



“AU Small Finance Bank Q4FY24 Earnings Conference Call”

April 24, 2024



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Moderator: Ladies and gentlemen, good day, and welcome to the AU Small Finance Bank Q4 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 presentation concludes. Should you need assistance during the call, please signal an operator by pressing “*” and then “0” on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Prince Tiwari, Head of Investor Relations at AU Small Finance Bank. Thank you, and over to you, sir.

Prince Tiwari: Thank you, Rayo. And hi, everyone. Good evening, and a warm welcome to AU Small Finance Bank’s earnings call for the 4th Quarter and the Annual Results for the Financial Year FY '24. We thank you all for joining the call and hope you have had a chance to go through the presentation that we have uploaded on our website as well as the stock exchange.

The format for today’s call will be very similar to last few calls where we will have “Opening Remarks” from the Management for the first 10 to 15 minutes, followed by 40 to 45 minutes of questions and answers from the participating analysts and investors.

To start the call, we will have our Founder, MD and CEO – Mr. Sanjay Agarwal, share his thoughts on the overall performance and strategy of the Bank. And beside him, we have our 2 Deputy CEOs, Mr. Uttam Tibrewal; and Mr. Rajeev Yadav, along with other senior members of our management team on the call today to answer any questions that you may have. For the benefit of everyone and so that we can take questions from everyone, we would humbly request everyone to keep the number of questions per participant restricted to 2 and join back in the queue if you have further questions.

With that, I will now request our Founder, MD and CEO – Mr. Sanjay Agarwal, to start today’s call by sharing his thoughts on the overall Bank’s performance as well as the outlook.

Sanjay Agarwal: Thanks, Prince. Good evening, and greetings to everyone. It’s my pleasure to welcome you all today.

Before I dive into Bank’s performance and future plans, I want to take a moment to express my sincere gratitude to everyone including the Government of India, regulators, customers, our employees, analysts, investors and all other stakeholders for your unwavering support and confidence in our Bank, which truly motivate us every single day.

As many of you know, building a successful Bank is a complex process, and your trust fuels our commitment to excellence. Further, we presented our 3-year road map to you last month in Mumbai, and I always look forward for your constructive feedback and incorporate the same for the continued success of our Bank. You will see reflections of this in our execution over the next 1 to 2, 3 years.



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On the macro front, India's inflation remains range-bound with strong GDP growth last quarter. However, the global geopolitics, developing situation in the Middle East and the global macro indicators remain key factors for policymakers to consider in the near future. India's economic landscape is surging forward with GDP growth projected with among the highest globally. We are likely to be \$5 trillion economy by '27 and \$30 trillion economy when we complete 100 years of independence in '47. This robust growth fuels optimism for business and entrepreneurs like me. Regulations are streamlining, making things easier to do business in India. Initiatives like GST are simplifying taxation, reducing Redtape culture and boosting economic activity. While navigating the regulatory landscape might require some initial effort, a nation's commitment to transparency and digitization is making compliance smoother. Additionally, efforts to harmonize regulation to ensure a level playing field across platforms will further simplify compliance for businesses.

We are in the midst of the celebration of democracy in the first quarter of this year with the entire nation going into general elections. I'm very excited about this election in the largest democracy of the world and the opportunity it presents to all the citizens to exercise their basic right to vote. There could be some break in business continuity during quarter 1 due to multiphase elections, but we don't see the impact to be material in our annual FY '25 performance. I continue to be very 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@ 27, is foundational period of first 10 years of our banking journey. I'm equally excited about the confluence of powerful forces driving our Bank forward. India's economic rise and demographic dividend of 1.4 billion population creates a vast canvas of opportunity. We are well positioned to capitalize on this with our extensive national presence around 2,383 physical touchpoints, complemented by our robust digital channels. Furthermore, we offer a comprehensive suite of products and have a proven track record of over 2 decades of consistent growth while maintaining pristine asset quality. Our unwavering commitment to being a customer centricity, coupled with our deep understanding of risk management and seasoned leadership team, position us for a continued success.

At the moment, the only factor outside our direct control is the elevated interest rate, and we don't anticipate a significant near-term reduction given the global headwinds. The NIMs are likely to continue to remain under pressure due to this and also due to the heightened competition for low-cost deposits. We continue to monitor the same and take all necessary measures to minimize the impact. Further, our asset quality remains intact, and we don't see any asset quality challenge in near term. We are currently focusing on calibrating our new investment and leveraging the existing investments.

Cost-to-income ratio will remain raised in the near future and should start tapering off in 2, 3 years. There are ongoing discussions that regulators may come with some road map for universal Bank license, application for small finance banks. As I had highlighted during our Investor Day last month, with the AD1 license and given our size and scale, the brand recognition that AU



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has received, many advantages of being a universal Bank are already in place for us. However, we're keen to be a complete universal Bank, strictly following the regulatory guidance around the same.

Before I get into the business and operation at our Bank, let me first talk about our merger with Fincare and reiterate my key strategic priorities for the next few years. I'm thrilled to announce that successful completion of merger with Fincare Small Finance Bank, we're starting to position the newly expanded AU for remarkable growth and leadership in the pan-India retail banking landscape. I wish to express my deep gratitude to all stakeholders for this merger, and more specifically to the regulatory bodies for one of the fastest merger approvals to the Indian banking sector, received in just 4.5 months. The swift approval is a testament to the well-planned approach and strong synergies between our institutions.

