opportunity where we can leave some of high-cost deposits actually.

Sanjay Agarwal: Yes. So just to add on here, Bhavesh, because we have a lot many hooks now. We are not operating only on the interest rate or better interest rate in terms of offering. We have a lot many other things to offer also. So I'm seeing that bank is getting a lot much traction now. We are getting more deals. We are getting more, I would say, customer attention also, right? So in that sense, we are getting more deals so that we can choose that, which one to take, which one not to take, right? So overall, of course, the rate is very competitive, market is very competitive, but we are sailing through.

Bhavesh Kanani: Wonderful, sir. All the best.

Sanjay Agarwal: Thank you, Bhavesh.

Moderator: Thank you. The next question is from the line of Renish Hareshbhai Bhuva from ICICI Securities. Please go ahead.

Renish Bhuva: Hi, sir. Sir, just two questions from my side. One, on the credit cost side. So now since given we are scaling some of the new products like credit cards, which sort of impacted the overall credit cost in this quarter, and maybe post-merger, we have MFI book as well. So historically, we have seen that we've been able to sail through all the credit cycle with, let's say, average 80 to 90 basis point of credit cost. But now given we are entering new products with MFI coming in, what should be the normalized credit cost for AU going ahead?

Sanjay Agarwal:

Yes. So Renish, good question. So because you would be seeing that there is an extra provision in this quarter, but I just want to tell everybody that ex credit card, our credit cost is around 55 basis points around about, which I believe is a normalized for the secured book. Already, as Mayank commented that 6%-7% credit cost on the credit card is there. So we won't -- we would like to say that it's a normalized kind of credit cost on credit cards.

Barring these two products, if you want to say to me about the micro finance, we already commented that we want to really even out that whole provision by providing at least 3% credit cost every year. This year's credit cost on micro finance book is very low. But as soon as we get that book merged with us, we really want to provide the even out kind of credit card, which is roughly more or less 3%. So I think we would give you a better guidance by next April once we get entire thing in place.

But I would say that you should assume that the normal AU book should give you this kind of credit cost, which is 0.5-0.6 range, and maybe 6%-7% range of credit cost on credit card, and of course, 3% on micro finance book. So I won't say that we are surprising it. Because we were coming out from the COVID time, we had a very good time for a good two years post-COVID. So now things are evening out. So I think we should believe in this kind of credit cost as we move forward.

Prince Tiwari:

Renish, just one point on the credit card for benefit of everyone, while we earlier also mentioned about 6%-6.5% and going in line of the industry. I think another thing we need to also keep in mind is the industry also sees a decent amount of recovery on the written-off book because credit card typically has a very stringent writing-off policy. Like we provide 100% on 120 DPD and write it off on 180 DPD, right? However, the book is still building up. So while we have started writing off from previous quarter in decent numbers, it's still not built up to a stage where we can start seeing recovery in a meaningful manner.

As Bhavesh bhai also asked earlier, as we move to a more normalized setup, probably in a couple of years from now, while there will be a 6%-7% kind of credit cost, which is there as per the industry, there will also be recovery, which will start coming up and probably the net credit cost would also follow what is there in the industry. Just to put that point.

Renish Bhuvra:

Got it. So just to get a sense, let's say, going ahead, even our focus is the way we want to build the deposit franchise. Credit card, of course, will be one of the key products in overall scheme of things. So naturally, let's say, that focus will continue on credit card, and with MFI coming in to meet the overall PSL requirement, we have to also grow the MFI book as well.

So going ahead, your secured plus credit card plus MFI will be a new normal book for us. So from that perspective, should we, let's say, assume 1% plus credit cost for the entire AU business or how internally you would like to look at it?

Sanjay Agarwal:

No. So Renish, as we already commented that our micro finance book wouldn't be more than 10% of our overall loan asset. We don't want to build more unsecured book. It will be another maybe 10% kind of range where we are looking for. So I won't say that because of this initiative, there would be an extra provision because these are also the high-yield assets. Once Micro

finance book coming in, they will -- they have a NIM of around 10%. So that will take care of extra provisioning, right? Credit card once it gets stabilized, it will have more positive impact on us.

So I don't think that it's right to see one within one eye that the credit cost just will go up. The revenue will also go up, right? I'm just saying you that on a secured book also, my entire credit cost is around 0.3 (corrected net credit cost is around 0.3%), but we provisioned around 75% of our NPA, right? So that makes us 0.5%, 0.6%, right? Otherwise, the entire credit cost is very less. (the real credit cost) because it's a provision which hits you, right?

