

Ref No: 12/SE/CS/FEB/2023-24

Date: February 15, 2024

To,

Listing Department BSE Limited Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai – 400001	Listing & Compliance Department National Stock Exchange of India Limited Exchange Plaza, 5th Floor Plot No. C/1, “G” Block Bandra-Kurla Complex Bandra (E), Mumbai – 400 051
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BSE Scrip Code: 544020

NSE Symbol: ESAFSFB

Dear Sir(s),

Sub: Transcript of the Earnings Conference Call on Financial Results of the Bank for the quarter and nine months ended on December 31, 2023

We would like to inform that the Transcript of the Earnings Conference Call in connection with the Financial Results of ESAF Small Finance Bank Limited ("Bank") for the quarter and nine months ended on December 31, 2023, held on Friday, February 09, 2024 at 10:30 hours (IST) is attached herewith. The above-mentioned transcript is also available on the website of the Bank at: <https://www.esafbank.com/investor-relation/?id=presentation-and-concall-transcript>.

This is for your information and appropriate dissemination.

Thanking you,

Yours faithfully,

For **ESAF Small Finance Bank Limited**

Ranjith Raj P
Company Secretary and Compliance Officer



“ESAF Small Finance Bank Limited
Q3 FY '24 Earnings Conference Call”

February 09, 2024



MANAGEMENT: **MR. K. PAUL THOMAS – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER – ESAF SMALL FINANCE BANK LIMITED**
MR. GIREESH C.P – CHIEF FINANCIAL OFFICER – ESAF SMALL FINANCE BANK LIMITED
MR. GEORGE K. JOHN – EXECUTIVE VICE PRESIDENT, IT & OPERATIONS – ESAF SMALL FINANCE BANK LIMITED
MR. HARI VELLOOR – EXECUTIVE VICE PRESIDENT, NETWORK 1, SOUTH – ESAF SMALL FINANCE BANK LIMITED

MODERATOR: **MR. VIRAL SANKLECHA – ORIENT CAPITAL**

Moderator: Ladies and gentlemen, good day. Welcome to Q3 and 9-month FY24 Earnings Conference Call of ESAF Small Finance Bank Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star, then zero on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Viral Sanklecha from Orient Capital. Thank you and over to you, sir.

Viral Sanklecha: Thank you, Muskan. Good morning, ladies and gentlemen. I welcome you for the Q3 and 9-month FY24 earnings conference call of ESAF Small Finance Bank Limited.

To discuss this quarter's provisional performance, we have from the management, Mr. K. Paul Thomas, Managing Director and Chief Executive Officer, Mr. Gireesh C.P., Chief Financial Officer, Mr. George K. John, Executive Vice President, and Mr. Hari Velloor, Executive Vice President. Before we proceed with this call, I would like to mention that some of the statements made in today's call may be forward-looking in nature and may involve risk and uncertainty. For more details, kindly refer to the investor presentation and other filings that can be found on the company's website.

Without further ado, I would like to hand over the call to the management for their opening comments and then we will open the floor for Q&A. Thank you and over to you, sir.

K. Paul Thomas: Okay. Thank you. Good morning, everyone. On behalf of ESAF Small Finance Bank Limited, I extend a warm welcome to all the participants on our second earnings call to discuss the Q3 and 9-month FY24 business performance. I wish to express my heartfelt gratitude to all those who dedicated their time to join the call and have consistently been part of our journey.

Today on this call, I am accompanied by my colleagues, Mr. Gireesh C.P., our Chief Financial Officer, Mr. George K. John, Executive Vice President, and Mr. Hari Velloor, Executive Vice President. I hope everyone had an opportunity to go through our quarterly results and investor presentation that has been uploaded on the Stock Exchange and on the company's website.

Before I start with the business update, I would like to give a short introduction of the company to all and for the participants looking at the company for the first time. ESAF Small Finance Bank Limited, ESFB, a scheduled commercial bank, commenced its banking operations on 10th March, 2017. Mr. Kadambelil Paul Thomas and ESAF Financial Holdings Private Limited promoted the bank. The bank's triple bottom line approach, focusing on people, planet and prosperity, exemplifies its commitment to universal financial access and inclusion.

