"Karur Vysya Bank
Q1 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Karur Vysya Bank's Q1 FY2020 Earnings Conference Call hosted by Spark Capital Advisors India Private 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 "*"then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhinesh Vijayaraj from Spark Capital Advisors. Thank you and over to you Sir!

Abhinesh Vijayaraj: Thank you Steven. On behalf of Spark Capital, I welcome you to the 1Q FY2020 earnings call of Karur Vysya Bank. We have with us today the management team of KVB represented by the MD & CEO, Mr. Seshadri, President & COO, Mr. Natarajan, General Manager & CFO, Mr. Sivarama Prasad and Company Secretary, Mr. Srinivasa Rao. I now request Mr. Seshadri to take us through the highlights of the quarter gone by after which we will open the floor for questions. Over to you Sir!

P.R. Seshadri: Thank you very much Abhinesh. Good afternoon everybody and thank you very much for joining us on this call today. It is indeed a pleasure for me to walk you through the updates for the quarter that has just concluded.

During this quarter, our transformational journey continued and it continued to gather steam. As we have been saying for a longish period of time now that our focus was on growing our retail business and on that front, I think we have made significant progress. Our retail business grew 32% year-on-year and if were to exclude the IVPCs grew 27% year-on-year. So retail business continues to work. The changes that we have made to our technology continued to aid us to get incremental throughput from our branches.

On the commercial front, we actually over this quarter did two or three things. A. We realigned our business into three component parts. Business has not reported in this deck in three component parts, however, for the purpose of managing the business, broke it into three component parts. One is what we call the small business group. These are businesses where our credit to them is up to approximately Rs.2 Crores which is managed now through a new entirely digital process. The second subcomponent is what we call the business banking group where customers have limits of between 2 Crores and 15 Crores which is relationship managed, so we have set up a large team of relationship managers. This was done in the quarter that went by. The third group is what we call the emerging corporate where the tickets are larger than 15 Crores and which is being handed off to our corporate and institutional group RMs to actively manage because then we can upscale them if necessary.

This process is progressing well. On the commercial side, our focus is to drive small ticket volumes through the digital system. I am happy to tell you that the commercial loan origination that is the total number of applications that we have received that was fed into our system in the first quarter increased by 109% over the total number of applications that we received in Q4 of last year so sequentially, an increase of about 109% in applications. However, the approvals or sanctions dropped by 2%. This is on page 7. There is a small typo. We will issue an amended page 7 subsequently.

With respect to retail loan originations, our approvals or the number approved increased sequentially 37% and the sanctions in value terms increased 30%. So from Q4 of last year to Q1 of this year, there has been a substantial uptick in business through our new digital technologies that we have implemented. So, they are getting embedded. We think that the impact of this is that it will enable us to increase productivity and therefore we are setting ourselves up structurally for growth. Growth can come through two means. One is by throwing more resources so that you get greater output and the other method to get growth is to increase operating efficiencies and we think that the digital transformation journey that we have undertaken enables us to get significant increase in operations efficiencies, which is a good method of increase throughput and growth. So, we are feeling reasonably good on that front.

From a non-branch distribution, we have been setting up a team which we call NEO that is now live. It booked its first loan in last quarter. We are hopeful that the throughput from that entity will start coming through in large numbers as we go through this quarter.

Our digital offering so far has been setup on an assisted mode i.e., one of our officers helps the individual to either apply for a retial credit product or a commercial credit product. We will shortly be launching a Self-Service only option which means that the customer will be able to service himself, which gives us the ability to then create an internet-only proposition which can be appropriately marketed to customers across India. That will again be accretive from a distribution standpoint and this is something that we intent to go live very shortly.

You would have all noticed that there has been a sequential reduction in our asset book on a quarter-on-quarter that is year-on-year we have actually grown, the growth has not been very robust, we grew 3%, sequentially we actually shrank, but the fact of the balance sheet structure is changing and it is very, very clear to you. The retail continues to grow, corporate balance sheet continues to shrink, it has shrunk sequentially and it has also shrunk year-on-year.

On the commercial front, on a sequential basis, there has been substantial reduction in balances and here I would like to take you back about four or five months ago when I was talking about issues that we were seeing in the marketplace. So we flagged to you certain challenges that we were facing. I think those challenges that we have flagged to you four or five months ago are now being more generically observed and in fact, in that call when we had mentioned to you that our expectation was that there would be a front loading of NPA attrition, we did unfortunately get a significant negative reaction, but having said that, I think we sort of on that one particular account, we were perhaps ahead of the market and we did bring to your attention the fact that we were operating in challenging times. Under those circumstances, we believe that the reduction in both the corporate balance sheet as well the commercial balance sheet is not a reason for concern.

