FEDBANK
FINANCIAL SERVICES LIMITED

Secretarial Department

January 18, 2024

Ref. FEDFINA/ CS/ 36/ 2023-24

To, National Stock Exchange of India Ltd., Listing Department Exchange Plaza, C-1, Block G, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051	To, BSE Limited, The Corporate Relationship Dept. Rotunda Building, Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai- 400 001

Re: Scrip Code: 544027, Symbol: FEDFINA

Sub: Transcript of Earnings Conference Call held on Monday, January 15, 2024

Dear Sir/Madam,

Pursuant to Regulation 30(6) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended, please find enclosed the transcript of the earnings conference call which was held on January 15, 2024.

The transcript of the earnings conference call shall be uploaded on the website of the Company at https://www.fedfina.com/ under the section 'Investor Relations' in due course.

The above is submitted for your kind information and appropriate dissemination.

Thanking you,

Yours Faithfully
For Fedbank Financial Services Limited

RAJARAMAN SUNDARESAN Digitally signed by RAJARAMAN SUNDARESAN Date: 2024.01.18 15:57:35 +05'30'

Rajaraman Sundaresan
Company Secretary & Compliance Officer
Membership No.: F3514

“Fedbank Financial Services Limited

Q3 - 9M FY '24 Earnings Conference Call”

January 15, 2024

MANAGEMENT: MR. ANIL KOTHURI – MANAGING DIRECTOR AND CHIEF EXECUTIVE DIRECTOR – FEDBANK FINANCIAL SERVICES LIMITED

MR. C. V. GANESH – CHIEF FINANCIAL OFFICER – FEDBANK FINANCIAL SERVICES LIMITED

MR. AMIT SINGH –INVESTOR RELATIONS – FEDBANK FINANCIAL SERVICES LIMITED

MODERATOR: MR. ANUJ MOHATA – EQUIRUS SECURITIES

Moderator: Ladies and gentlemen, good day and welcome to the Q3/ 9-months FY24 Conference Call of Fedbank Financial Services hosted by Equirus Securities. 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. Anuj Mohata from Equirus Securities. Thank you and over to you, Mr. Anuj.

Anuj Mohata: Thank you, Zico. Good afternoon everyone. I welcome you all to the Earnings Conference Call of Fedbank Financial Services to discuss the Q3/ 9-months FY24 performance of the company. We have the senior management team with us, represented by Mr. Anil Kothuri, MD and CEO, Mr. C. V. Ganesh, CFO, Mr. Amit Singh, Head, Investor Relations.

I would now like to hand over the call to Anil sir for his opening remarks, post which we can open the floor for question and answer. Over to you, sir.

Anil Kothuri: Thank you, Anuj, and welcome to everyone on this call. We finished our board meeting a couple of hours ago and have declared our Q3 results. This was a profit after tax of INR654 million or INR65.4 crores for the quarter. That's a 28% growth on a year-on-year basis.

Our return on assets was 2.5% and our return on equity was 14.3%. That was for the quarter gone by. Now, this was on the back of an AUM growth of 34% year-on-year. Our AUM in the quarter was INR107.1 billion. This AUM was because we had disbursals of INR33 billion for the quarter, which includes INR11.2 billion for non-gold and the remainder, which is about almost INR22 billion for gold. So, our disbursements have grown 24% year-on-year and 14% quarter-on- quarter.

So, we've seen some disbursement growth in the quarter gone by. As far as asset quality is concerned, our level of absolute GNPAs have actually declined by INR8.18 crores and by 15 basis points quarter-on-quarter. So, our GNPA or gross stage 3 stand at 2.2%. The other important fact on asset quality is that we've taken up our LGDs on mortgage loans to 23% from the earlier 20%. So, we've taken up our provision by about 3% on mortgage loans. As a consequence of this, our overall PCR is now 24.5% and our net stage 3 is 1.7%.

During the quarter, we commenced co-lending on gold loans and the co-lending AUM stands at INR1.8 billion. We started this in December and in one month, we've covered about INR1.8 billion. We've also sold down our portfolios through direct assignment transactions. So, INR457 crores was the total quantum of portfolios sold, the investor share of the portfolios sold.

The other positive development that has happened albeit after December 31st was the fact that our credit rating has got upgraded. We are now rated AA plus stable by CARE ratings. Now, this is a two-notch upgrade over the past 14 months.

We used to be AA minus till December 22 and in December 22, we got upgraded to AA and January 24th, we got upgraded to AA plus. CRISIL has also rated us and we are rated AA positive. This happened in the first week of January.