With a dedication to predominantly serve the low-income and middle-income segments, ESAF continues to contribute to livelihoods and economic development, embodying empowerment,

inclusivity and positive transformation in every financial interaction. ESAF Small Finance Bank, along with its promoters, has over 28 years of experience in the Indian BFSI space, primarily serving the unserved and underserved.

It has expanded product portfolio in the last three years to cater to individuals, groups, MSMEs through retail loans and other loans and now boasts an Advance Under Management of INR181 billion and deposit of INR188 billion. ESAF Small Finance Bank has set up extensive network of 731 banking outlets, 917 customer service centres, 30 business correspondents, 4,003 banking agents, 723 business facilitators and 600 ATMs spread across 21 states and 2 union territories. Before I hand over the call to Mr Gireesh to discuss the financial performance, let me give a brief about Indian economy's performance followed by our operational performance.

In the monetary policy meet yesterday, the RBI kept the repo rate unchanged at 6.5%, they also anticipate real GDP growth of 7% for the fiscal year 2025, with risk evenly balanced. Moreover, headline inflation has shown a decline to 5.5% during April to December 2023, compared to 6.7% in FY23. For the fiscal year 2024, headline CPI inflation stands at 5.4%, with a projection of 4.5% for the current quarter Q4.

The country's economy remained healthy and stable, thanks to strong government investments, particularly in building infrastructure, enhancing local manufacturing and the steady performance of service industries. In the third quarter, economic activity continued its steady pace, with strong urban demand and a gradual recovery in rural areas. Public sector investments remained robust, supporting investments endeavours.

Financial markets and banking conditions remained largely stable. Bank lending grew consistently at around 16%, while deposit growth increased from 12% to 14%, narrowing the gap between them. The banking system saw liquidity moving from a deficit to a surplus as the RBI scaled back pandemic-era monetary support.

Looking forward, we anticipate private consumption to be bolstered by improving rural demand, a thriving manufacturing sector and ongoing growth in services. Additionally, government infrastructure initiatives and anticipated private sector investments should further drive economic activity. Moving on to our operational performance, as on December 31, 2023, we proudly served over 7.94 million customers, with a significant majority being women.

Our extensive reach and spans across 21 states and two union territories, notably our gross advances to customers outside of Kerala amounted to INR10,412 crores, constituting 60.7% of total gross advances. The top five states outside or home state of Kerala for gross advances including Tamil Nadu, Maharashtra, Madhya Pradesh, Karnataka and Chhattisgarh collectively accounted for INR8,301 crores, representing 48.4% of total advances. Our advances under management surged from INR13,351 crores in Q3 FY23 to INR18,149 crores in Q3 FY24, marked a growth of 36% on year-on-year basis.

Moreover, our commitment to accessibility is evident with 731 banking outlets and 600 ATMs, which are strategically located in these areas. In addition to these, we have 917 customer service

centres operated by 30 institutional business correspondents and 403 banking agents. To conclude, I would like to express my appreciation for your continuous support.

We are committed to sustaining our focus on growth, the quality of our portfolio and operational efficiency. With a strong financial foundation and strategic initiatives in place, we are well-positioned for a prosperous and profitable future. With that, I will now pass on the call to Mr. Gireesh. C P, CFO, to present the financial performance.

Gireesh C.P:

Thank you, sir, and good morning to all of you. I sincerely appreciate your presence on this conference call today. Please allow me to provide you with an overview of financial performance for Q3 and 9-month FY '24.

We as a bank are focused on the unbanked and underbanked, particularly in rural and semi-urban areas. As of December '23, approximately 70% of our gross advances cater to customers in these regions, with 62% of our banking outlets strategically placed there. Our key offerings include microloans, retail loans, encompassing gold, mortgage, personal, vehicle loans, MSME loans, financial institution loans and agricultural loans.

We take pride in serving these diverse segments with a commitment to financial inclusion and community development. Our gross advances reached INR17,153 crores in Q3 FY '24 as compared to INR12,544 crores in Q3 FY '23, making a growth of 37% on a Y-o-Y basis. In Q3 FY '24, the disbursement stood at INR3,893 crores as compared to INR3,521 crores in Q3 FY '23,

Making a growth of 11% on a Y-o-Y basis. In terms of deposits, we witnessed substantial growth, climbing from INR13,412 crores in Q3 FY '23 to INR18,860 crores in Q3 FY '24, marking a growth of 41% on a Y-o-Y basis.