So I would say that we have already guided you on our whole philosophy around how we want to provision it. By April, we'll be more clearer how we really want to build ourselves for next three years around the unsecured piece, credit card piece or maybe around micro finance piece. Then we'll be able to tell you that what type of credit cost you should take in your calculation?

Renish Bhuva: Got it, sir. This is very helpful.

Sanjay Agarwal: As of now, I would say that it's 0.5% and 0.6% is as per what we've thought through, right?

Renish Bhuva: Got it. Sir, just one clarification on the other interest income part. So when I look at the total securitized quantum for Q2 and Q3, it is broadly similar at around INR2,500 crores plus. But when we look at the income portion, this quarter's income is significantly higher, INR180-odd crores versus INR75-crores-odd. So what am I missing here? Is there some NIM expansion significantly on the securitized book or how is it?

Vimal Jain: So as mentioned on Slide number 19, our overall securitization book has been increasing, and we have securitized around INR5,700 crores in the last two quarters. The income on securitization book was getting recognized with a lag of M plus one basis as per the underlying legal structure of the SPV. However, the interest expenses was getting booked in the same quarter. So now we have followed the matching principle to recognize both interest expenses and interest income in the same quarter to remove any lag impact.

Renish Bhuva: We'll sustain at around INR2,500 crores. So then this INR180 crores odd other income will also sustain, right? I mean is that the right assumption?

Prince Tiwari: So depending on how exactly the securitization book builds out, and it is going to build out as it's part of a funding and diversifying strategy. So you can assume that depending on how we go ahead in future quarters because it's not only about securitization in that month, the previous book is also building up, right? So now our securitization book is about INR8,500 crores, so there is a larger income recognition that's coming in through that.

Renish Bhuva: Got it, got it. Okay. Thank you and best of luck sir.

Prince Tiwari: Thanks Renish. Thank you.

Moderator: Thank you. The next question is from the line of Kunal Shah from Citi Group. Please go ahead.

Kunal Shah: Yes. So the first question is on...

Moderator: Sorry to interrupt, Mr. Shah may we request you to use the handset mode because your voice has a bit of an echo.

Kunal Shah: Yes. So I was just saying with respect to your entire strategy of deposit led loan growth. So now almost the deposit growth is 31%, but still we are growing at 20%-21%. And if we look at it right from March till December, in fact, the incremental CD ratio is 80-odd-percent. In fact, this quarter, the incremental CD ratio was hardly 50-odd-percent. So when do we see maybe like we are comfortable and now maybe we should resort out to a lesser amount of securitization because deposit growth has been quite strong, yes.

Sanjay Agarwal: Kunal very important question, but very early days. We have worked strongly on our deposit franchise. And that is why I'm emphasizing again and again on a 10-year story of AU because these are the foundation years. You never know how customers react, how market react, how the competition reacts. So our objective is to be really more deeper, more retail, more closer to customer in every sense. We want to make AU as one of their preferred banks, right?

And that is why we are doing everything irrespective. Honestly, we don't see much on our cost side because that is needed in this year, right. It's not easy to build a retail franchise in this country, right? So I would say that there is a narrative from the other stakeholders also. The whole regulatory framework also, where we need to calibrate our growth also, right?

So based on that, we have to balance ourselves. But we don't want to compromise on our deposit growth. We just want to do it based on the whole –situation we keep track on the cost, but I think as of now, the kind of competition we are seeing, the kind of India story is being unfolding in the next maybe 5, 10 years, and we really want to play a very important role in that. So that is why we are too focused on our deposit franchise in every aspect. So of course, the CD ratios and all those things are the outcomes, right?

But at the general trend, general operating time, we don't see this way that our CD ratio is too good, let's not raise the deposit side or let's do more asset side because we are a concurrent kind of organization where people come and just deposit the money with you, and we have to accept it, right? So I think it's a very good sign that we are having this kind of ratio which you just described. And that is the whole secret, right, that is the whole success, right, in my opinion, where we've been preferred by customers as now their banker, right.

So Kunal, I think a little bit here and there, but I think we are absolutely on track, and we are managing it. Of course, we will not securitize just for the need of securitization. It's other factor also which works to manage that securitization. And so that's the whole story.

Kunal Shah: Yes. Yes, so not very completely on the deposit side. Absolutely, it's a great growth. The only thing that does it now provide a cushion in terms of securitizing relatively low compared to what we had seen over the past two, three quarters given that we are at 20% loan growth. Would we start following that...

