ESAF Small Finance Bank Limited

Q1 FY27 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day, and welcome to ESAF Small Finance Bank Q1 FY27 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Dr. K. Paul Thomas, Managing Director and Chief Executive Officer. Thank you, and over to you, sir.

K. Paul Thomas: Thank you and good afternoon. We welcome you to the Q1 FY27 earnings call of ESAF Small Finance Bank. Joining me today are my colleagues Mr. George K. John, Executive Director, and Gireesh CP, EVP and CFO.

Crossing INR 50,000 crores business is more than a numerical milestone. It reflects the successful execution of our transformation strategy over the last two years. We have consciously diversified our portfolio, strengthened underwriting, improved collections, enhanced our liability franchise, and invested significantly in technology. The improvements we are seeing today are therefore structural rather than cyclical. I would like to thank all our stakeholders including our employees and most importantly our customers for the trust they have placed on us.

Our MARG strategy has clearly been the key highlight of our transformation journey, and all the constituent segments of MARG, especially gold, agri, vehicle, and mortgage, have all shown strong growth both on year-on-year and quarter-to-quarter basis. This portfolio also has lower delinquencies which has helped us in improving our asset quality. Our objective is no longer to pursue growth through a single product or customer segment; instead, we are building a well-diversified retail franchise where secured lending, emerging households, microfinance, deposits, and digital capabilities complement each other. This creates a more resilient balance sheet across economic cycles.

Another important area for us now where we are looking at a renewed focus is the emerging household loans category, and we believe it to be the next catalyst for growth. Emerging households represents customers graduating from financial inclusion towards mainstream retail banking. These customers already have established repayment behavior and growing income profiles. By serving them through a broader suite of banking products, we deepen relationships while improving portfolio quality and lifetime customer value.

The idea is to use a calibrated approach and build on our strong presence across rural and semi-urban geographies to provide a wider range of banking products and financial solutions to customers who have progressed beyond traditional microfinance. These customers should mostly be individuals, self-help groups, small entrepreneurs, and other emerging business customers with a maximum ticket size of INR 10 lakhs. Over time, we expect emerging households to become one of the largest customer franchises within the bank.

All our strategies have been built with a clear focus on creating a stable, diversified, and resilient asset base that is supported by disciplined execution, investments in technology, prudent risk management, strong governance, and operational efficiency. This will help us serve a wider customer base and further improve our financial and business parameters in the coming quarters as well.

On the macro front, the Indian economy and the banking sector continue to show resilience despite the ongoing West Asia crisis, with healthy credit growth across segments and steady deposit mobilization. While these events have not had any material impact on our business or operating performance, we remain cautious and watchful for future developments.

So, overall, Q1 FY27 has been a good quarter for us and gives us confidence that we are moving in the right direction for the next phase of growth. The MFI sector appears to be gaining momentum. We have enhanced our secured portfolio and financial parameters have started improving again. Last two years, because of the asset quality and industry challenges, we could not fully leverage on the network that we have built. But going forward, we are seeing a great opportunity to efficiently build on the strength of this network, present mostly in the rural and semi-urban areas to expand our deposit franchise and strengthen our lending business, ultimately ensuring sustainable profitability.

I now invite our Executive Director, Mr. George K. John, to take you through the next segment.

George K. John: Thank you, Paul sir, and good afternoon, everyone. We continued our focus on sustainable growth and financial discipline during the quarter. As a result, there was a marked improvement across key parameters sequentially, including improved profitability, asset quality metrics, moderation in slippages, better operating efficiencies, and increasing return ratios.

As of 30th June 2026, the total business stood at INR 50,140 crores, registering a healthy year-on-year growth of 23% compared to INR 40,923 crores last year. During the same period, gross advances grew by 27% while deposits increased by 19%, reflecting balanced growth across both sides of the balance sheet. If we add IBPC transaction done during the quarter, our total business stands at INR 51,140 crores.

On the liability side, retail deposits remained strong at 91% of total deposits and CASA stood at 23.4%. Our liquidity coverage ratio stood at 133.31% as of 30th June 2026, indicating a comfortable liquidity position. Our liability strategy remains centered on granular retail deposits. We continue to deepen customer relationships while improving the quality and stability of our funding base. This remains a strategic priority for us.

On the advances side, secured loan book grew by 35% Y-o-Y and now stands at 62% of total gross advances, whereas the unsecured loan book grew by 16% Y-o-Y. The improvement in asset quality is driven by better portfolio mix, stronger underwriting standards, disciplined collections, and normalization within the microfinance sector. We therefore believe the current trend is supported by structural improvements rather than temporary recoveries.