We have strategically prioritised the expansion of our retail deposits, witnessing a rise from INR13,346 crores in FY '23 to INR16,994 crores in Q3 FY '24, showcasing a 27% increase. Highlighting the significance of current and saving accounts, CASA stood at INR3,563 crores in Q3 FY '24 as compared to INR2,960 crores in Q3 FY '23.

Net interest income for Q3 FY '24 stood at INR597 crores as compared to INR451 crores in Q3 FY '23, showcasing an increase of 32.3% on a YOY basis. Net interest margin for Q3 FY '24 stood at 10.6% as compared to 9.9% in Q3 FY '23. GNPA for Q3 FY '24 stood at 4.2% as compared to 7.2% in Q3 FY '23. Net NPA stood at 2.2% as compared to 3.7% in Q3 FY '23. Portion Coverage Ratio for the quarter remained stable at 59.5%. ROA for Q3 FY '24 stood at 2.3% as compared to 1.5% in Q3 FY '23. Return on equity for Q3 FY '24 stood at 25.5% as compared to 17.6% in Q3 FY '23. Profit after tax for Q3 FY '24 stood at INR112 crores as compared to INR37 crores in Q3 FY '23, showcasing an increase of 199% on a Y-o-Y basis.

9-month FY '24 profit stood at INR382 crores. Our comprehensive services extend beyond traditional banking offering, safe deposit lockers, foreign currency exchange, access to Bharat Bill Payment System, money transfer services and Aadhaar Seva Kendra services.

Additionally, we take pride in providing our customers with a diverse range of offerings, including distribution of third-party life and non-life general insurance policies and government pension products. In conclusion, ESAF Small Finance Bank is well-poised for a bright future. Our commitment to serving the unbanked and underbanked parts of Indian demography remains unwavering.

We will continue to invest in technology, expand our reach in the chosen geographies and maintain a strong financial position to serve our customers better. We are excited about the progress we intend to make and we appreciate your continued support. Thank you all and we will go forward with question and answer session.

Moderator: Thank you very much. And the first question is from the line of Sagar Tanna from Alchemie Ventures. Please go ahead.

Sagar Tanna: Hi sir, I have couple of questions. One is on the Other expense. What is the nature of these Other expenses?

Gireesh C.P.: Other expenses, it is primarily BC expenditure. It is mainly BC expenditure, rental, electricity, then advertisement, publicity.

Sagar Tanna: So what contributed which of these other expenses, what contributed to the rise by almost 45%-50% in this quarter, Y-o-Y? And if I see other expenses as a percentage of income, that too has gone up by nearly 300 bps-400 bps. Can you explain what caused this rise?

Gireesh C.P.: There is an increase of advertisement and publicity expenditure to the extent of INR17 crores on a Y-o-Y basis. Then there is an 8.77% increase in rent, taxes and lighting. There is a 27% increase in the employee cost and 46% increase in the other expenditure which mainly is the BC expenditure which is increased by 48%, that is INR180 crores because of the business volumes have gone up.

Sagar Tanna: But sir, if I see as a percentage of, if I see BC expenses as a percentage of income, that has gone up. So is there any formula with respect to these BC expenses because I believe BC expenses is to our own parent, right, to the promoter itself?

Gireesh C.P.: No, there is no change in the formulas. The BC expenditure has primarily gone up because the business volumes also have gone up. And the collection, vis-a-vis last year, the collection efficiency also has gone up.

Sagar Tanna: So is it linked to some kind of volume growth, number of customer acquisition growth, NII growth? What is it linked to?

Gireesh C.P.: The main component of the basic cost is the percentage of collection, collected amount. That is the primary thing. There is a small component of new customer addition as well as maintenance of customer.

Sagar Tanna: Got it. My second question is with respect to NPAs. So if you see this quarter NPA has shot up to INR335 crores versus INR186 in Q2. Can you explain this?