Sanjay Agarwal: I think Kunal, I just want to interrupt here, by the March end, you will see this growth in the range of 26%, 27% because there was some base effect because of December '22, but you will see our growth on assets on book will be around 26%, 27% by the end of this March.

Kunal Shah:

Okay. Perfect. And secondly, maybe the overall yields are still down 10-odd basis points. We have been talking about incremental yields. The mix shift is clearly happening on the AUM side, but still not entirely getting reflected, and we are saying that given the fixed rate, we should be positively poised. But somehow, I think this 38-bps incremental yield completely getting offset by the mix change plus 20 bps kind of a decline.

So if we exclude this entire securitization income, would there have been the pressure on the margins to the extent of 30-odd basis points during the quarter? And then how comfortable we would be when you have lowered the guidance and said like we will be at the lower end of 5.5% for the full year, and we are at 5.6% for the first nine months. Does that suggest that we'll settle much lower getting into Q4?

Sanjay Agarwal:

So of course, if you add on, maths, the data, which you're describing will be there, but we are running a bank, right? So there are many levers which support us. There are many challenges, which makes us difficult on our cost side. So we are balancing that out. And I'm happy to say that we're still in this tough time because the kind of market we are in, as of now, is tough to actually incrementally build better rates. We are pushing our wheels team, and they've already done maybe around 40 bps point and incrementally, they are doing better yields.

MBL business does not allow space because we are already around 14.75% to 15% kind of rate that doesn't allow. The commercial banking space still is more on floating than fixed. Housing book does not allow you to give much space. We are around 11.6%. And then, of course, the personal loan space, we are around 18%. So already, we are at the rates which makes us comfortable. Beyond these rates, we don't want to compromise on the asset quality.

And we are growing at 25%, 26% in our asset also, right? So I think we have to be a little patient here because this is a tough time and with this kind of interest rate scenario, we are just balancing this out through various means. And showing you the best kind of decision making to make your balance sheet very stronger, right? So I think there are a lots of if and buts, but I believe that at our end, we are putting our best foot forward to balance it out.

Kunal Shah:

Thanks. And all the best. Yes.

Prince Tiwari:

Kunal just one last point. The NIM in any case, when we had guided for the full year, The quarter-on-quarter because we knew that because of securitization, there are impacts. Sometimes, there is a lag recognition of the income because of the underlying SPV structure and the legal documentation. And that is why when we guided, we guided for the full year.

And it was assumed that for the full year, securitization income would be part of that because again, that interest income or the net interest income on securitized book is added to the entire NIM calculations. So honestly, while the cost of funds have gone the way it has gone, whatever we had guided for NIM, we are very much in that range irrespective of the cost increase on the deposit side, right, or the cost of fund side.

It would have been the same the case.

Kunal Shah:

Got it. Okay. Thanks. And all the best.

Prince Tiwari: Thank you. Thanks Kunal.

Moderator: Thank you. The next question is from the line of Shubhranshu Mishra from PhillipCapital. Please go ahead.

Shubhranshu Mishra: Hi. Thank you for the opportunity. So just looking at the credit card Slide 44, and just matching it up with the kind of credit cost that's been discussed on previous questions. This just seems out of whack 75% issuance new to bank customers, just like very high even on a global parameter, even the closest competition, which does new to bank would be around 50%.

And the average limit per card is around 1.74 lakhs, which would be easily around 50% to 60% more than the industry average basis that the kind of credit cost that we are taking off around 5% or 6% looks absolutely benign. So what's the case here? We do not have a risk management team at all in credit cards? What are we doing here in credit cards, that looks absolutely outrageous?

Sanjay Agarwal: Mayank, do you want to add on something?

Shubhranshu Mishra: Also if you can speak about the cost of acquisition per card. That's all.

Mayank Markanday: Yes. Shubhra I'll answer all your questions. I'll take the first question on the limit side. So Shubhra on the limit side, if you see, you must be comparing this limit with the average limit of the industry. Whereas the industry portfolio has built in over a year, which is last five, six, seven years, the cards are moving there. We have issued new cards to the customer. So if you see and compare with the new cards issued in the last two, three years, you will see us much more close up with the industry.

This is the first. The second is on the 75% issuance to the NTB customers overall. So more or less in the industry, the cards around 60% to 70% cards are issued to the ETB customers, but that is the phenomena of the top few issuers. Rest of the issuers like are close competitors, they are also issuing cards to the new customers, though the percentage varies from bank to bank. And on the last question on cost of acquisition.

So cost of acquisition depends upon the NTB versus ETB and the channel from which you are acquiring the customer. So our acquisition, you see, we have all sort of multichannel acquisition, which gives us some space to lower our cost of acquisition and it also depends as how much we will scale and which channel we want to scale. So we've built the multichannel distribution.