Secured book is driven largely by MARG portfolio, and we saw strong growth in all its major constituents driven by effective execution and tailored offerings across key geographies. Agri, gold, and mortgage were the standout performers. At INR 12,909 crores in Q1 FY27, the MARG portfolio has grown by 42% Y-o-Y and now stands at 56% of total portfolio. MARG is not simply a portfolio classification. It represents our strategy to increase secured retail lending through products where we possess strong distribution capabilities, local market knowledge, and attractive risk-adjusted returns. This portfolio is expected to remain one of the primary growth engines over the medium term.

We have also renewed our focus on the emerging household segment. Emerging household (EH) loans consists of disbursements to customers who are typically individuals and small entrepreneurs who have progressed beyond traditional microfinance. It caters to customers transitioning towards greater financial stability and retail banking relationships and who are ready for a broader range of banking solutions. Their annual income is in the range of INR 3 lakhs to INR 15 lakhs and ticket size in this segment will always be less than INR 10 lakhs. This segment has been broadly classified into individual, SHG (self-help group), enterprises and FIG (Farmer Interest group). In this portfolio, unsecured lending is restricted to individual loans only. All other lending within the segment is secured. This segment has grown 185% Y-o-Y and 14% quarter-on-quarter while contributing 32% of total gross advances.

Microfinance loans portfolio comprising of group loans has degrown. This decline in the traditional group lending portfolio is entirely consistent with our strategic direction. Rather than exiting customers, we are migrating eligible borrowers into individual and secured lending relationships under the emerging household framework. This represents customer progression rather than customer attrition. This portfolio transition is ultimately aimed at improving portfolio quality, reducing volatility, and supporting sustainable long-term growth. We are leveraging the improving macro environment by adopting a calibrated strategy for growing our MFI portfolio.

We have reduced our corporate loans exposure, and we expect them to remain in the current range as we continue to focus our efforts on increasing the MARG and EH portfolio.

During the quarter, we added 17 new banking outlets and now our distribution footprint stands at a total of 821 banking outlets, 721 ATMs, 1,064 customer service centres, and 31 institutional business correspondents across 24 states and 2 union territories, enabling deep customer reach and connect. We added 1.86 lakh new customers during Q1 to reach a total of 1.04 crore customers as on 30th June 2026.

We have already mentioned over the last couple of calls about ESAF 2.0 StratoNeXt, which is our key strategic digital and IT transformation program. It is aimed at strengthening the bank's technology backbone, and we have been progressing quite well on its training and adoption within our ecosystem. We estimate it to be fully implemented by the end of this calendar year.

It will bring in the much-needed agility in the core business processes that will enable quick adaptation to the emerging market needs, improve turnaround times, and ultimately enrich customer experience and service. ESAF 2.0 is expected to significantly improve scalability, automation, and operational efficiency. It will enable faster product launches, improved straight-through processing, better customer experiences, and stronger risk control. We believe this technology platform will support the bank's growth over the coming decade.

We continue to further strengthen our leadership with the appointment of Mr. Venkateswarlu Mallineni as National Head, Branch Banking, and Mr. Narasimha Murthy as Chief Risk Officer. These additions add to our domain expertise and help us further in building a high-quality, future-ready institution.

As we move into the rest of FY27, our priorities remain clear and consistent. We will continue to execute our strategy with discipline by further strengthening our secured lending franchise through MARG, scaling the emerging household segment as the natural progression of our financial inclusion journey, and maintaining a balanced approach to growth and risk. At the same time, our investments under ESAF 2.0 will enhance agility, productivity, and customer experience, creating a stronger technology foundation for the future.

The improvements in our business performance, asset quality, and profitability reflect structural changes we have made over the last two years, and we remain confident that disciplined execution, prudent risk management, and customer-centric innovation will enable us to deliver sustainable and profitable growth, while creating long-term values for all our stakeholders.

I will now invite our EVP and CFO, Mr. Gireesh CP, to take you through the financial performance.

Gireesh CP: Thank you, sir. Good afternoon, everyone. I thank all the participants for taking time for joining us on this earnings call. Let me give you an overview of our financial performance highlights for Q1 FY27.

As of Q1 FY27, total deposits stood at INR 26,924 crores, growing 19 percentage as compared to INR 22,698 crores last year, with a healthy CD ratio of 82.3 percentage. Retail deposit increased to INR 24,487 crores, registering a growth of 13 percentage Y-o-Y, which now constitute 91 percentage of the total deposits. Our retail deposits reflect a stable and granular deposit base which we will continue to build further. Additionally, we are also seeing good traction in our non-resident deposit base, witnessing a steady sequential growth for the last four quarters. CASA deposits grew at a slower pace than term deposits to INR 6,297 crores in Q1 FY27, registering a 12% Y-o-Y growth with the CASA ratio at 23.4 percentage.