So, the outlook for Q4 remains good and strong. Our disbursals have grown in Q3 and will continue to grow in Q4. And this is because we are now present in 17 states and union territories, 609 branches.

We added two branches in the quarter gone by. So, with that preamble, I'll open up for questions and Yes.

Moderator: Thank you very much. The first question is from the line of Sameer Bhise from JM Financial. Please go ahead.

Sameer Bhise: Yes, hi. Thanks for the opportunity and congrats on a good quarter. Anil, I just wanted to understand how do you see the ROA flow through for a co-lending model in gold? And also, what are the current rates of direct assignment that you guys are getting? These are my two questions. Thank you.

Anil Kothuri: The ROAs on gold will obviously be very high, Sameer. The reason for that is that it's two-fold. The first is that our overall AUM goes up because we have access to a segment that we hitherto wouldn't cater to. Our yields on our gold loan are about 17.5%-17.75%. We've stayed anchored to that yield. Because we do co-lending, we are able to access customers at lower price points. Let's say we have somebody at 13.5%. The difference between 13.5% and 9.5% is 4%. 80% of the loan goes to the partner's book. 20% stays on our book. It is 4% into 5, which is 20% that you get on your own capital in terms of the spread alone.

That's in comparison with the normal 10% or 9% spread that you get on a regular home loan. Obviously, it is ROA accretive, ROE accretive for the co-lending business. As far as our mortgage and unsecured DAs are concerned, the sell-down rate is approximately close to our cost of borrowing, which is why we pursued the sell-down strategy because it also releases capital, which we can re-deploy.

For unsecured loans, there's obviously a premium of 100 basis points over our current borrowing rates.

Sameer Bhise: Okay. How much of co-lending do we intend to scale this up to?

Anil Kothuri: We'll wait and watch the next quarter, but our intent is to take it up to as much as is possible because it is hugely capital-efficient for us. We will just see how the subsequent quarter goes and we will scale it up quite significantly.

Sameer Bhise: Okay. Great. That's all from my side. I'll come back in the Q&A space for other questions. Thank you and all the best.

Anil Kothuri: Thanks so much.

Moderator: Thank you. Our next question is from the line of Vivek Ramakrishnan from DSP Mutual Fund. Please go ahead.

Vivek Ramakrishnan: Good evening and congratulations. My question is on the credit environment that you're seeing is it still robust, collection efficiency is holding up, and the provisions that you have made, you know, you've nudged up the loss-driven default. So, could you just explain the methodology around that? Those are my two questions. Thank you.

Anil Kothuri: Hi, Vivek. So, the first question first, the overall credit environment, I think, continues to be benign in that our collections are on track and we see our customers, you know, paying up. So, I have no additional point to make other than the fact that it continues to be robust.

Yes, the LGD, what happens is that we've had LGDs of about 20-ish percent thus far. So, what we've done this quarter is to take up the LGD on mortgage loans from 20% to 23%. We used to have a management overlay of 1%. Now, what we've done is to take the whole thing up to 23%. This is an annual, you know, refresh exercise that we do and we've done that and we've taken up to 23%, Yes.

Vivek Ramakrishnan: Thank you very much and wish you all the best.

Anil Kothuri: Yes, thanks.

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

Madhuchanda Dey: Hi, I have a question on your interest margin. Like, this quarter we saw a tad drop in interest margin, but as you mentioned that you have seen credit rating upgrades, it should have a positive impact on your borrowing cost. You are getting more aggressive through the co-lending in gold loan, which is also a high yielding segment. Given all these pieces and given that you have raised a lot of capital also, what is your take on interest margin going forward, maybe in FY25, if you could give us some color?

Anil Kothuri: There are three factors which will come into play in terms of our interest margins on the coming quarter or in the coming years. The first is the fact that our product mix will continually get enriched by higher yield products, okay, whether it is small mortgages or gold loans. So, that is point number one.

Point number two is that we will continue to do co-lending. So, therefore, there is lower capital and there is no interest cost to be paid on that. So, that is the second point. The third point is that we very recently got a rating upgrade. So, it will hopefully have a positive impact on our cost of borrowing. That is number three.

Against all of this, there is the fact that there has been an increase in risk weights over the past, what, month or so after the RBI circular. The effect of that is not yet played out. We also have money that we have raised in the IPO, okay, which, you know, we have seen the impact for only one month in the quarter gone by.