So we can scale it as per the cost of acquisition we will think of or our desired cost of acquisition you want to build the business.

Shubhranshu Mishra: And what's the blended dollar value of ETB versus NTB, blended number would be helpful.

Mayank Markanday: It is close to INR2,000.

Shubhranshu Mishra: This is ETB?

Mayank Markanday: Both. Blended.

- Shubhranshu Mishra:** No, no, what is ETB and NTB blended cost?
- Mayank Markanday:** ETB is existing to bank customers. We already have the acquisition of customer available with us. We just give them the card basis, they're already relationship with us. NTB is new to bank customers.
- Shubhranshu Mishra:** Okay – I'll probably come back in the queue. That's fine.
- Mayank Markanday:** Yes. Thank you.
- Moderator:** Thank you. The next question is from the line of Manish Shukla from Axis Capital. Please go ahead.
- Manish Shukla:** Yes, good evening. And thank you for the opportunity. Just sticking to card for once. If I look at the segmental yield, the differential between your home loan yield and credit card yield is only 40 basis points. capital requirement rather will be probably 3x. And yet on a Y-o-Y basis, if I compare both the books have ballpark grown about INR1,600 crores.
- I'm just thinking that from a return on capital perspective, how do you all thinking of card business? Where do you think you would need to take a call whether it makes sense or doesn't make sense, because at 12%, you probably will be on the lower side as far as credit card yields are concerned.
- Prince Tiwari:** So Manish, hi this is Prince here. Now of course, there is a large fee component in the entire credit card business, right? So while home loan only has a typically NII business with some processing fee, credit card has an equally strong fee business as is already reflective in our other income that you can see. However, we do take your point, and I think Mayank will add views on that. But our overall yields... Yes, Mayank Ji please go ahead.
- Manish Shukla:** I'm sorry, but just to point there that I mean I appreciate the higher fees, but the credit cost delta we are saying is also significant, and I'm sure opex delta is quite high. So I'm not sure if fees is negating the opex and credit cost delta between home loans and credit cards.
- Mayank Markanday:** So Manish, I'll add to what Prince said and make it more clear -- try to make it more clear for you. When we say 12% in credit, credit card is a business which also builds a term book in it to get yields and let the customers stick with us and make an interest earning book for us. So we are quite new to this business as of now. From last one year, if you see, we have built our term book from almost 8%, 9% to 17-odd-percent this year.
- And we will close it around 20% in this financial year. And if you see with the larger issuer, the term book goes beyond 30%. So your interest earning book gives you a larger portion on the overall funds or the ANR which you have deployed in the market. So over a period of time, you'll see this is also improving a lot as our term book will start building towards 30% sort of.
- Manish Shukla:** Sorry to harp here Mayank, but during the tenure in which you are talking term book has gone up, yield on the book has actually gone down at a time when interest rates are high. So even that math doesn't hold up, right? If you YoY yield, the yields are down on credit card book.

- Mayank Markanday:** Yes, Manish. So there is also one regulation which has come over the last one year which states that you cannot charge interest on interest. So that has come in credit cards in the past years, which has reduced the yields.
- Manish Shukla:** Will you be able to quantify that, please?
- Mayank Markanday:** So I'm saying there is a regulation...
- Sanjay Agarwal:** Okay. Manish, I'm hearing your view and the other participant also, but you have to give us some time to really showcase our whole purpose around credit card business. I think we have done well enough to create that buzz around the franchise. So there are other benefits also. And of course, what Mayank is just explaining that there are some regulation changes, and this industry has been watched by everybody from regulator to other things you know about it.
- So I'm pretty sure that we are absolutely on track in terms of our guidance. We are not aware that you will be asking too many questions around credit card business because it's still a very small business for us. But by next call, you will find our more strategy in place. that how we want to build and why you want to build? And by what time will get a BEP.
- Manish Shukla:** Sure, sir. One last question on cost to income, you've suggested that FY '25 might be similar to current levels. So on a stand-alone AU Bank, excluding the merger, when do the cost synergies start kicking in and we go to less than 60%?
- Sanjay Agarwal:** Sorry, sorry, Manish, can you repeat your question?
- Manish Shukla:** Cost to income, your commentary suggested that FY '25 cost-to-income will probably be closer to where we are right now. When does the stand-alone bank cost to income...
- Sanjay Agarwal:** Manish, no, I understand your question now. So I would say that that is I am saying to you that if you go back in the history of Indian banking, it's not easy to build bank. It requires some patience; it require some more detail out of every aspect. That is why we are saying that first 10 years is the foundational year for AU's journey.
- We have done everything in terms of building assets to this level. It's not easy to build INR80,000 crores deposits. It's not easy to build INR1 lakh crores balance sheet in the first 7 years, and with this kind of track record. The idea is to really go more and more in terms of holistic approach, where you build a bank which has been likable by the customer, right? Customers should like you because if a customer doesn't like you, a customer doesn't have visibility of AU then they won't transact with you. They won't bank with you. And then there won't be anything, right? So our entire piece, whether our initiative around digital, our initiative around credit card, QR code, even AD1 license, it requires a lot of investment, time, effort, and everything.
- But I think everything is being done with a lot much sincerity, lot much detail out so that we are on the right path. So I think you have to give us another maybe 3 years to really come out with any kind of specific leverage expectation, right? Because the inflation is there, the competition is there. You know that a lot, many new things are coming up every day, every night.