Our institutions have highly complementary strengths. Fincare brings a robust geographic footprint, particularly in South India, while AU offers a comprehensive product suite backed by cutting-edge digital capabilities. This strategic combination allows us to leverage the strength for significant market expansion and deeper customer penetration. With a combined customer base of nearly 1.1 crores and an employee strength of over 46,000 dedicated employees, the merger positions us a formidable financial entity. Our physical presence expands to 2,383 touchpoints across 21 states and 4 union territories, giving us a pan-India footprint. Apart from a brick and mortar presence, we have a body and soul present in all these locations, giving us an extensive network, which ensures we are closer to our customers than ever before and fast forward our distribution buildout by many years.

Our immediate focus is on ensuring a smooth and seamless integration within the next 9 to 12 months. We have meticulously crafted integration blueprint that prioritizes minimal disruption for all stakeholders, employees and customers. We have provided more details on the same in our quarter 4 investor presentation.

From 1st April, our interest rates have been aligned across savings and fixed deposits. As a next step, we are working for Fincare customers to gain access to AU flagship products, both on deposits and asset side. Deposit products, including our digital offerings, will be available to all new customers in Fincare branch within quarter 1 this year only. Asset products like wheels will follow in the coming quarters.

Following up on our Investor Day discussion last month, I would like to reiterate our top strategic priorities for the next 3 years. These priorities have been designed with the objective of returning to a level of ROA, which this business model commands. The first priority is around increasing the disbursement share of high ROA, high-yielding assets like vehicle loan, micro business loans, microfinance, among others. With expanded distribution and deeper geographies, we are confident to grow these segments to approximately 70% to 75% of our portfolio, up from current 70% by '27. We're also calibrating our low and medium ROA businesses. On the housing loan business, we're asking the team to originate more MBL business given they operate in similar

geographies and similar markets. On the business banking and agri banking business, teams are working together to drive more synergies. These are few examples.

The second priority is around driving branch profitability. We aim to achieve a healthy current account book targeting at least 7.5% of deposits from approximately 5% currently. Additionally, we have asked all asset verticals as well as business like credit card, wealth, commercial banking to focus more on leveraging the branch presence to originate their business to improve individual branch-level profitability. We will endeavor to make around 65% of branches, which are live as on December '23 to be profitable by '27.

Another priority is around calibrating our investments. With our core digital platform now established, future investments will be focused on maximizing its potential. For the credit card business, we will moderate issuance to around FY '24 levels to control upfront acquisition costs. Moreover, we'll focus on increasing the proportion of cards sourced from branches. Video banking and QR code will act as channel for liabilities and customer acquisition and support branch banking.

I want to give you some highlights around our operational 4th Quarter. So, we delivered an ROA of 1.6% for Q4 as well as FY '24, gross of exceptional items related to merger expenses. Reported ROA is around 1.5%. Our asset quality improved by 26 bps with strong collection efforts in the last quarter with a gross NPA of ~~1.47%~~ (Corrected 1.57%) of gross loan portfolio vis-a-vis 1.83% in quarter 3. We expect our asset quality to remain stronger over the years. Our deposits registered at 26% year on increase, in my opinion, phenomenal performance, crossing Rs. 87,000 crores mark. Our GLP, gross loan portfolio, also grew by 28% year-on-year, and now it's around Rs. 82,000 crores. And net of securitization is around Rs. 74,000 crores. We will continue to grow our balance sheet by maybe around 25% annually over the next 3 years.

I think this is achievable the way we have grown ourselves in the last maybe 7 years, I think the growth of 25% is there for us in the next 2 to 3 years. While witnessing a healthy 9% growth in our overall deposits compared to the preceding quarter, our CASA also has increased by 10% quarter-on-quarter. The combination of CASA plus retail term deposits now accounts for 64% of our deposits, with CASA contributing 33%.

As I highlighted in my last quarter's commentary, our current account franchise built-out has not been to the extent we would have liked, partly because limitation of the platform, partly because of excessive competition in this zone. We are in the mid of reworking our current account strategy and are aspiring to increase our CA% to at least 7.5% of deposits by '27. Operationalization of AD1 business, which includes trade-forex, a revised current account-led QR code business strategy, are likely to enhance our current account proposition.

The major risk nowadays is coming from the AML side and has attained prominence with increased cybercrime and identity theft. We remain vigilant and have implemented robust systems and processes to effectively mitigate this risk associated including our AD1 business.



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To conclude, I'm deeply committed to building one of the most trusted and expected financial institution in India. We, as a team, strive to be a full-service Bank, meeting the diverse needs of our customers. This dedication to multiple stakeholders can be complex but essential for our long-term success. As your CEO and custodian of your trust, I stand before you today with the sincere commitment. We will continue to push boundaries, seeking innovative ways to create sustainable value and deliver our promises. The path ahead may be challenges, but I am confident that with your unwavering support, we will overcome them together.

So, thank you once again. And I would like to hand over to Prince again for your Q&A, please. Thank you so much.

Prince Tiwari: Thank you, Sanjay ji. And with that, we can now open the call for Q&A.