So, we will see the entire full three-month impact in the subsequent quarter. So, that will also take up our margin. So, these are the different factors at play because of which I expect that we will reasonably maintain the current margins if not improve on them.

Madhuchanda Dey: Okay, I mean, as you rightly mentioned, this increase in risk weight is going to increase your cost of bank borrowing, right? What kind of conversations are you having? What kind of increase in rates do you expect because of this?

C V Ganesh: So, can I come in here, Anil? Sorry.

Anil Kothuri: Yes, please go ahead, Ganesh.

C V Ganesh: Yes, Madhu. So, we have had conversations with banks and we have reason to believe that we will come out relatively with a lower increase in rates than we had originally guided. And we also believe that we will come out with a lower increase in rates than the peer group.

Madhuchanda Dey: I mean, why is that? Because of your credit rating.

C V Ganesh: So, there are various factors, right? Please also note that currently, we are sitting as of 31st of December, we are sitting on cash and cash equivalents of about a little over INR1,500 crores. Okay, we have the IPO money which has come in, plus we have our regular liquidity and investment.

Now, this amount would typically cover at least 5 to 6 months of disbursements in a normal year. So, we are sufficiently carrying liquidity. And I think it positions us well to have these conversations with the banks.

Also, the fact that our lending is non-consumer, it is to the MSMEs, that is also a strong point, which positions us well in these conversations. Yes, I am sorry, I cannot give you more guidance than this. But all of this will play out in Q4. And you will, I think when we come out with the full year results, you will get to see a little more data around this.

Madhuchanda Dey: Okay, I just one question, which is a little general question. Some of the other gold loan financing companies that we speak to, they have been saying that because of the increase in risk weightage on, you know, unsecured consumer loans, that could actually motivate people to, you know, take gold loans, in case if they have surplus gold in their household. Do you see this factor playing out at all? Is there any kind of credibility to this kind of argument?

Anil Kothuri: Difficult to say, Madhuchanda. I'll tell you why. One hand, the kind of person who borrows against gold is completely different from the unsecured customer. So that is my intuitive understanding. The second thing is that once people begin to take on debt, they will need to, it becomes a lifestyle and they will need to substitute with other kinds of debt.

That is also a feature of the lending industry. So there could be some migration of unsecured to gold. But really, the kind of people who borrow small ticket unsecured is different from the kind of people who take gold loans. The customer profile is different. So I think the impact may be there, but it'll be muted. That's my take.

Madhuchanda Dey: At least you guys have not seen it so far?

Anil Kothuri: Yes, we haven't seen anything so far.

Madhuchanda Dey: Okay. Thank you. Thanks for all answering all my questions.

Anil Kothuri: All the best.

Moderator: Thank you. Our next question is from the line of Nischint Chawathe from Kotak Institutional Equities. Please go ahead.

Nischint Chawathe: Just a small question. How do you think about leverage, optimal leverage for the business? And what is the conversation with rating agencies on this?

C V Ganesh: So can I take this question?

Anil Kothuri: Yes.

C V Ganesh: Thank you. Yes. So Nischint, we are all said and done the subsidiary of a bank, right? And that means that from a financial leverage, while it is a hypothetical construct for most NBFCs, for us, it is a demonstrable lever. And our banking covenants permit us to go up to 6.5x to 7x over equity.

So that's the extent to which we can currently lever based on our partnerships with lending institutions. However, I think in the course of the, you know, the last few quarters, we have also embarked on a journey of, as we have put in our deck, delivery on strong margins, strong ROAs, and strong ROEs. So what the whole securitization and co-lending program is to, help us allocate the equity we have to the higher yielding loans.

And at the same time, collaborate with partners who have access to lower cost of funds than us, to ensure that we do not vacate the other segments and are also making margins there without allocating equity. What that does is it permits us to travel far with a lesser amount of equity. So essentially, I think what we have demonstrated is with two things, one with the fresh equity rates, as well as this monetization program of loans, we have like a solar charged battery, we have a borrowing substitute in the form of these two instruments, which should allow us to go much further with much lesser gearing than what we had originally estimated.

And that is precisely why, and one of the bigger reasons why, all the rating agencies have taken a very positive or upgraded view on us, because they see us as being able to not only lower gearing over an extended period of time, but they also, at the same time, see us being able to generate stronger return metrics.

Nischint Chawathe: So I think that net, what we are saying is that maybe you can theoretically go up to 6x, 6.5x to 7x on balance sheet, and you can probably have another 20%, 25% outside of that. Is that a fair reading?