So we need to be responding to those facts, right? So that is why I'm consistently saying you that is a 10-year journey. First 10 years are very foundational years, and people need to support us. And I think we are doing everything right in that context. If you really see, barring some math here and there, you're absolutely on track.

- Moderator:** The next question is from the line of Param Subramanian from Nomura.
- Param Subramanian:** First, my first question is on the interest income, on securitization. So if I understood it correctly, you have booked both last quarter's interest income from securitization as well as this quarter's, both in this quarter, right? That understanding is correct.
- Prince Tiwari:** Yes. So last quarter would have got built, so generally it happens with the lag of a one month as we said, based on structure of M plus 1, so you're right,
- Vimal Jain:** Only for one month and not for the quarter
- Param Subramanian:** Yes. So last quarter, it was not recognized. It pushed into Q3. And this quarter securitization has also been recognized in this quarter, right?
- Prince Tiwari:** Absolutely.
- Param Subramanian:** Okay, okay. Fair enough. And my second question is, again, coming back to the credit card portfolio. So if I understood correctly, sir, based on the disclosure you've made, the credit card provisioning in this quarter is about INR50 crores there or thereabouts?
- Prince Tiwari:** Provisioning plus write-off all put together would be about INR45 crores - INR43 crores to INR45 crores.
- Param Subramanian:** Prince, so that INR43 crores to INR45 crores is about INR180 crores annualized. If you go back to last year, the credit card book, the base of the credit card book was about INR1,000 crores last year. That suggests a pretty high credit cost on the credit card book. Of course, on a moving base that has grown like 2.5x over the last year, the credit cost looks lower. But if you look at it from a base adjusted book, it looks like it's 17%, 18%. So isn't that very high compared to that level.
- Prince Tiwari** Param, just hold on. See, I think we have been talking about credit cards a lot, right, just for everyone's benefit. We have very clearly articulated that credit card is a business, and everyone knows it, including yourselves, that credit card as a business on a steady state basis, even for the larger peers who have been doing this business for multiple decades have a top line credit cost of anywhere around 6% to 7%.

And then there is a recovery angle of 1%- 1.5%. So it's a business which is known to have a 5% kind of credit cost and a 4% to 5% kind of ROA. Now fortunately, unfortunately for us, we are too young in this entire business. A credit card books actual colors will start coming in once you built up a 18 lakh to 20 lakh kind of card base, right? Right now, all we are doing is just adding cards, and that's where the limit comes into play, that's where the suppressed yield comes into

play because ultimately, you're calculating to answer earlier question, you are calculating your yield on the outstanding book.

The outstanding book is growing much, much faster because they're issuing newer cards. Last year, I started my card base at about 5 lakhs. Before that, I was 1.7 lakhs. I have already reached about 8.5 lakh cards today, right? So what is happening is we are in a build-out period. Also the fact that for the first 2 years, if you go back and see our credit card costs, the credit cost, it wasn't that high because the book was still being built out. Now that we have got some seasoning, the cards that probably would have sourced about 6 months to 9 months back.

Some amount of credit costs have started coming in. However, there is no recovery in it. So just allow us some time and which is what Sanjay articulated as well as Mayank articulated on the call, that this book will need to be built out. And once it's built out, it is not going to be any different than any other player in the industry. At least we don't have any reasons to believe so far basis whatever numbers we have seen internally, right? So I would just request allow us some time to build this book.

Param Subramanian:

Fair enough, Prince. But we've grown this book like 20% quarter-on-quarter. Are we still comfortable growing it at this pace? Or should we, as investors, be looking at a moderation in the pace going ahead at this pace, as you pointed out, the book is seasoning and the credit costs are catching up now?