Moderator: We will now begin the question and answer session. The first questions is from the line of Renish from ICICI. Please go ahead.

Renish Patel: Congrats on a good set of numbers. Just 2 questions from my side, so one on the credit cost side. So, in PPT, we have mentioned about the MFI portfolio. On a steady state basis, we'll have 2.5% to 3% kind of a credit cost. And when we look at the MFI portfolio of Fincare, which is at currently Rs. 8,000 crores on which Fincare has already provided 1.5%, so the incremental 1.5% works out to be Rs. 100-odd crores. So, that, we will provide in FY '25, right, sir?

Sanjay Agarwal: Yes, Renish. Good evening.

Renish Patel: And after factoring that one-time impact, what should be the steady state credit cost for a merged entity, sir, given our stand-alone credit cost has already been normalized to 70 basis point odd including credit card cost of Rs. 45 crores? So, what should be the steady state credit cost for the merged entity?

Prince Tiwari: So, Renish, I think if you go back to March 18 presentation on the strategy that we had done, and we had laid out what each individual product group-wise credit cost on advances. And we also said that it will depend on the mix that we go forward because the mix is also changing compared to where it was historically. So, as you rightly said, I think the normalized book without MFI has now reached to about 70 bps on average advances. And of course, to that extent, MFI will come up, and we have already articulated that it will be about 10% of the book. So, I think anything about 1% to 1.1% on overall advances and anything around about 70 to 75 basis points on total assets is where we should work with.

Renish Patel: Got it. So, to summarize, 100 to 110 basis points should be the steady state credit cost ex this Rs. 100 crores of what we have to provide for to take this 1.5% to 3%, correct, in FY '25?

Sanjay Agarwal: Yes. So, just again, for the clarification, around 0.75% on total assets and 1.10% around on the advances.

- Renish Patel:** And sir, next question is on the NIM, So, considering that we still believe that there could be a cost of fund increase by 40 to 45 basis points in FY '25, so does that lead to further NIM contraction from Q4 exit level? Or, let's say, we have some leeway to sustain the NIM in FY '25?
- Prince Tiwari:** So, basically, you're right, on a stand-alone basis, as we have articulated, we do expect some more cost built up because there's still a gap between the cost of funds on the book and the incremental cost of funds and which we had articulated as well as in the presentation also, we have said that another 40 to 45 basis points cost of funds can go up from here on an average basis for the next financial year because this financial year, while the cost was 6.80, the exit cost for us has been 6.98 in Q4, right? Having said that, definitely, there is a merger on the cards, and we have already committed and started working as one entity with 1st April. So, Fincare obviously comes with a slightly higher margin. So, on a merge basis, our endeavor would be to protect the margins on the overall level for next financial year, at least.
- Sanjay Agarwal:** Yes. So, Renish, to supplement Prince, so we want to defend 1.6% ROA next year too. So, there would be some cost coming around 30 bps because of the increased cost of fund. But we acquired Fincare, so we will have the high yield book from there. And also, incrementally, we are passing on some cost to the borrower in our Wheel book or MBL book and really see the mix changing up, right? So, we want to do more book from disbursement from high yield book, which has microfinance, Wheel, MBL, gold loan, all these things, right? So, as of now, the whole endeavor is to defend 1.6% ROA for next year. And I don't see first rate cut maybe first 6 months. And if at all rate cut comes, the only impact will be visible next year. So, I don't think that there would be any help from interest rate kind of scenario this financial year. So, we are building up in that way that, we can defend 1.6%.**Renish Patel:** And just a clarification. So, when we say 1.6% ROA, this is including that Rs. 100 crores of cost?
- Sanjay Agarwal:** Yes. So, everything we have incorporated will be around 0.75% on total assets, the NPAs and all those things. So, yes.
- Vimal Jain:** Renish, Vimal this side. So, you are taking Rs. 100 crores wrongly. So, 3% total credit cost on MFI portfolio. So, it includes our historical credit cost also. So, the additional credit cost will be 1% and 1.5% over the year, which will create a buffer.
- Renish Patel:** Yes. So, let's say in PPT, we have disclosed that our existing credit cost on MFI is 1.5%. So, incrementally, we have to provide 1% to 1.5% in FY '25 to take that credit cost to 3%, right?
- Sanjay Agarwal:** Correct. Absolutely right.
- Renish Patel:** On Rs. 8,000 crores of portfolio. Okay. Got it.
- Moderator:** The next question is from Kunal Shah from Citi. Please go ahead.