C V Ganesh: That would be a fair statement, whether we choose to go there or not would be a choice on us. But, I think we would have our own criterion from time to time. But yes, some of these levers are available to us.

Nischint Chawathe: So and the second question is on your coverage on Stage 2 and 3 loans, we're seeing a gradual inch up on a sequential basis. So is this sort of some revisit of estimated losses or is it to do with just the changing product mix?

Anil Kothuri: So, Stage 2 and Stage 3 have to do with product mix, yes, Nischint. Because as for each product, there is a certain model LGD that is required. So depending on the change in mix of by each stage, the ECL provision is an output variable.

Nischint Chawathe: And how many years of data have you considered for calculating LGDs? And then how frequently does this get revisited?

Anil Kothuri: So we refresh our LGDs every year. And we've been considering data since 2017. So how many years is that? That's about six years of data at this point in time.

Nischint Chawathe: So you'll consider data since 2017. And it's not like rolling six years, but, you know, keep on sort of, you know, adding to the data. And you probably revisit it like, I mean, once a year, it's like typically fourth quarter, is it or like first quarter.

Anil Kothuri: So that's right. So this time, we've done it at the end of the third quarter. So 2017 to 2023 is six year data that we have. So on that basis, we've worked our LGDs that you see on slide 37 of our Investor PPT.

Nischint Chawathe: Okay. So you have revisited something between the second and the third quarter. That's what my question was?

Anil Kothuri: That's right.

Nischint Chawathe: Okay. Perfect. Thank you very much and all the best.

C V Ganesh: Nischint, I'll just add one point, just to add a little more color to the optics around what you may see as the coverage on Stage 2 and Stage 3. Currently, 86% of our loan book is secured. Right. And secured either by gold or property. And if you see the LTVs we have published, the LTVs on the properties in the range of 52% to 55%. And on the gold loans is 70%. So when you look and form a view on the coverage, please also consider the security covers we run with.

Nischint Chawathe: Yes, of course. No doubt. Thank you.

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

Renish Bhuva: Yes. Hi, sir. Just two questions from my side, one on the credit card side...

Moderator: Sorry to interrupt, sir. May we request you to use your answer, please? Your audio is not clear, sir.

Renish Bhuva: Am I audible now?

Moderator: Yes, sir. Please go ahead.

Renish Bhuva: Okay. Yes, so just two questions from my side. So one on the credit cost side. So if you look at the sequential movement in the ECL provision, so the net increase is hardly INR10 crores, INR11 crores, but our P&L provision is close to INR25 odd crores. So I'm assuming there will be some write-offs. So can you please throw some light on this write-off numbers, please?

Anil Kothuri: So, Yes, we have done a INR17 crores write-off in the quarter gone by. Yes. Okay.

Renish Bhuva: Okay.

Anil Kothuri: Yes. So that includes mortgage loans, unsecured loans, as well as gold loans. So that's the number that we've done.

Renish Bhuva: In Q3, you have done INR17 crores write-offs. Correct. What's the write-off in this quarter?

Anil Kothuri: Q3 is the quarter gone by. Yes.

Renish Bhuva: Okay. Okay. Cool. And so going ahead, I mean, let's say the annualized credit cost, which stood at 0.9% or let's say 90 basis point in Q3, including these write-offs. So what should be the steady state credit cost? I mean, or if you can throw some light on the, let's say, write-off pool, which we might have as on Q3.

Anil Kothuri: Our sense is that the standard credit cost should be about 80 basis points. So that's what we will guide. Q3, we take these write-offs on a chunky episodic kind of a basis. So we chose to do some of it in Q3. So which is why the number is INR17 crores.

Renish Bhuva: Got it. Okay. So should we assume this is a peak write-off, at least for this year?

C V Ganesh: So can I come in here, Rinesh?

Renish Bhuva: Yes. Yes.

C V Ganesh: The fact that we have increased our PCR on the mortgage book, which constitutes over 55% of our total book, means that we have done a PCR increase on the entire stock in Q3. So it's like a one-time raising on the entire book. So in that sense, it's like not a frequent exercise. So like, for example, the same PCR in Q4 would be only on the incremental. So I think with that perspective, it should come back to a more normalized number towards the range which I indicated.