Prince Tiwari

No, fair question. Fair question. And in fact, this question will ask to us when the entire circular also came up around unsecured lending. Please understand, and I mean, through you, I want to send this message or request everyone to understand that my credit card business is a liability business. It is not an asset business. I don't really have a choice.

The reason why we are building a credit card, the reason why I'm building a QR code, the reason why I'm building a personal loan, the reason why I'm building a wealth solution is to support my liability franchise, right? The earlier question that why NTB is higher? Again, the NTB is higher because I'm using this credit card as a hook to acquire an urban and metro customer like yourselves to come and join the bank as a customer and then try and cross-sell you as a liability product, right?

Similarly to the liability customers who are joining in from Mumbai, Delhi, Bangalore I can't really offer you a car loan at 8.5% today because my cost of funds don't allow that, right? But I do need you as a customer, right? All the HNI customers. So what is the product that I can sell you. I need to sell you a credit card, I need to sell you a personal loan. And that is why please understand these businesses are not being built from an asset perspective as currently.

And hence, I don't really have a choice in terms of the pace at which they're getting built up. If I want to build my liability franchise, then I need to offer these products. And accordingly, the growth rate will be more determined by liabilities than my asset strategy. On asset strategy, I'm very, very clear that it's a secured asset book that I'm driving, which has our credit cost of anywhere around 50 to 60 basis points, and that has come down.

It used to be about 1% point or 90 to 100 basis points. But as we have de-risked the book, as the commercial book has got built up, as the home loan book has got built up, the credit profile has become better and better. And hence, we are now getting the benefit of that credit cost, right? So I mean, in summary, I think some of these businesses, we don't really have a choice if I really want to build a franchise. And that's all we are saying again and again that it takes 10 years to build a bank.

Give us time till 2027, have a slightly long-term view because if you really want to build a retail franchise in India, you will need to do everything that is needed to be done to ensure that you are able to attract the customer or at least to make yourselves in the first three banks in any customers' mindset. I needed to be clear that if a customer wants to open a bank account, we should be in his consideration set. I'm sorry to get that long answer, but the idea was to just put a context to the whole thing.

Param Subramanian: Yes, very clear, Prince. Thanks. So in a way, we should be looking at credit card as a sort of customer acquisition cost, if you will. That is my takeaway.

Prince Tiwari: Absolutely. Absolutely.

Param Subramanian: So but quickly, in the past, you've highlighted that FY25, we should see breakeven of the credit card business. Now in the light of – like the previous participants also mentioned that the yield is moderating and now we're seeing credit costs inch up. Do you want to revisit that or on the credit card business specifically? That's it for me.

Sanjay Agarwal: So Param, I think we'll be more specific in our next call. But if you ask me as of now, I will hold on to my statement that we might want to breakeven next year only -- by last quarter.

Mayank Markanday: Yes, we had said at the end of last quarter, one or two quarters here and there. But broadly, we are on track.

Param Subramanian: Perfect, perfect. Thanks a lot sir. All the best. Thank you, sir.

Moderator: Thank you. The next question is from the line of Madhuchanda Dey from MC Pro. Please go ahead.

Madhuchanda Dey: Hi. Good evening. I have a slightly...

Moderator: Sorry to interrupt, ma'am may we request you to use the handset mode?

Madhuchanda Dey: Yes. Hi. My question is slightly long term. As you rightly alluded to the build-up phase of the bank, and we are in the 7th year. So given that there's a build-up phase, given that there's slight change in your strategy now in favour of the high yielding book through the acquisition of the small finance bank, which is predominantly into unsecured. Given this entire context, how should we look at ROA trajectory in the next three years for the bank?

Prince Tiwari: Thanks, Madhu. And again -- hi Madhu. And again a long-term question where probably it involves merger, as you rightly said, and there will be dynamics around that in terms of how much we want to grow our MFI book, what kind of credit cost. We need to understand that book

much better. So that's where we are again and again saying that allow us probably April quarter or this quarter for us to come back with a more clearer strategy because by the time -- assuming regulatory approvals come through, we'll have a much better clarity on the merger and the numbers around that..

But having said that, look at our past trajectory, I think in the last five or six years, we have been doing all these investments, right? And we have been going through external shocks. So we converted ourselves in a bank in 2017. We have been building out the entire franchise. Some 5,000 people went ahead to now 29,000 people.