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- Kunal Shah:** So, firstly, when we look at it in terms of the integration expenses, what we have highlighted of Rs. 300-odd crores, so out of that, we mentioned like Rs. 77 crores is the stamp duty, another Rs. 50 crores, Rs. 60 crores which will be BAU. And balance has been already taken care of by Fincare. And when we look at it, the net worth, which is being given at Rs. 2,421 crores on the merged basis, that is after taking into account those merger-related expenses?
- Vimal Jain:** Yes. Yes, Kunal.
- Kunal Shah:** So, it's already been factored in by Fincare. And incrementally, what we will see by way of the integration will be only Rs. 50 crores to Rs. 60-odd crores in BAU expenses.
- Sanjay Agarwal:** Yes.
- Kunal Shah:** Rest all is accounted for now?
- Sanjay Agarwal:** Yes, yes. So, in other words, you can calculate, it's not about Rs. 2,400 crores net worth, it is around Rs. 2,550 crores, Rs. 2,570 crores kind of net worth deal.
- Kunal Shah:** Okay. So, sir, I was just seeing like in terms of like what we expected as an additional transactional expenses, Rs. 300 crores?
- Sanjay Agarwal:** Yes. So, Fincare has super, I would say, quarter 3, quarter 4. So, they built up more buffers, and we are able to put more expenses in that year itself so that there is no one-off in coming years. And Rs. 50 crores, Rs. 60-odd crores in the next 2 years will be treated as business as usual kind of expense.
- Kunal Shah:** Sure. And secondly, in terms of the segment-wise ROA, okay, so it's quite an interesting one in terms of like 1.6% ROA and we had given the retail and the commercial. No doubt, Fincare will get added into this, which will be relatively ROA accretive. But besides this, where could we see the levers in terms of what we are seeing, like, say, credit card, let's say a drag of almost 27-odd basis points. And I think regulatory drag would also continue. So, would there be any other levers besides Fincare out there and the Opex out there? Or if we just look at this slide, particular slide, which is there, yes.
- Sanjay Agarwal:** I believe that retail asset ROA will go up, so may not be in immediate terms, but in a 12- to 18-month period, you will see ROA of retail assets will go up because we are focusing more on Wheel and MBL, maybe micro finance business. Of course, micro finance business will have a cap of 10% of total advances. So, that will go up. The second lever, which I strongly believe is that the branch banking has to be more efficient and profitable by building CA, because our CA is around 5%, right? And even if we increase it by 1%, right, it saves us a lot of money. So, we want to really focus more on branch banking as an overall franchise. And we have invested a lot in terms of lot many products in the sense that credit card, wealth, insurance, AD1, so many products are there. So, the branch banking need to leverage those products so that they become more profitable. So, second lever would be coming from there.

So, I think if you add up these 2 things, I can say at least maybe 10-20 bps in coming year, right? So, that's our whole strategy and of course, the treasury and all those things won't come profitable unless until there is a cut in interest rate. So, I think these are 2 levers. And I think commercial banking also, we just want to be more rational around our whole franchise there. So, of course, they are giving us 2.75% to 3% kind of ROA, but I think they can also move a little bit up. So, we have been focusing more on high-yield businesses in those assets also. So, I think these are 3, 4 levers, which will help us to defend 1.6% at least this year, and we'll look for a better ROA next year onwards.

Kunal Shah: And credit card, we are not expecting much?

Sanjay Agarwal: Sorry for not commenting on that. But credit card, we're moderating in terms of our issuance. So, we'll be issuing same level of last year. And I think we have taken a lot many measures to really see the early delinquencies or early challenges in our asset quality. So, that's already been arrested in last quarter. And we really want to watch another 2 quarters to be really sure that at what level our credit cost can be there. But the initial feedback is just that it won't be crossing 6%-6.5%. And these are certain measures we have taken, and it will start coming up in the next 2 quarters itself.

Moderator: The next question is from the line of Nidhesh from Investec. Please go ahead.

Nidhesh Jain: So, firstly, on credit card business, if you can spell out the drag on P&L that the credit card business has had in this quarter, which you have shared in the analyst meet for 9 months that will be useful. How should we think about the profitability of credit card portfolio over next year and subsequent years?

Sanjay Agarwal: Nidhesh, Mayank will speak more on this, but I'll just give you some high numbers there that we have gone back to our drawing board in last quarter and really want to calibrate the entire credit card business. So, we learn more deep about every aspect. So, we'll not be issuing more than 6 lakh credit cards this year, too. And we really want to watch the space out in the sense that what the real sense of credit cost there, right? Again, the initial feedback is around 6% to 6.5% on an average basis for the entire year. We are also expecting some more circulars, more direction from regulators to regulate this industry or this vertical more in the sense that they want to put more stringent norms so that this industry becomes more stronger or in terms of there's no risk to the system. So, difficult to assess when it will become profitable or when we'll achieve the breakeven.

But I think one thing is sure that for next 2 years, it's not getting profitable. And beyond 2 years, the visibility is not there because it has lot many variables, like the cost of interest, any norms which will come from the RBI about the expense side. You're hearing so many things in the newspaper. And of course, how our credit cost can get stabilized, right?

So, there are certain variables, which we really want to comment maybe next year that how we really want to make it profitable. But we want to build this vertical because this vertical remains an important vertical for any Bank. And we have done lot many good things in terms of issuance, in terms of spend per card, the acceptability of people. Generally, people have accepted our credit card to a very high-level, right? And acceptance has gone up every month. So, we are really interested in this business. But we really want to take one pause, learn more, go more deep and then take the final view in next 2 to 3 years that how we want to become profitable, right? Mayank, you want to add on something?