Renish Bhuva: Got it, sir. And sir, my next question is on the, let's say, the AUM mix side. So clearly, when we look at PPT, incrementally, we are growing high lending book, which is your gold loan, the small ticket LAP. So what should be the idle mix, let's say by FY'25 in terms of small ticket LAP plus gold loan put together? And if that has to play out over the next four to five quarters, so where do you see the asset on yield settling and ultimately the NIMs? Because naturally, if we continue to grow our high lending book, that will have a positive impact on NIM. So how do you see this NIM profile internally?

Anil Kothuri: Let's talk about the product mix first and the NIM separately.

Renish Bhuva: Yes.

Anil Kothuri: Now we have three of our products which yield 17% plus, which is gold loans, small mortgage and unsecured loans. Now the proportion of medium ticket mortgage is lower and it is going to keep coming down.

Now, overlay on this, the fact that we are going to do co-lending, so therefore, your yields will be a little higher because you recognize only the spread on the book. Therefore, there is an upward bias to the yields for these two factors.

So I'm happy and comfortable guiding that our NIMs will be definitely there at the current levels and how much they will improve by we will be able to cost once we do the annual operating plan for the next year.

Renish Bhuva: Got it. But so directionally, I mean, considering the recent rating upgrade, plus, considering the business model, wherein we don't have any sizable exposure to any unsecured PL, wherein the risk rate will come into picture when it comes to borrowing costs. So directionally NIM should improve, right? I mean, considering the yield mix change towards 17% yield book plus the rating upgrade?

Anil Kothuri: Yes, NIMs should definitely be at least at the current level, if not better. Yes.

Renish Bhuva: Okay. That's it from my side, sir. Thank you.

Anil Kothuri: Thanks, Renish.

Moderator: Thank you. Next question is from the line of Bhavik Dave from Nippon India Mutual Funds. Please go ahead.

Bhavik Dave: Hi. Good evening, sir. There are a few questions. One is just to have a little bit of the main point…

Moderator: Sorry to interrupt, sir. May we request you to use your handset, sir. The audio is slightly muffled, sir.

Bhavik Dave: Is it better now?

Moderator: Yes, sir. Please go ahead.

Bhavik Dave: Yes. Okay. Sorry. So just a little, just to dig a little deeper into the main argument, just wanted to understand what's our incremental cost of borrowing? After like, suppose we've got a rating upgrade, the incremental cost of borrowing, has it come down meaningfully for us?

Anil Kothuri: No. So the rating upgrade is only 10 days old, Bhavik, and we haven't done any borrowing since then. So there is no obviously impact as yet that is crystallized. But, give it a little time and I'm sure it will have the appropriate impact on our cost of borrowing.

Bhavik Dave: Because when we look at the quarter-on-quarter cost of borrowing movement, it's like even if we've not borrowed quite a bit, the cost of funds increased from 8.5 to 8.7. That's a 20 basis point up move. Considering we had like capital benefit this time around, just trying to understand, are we like borrowing at a significantly higher cost today and that will come down post this upgrade? Like what was like maybe the incremental cost of borrowing before this upgrade? If I like ask that of it now.

C V Ganesh: So can I come in here, Anil, can I? Yes. So Bhavik, again, we cannot give out numbers which are not already in the public domain. But I'll tell you the argument for NIM expansion. Okay. Just before the equity rate, we were running at a leverage of 5.5.

Bhavik Dave: Correct.

C V Ganesh: September reported number was 5.45. By November, it had crossed 5.55 level.

Bhavik Dave: Correct.

C V Ganesh: As a result of the equity rate, the December, mentioned gearing is 3.69.

Bhavik Dave: Sure.

C V Ganesh: Okay. That is a significant drop in gearing.

Bhavik Dave: Correct.

C V Ganesh: Now from a NIM expansion, if you have more equity.

Bhavik Dave: Correct.

C V Ganesh: That also results in an expansion of net interest income. So that's point number one. Okay. Now on the borrowing side, the banks or our lending partners have always seen us as different from the peer group with the same rating.

Bhavik Dave: Okay.

C V Ganesh: Isn't it? So, you know, the impact of this would be in two ways. One, a AA plus gives us access to maybe funds which earlier had a threshold which would not permit them to invest in. So it gives us access to deeper pools of liquidity than what we earlier had. And per se on the market borrowing side, it opens up pools which were not earlier available to us or may have been available at a higher cost. Okay.

Now, when and how much this will play out is a little bit into the future. It will have to be seen. As you know, right now, you know, RBI is tightening liquidity around bank lending to NBFCs. And in line with our earlier guidance, you know, I think when the times are tough for NBFCs, bank owned NBFCs like us come out with a better advantage than some of the other peers.