Gross advances increased to INR 23,216 crores from INR 18,224 crores a year ago, registering a growth of 27% Y-o-Y. Our strategic priority of diversifying the loan book remains on track. The secured portfolio stood at INR 14,465 crores with a growth of 35 percentage Y-o-Y, whereas the unsecured portfolio stood at INR 8,751 crores with a growth of 16 percentage Y-o-Y, aligned with our strategy.

Net interest income improved to INR 584 crores in Q1 FY27 from INR 378 crores in Q1 FY26, driven by a healthy loan book growth with a strategic product mix coupled with low slippage numbers.

On the cost side also, we could contain the funding cost by calibrated funding and pricing strategy. Quarterly net interest margin is presently at 7.9 percentage, which may moderately come down because of the subdued deposit growth witnessed by the banking system in the recent past. However, we expect that NIM could be kept at a level above 7.5 percentage. Lower cost of funds and lower slippages, primarily on unsecured, will continue to maintain improved margins.

The cost of operation is also normal and under control, and the bank will leverage the increase in network for its planned business growth. Pre-provisioning operating profit for the quarter of INR 349 crores is up by 179 percentage Y-o-Y. The improvement in PPOP was consistent and promising for the last couple of quarters and is expected to remain stable. This was achieved through robust business growth, appropriate pricing of products, and consistent growth in fee-based income. Other income for the quarter grew by 27 percentage Y-o-Y.

Operating expenses in Q1 FY27 grew by only 1 percentage Q-o-Q and 8 percentage Y-o-Y, and cost-income ratio stood at 58 percentage as compared to 78 percentage in Q1 last year. We will continue to focus on further improving operating efficiency, enhance productivity, and optimize overhead costs for the remaining year as well.

Normalization in the MFI sector and the changes in portfolio mix has led to improvement in asset quality and lower slippages. As compared to Q1 FY26, gross NPA for Q1 FY27 declined to 5.4% from 7.5% and net NPA declined to 0.8% from 3.8% while slippages reduced sharply to INR 75 crores from INR 468 crores on a Y-o-Y basis.

We have set aside an additional provision of INR 65 crores during the quarter over and above the RBI norms and Board approved policy. And accordingly, our provision coverage ratio improved to 86%, but for which it would have been 81%. Credit cost on annualized basis at 4.4% flattish, but due to a lower net NPA stock and slippages well under control, we estimate the same will come to around 2% by the year-end. Our gross slippage ratio for Q1 FY27 on an annualized basis stands reduced to 1.4%.

Q1 FY27 profit after tax increased sequentially to INR 80 crores from a PAT of INR 24 crores in the previous quarter. ROA and ROE are reaching normalized levels and stood at 1% and 17.5%, respectively, on an annualized basis.

As business volumes continues to scale up by exploiting the operating leverage from our distribution network and improved technological capabilities, further improvement in the return ratios are expected in future. This marked turnaround has been achieved with our continued focus on strategic transformation through stable business growth, diversified asset book, disciplined underwriting, improved operating efficiency, and supported by stable microfinance sector.

As we enter the next phase of our journey, our priorities remain unchanged: profitable growth, disciplined risk management, operational excellence, and customer-centric innovation. We believe the investments made over the past 2 years have created a strong foundation for sustainable value creation for all stakeholders.

Thank you very much. And now the floor is open for question-and-answer session.

Moderator: Thank you very much. We will now begin with the question-and-answer session. Your first question comes from the line of Deepak Poddar with Sapphire Capital.

Deepak Poddar: Many congratulations for a good set of numbers. Sir, just wanted to understand, first up, now on this credit cost outlook that you have given 2% credit cost by FY27 end, right? And currently, including the management overlay, it was close to 4.2%. But if you exclude the INR65 crores, it would be around 3%, right?

So, you expect this additional provisioning, because given the PCR is already at 85%, so coming quarters, you wouldn't need to provide this additional provisioning?

Gireesh CP: Yes. Our stock of net NPA is only INR 184 crores as of now. And last quarter, the slippage number was very meagre at the gross level, now it is INR 74 crores. And at net level, it is only INR 40 crores. So going forward also, we don't see any drastic increase in the NPA number. So, this gives us the confidence that the credit cost will come down in the coming quarter.

Deepak Poddar: Okay. 2% by FY27. And what does it mean for ROA? I mean, for this FY27, what sort of ROA, then we are looking at given credit cost will decline to 2% by FY27?