Mayank Markanday:

Yes. Just to add upon what Sanjay ji said, we have been reviewing and doing a lot of calibrations in the business. And you will see a continuous improvement in our operating metrics also quarter-on-quarter. Apart from this, on the credit side, a lot of calibrations we have taken in the last 9 to 12 months as we told on the 18th March presentation also. So, good part is that we are seeing a positive impact of the calibrations we have undertaken and the early trends are quite visible. This quarter, we have seen similar credit cost in our actual amount what was there in the last quarter despite of the increase in E&R book. So, we are quite positive around it. And all our early indicators, be it a nonpayment on the due dates, 30 plus in 3 months, are quite promising. And nevertheless, we are continuously monitoring our portfolio, and you will see the results coming on.

Sanjay Agarwal:

So, one more thing, Nidhesh. We have also changed our strategy around video banking and QR code. So, video banking and QR code is no longer a product for us. Actually, we have changed them from product to channel. So, video banking had got merged with branch banking team now. And so there also the investment will not be there because now the whole leverage will happen through branch banking team. And similarly, in the QR code also, we don't want to put QR code as a separate business. Rather, we want to put the QR code to our current account acquisition kind of strategy, right? So, I think there also the QR code will become profitable, right? So, it's more a value proposition. So, I think that will also help us to cut costs in those 2 initiatives.

Nidhesh Jain:

Sure, sir. Sir, you shared a number around Rs. 200 crores of drag because of credit cards for 9 months. If you can share that number for full year FY '24, that would be useful.

Prince Tiwari:

We have already given that, Nidhesh. On the SBU wise profitability, the digital side, I think you can assume 90% is credit cards only, Slide #37. So, you can refer that. I think it's Rs. 268 crores. So, you can assume 90% of that to be coming from credit cards.

Nidhesh Jain:

Okay, sure. And just lastly on incremental disbursement piece, we see some improvement in this portfolio. But in housing loan and micro business loans, at least the on-book yields have not changed for last 3, 4 quarters. So, any data point on how the incremental yields are behaving in these 2 portfolios, micro business loans and home loans?



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Sanjay Agarwal:

So, 2 things here, Nidhesh. One, like after acquiring Fincare, so in South market, we have seen that on the MBL business, the team do around 18% kind of yield. So, we really want to focus more in South market through the Fincare unit, because MBL is more competitive in North nowadays, right? So, we are not getting space there. But fortunately, Fincare team has done a decent job in terms of yield there, so we really want to capitalize our positioning in those markets. And you will see yield uptick as we move forward, right? And second, we haven't invested a lot in our MBL franchise in the last 2 years, but now focus has come back.

And as I have commented earlier also that we really want to build more ROA, high ROA business. So, there may be a case where the yield is lesser, but the ROA proposition in overall profit will go up from these businesses, right? And we really don't want to build more affordable housing space because, again, affordable housing space to increase rates are not easy, right? So, we want to change our strategy more in favor of MBL than AHL because generally, markets are same, the operational ability is same, the customer is also same. So, we really want to capitalize our positioning more in MBL than in AHL.

Moderator:

The next question is from Prakhar Agarwal from Elara Capital. Please go ahead.

Prakhar Agarwal:

So, first is I just wanted to understand on yields, any of the products wherein you have tweaked the yields on the fresh disbursement and if you could just highlight in terms of which product and what yields adjustment that you have made, which is first. And then probably I'll go ahead with the second question.

Prince Tiwari:

Yes. So, see, Prakhar, again, as we have said earlier, I think given the competitive intensity, we were a bit cautious, let's say, in terms of increasing the price and underwriting the business. But I think beginning of quarter 4, sometime mid of quarter 4, as we had articulated earlier, there has been a let up or some sort of room is now available in the market, where we are seeing that competition is also starting to increase rates, right? And that has given us some room. Maybe if you look at the whole quarter number, it might not give you a very clear picture, but we can say for sure that in March, while it has been a record March for us, but we have seen a disbursement Yield also increased by at least 10 to 15 basis points. At least in the retail asset products, but maybe Bhaskar ji can offer you more clear details.

Bhaskar Karkera:

Bhaskar here. Just to give you 1 data point, just the Q3 of Wheels and the Q4 of Wheels, we have an incremental of 27 bps on the rate, I'm just talking about the 3-month period. And the fact that we have already calibrated as the same goes for MBL where we've also, while the rate increase, we take a little more time in MBL. But all the 3 businesses, which is when I'm talking about, be it the affordable home loan space, even there also, we have been able to increase it by about between the 2 quarters itself, Q3 to Q4. In the AHL business also, we have been able to increase it by 20 bps. So, it is more the traction that we are putting on the ground in terms of all the incremental businesses have to happen at an incremental rate, right? So, you would see it coming. As it comes, it will come, but it will take time to show on the book, though. But incrementally, in all the businesses, we are in the trajectory of taking it upwards.