- Hari Velloor:** Good morning, this is Hari Vellore. So we have been seeing a bit of stress in some of our markets, particularly in Kerala. There are a few factors behind this. One is of course that our principal BC with whom we have a lot of business going on. We have seen a lot of staff attrition happening in that BC, one.
- Second, there is a lot of unregulated entities who have also entered this business in the last two years or so. What we have been doing in fact is that we are slowly reducing our exposure in some of these markets where we see stress. Apart from Kerala, we have seen a stress in a few districts in central Tamil Nadu. Then there has been some stress in Madhya Pradesh and Chhattisgarh. So in these places we have deliberately reduced our exposure.
- We have reduced disbursements also. And wherever we have been able to control it and our recovery collections have gone up, we are continuing to do business. In other places, until our collections come up significantly, we have taken a decision to control the kind of business we do. This is the primary reason why the NPAs have gone up.
- If you see from a state point of view, as I said, Kerala, primarily in central and south Kerala. Tamil Nadu, it is mid Tamil Nadu. Whereas in the coastal areas in south Tamil Nadu, we are doing extremely well. Madhya Pradesh and to some extent in Chhattisgarh.
- Sagar Tanna:** But sir, if we see our provision costs and that has come down despite the NPAs going up. So what explains this?
- Gireesh C.P:** The provision costs have not come down. In fact, we have done some kind of over and above the minimum required provisions we were maintaining, which have been partially utilized for the slippages.
- Sagar Tanna:** Sir, if I see Q2 provision costs, that was INR100 crores and this quarter, despite NPAs going up nearly double, our provision costs have gone up only by 30%, 35%.
- Gireesh C.P:** You are comparing with last year's third quarter?
- Sagar Tanna:** No. even, if you see, you can compare to last year's third quarter or even if you see Q2 FY '24, our provision was INR101 crores. This quarter is INR137 crores, which is a rise of 36%, 37%. But if I see NPAs have gone up from INR186 crores to INR335 crores.
- Gireesh C.P:** In fact, we are on a conservative basis. We are providing for SMA also at a higher level of provision. So the immediate slippages, we will utilize the SMA provision, which is already made in the books.
- Sagar Tanna:** So what is the quantum of SMA provisions or the floating provisions that we hold?
- Gireesh C.P:** SMA, at present, we are holding around INR30 crores additional provision in the SMA book and also a 40% in the NPA book.
- Sagar Tanna:** And how much did we utilize in Q3?

- Gireesh C.P.:** INR30 crores. INR30 crores, plus INR70 crores, today we are holding. So last quarter, it was INR19 crores in the SMA. So that has been utilized for SMA.
- Sagar Tanna:** Sorry, so how much did we utilize in Q3?
- Gireesh C.P.:** INR19 crores we have utilized in Q3 and we have created a provision of INR30 crores there. Net is a charge of INR11 crores.
- Sagar Tanna:** Okay. If I may be, there is one more question if you are okay. We also have a third-party product income. Can you explain this? Because that has been on an increasing trend. What is the nature of this income?
- Gireesh C.P.:** Third-party product out of the total INR25 crores, around INR9 crores is a backlog kind of income. So INR15 crores pertains to the current quarter alone. So mostly insurance, the penetration bonus, etcetera, which is provided by the insurance companies is the main reason and also the business volume also has gone up.
- Sagar Tanna:** Got it. Thank you.
- Moderator:** Thank you. The next question is from the line of Narendra from Robo Capital. Please go ahead.
- Narendra:** Hi, thanks for the opportunity. Given that you said that there are problems in the markets that you are facing related to asset quality, so what is your outlook on credit cost and asset quality in general going ahead in the next couple of years?
- Gireesh C.P.:** There could be some level of this current elevated credit cost position may continue for one quarter or two quarters. That is what we expect as things stand today. We can't precisely quantify, but the current elevated levels may continue on the credit cost aspect maybe couple of quarters.
- Narendra:** Okay. So then you see the situation normalizing after, say, H1 FY '25?
- Gireesh C.P.:** Yes, because the measures taken as explained by Mr. Hari, this will yield results in the coming quarters.
- Narendra:** Okay, got it. And what kind of loan growth are we looking for next year? And the year after that if you could provide any idea on that.
- Hari Velloor:** In terms of, we are not able to give a concrete figure to you for obvious reasons as you know. But generally, we have been saying that a minimum of 25% growth, compared to our record it is a little less, but we generally come in saying a minimum of 25% growth.
- Narendra:** Okay, got it. And regarding your cost to income, so it has risen a bit this quarter. So should we see this trend going ahead or is it expected to moderate going ahead?
- Hari Velloor:** Would you repeat the question please?
- Narendra:** I was saying that your cost to income ratio has gone up a bit this quarter. So is this the steady state cost to income or can we expect it to be moderate going ahead?