I think that's the limited point we are making. And that should also help both from an availability and a cost of funding. On a relative basis we believe we will continue to enjoy those advantages, which will be further boosted by the upgrade.

Bhavik Dave: Understood. And second, sir, again, a question regarding your incremental growth, right? Like when we see our disbursement this quarter, the growth is significantly coming from small ticket and medium ticket LAP, right? Just wanted to understand from you, one is how is the yield or the competitive density in these segments because a lot of affordable housing companies are also getting a little competitive when it comes to LAP in the small and medium ticket. That's question number one. So yields on this product, how are they shaping up?

Second is on the business loans. When I see your last four or five quarters, the numbers that you've reported, the number is like hovering around this 300 -- sorry, 330 crores, 340 crores, 350 crores, 360 crores range. Any thoughts on this? Why are we not increasing the density or what's happening on this part of the loan book? That's question two.

Anil Kothuri: Sure. So, look, competition always exists, okay, but it is quite low in the small mortgage segment, okay? That's because we are present in several states, you know, 17 states, and there is nobody else who's present in so many states. There are regional players and there are players who go deeper into the market as opposed to wider like us.

So, therefore, there is less competition in the kind of ticket size that we cater to. The competition tends to be a little more concentrated and slightly smaller ticket sizes, INR8 lakh, you know, INR7 lakh, that kind of stuff. Our average ticket size is INR12 lakh, INR13 lakh.

Okay. So, the second point is that it's a reasonably virgin market and it's getting created as we speak, and my estimate is about 3% of the overall loan against property AUM is in this segment. And even this 3% has got created over the past maybe four, five years. That's my assessment. So, that's as far as competition is concerned.

Now, in terms of unsecured, we keep our originations calibrated to our risk appetite, okay? We want to keep less than 15% of our book as unsecured. The current number is 13% and directionally take this down.

Bhavik Dave: Okay.

Anil Kothuri: And our strategy is to originate and sell the bulk of this down. You'll notice on one of our slides, Slide 25, that our percentage of book for unsecured has actually increased. It used to be 27% and now it's now 32%. A year ago, it was 13%. So, we have these relationships and these pipes in place now. So, we will take up our unsecured originations to feed the appetite of our buyers in future.

Bhavik Dave: Understood. And, sir, one more question is regarding the conversation around increasing our PCR or the ECS on Stage 2 and Stage 3. When I see your business mix increase is broadly more towards the LAP, the small and medium ticket LAP over the last nine months.

So, in that context, what led to this increase? Because even after the increase, we're still a little lower than a lot of these affordable housing companies who do both housing and LAP in that 8 lakh to 10 lakh ticket size. You think this 24%-25% ECS we have on Stage 3 is good to go for now and we won't require any further change in this? Is that the way to think about it?

Anil Kothuri: So, what we have is the LGD on the entire stock and we do an annual refresh of the exercise of the entire stock. So, the most recent refresh was done using data ended November 30th. Okay. On that basis, this is more than adequate. Okay.

Bhavik Dave: Sure.

Anil Kothuri: Now, obviously, we keep doing this every year and, you know, the number will either go up or down depending on how the portfolio and our collections have performed and stuff. Okay. So, that's the point about this. We've guided that we'd like to keep taking this up and we will keep taking the provisioning up with the passage of time.

Bhavik Dave: Understood. And, sir, last question is on your operating expenses. And like when I see your other operating expenses, X of employees, that remains flat quarter-on-quarter and we've seen like a healthy disbursement growth this quarter.

Just wanted to understand what's playing out here and what -- is this 56% cost to income that we've achieved, which is a big deal in terms of the quarter-on-quarter decline. Do you think that this is sustainable? Anything on the other operating expenses that we've been able to deliver this quarter?

How are you thinking about it? Like is 56% cost to income a reasonable number to work with? Or do you think that maybe this was a one-off and it will like go back to that 58%, 60% odd level that we were at?

Anil Kothuri: So, I'll tell you the different moving parts here. Okay.

Bhavik Dave: Yes.

Anil Kothuri: So, last quarter, we had the IPO money for what, 20 days, 25 days or something. Okay.

Bhavik Dave: Correct.

Anil Kothuri: This quarter, we will have the IPO money for the entire quarter. Okay. So, obviously the income will go up to that extent. Okay. So, that is one moving part. The second thing is that normally your cost gets reset in the first quarter of the year and the impact of that increase happens in the first and second quarters. Okay.