Gireesh CP: ROA, we expect that it will be 2% by year-end.

Deepak Poddar: Okay. So, 2% of an ROA by FY27 end, right?

Gireesh CP: Yes.

Deepak Poddar: Okay. And now coming to your other income. I noticed that this first quarter, you had INR 69 crores of PSLC income. So just wanted to understand, I mean, how is it distributed between the quarters? I mean do you expect this trajectory to continue in coming quarters as well or PSLC income will decline?

Gireesh CP: It will continue because we are in the growing space in the priority sector. But normally, the rate of the PSLC in the coming quarters will be on the lower side. So, this kind of magnitude may not be there in the coming quarters. But definitely, there will be some contribution from that side.

Deepak Poddar: Okay. So, for the entire year, what sort of PSLC income we are expecting to generate?

Gireesh CP: Maybe around INR 20 crores to INR 25 crores in this quarter alone.

Deepak Poddar: Okay. And just one last thing on FY28 now. I mean, earlier, we were alluding to FY28 being a 2% ROA for the entire year. Now we are targeting to achieve by fourth quarter itself this year. So, for FY28, then how should one look at FY28 in terms of your ROA?

Gireesh CP: It is too early to precisely give a number because the liability side, how it is shaping out, what are the challenges going forward, what will be the RBI policy on the rate front. All those things will be dependent. But as it stands today, it will be more than that we are seeing in FY27 as per the revised estimate.

Deepak Poddar: Higher than your exit FY fourth quarter ROA?

Gireesh CP: That is right.

K. Paul Thomas: This is Paul Thomas, the MD. So, we are on a growth phase. So, if some totally unprecedented and unexpected things don't happen, we will stay on the growing phase. We are not just giving you a specific number, but the direction is very clear about this.

Moderator: The next question comes from the line of Amit Mehendale with RoboCapital.

Amit Mehendale: My first question is on the effective tax rate for FY27 and '28. I mean considering that we have had losses in the past, what do you expect the effective tax rate to be?

Gireesh CP: Effective tax rate will always be around 25.5.

Amit Mehendale: So, we will have some DTA to offset, right?

Gireesh CP: Yes, DTA will be there.

Amit Mehendale: Do you still expect 25% of tax rate?

Gireesh CP: Yes, because the DTA impact will come only on the cash outflow on the taxes, etcetera. But we have recognized the tax gain or loss during the last year itself.

Amit Mehendale: Right. And sir, in terms of capital, do you plan to raise any Tier 1 capital in FY27?

K. Paul Thomas: Our CRAR is very comfortable now. We have close to 24% CRAR. But as per our long-term strategy, we also have to bring down the promoter holding to 26% by 2032. So as the market conditions improves, we are exploring.

Amit Mehendale: Right, sir. I mean is it fair to say that you are exploring in like next 2, 3 quarters? Or will it be in FY28?

Gireesh CP: As per the capital plan, we are growing around 25% minimum growth. And with the ROE coming around 17% to 20%, definitely growth capital requirement is there. And during the last 2 years, we were infusing Tier 2 capital because the price levels were not conducive enough for raising Tier 1 capital.

And as MD was expressing, the promoter stake also has to come down by 2032. So, keeping all these in mind, if the price level comes at appropriate level, we may hope for raising Tier 1 capital by the end of this year.

Amit Mehendale: Right, sir. And what type of price-to-book multiple are you comfortable when you dilute the stake? Is there any broad guidance like 1.5x or 2x, any price-to-book ballpark number?

K. Paul Thomas: We have not started those discussions.

Gireesh CP: Anyway, you know at what price we have raised IPO. And also, before that, we have taken some rounds of private placement, etcetera. So, keeping all the sentiments of the existing investors, we will take a call at the appropriate time.

Amit Mehendale: Right, sir. And my last question is on ROA. Like 3, 4 years out, what do you see as a steady-state ROA for the business? Because our secured book has now expanded significantly. And how do you see it as a business on a steady-state basis?

Gireesh CP: See, on the ROA, I have already given that even for FY28, it is too early to predict. But on a steady-state ROA, I think 2% to 2.5% will be a good guess given the growth rate as well as the expense, which is additionally required for the investment in IT, technology, spread, etc. All those things we will have to keep it into account and so 2% to 2.5% will be a comfortable level of ROA going forward.

Amit Mehendale: Okay, sir. Thank you very much. That's it from my side.

Moderator: Thank you. The next question comes from Rishabh, who is an Individual Investor. Please go ahead.

Rishabh: My question is as per your investor presentation, 71% of total deposits are from Kerala. So how you plan to diversify this pool?