Gireesh C.P.: The cost to income ratio is almost stable. There is no significant increase as far as the cost is concerned.

Narendra: Okay, so it should be around 56-57 going ahead, right?

Gireesh C.P.: Yes.

Narendra: Okay, got it. Thanks, I will join back in the queue.

Moderator: Thank you. The next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: First of all, thank you very much for this opportunity. Sir, just wanted to clarify, you mentioned cost to income of 56% to 57%. Which period are you talking about?

Gireesh C.P.: The current quarter.

Deepak Poddar: Current quarter, you are saying fourth quarter?

Gireesh C.P.: Yes, third quarter also is almost at the same level, yes.

Deepak Poddar: So that includes your other income as well, right, in this calculation?

Gireesh C.P.: Yes, other income, the one off is only to the extent of INR9 crores.

Deepak Poddar: Okay. So how do we see that going forward? I mean, if we have to see for FY '25, FY '26 next two years, how do we see the cost to income?

Gireesh C.P.: We will be able to maintain at 60 percentage level. Marginally, plus or minus.

Deepak Poddar: 50% in what, next two years, or...

Gireesh C.P.: 60% which is at the current level. It may not significantly change.

Deepak Poddar: Okay. And this quarter you mentioned there were ad expenses, right? So what was the quantum, I missed that number you mentioned.

Gireesh C.P.: INR17 crores.

Deepak Poddar: INR17 crores. Okay. And so that will continue, I mean, was there any one off in other expense that will not reoccur or this will be on a continuous basis?

Gireesh C.P.: This is one thing which we have incrementally done for granting during the current quarter, which may not repeat in all quarters.

Deepak Poddar: So what is that quantum?

Gireesh C.P.: That INR17 crores, you know.

Deepak Poddar: INR17 crores may not repeat?

- Gireesh C.P:** Yes.
- Deepak Poddar:** Okay, fair enough. I got it. And in terms of your credit cost, I mean, even if you see our PCR is also low at about what, 55%, 60%. So just wanted to have some understanding where do you aspire your PCR to go up or because some of your peers do have a very high PCR that they are maintaining, right? So what is our thought process in terms of PCR ratio and secondly, in terms of credit cost for next year, how do we see that? I mean, you mentioned that for two quarters, it might remain elevated, right? But once it normalizes, maybe in three quarters, what's the level that we are looking at?
- Gireesh C.P:** Yes, the PCR came down because of the recent slippages which we have seen. So once the slippage ratio comes down, definitely the PCR will go up. And as I explained, maybe one quarter or two quarters, it will be almost at the same level. And after that, definitely the PCR will improve drastically. And next year, if you estimate, the credit cost will be somewhere around 2.5 percentage plus.
- Deepak Poddar:** 2.5% year as a whole, right? We're talking about?
- Gireesh C.P:** Yes.
- Deepak Poddar:** Okay. And generally in terms of ROA, I mean, do we have any kind of aspirational ROA or ROA range that we generally...
- Gireesh C.P:** ROA, what we have in mind is around 2%.
- Deepak Poddar:** 2% ROA on a sustainable basis, I mean.
- Gireesh C.P:** Yes.
- Deepak Poddar:** And one last thing, you spoke about a problem in one of a few key areas. I mean, if you see your portfolio mix, about 70% of your portfolio is Kerala, Tamil Nadu and Madhya Pradesh only. All the three markets that you have big exposure, you're talking about some problem, right? So, how do we see that? I mean, we do expect your gross NPA can go up further in coming next two quarters?
- Hari Velloor:** Well, it is like this. We have, as I said, we have restricted our lending to certain categories, etcetera, drastically in the last three - four months. What we are seeing is that these results are paying off. The pace, I will say, is kind of coming more under control. So, while I'm not able to give you a forward-looking statement, but let me put it this way that the way we have certain evaluated certain strategies, especially, in the way we distribute, etcetera, we expect it to come under control over the next two quarters. Definitely, this is what we see, the kind of steps we have taken.
- Deepak Poddar:** Okay. I got it. And in terms of your secured versus unsecured, I think currently MFI book still forms about 70%, right-odd? So, how do we see that changing over the next two years, three years?