- Sanjay Agarwal:** So, just to add on, Prakhar, one more clarity is that Wheel business, MBL business, the micro finance business, the gold finance, maybe NBFC funding and of course, the REG business, gave us north of 3% ROA. So, the idea is to build more disbursement from this business from this year onwards. So, the proportion of disbursement of affordable housing or commercial banking or maybe low ROA businesses will come down. So, I think there is one way to increase the yield on this high-yield ROA business. And the other way is to really build more businesses from this high ROA businesses, right? So, I think that that's a 2-way strategy we are working upon. And you will see that in the next 6 months, when we'll give you the data of disbursement, you will see yourself that it is more high ROA-led businesses, we are doing more. And that's the complete, complete, focused and deliberate strategy.
- Prakhar Agarwal:** Just one follow-up on this. Do you see further room for the hike in rates or probably we are probably done with one leg and now it will be more of a disbursement mix change that you have highlighted? Or probably some room is still left on yield adjustments that you can make?
- Sanjay Agarwal:** Prakhar, it's both ways, right? Because beyond a point, if I want to push more high yield, it can be counterproductive. There can be a slowdown in our growth rate, right? So, idea is more to have a high ROA-led businesses to grow more, right? So, for example, our own estimation says that our 75% of disbursement this year would be from high-yield assets. And now the respective businesses need to figure out that for that particular disbursement at what rate they want to really operate, right? But if your 75% business operate, at 3% plus ROA business, eventually we'll get to 2% ROA in next 3 to 4 years and the interest rate cut starts. That's the overall positioning.
- Prince Tiwari:** Prakhar, just to add one last data point on that. I think what we have given on Slide #32. The overall disbursement yield for the entire business for the full quarter went up by 8 basis points. So, while Bhaskar ji said that vehicles went up by about 27-28 basis points. For the full business, it was up by 8 basis points. So, we'll start seeing this going up because of the mix as well as the yield push in the future quarters.
- Prakhar Agarwal:** Got it. Just second thing on one clarification. The Rs. 300 crores that you said on the merger expenses, large part of that is already done. So, Rs. 50 crores, Rs. 60 crores per year is left or only one tranche of Rs. 50 crores, Rs. 60 crores is left?
- Sanjay Agarwal:** So, overall, Rs. 50 crores, Rs. 60 crores in maybe 1 to 2 years. I won't say 3 years. But maybe in the range of 18 to 30 months.
- Prakhar Agarwal:** Okay. So, Rs. 50 crores, Rs. 60 crores over the next 2 years?
- Sanjay Agarwal:** Yes.
- Moderator:** The next question is from Nitin Aggarwal from Motilal Oswal. Please go ahead.
- Nitin Aggarwal:** So, one question is on the other income. Like if I look at the fee income, traction for us has been very, very strong, and it has been only like getting better. So, how sustainable really this is

because, fee intensity, if I just look at on a quarterly basis on the total assets, it's already on the higher side. And so how sustainable is this? And what further levers do you see going ahead in FY '25?

Sanjay Agarwal:

So, Nitin, this is, I think, on a sustainable basis only nowadays because as a third-party product, insurance has stabilized in all sense, right? And the team is doing fantastically well. The organic service incomes and all those things is also now stabilized. So, I don't think any challenge there. We have add on the wealth product. I believe that wealth product from here onwards should be more firmed up. So, that will give you more income. And fourth, we have just started AD1 product. So, that need to be more stitched. But the initial feedback is so strong that it will only add to the whole kitty. So, I believe that the sustainability is already on the table. It will more firm up in coming years.

Nitin, other thing is this that because by acquisition of Fincare, we don't have anything to buy now as a Priority Sector requirement. Rather, it may have some surplus, right? But that needs to be seen in this coming year. But there won't be any negative drag because of our Priority Sector requirement. They can be only better off there, right? So, let's see.

Nitin Aggarwal:

Right, of course. And the other thing on securitization because you talked about like growing 25% on a steady basis over the next 2, 3 years. So, should we expect lower securitization now going forward as you will be able to mobilize more resources and make Fincare branches also as part of synergies to your Bank. So, how should we look at that?

Sanjay Agarwal:

Optically, yes. We don't want to securitize because it has its own cost. But in the interest of CD ratio, in the interest of other things, sometimes we might have to do. But on an overall basis, our securitization requirement will come down in coming years.

Moderator:

The next question is from Param Subramanian from Nomura. Please go ahead.

P. Subramanian:

My first question is on the margin. So, could you explain the quarter-on-quarter walk for the margin because the funding cost is only up 8 basis points? So, we are seeing 5.5% go to 5.1%. If you could break that up for us.

Prince Tiwari:

Yes. Param, so I think margins, you have to look at it in 2 steps. As we had said last quarter, last quarter's margins had a one-off impact from the securitization income, which we had taken for an additional month last quarter because of the matching principle that we followed. So, it was onetime adjustment. And because of that, the last quarter's margins, and we discussed this on last quarter's call as well, the last quarter's margin should idly be looked at as 5.3% after adjusting that. And from there, if you add the 10 basis points and the fact that it was a short-term quarter, so to that extent, on an average basis, it's actually 5.14%, not 5.1%. So, hope that clarifies.

P. Subramanian:

Okay. So, the core margin last quarter was 5.3%, that was including securitization.