Bhavik Dave: Right.

Anil Kothuri: That is now behind us. Okay.

Bhavik Dave: Right.

Anil Kothuri: Q4 for everybody tends to be an extension of Q3 in terms of how the costs play out and stuff. Okay.

Bhavik Dave: Yes.

Anil Kothuri: For these reasons, I believe that the gains that we made will probably consolidate on those in the subsequent quarters.

Bhavik Dave: Okay.

C V Ganesh: Sorry. I'll just add one point to what Anil said. That is that we normally front end the branch expansion.

Bhavik Dave: Correct.

C V Ganesh: So, this year, in the first half of the year, we added 34 branches to our small ticket LAP and affordable home loan network. So, in the last three years, you would have seen that we have grown from about 59 branches to about 172 at current count.

Bhavik Dave: Correct.

C V Ganesh: That's a significant increase in firepower for this high yielding product. Now, obviously there are new hires who have come in. We have done some reengineering of the construct in terms of the credit and underwriting teams and so on. Now, this engine will slowly start firing with higher productivity. Right. And so that also will translate to an improvement in opex.

See, I think last time -- the last quarter when we guided, I think what we took pains to say is that we don't see this as a sprint, right? We see it as a marathon. We will not compromise on the build expense. We are in it for the long haul.

Bhavik Dave: Correct.

C V Ganesh: Right. We have to go far and we will build it surely but slowly, but very clearly. I think there is a commitment out there in terms of bringing down the cost to income in a gradual way. There are also economies of scale playing in, right? All of this will help us in the journey to optimizing opex to AUM and opex to AUF and consequently expansion of ROEs.

Bhavik Dave: Sure. But from a one-year or two-year perspective, this 5.5% that you have achieved this quarter, you think this will eventually trend down maybe in FY '25-'26. It will maybe improve by 10-20 basis point every year. Is that a fair assumption?

C V Ganesh: See, we don't want to put numbers out there. All we are guiding is gradual improvement in margin.

Bhavik Dave: Sure. Fair point. All right. Okay, sir. Thank you so much. Thank you.

Moderator: Thank you. Our next question is from the line of Shubhranshu Mishra from Phillip Capital. Please go ahead.

Shubhranshu Mishra: Hi, sir. Good evening. Thank you for the opportunity. Three or four questions. The first one is given the fact that we are focusing more on mortgages and we also have a substantial part of the gold loans. The 23% LGD is largely coming out of the mortgages because the LGD for gold loan would be lower. That's the first question. Second is…

Moderator: Sorry to interrupt, sir. May we request you to use your handset, sir? Your audio is not clear, sir.

Shubhranshu Mishra: Okay. One second. Hello. Is this clear?

Moderator: Yes, sir. Please go ahead.

Shubhranshu Mishra: Right. So, the first question is around the LGD. If you can spell out the LGD for each product because I think the 19%, 23% increase of the LGD my suspicion is that it's starting mostly because of mortgages.

The gold loans won't have such high LGDs. So, if we can spell out the LGDs also because we are taking six years of data for the LGD. So, when we roll it over the next few years, the COVID impact would also come off. So, should we see LGDs coming off in the next couple of years and we should see improvement in ECL coverage going forward?

And the third would be around opex. What sort of employee addition and branch addition are we going to look at in FY '25? We have had a sharp increase in the last three, four years. And if we can speak on the risk management in the unsecured as well as a small ticket LAP. Thanks.

Anil Kothuri: Thanks very much. I'll take your questions one after the other. The first up, you had a question on increase in branches. So, this year what we've done is to take up our small mortgage branches, whereas we focused on taking up the AUM in the existing gold loan branches. So, that's why our small mortgage branches have increased from 130 to 180 approximately. So, about 50-ish branches we've opened this year.

Now, every year when we make the annual operating plan, we firm up the expansion, whether it's for gold or mortgage, and that process is underway. So, specifically where we will add branches in the coming year, I will be able to talk about in the subsequent call. So, at this point in time, we are rationing out branches across these businesses, and we will firm that up by the end of the month.

The second thing is for gold, the LGD is 0.75%. So, that is what the model says. And obviously, there is nearly no loss to be had on the gold NPAs. That is transient, that gets created at 90 DPD and gets extinguished by 150 DPD. So, we carry about 60 days of NPA on gold.

Now, in future, what will happen to the LGDs, well, it obviously depends on the collection performance in the current year, okay, and really what the translation of one bucket to the next is and how much we are able to collect and arrest. And most importantly, how much we are able to crystallize in terms of loss at the time of enforcement of collateral.