We got tested by pandemic and everything else, which required us to put more liquidity, more provisions. But still, we have kind of delivered a 1.6%, 1.7% kind of ROA across on an average basis, right? So I don't really think that should materially derail, right? But yes, allow us some more time and probably because merger is a significant event, which can have positive impact definitely in our view. So give us some time and let us come back to you.

Madhuchanda Dey:

But you would have thought through this before embarking on this step, right? So if you could share some of those...

Sanjay Agarwal:

Yes, yes. So, Sanjay this side. So you're absolutely right, Madhu, because sometimes we don't want to be very specific on our numbers, but I would say that -- as you know that we have already crossed INR1 lakh crores balance sheet. If these mergers go through, then we will be around INR1.25 lakh crores by March. Then even we grow by 25% every year, we are doubling our balance sheet in three years. So we know where we are going, but there are lot many variables in place, right?

What happened -- how the interest rate cycle will be there in the next few years, no one knows right. We know that our credit cost won't surprise anybody because that's our forte. That's our expertise. And I already commented on our overall credit cost on different book. We know how well we will distribute it across India. We know that in our credit card business, QR code business, personal loan, all this business, wealth business will eventually get profitable, right, in the next three years.

So there are so many things. But we don't want to comment any specific the ROA guidance or ROE guidance because our track record itself is so strong that we are around 1.7, 1.8 in the last six, seven years. We already delivered you around 14% or maybe 15% ROE last seven years. So that's a strong indication that there are better days ahead because there are not much challenges now left, except interest rate cycle, right?

So I would say that give us some more time in terms of specific guidance because that guidance requires lot much calculation around so many variables because if merger happens, this will happen, otherwise it will be like this, what is our perspective on interest rate. So that is why we are looking for some more guidance. And that is why we are saying that if you are able to pull through in the next three years, this kind of data, this kind of product, this kind of size and scale, which haven't been done by any bank in the past in my opinion, in the first 10 years.

And being a SFB, so well diversified in terms of everything, right? So I mean that is the way we want to push ourselves that there would be a case, there will be a quarter where some data here and there for some time. But in the long term, AU remains absolutely on track, and we want to become one of the best retail franchises for this country.

Madhuchanda Dey: Thank you very much and all the best.

Sanjay Agarwal: Thank you.

Moderator: Thank you. The next question is from the line of Aravind R from Sundaram Alternates. Please go ahead.

Aravind R: Thank you so much for the opportunity. Sir, I would like to understand like you have given the operating expense breakup this time, like on investments that have made in credit card, QR and video banking. I would just like to understand, like, could we look for the similar run rate whatever we have in this nine month of FY'24 into next year also? Like, do you see slightly higher run rate required in the next year? That is my first question.

And in slippages, if I take as a ratio like it has inched up a bit. Like is it only because of credit cards or any other portfolio is also contributing to it? That is my second question. And ROA is like at 1.5 percentage this quarter. But what do you think could be the levers to improve in the subsequent quarters? Thank you.

Prince Tiwari: So second question was around credit cost?

Aravind R: The slippages, yes.

Prince Tiwari: Arvind, as far as slippages is concerned and the credit cost is concerned, I think we -- Sanjay did alluded in his speech that typically, what happens is in a festival quarter, generally your self-employed customers and merchants prefer to use the money, cash in the business and which happens every year, honestly.

And after that, generally, you have a good recovery coming in because the festive season is good. Generally, you have good cash flows. The only challenge this time happened was the festive season was immediately followed by the state election in two of our major markets, like Rajasthan and MP, right? And these two markets broadly contribute almost 40% to 50% by business, especially in Wheels and SBL, right?

So what happened is during that election period, there's a model code of conduct, which is there and which kind of hampers the entire security enforcement or a collateral enforcement process. And to that extent, what you will see is the slippages hasn't really grown, right? From 349 crores it has gone about INR403 crores. But more importantly, the recovery has not really happened the way it is expected to happen in Q3.

And accordingly, there was reductions as well did not happen in the same way. And to that extent, the existing NPA buckets moved and we had to provide because we have a very conservative provisioning policy even on a secured book. Like on a 90 DPD, we provide 25%,

but 180 DPD, we provide 50%, right? So to that extent, I think it's more of a one-off in this particular quarter, especially for Q3.

So Q1 and Q2, we generally see these phenomena. Q3, generally, there is a pullback. So I would say this is more of a one-off and Q4, hopefully, should be much, much better as we get a full quarter to do the credit recovery. Sorry, I missed your first question.

Aravind R: Sir, like I wanted to understand like the run rate, similar run rate do we -- can we expect investments in credit cards and QR and video banking, whatever you have provided in the presentation now, like in terms of absolute number or like in terms of percentage, if you can give some color on that.