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- Prince Tiwari:** Yes, absolutely.
- P. Subramanian:** And the comment you made that on a blended basis, post merger, we will defend this margin, that is this 5.1% is the one that you're saying will be defended or the average for the year?
- Sanjay Agarwal:** So, we want to defend 1.6% ROA.
- P. Subramanian:** Fair enough. So, on the fee line, and so the comment you made on credit cards where you are saying the pace of issuance is going to be flat Y-o-Y going into next year. So, we can see that credit card fee is above Rs. 300 crores in your P&L and OpEx is about Rs. 600 crores that you called out. So, how do these numbers get affected next year? Is it more a positive delta or a negative?
- Prince Tiwari:** Delta will be positive. What will happen is, obviously, because we are going to issue lower and the base has increased, so Mayank, do you want to add to that?
- Mayank Markanday:** So, Param, what happens, major fee income is through interchange, which comes through the spends happen from the entire base. So, whatever you add to it also, the previously added 1 million card will also contribute to the fee income coming to us. So, it will increase from here.
- Sanjay Agarwal:** So, drag will be less, in my opinion. The drag will be less.
- P. Subramanian:** Fair enough. So, this sort of fee trajectory that you're seeing where actually your quarter-on-quarter trajectory as well as year-on-year on fees very strong. Going into next year also, you actually expect this sort of to be maintained, despite the credit card going down.
- Prince Tiwari:** On the fee income side?
- P. Subramanian:** Yes. Yes, on fees. Yes.
- Prince Tiwari:** Yes. So, I think this year has been obviously coming together of couple of things. Obviously, there was the insurance and third-party distribution as well as the credit card. There was a lesser drag from treasury. In fact, last year, there was a drag from treasury. This year, there was a positive impact, right? So, all put together, this year was exceptionally strong for us, where we grew the other income by 70% or 69%. Next year, definitely, it's not going to grow by this percentage points, but trajectory will be positive and these should grow in line with the balance sheet is our expectation at this stage.
- Moderator:** The next question is from Manish Shukla from Axis Capital. Please go ahead.
- Manish Shukla:** What is the micro finance yield or the rate at which you are lending today?
- Rajeev Yadav:** Manish, this is Rajeev Yadav. So, our lending rates in micro finance are about 25% at this point of time.



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Manish Shukla: So, Rajeev, if RBI were to put any kind of a spread or yield cap, would you still be keen to take 5% to 10% of the book or you would want to revisit in that scenario?

Rajeev Yadav: So, the principles of pricing in a Bank for a microfinance portfolio are linked to the input variables, which are typically the cost of fund, the operating expenses, the credit cost and all those variables. So, as a Bank, we are expected to have a pricing policy, which is well defined on those variables and the profit margins that you need to sort of build on. So, the broader expectation more is that the regulatory is keen to track those variables. And therefore, we are able to align our pricing to the conditions, whether it's a worsening condition or an improvement in the condition. But I think from a policy perspective, banks are typically not governed on a margin or a pricing cap for any portfolio.

Sanjay Agarwal: So, Manish, just to add on, I'm Sanjay this side, again, I'm repeating that it is about high ROA business, taking more business share in overall disbursement. And micro finance gives us a north of 4% ROA. I don't know what cap you're talking about because I haven't heard anything from regulators or anything in newspapers about this whole capping of interest rate. Rather, they have opened up last year. So, there is no cap on it. We can actually price 30% also. But it's fine, right? We can do that, right? But we are not doing it not because of cap. We're not doing it because of business sense, right? But it's a high ROA business, and it's an inclusion where I strongly believe that Fincare has given us around 770 touchpoints where they operate as a micro finance unit.

And those 770 points, we have a body-soul, right? And it's a very detailed franchise available. My sense is that because of this distribution, we can actually leverage those touchpoints by building more Wheel business, more SBL business, more affordable housing business in times to come. And I'm very positive about this whole positioning of AU, getting around 2,400 touchpoints in the entire country at one go, right? So, I think the idea is to really build more high ROA business, then really focusing more on yield, right? Because sometimes high yield is counterproductive. So, you need to balance it out, right? But idea is to really be around 75% of disbursement happening in north of 3% ROA businesses.

Manish Shukla: What I was saying is that the rebranding of the Fincare touchpoints to AU touchpoints, has that already happened? Or is it yet to happen?

Sanjay Agarwal: Yes, work in progress, Manish. So, in our urban branches, which is around 138, nearly 90% branches has been rebranded in a transitioning brand, and rest will be in due course of time. But necessary compliance, necessary information, necessary communication has already been done with the entire stakeholders.

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

Aravind R: Expenses for credit cards continues to increase despite having a similar rate of acquisition like in third quarter versus 4th Quarter. That is one thing. And also despite our focus on sourcing

mainly through branch banking channel, I'm just trying to understand like how this could shape over the years. Why is it like not coming down? That is one thing.

And, I mean, it was also said that video banking would be like merged with branch banking and QR would be part of the current account acquisition. So, does that mean that there won't be any additional expenses needed for these two? I understand this is a very small part of that Rs. 200 crores in 4th Quarter. But I'm just trying to understand that.

And also, on AD1, have we already started making investments in this? Like is it already part of the expenses, OpEx?

Sanjay Agarwal:

So, Mayank, can you answer credit card? And then Vivek, AD1.

Mayank Markanday:

So, Aravind, on your first question related to the cost of third quarter versus the 4th Quarter, yes, there was an increment of just 11,000 cards from quarter 3 to quarter 4. That impacts only the sourcing cost, but the rest of the cost remains same because we already have a base which continues to give us cost in the third quarter also, the same basis given the cost in the 4th Quarter also. But yes, with the growing book and this quarter, only a book of around Rs. 400 crores, there was an incremental book which happened. So, quarter-on-quarter, you will see this operational cost improvements. But yes, the impact, which will not be a very large impact from quarter-to-quarter. It takes around 3 to 4 quarters till the time the average cost looks better. So, that was one.