- Hari Velloor:** Yes. Basically, we have been steadily bringing this down from almost 99%. It is now at 72%. As you know, in terms of the trend, we have been saying that by '26, '27, we see this at around 60%. This is what we've been discussing during our various meetings. So, we are still sticking to that.
- Deepak Poddar:** Okay. Fair enough. I got it. I think that's it from my side. All the best to you. Thank you so much.
- Hari Velloor:** Thank you.
- Moderator:** Thank you. The next question is from the line of Madhuchanda Dey from MC Pro Solutions. Please go ahead.
- Madhuchanda Dey:** Yes. Hi. Good morning and thanks for the opportunity. While there were lots of questions on NPA and many of my questions got answered, I have a very fundamental question. Since you operate, still largely in the unsecured space, which inherently is a little risky, and these accidents keep happening. Even last quarter, you alluded to some problems in your key state of Kerala.
- If you could shed some light on your underwriting process, I mean, what are the kind of checks and balances that you follow? How much reliance do you have on your business correspondent? I mean, basically, to give us some understanding of why things go wrong and why you have been successful otherwise.
- Hari Velloor:** Right. So, to start with, let me say that always, right from the beginning, and it's nothing new, the underwriting has always been with the bank. In fact, the regulator doesn't allow us to outsource underwriting.
- So, the business rule engine, the system, everything is controlled completely by the bank. The partner, the business partner or the business correspondent, is only the front end who's sourcing and then doing the collection. So, that has been the system ever since we set up the bank and even before that.
- But in terms of the credit rules, we keep constantly looking to see what we have to do. So, going back to the first questions which came and the kind of things I said in terms of regulating our business in some areas, etc. What we are doing is to see that we are constantly scanning the credit bureaus we are seeing the exposure levels, we see the heat map of Enfin, there are various other things which we look at and then take calls on how we have to do business in specific geographies.
- Of course, the first primary consideration is how our own portfolio is doing. Now, in Kerala, as you know, we dominate this space because we've been the first player in microfinance and we continue to be the institution with the biggest exposure. So, Kerala generally in this sector, and I'm not, what do you say, talking specifically of other companies, etc.
- But there is stress. This is what we see. If you see the financial news, etc., etc., from a Kerala point of view, the signs of stress are pretty evident. The other thing we see is, after the rates of interest, etc. were freed up, and we also see a lot of unregulated entities coming in and lending. We have noticed this particularly in the border districts of Kerala.

Now, what happens is that when such people come in, we have to be careful because they have their own ways of doing business, which we may not be able to do, and we do not want to do, etc. So, keeping these things in mind, and the fact that we want to keep, bring down exposure in Kerala to 25% as a bank, which is our long term, by another two, three years or so. We've been steadily bringing it down.

Currently, it is 39% or so. We want to bring this down to 25%. So, specifically on the Kerala, what do you say, piece, this is what I have to say.

Even in Tamil Nadu, I think, on the other side in Kerala, the secured thing has also gone up. Primarily, if you see from a gold loan point of view, we are currently at about INR2,800 crores, INR700 crores, something like that. And this is something we have been pushing very, very hard, not only in Kerala, but across the country.

So, even in the agri piece, we have built something close to INR1,000 crores or so, which is also doing pretty well. So, we are steadily reducing our dependence on the unsecured book, so to say. Not only in Kerala, across the country, Kerala particularly, because we always had a big exposure.

The same thing holds good in Tamil Nadu. You must have heard what I said to the earlier questions of the gentleman who'd asked. In central Tamil Nadu, we are seeing some issues, which is why we have kind of reduced disbursements, etc., and bringing up the collection efforts. Whereas, South Tamil Nadu is doing well. And that's a big market for us also. So, we are taking a very, what do you say, micro approach to where we will do lending, not in a big geography like a state, etc.