Kunal Kakkar: Hi, Arvind, Kunal this side. So in terms of the operating expenses on the new investment, as we have already articulated that we will stay invested in the new investments, largely around credit card, QR, video banking. So the expenses which you can see over the slides, which you are mentioning, so we'll remain kind of in this growth range only. I think it's around 55% to 60% of a jump in these investments -- this cost, and this will remain like this for the next year also.

And second point that apart from these expenses, business as usual, will go as it is. Apart from that, we are focusing more on productivity and efficiency, and we are trying to control our employee costs and other related costs.

Prince Tiwari: Absolutely, which is visible in the ratios also, right? If you see apart from the new businesses, the other ratio hasn't really gone up very significant, impact has come down or stayed there despite the business growing on a year-on-year basis.

Aravind R: Yes. So when you mentioned like it would grow up, you're talking about the growth would be in the similar range you're saying, growth in this new investment?

Management: Yes, because we'll need to invest in brand. credit card is upfront cost. The moment you issue 1 lakh credit card straightaway acquisition costs. So those things will continue. We don't really see that changing course.

Aravind R: Sure. And my final question is on levers which are available, like since cost of funding is going to be tough for some time and like yields are also like having a bit of pressure. I'm just trying to understand where are the levers to improve ROE?

Sanjay Agarwal: Which time period you are looking for Aravind? Which time period of levers? Like for us...

Aravind R: Looking at quarter-to-quarter. I was looking at third quarter of FY '24.

Sanjay Agarwal: No, I don't think because as we are already commenting that we are little looking long term. These are tough times in terms of interest rate cycles. So I won't say that our quarter 4 would be very different what we have done this quarter. But in the long run, next 3 years, you will see our credit card becoming profitable, our video banking becoming more productive. You'll see our AD-1 license coming in, giving us other income, like what we are seeing now in insurance income that has been stabilized.

After the merger, you'll have the high-yield book that will allow us a better NIM because of that book, after even we put out provision there. So there are lot many levers in the next 3 years, right? And that needs to be counted on a quarter-to-quarter basis. And our track record shows that what we've done is always given a push to this franchise to the next level.

- Moderator:** The next question is from the line of Ashlesh Sonje from Kotak Securities.
- Ashlesh Sonje:** First question is on the investments towards digital initiatives, within that expense towards credit cards, QR and video banking that has gone up sharply, both Y-o-Y and Q-o-Q. Can you just qualitatively detail out, which are the main cost heads within this, not -- no numbers, but just what kind of costs go into this?
- Prince Tiwari:** But Ashlesh, I think we have been disclosing these numbers every quarter.
- Ashlesh Sonje:** I'm talking about that INR170 crores. That INR170 crores in this quarter, which went towards credit cards, QR and video banking. What are the main expenses within this? What kind of costs does this include?
- Prince Tiwari:** It's predominantly credit cards because, as I said, the moment you issue credit card, one fresh new credit card, you straight away have a upfront impact of whatever acquisition costs that Mayank was saying, at anywhere around INR2,000 to INR2,500 per credit card is an upfront impact, right?
- Ashlesh Sonje:** Okay. So you'd say credit card acquisition would be a big charge within this.
- Prince Tiwari:** One of the biggest chunks, one of the biggest chunks. Then of course, last quarter, we also did a lot of branding as well.
- Ashlesh Sonje:** Understood. Okay. And secondly, can you just remind how we are accounting for the securitized book, specifically what part is recognized as interest income and interest expense? And what part is recognized as non-interest income, if any?
- Prince Tiwari:** So everything is whatever we get in securitization on a net basis because of balance sheet, right? So whatever we get on a net basis goes into the interest income line under other interest income under the P&L.
- Ashlesh Sonje:** Okay. So there is no -- nothing which goes into non-interest income?
- Mayank Markanday:** No, no, no, absolutely nothing. Barring, you might be getting some servicing fee, which is very small residual.
- Moderator:** Ladies and gentlemen, that was the last question. I now hand the conference over to the management for closing comments.
- Prince Tiwari:** Yes. Thank you, Sagar, and thank you, everyone, for participating in today's call eagerly, and we look forward to your feedback and views. In case you have any further questions, kindly reach out to the IR team, and we'll be more than happy to respond to your queries. Thank you so much and have a good Republic Day.



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Moderator:

Thank you. On behalf of AU Small Finance Bank, that concludes this conference. Thank you for joining us. You may now disconnect your lines.