The other is on the branch banking, yes, we do acquire customers from the branch banking team, but we have a multi-distribution channel also. So, we acquire through other channels also and every channel has a different cost which comes through the sort of customer we bring in. So, we are recalibrating all those things, and a lot of review undertaken on this. And we will be continuing doing much better business from the branch banking and acquisition channels. It's already there in the Bank.

Vivek Tripathi:

See, in terms of the rolling out AD1, we have already rolled out. So, the CAPEX part has been already incurred. Only a few parts of the AMC or the operational part, which will be there, but that's not a very large extent. In terms of revenue, the business has already been rolled out and since we have a large base of MSME customers as well as individual customers, so the first attempt is to reach out to those customers and maximize the business from across our distribution points, especially in the urban branches.

Sanjay Agarwal:

And last one is our video banking and QR code. So, we had a very detailed heavy setup at Mumbai to build a video banking as a project. But we figured out that video banking customers, we are not able to penetrate more. So, we decided to build with the branch banking team so that it's become an acquisition channel for us with a very less expensive acquisition channel, and we really want to move out of Mumbai, too. The bankers can be at Jaipur or maybe at somewhere in South, somewhere in East, somewhere in West. So, that is 1 or 2 things we want to do it in



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the next 2 to 3 years. But we don't want to invest more in video banking center in Mumbai and want to really leverage the entire acquisition through the branch banking penetration so that we can create a value out of it.

And second, QR code also, because QR code, generally, is very competitive in that sense, right? But we really want to build around the current account customers, right? So, the additional expense won't be there. So, there will be a separate account or separate pool for investment in these strategies. Rather it will be clubbed with branch banking, and we really want to monetize it through the current account value or maybe value through more penetration in those accounts, right? So, that is why maybe this year onwards, you won't see the drag from video banking and QR code in our balance sheet.

Aravind R: Sure, sir. Just one question, if I can ask. Like what will be the quantum you would have invested in AD1, so we don't need any capital investment going forward?

Sanjay Agarwal: Any CAPEX, what we have done in AD1 will be not more than?

Vimal Jain: So, we incurred around Rs. 20 crores.

Aravind R: Okay. And what about branding expenses?

Vimal Jain: So, this Rs. ~20 crores is as a CAPEX.

Sanjay Agarwal: Largely on building up that application and related hardware.

Aravind R: Sure. Just last question. Branding expenses will continue through next year or also?

Sanjay Agarwal: Yes. We need to build because the idea is to remain really focused on building the deposit franchise, right, because the whole purpose of Bank is to build deposit franchise. And I'm so happy to see that AU is now able to create their name and visibility across this country, and Fincare acquisition has helped us a lot. So, I think the visibility of brand is must to build a brand. But I think the idea is more to really make effective branch banking in overall sense, right? So, the branding initiative helps those people to build those things right. So, we won't be doing very high, but it has to be calibrated or somehow, we have to manage it right. So, we have built that expense in our future projections so that the whole alignment around building up the deposits remain on track.

Moderator: Next question is from Pritesh Bumb from DAM Capital. Please go ahead.

Pritesh Bumb: Sir, just one question on Tier-1. As of April 1, what will be our Tier-1, sir? This is again including the merger, I'm asking.

Vimal Jain: Just give me one minute. Tier-1 capital, so total capital will be about Rs. 14,981 crores, ~~it will be the Tier-1.~~



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- Prince Tiwari:** So, it will be around ~~20% to 21%~~ (Corrected 19%-20%). But we can come back to you with that number.
- Pritesh Bumb:** So, approximately 21%, 22% is the Tier-1 we are talking about, right?
- Prince Tiwari:** ~~20% to 21%~~ (Corrected 19%-20%)., more around that.
- Pritesh Bumb:** This is Tier-1, right?
- Prince Tiwari:** Yes.
- Pritesh Bumb:** And we would have taken the benefit of lower risk-weighted assets on the MFI book, which comes in through the Fincare side. So, that will be included in this?
- Prince Tiwari:** Yes. So, what has happened, Pritesh, is the merged balance sheet, because we just closed both the balance sheets for both the entities between yesterday and today on the audited side, the opening balance sheet, which still needs to be formed because it can only be done once both the balance sheets had got audited. So, we have got both the balance sheets audited today. And then the opening balance sheet will now be formed, so we can come back to you with some of these questions. But yes, if there is a benefit on the table for the MFI, we'll definitely take it, why not?
- Vimal Jain:** Pritesh, broadly, we are getting the benefit of 50 bps in our Tier-1 and Tier-2 capital. So, this maybe the impact only on merged basis.
- Moderator:** Thank you very much. That was the last question in queue. I would now like to hand the conference back to Mr. Prince Tiwari for closing comments.
- Prince Tiwari:** Thank you, Rayo, and thank you, everyone, for your participation today evening. I know it was a busy evening with multiple banks results coming through. So, thanks for coming on the call. And in case you have residual questions, do reach out to the IR team. Thank you so much.
- Moderator:** Thank you very much. On behalf of AU Small Finance Bank, that concludes this conference. Thank you for joining us. Ladies and gentlemen, you may now disconnect your lines.