And that is what we will continue to do going forward. And the fact that we are evaluating to see if we should reduce our dependencies on the BC, what do you say, way of doing business, whether the bank should do directly, should handle these things directly. These are under active consideration, let me put it that way, because I can't commit on certain things.

Madhuchanda Dey: So, my question is very simple. As you mentioned that next two quarters, this kind of stress might continue. And after that, you expect better days. So, what gives you confidence that things would reverse or change after two quarters?

Hari Velloor: Well, whatever we have done in the last three, four months, we are seeing some progress, let me put it that way.

Madhuchanda Dey: So, I mean, that's a very valid point. But on a go forward basis, I mean, you have been running this business for many, many years. You're an expert in this business.

What kind of slippage? I mean, now there is no black swan event in the economy, thankfully. So, in a normal economy like ours today, what kind of normalized slippage should we be factoring in?

Hari Velloor: Normalized?

- Madhu Chandan:** Slippage, slippage, slippage.
- Hari Velloor:** I think Gireesh had covered that.
- Gireesh C.P:** Yes. If you see, before COVID, which was FY '20, was a normal kind of year. Because by that time, one of the black swan events, that is demonetization impact also has vanished.
- And the flood which has happened in 2018 impact also has vanished in FY '20. So, at that point of time, the credit cost was to the minimum. It was less than half percentage, slippage and credit cost we were experiencing.
- So, when the impact of all the black swan events are -, out of business, then definitely one percentage is the traditional kind of credit cost which is experienced in this micro banking field. But at that point of time, we were, more than 90% micro banking. So, as a risk management strategy, we are strategically bringing down the micro banking exposure to 60% by 20 states in order to have a combination of, various kind of portfolio structure and the risk profile is getting diversified.
- So, after taking that also into consideration, maybe a 1.5% slippage and credit cost can be taken as a valid number going forward when things are normalized.
- Madhu Chandan:** Got it. Thank you. Thanks a ton.
- K. Paul Thomas:** Thank you, ma'am.
- Moderator:** Thank you. The next question is from the line of Manthan Patel, an individual investor. Please go ahead.
- Manthan Patel:** My question is regarding NPAs. In last quarter, you mentioned that some of, I mean, areas in Kerala due to flooding, you weren't able to collect. And in that quarter, you haven't mentioned about a particular issue which is going in other states and currently with regards to like unauthorized guys who are into lending business and all.
- So, I mean, I want to know, you mentioned just, I mean, before -- a couple of minutes back that this is going on since two quarters, three quarters. So, in second quarter, impact was low or what? I mean, I want to understand why didn't you mention in that quarter about this issue?
- Hari Velloor:** Well, last quarter, if I remember correctly, we had mentioned about certain climate events, etcetera, which had affected some of our collection efforts. So, these were very specific things which we had brought up. So, it was a reply to a specific question also. So, I mean, I'm not able to link up why we have brought this and not at that time, etcetera. So, the question must have been like that. I can't recall what the exact question was.
- K. Paul Thomas:** Yes. Normally in the quarter 2 events, it used to happen, but we were able to recover that. I think that may be the context we have mentioned that. But this year, I think that recovery is taking a little bit time. And also, as we have explained earlier, some of the staff attrition around 40% in one of the BCs, also have impacted. Because this is a highly people-centric collection model

which we are following. So, that also really impacted. So, we have handled such situations in the past. So, we are confident that we will be able to turn it around.

Manthan Patel: Okay, sir. And my second question is with regards to leverage. I mean, compared to our peers, which are also, I mean, in similar category, our leverage ratio is a bit high. So, can you make any comments on that?

Gireesh C.P: Yes, leverage is -- we are comfortable at a leverage of around 10 percentage. Since the risk weight profile of our lending is like that. And RBI, the minimum leverage they are talking about is 4.5.

Manthan Patel: Yes, I get it. But in our business, the risk is also like quite high compared to a secure portfolio. So, any plans to bring down leverage ratio or anything like that in the future?

Gireesh C.P: Since then, today, there may not be any significant change in the leverage level.

Manthan Patel: Okay. Understood. Okay, that's it from my end. Thank you.