K. Paul Thomas: We already have a very good buildup over the last couple of years. We built a branch network across 26 states. So that's why we said that during the last 2 years because of the asset quality issues and all, we couldn't leverage on that branch network we built. So, we have good branch network spread across the country, and we will be now leveraging that network.

Rishabh: And sir, secondly, what is your take on further branch expansion? I mean any guidance for next 3 to 5 years?

K. Paul Thomas: For this year, we have planned 50 branches out of that 17 is already opened and operationalized. And in a phased manner, we'll be opening the rest. Most of these new branches will be opened in the newer geographies where we have started last couple of years.

Rishabh: And sir, which kind of locations you'll be focusing? Is it metro, semi-urban or urban?

K. Paul Thomas: Mostly semi-urban and rural because as you all know that 25% of our branches has to be in unbanked rural locations. So, we have a regulatory requirement to meet that. So rural, semi-urban, and a few branches in metro.

Rishabh: Okay, sir. That's all from my side. Thank you and all the best for upcoming quarters and years.

K. Paul Thomas: Thank you. Thank you very much.

Moderator: Thank you. The next question comes from the line of Sebin Joy, an Individual Investor. Please go ahead.

Sebin Joy: First of all, congratulations on the results. It looks great coming back from our times when we had losses in the previous quarters. My question was mostly on the gold loan portfolio. When I look at it overall, it's 42% of our loan portfolio. Are we planning to keep this at this range?

And the follow-up question on that is like what is the approximate LTV value on these loans? Are we lending out to the maximum regulatory possible limit or are we keeping an internal buffer on those?

K. Paul Thomas: Thank you, Sebin, and we'll be continuing at almost this level, 40% to 45% we will be continuing. And our overall book level LTV is at 72%. We are not going for the upper limit.

Sebin Joy: That sound prudent. Yes, I just had that question. Thank you and congrats on the results.

K. Paul Thomas: Thank you very much.

Moderator: Thank you. Your next question comes from the line of Ankur, an Individual Investor. Please go ahead.

Ankur: Hello. My question is on the Credit Guarantee Scheme. Few of the competitors I've noticed have got INR 500 crores plus recovery from such scheme, if I can name them, it's IDFC Bank and Suryoday Bank. So, wanted to know if our microfinance book was covered in this scheme, and if not, what was the business rationale for that? And if it's covered, how much recovery are we expecting?

Gireesh CP: On the CGFMU, we have not covered our micro banking portfolio because traditionally, the delinquencies are very low on that book. And as a conscious call, we have not taken it so far. So going forward, having experienced this kind of delinquencies in the past, we will be taking a call going forward.

Ankur: Okay. And my second question is on the disbursement front, the disbursement for the quarter was INR 8,500 plus, which is significantly lower Q-on-Q basis. So just wanted a color on this.

George K. John: So, we'll be keeping that same pace when compared to Y-o-Y. This quarter, we have a much better disbursement happening considering the industry as a whole has improved in all segments. So, we expect that to be keeping in same line.

Ankur: Sir, I was asking Q-on-Q. So basically, if you look at from March quarter versus June quarter, disbursement has come down?

Gireesh CP: Last year, the gold loans, the prices were going up in a unidirectional way. So that is not the case now. So, people are pledging the gold loan, which is typically for a 1-year loan, which we are giving them. But most of the people, because of the additional funding requirements, the same amount of gold, they will be repledging the gold for getting a higher amount or getting a partial release of the loan by way of closing and booking a fresh loan.

So that intensity has come down during the year because of the price correction, which has happened in the recent past. So that is one of the reasons why the disbursement is on the lower side.

Ankur: Okay. So going forward, but on an AUM basis, we expect 25% to 30% growth year-on-year basis. That would be the right assumption?

Gireesh CP: See, book growth, we have given the guidance only to the extent of 22% to 25% on the asset growth. So, with the current level of disbursements, we are confident of achieving those kind of numbers.

Ankur: Okay. Thanks a lot.

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

K. Paul Thomas: So, thank you very much all for participating in this call. So, we believe we have taken the right strategic steps and the improved performance validates the same. We will continue with the same dedication and hopefully supported by a positive macro environment we can expect to see continued growth in the coming quarters.

So, thank you all, all the participants, investors, and analysts for taking the time out for this conference call today. In case you have any follow-up questions or inquiries, you can always reach out to our Investor Relations team. Thank you very much.

Moderator: Thank you, all the members of the management. On behalf of ESAF Small Finance Bank, that concludes this conference. Thank you, everyone, for joining us, and you may now disconnect your lines. Thank you.