But it's reasonably fair to say that there is a certain industry standard for mortgages, and we are kind of there. Now, how much we will seek to provide against that is a matter of choice. The industry is at about 25%-ish, and we are at about 23%. So, there's not too much of a gap.

Finally, in terms of risk management, I'll just encapsulate this in a nutshell. We choose our markets with some care and caution. We make use of data from the Bureau, as well as intelligence from the market and open up branches. We seek to populate our branches with people who have relevant experience in the same geography so that nuances of either property or business in a specific location are understood, and individual learning translates into organization learning.

We have a standard personal discussion template, okay, based on which there is -- there are decisions made. Essentially, what we do is to try and ascertain the individual's income for mortgage loans as accurately as we can. We seek to triangulate it using various data points, which is to say that if he has a certain surplus every month, we try and see what he's done with that surplus -- the past year or the year after and use that to validate our assessment. We have a salesperson, a credit person, and a collections person in each branch so that we are able to optimize our performance on all three vectors.

As far as unsecured lending is concerned, we lend only to customers who have declared income on their documents, okay. Typically, these customers are P&L, balance sheet, tax returns, audited financials, and about 30% of our customers are objective rejects, and the remainder are subjective rejects, and that's the way this works. So some data regarding the quality of the book is provided on slide 34 with regard to the kind of score bands of customers that we lend to. Yes, so this is a bird's-eye view of our risk management.

Shubhranshu Mishra: If you could just spell out one question that's unanswered, what's the LGD product-wise?

Anil Kothuri: Product-wise, LGD, mortgage is 23, gold is 0.75, and unsecured, we write off at 90 DPD, Yes.

Shubhranshu Mishra: Understood, sir. Thank you so much. I'll come back and declare.

Anil Kothuri: Yes, you're welcome.

Moderator: Thank you. A reminder to all participants, you may press star and one to ask a question.

C V Ganesh: Ladies and gentlemen, to ask a question, you may press star and one.

Moderator: Thank you. We have a question from the line of Sagar Doshi from Fintuit Investments. Please go ahead.

Sagar Doshi: Yes, so basically, just wanted to know, like, we are on a small page as of now, and looking at the leverage that we can pull off. What is the growth rate that could be expected, let's say, a year or a further two years period from now on?

Anil Kothuri: So you look at our past, we had a INR1000 crores of retail AUM in FY'18, and as of right now, we are at just shy of INR11,000 crores. Okay, the opportunity is vast. We have all the resources, branches, employees, as well as capital and the ability to raise debt. So from here on, I'm happy guiding a compounded growth rate of 25%, and we will try and top that.

Sagar Doshi: Okay, and any other new products that we may go in, apart from what we are doing?

Anil Kothuri: No, for the foreseeable future, we will optimize our performance in the products that we offer right now, and we will refine our current operating model for superior results.

Sagar Doshi: Okay, thank you.

Moderator: Thank you. Our next question is from the line of Shubhranshu Mishra from Phillip Capital. Please go ahead.

Shubhranshu Mishra: Hi, sir. Thank you for taking my question again. Which part of the book are we going to do the Co-Lending in? And second question is, how do we differentiate our gold loan portfolio from our parents' gold loan portfolio? Thanks.

Anil Kothuri: Currently, we have Co-Lending arrangements for gold loans. Okay, and that has got tested through the month of December, and we're going to scale that up in the coming quarter, okay. As far as our parent Federal Bank is concerned, they lend to a different segment of customers, their average ticket size is between three and four times our average ticket size, and their average yields on the portfolio are also significantly lower than ours.

Look at the previous quarter's investor deck, you'll see that their yields are, I think, about 10.15% or so, okay, our yields on the gold loan portfolio are upwards of 17.5%. So, we cater to a completely different customer base in different geographies. So, it's different.

Shubhranshu Mishra: Understood. Thank you so much, sir.

Anil Kothuri: You're welcome.

Moderator: Thank you. Ladies and gentlemen, that was the last question of our question and answer session. As there are no further questions, I would like to hand the conference over to Mr. Anuj Mohata for closing comments.

Anuj Mohata: Yes, thank you, Zico. Once again, thank you all for participating in the call, and we would like to thank the management of Fedbank Financial Services for giving us the opportunity to host this call. Thank you, everybody, and have a good evening.

Anil Kothuri: Thanks, guys. Have a good results season. Thank you, again.

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