Moderator: Thank you. The next question is from the line of Pranav Singh, an individual investor. Please go ahead.

Pranav Singh: Thank you for taking my question. My first question is about agricultural loans. So, for those who do not know, can you give some details about agricultural loans, like how do these loans operate, what is the role of agri-loans, how are they different from micro-finance loans?

Gireesh C.P: Can you come back once again? Because it's not clear.

Hari Velloor: We heard something about agri-loans. What exactly was the...

Pranav Singh: Sure. I was saying that to uninitiated like me, could you give us some details about agri-loans, like how do these loans operate, what is the role of agri-officers, how are they different from micro-finance loans? Some basic details.

Hari Velloor: Right. So, we have a team of close to 120-odd Agricultural Relationship Officers, we call them AROs, who are in the field. Essentially, the lending is through farmer organizations. And we actually, we are a pioneer in promoting such organizations also. As a strategy, we believe that we will be doing far more business in this field in the days to come.

So, groups of farmers who have come together and registered themselves in a particular fashion, we approach them and we do lending to them in a secured manner. Broadly this is the, what do you say, arrangement we have for agricultural lending. Apart from that, as other banks do, we have farmers green card, we have a Kisan card, we do other secured lending to agriculturists, etcetera.

Pranav Singh: Okay, and what would be the security in these cases, if you could share nature of security?

Hari Velloor: Yes, there is a hypothecation involved.

K. Paul Thomas: And also, large ticket loans, we take collateral security. We also have entered into a partnership with NABARD for a guarantee fund for lending to farmer producer organization. And also, we have signed up for the Agri infrastructure funding of the Government of India. It also comes with a guarantee. So, we also signed up for that guarantee also. So, we are focusing, we are adding our team strength in the Agri relationship offices. All of them are agricultural graduates and they are experienced in working in the agri-finance domains. So, we will be expanding that supply.

Pranav Singh: Thank you, sir. Yes, this is, I would say, a much needed initiative. And my second question is about advantages and disadvantages of using banking correspondence rather than own branches and employees in the bank. And is the regulator concerned that our largest BC is a related party?

Hari Velloor: He is asking about the strategy of using business correspondence for extensibility. Second, the largest BC also being our biggest business partner. And has the regulator expressed any concern?

K. Paul Thomas: No, essentially, this is, BC is an approved, regulatory approved channel which we have adopted from the beginning in 2017 when we launched the bank. So, we started with one BC, which is a related party, part of the group entity, a cooperative. But, as of now, we have expanded to 30 business correspondents. And we have taken this channel as one important channel along with our banking outlet channel.

So, the business correspondence, the institutional BCs together, they have a distribution center of more than 900, 917 customer service centers. So, all investment is borne by the BCs. So, it is a good sourcing center. And we are also now opening banking outlets surrounding those BCs as a hub and spoke model to extend all products to the customers sourced through the BCs. So, we believe that it is a very good model.

And we are also, at the same time, there is a, we understand the concern on the concentration by the investor community. So, we are also, as we have explained earlier, we are also evaluating other, some of the -- some other models also. Some of the activities done by the BCs, whether the bank will be directly taking over some, those options also we are evaluating.

Pranav Singh: Okay. And lastly, briefly, sir, the ROA guidance was 2%, but the way we calculate ROA is on the basis of gross AUM, not the total assets. So, like on the basis of INR18,000 crores, not INR24,000 crores. So, our 2% is, ROA is, denominator would be the gross AUM or the total assets?

Gireesh C.P: The 2% ROA is on a global basis. So, overall, we are targeting 2% ROA.

Pranav Singh: And we should take like INR24,000 crores as the denominator and not only INR18,000 crores. Thank you, sir. That is all from my side.

Moderator: Thank you. In the interest of time, that was the last question. I would now like to hand the conference over to Mr. Viral Sanklecha from Orient Capital for closing comments. Thank you.

Viral Sanklecha: I would like to thank the management for taking this time out for this conference call today. And also thanks to all the participants. If you have any queries, please feel free to contact us. We are

Orient Capital Investment Relations Advisors to ESAF Small Finance Bank Limited. Thank you so much.

Gireesh C.P:

Thank you. Thank you.

Moderator:

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