On the commercial side, the reduction is largely on account of reduction in utilization levels. It is not that we have lost clients. It is not that we are not acquiring clients. It is just that average utilization levels have come off quite sharply over the last six months and that is telling on the end period balances. The average balances are a little bit better than end of period balances as you can see, but having said that, until the environment improves, we are very happy that our customers are behaving prudently and are reducing utilization on overdraft lines.

Finally, from our point of view, the balance sheet structure is getting closer and closer to a structure that we would ideally like to have, which is significantly stronger on the smaller ticket granular stuff. So, here are some numbers that are not on the deck.

Retail advance is roughly about 11000 Crores. Out of the corporate book of about 16,000 Crores or thereabout, 9000 Crores or thereabout is the small advances which is less than 2 Crores book that we have, which is the one that we are focusing on to grow. Approximately, 5000 is between the 2 Crores and 15 Crores level and the remainder is between 15 Crores and above, which is what we call the emerging global corporate. So, our focus now is to grow the 9000 Crores commercial book and I am happy to inform you that the originations under the new system as I said to you, the new logins have improved by 109% Q1 over Q4. Q2 is even stronger, so we are running significantly stronger in terms of new originations and approvals in Q2 and therefore we are reasonably confident that we will be in a position to show you sustained growth on this front.

Given how the market is at this point in time, our focus is to grow these granular pieces where we do have pricing power and where we think that we also have the ability to exit a transaction where it to not go the way we want it to and therefore, our focus immediately is to push this as aggressively as possible while we use both corporate as well as our larger ticket commercial as elements where we balance the books as opposed to see them as elements where we grow aggressively in. Of course, we are strengthening both of these in terms of the total number of RMs that we have in place. We have increased that count very, very considerably over the last quarter to quarter and half so that when the environment changes, we have the ability to take advantage and grown rapidly on that segment as well.

You would have noticed that our deposit book has grown very considerably in this quarter. We believe that given the environment it was necessary to be liquid and therefore we went into the market and did raise retail time deposits in some quanta, not because there was very great visibility as to where those deposits would go, but because of the fact that we believe in difficult market conditions, it is important for the bank to stay significantly liquid. As a consequence of this, our treasury related assets have grown approximately 4000 Crores over the quarter and that has had an impact on the net interest margins and I will speak through the net interest margin for the quarter, perhaps when I do get a question so that I can answer it in some detail.

Having said that, it just shows the depth of the liability franchise that we have that in one quarter, we were able to raise a fairly substantial chunk of retail deposits without really increasing rates in any significant manner. Therefore, it gives us confidence that once our asset side of the house is set in order, we should be able to grow both retail liabilities as well as the assets so that we can fund one with the other.

Our DLite app, which is the banking app that we launched some time ago, it continues to do really well. We believe it is a best in class app. It has features that not very many other apps in the market today have. For instance, one feature is that it gives you complete card control in the sense that if you have a debit card or a credit card, you can actually switch it on, switch it off, you can limit usage in particular merchant categories, you can set limits on the daily usage basis, it has complete billing capabilities, most billers can be accessed through this app and once set up, the app will actually remind you that you have a bill to pay. It has both bill presentment as well as bill payment. So, it is a one of a kind app and this is the foundational element upon which the digital bank of tomorrow can be built. So it continues to grow. We now have more than 1.1 million downloads. We have very significant usage which continues and we look at it with a reasonable amount of pride that we have set this up and the usage levels are ratifying.

With respect to the portfolio, a couple of quarters ago, we had said that we expect over a five quarter period that our NPA would be in the neighborhood of 1100 Crores and then I had added about 200 Crores of buffer, so net NPA of about 1300 Crores over five quarter period. In Q4 of last year, our net NPA was roughly 390 Crores, this quarter it is about 60 Crores, so that takes us to about 450 Crores. We think that we have a good chance, good likelihood that for the full year, we will be as per the guidance that we had provided earlier i.e., over the five quarter period we should be at 1100 Crores or lower depending upon how the recovery process works. We have been quite gratified by the level of recoveries that have been coming through over the last quarter. One quarter it does not somehow make, but it is in our own view is that what we did last quarter is repeatable and therefore over a five quarter period, we think that the 1100 Crores number that we had given you holds in spite of certain large corporate assets, one of which you are all aware of being deeply stressed where we think that provisions will be required to be made which was not originally in our radar at that point in time.

You would have noticed that we continue to grown portfolio coverage, so PCR as defined by RBI is now up to 59% plus. We have on the investor deck in page 36, a chart that shows you how in a disciplined manner we have been growing our portfolio coverage. So RBI PCR has gone up from 54.09% to 59.05%, 500 basis points increase while the market PCR which is the provision held divided by gross NPA has gone up from 32.4% to 47% in a very, very disciplined manner as we have been communicating with you over the last many quarters. We are now getting closer to a level where we think we would be adequately provided and at 47% amongst the old private sector banks, we are one of the better provided and placed institutions.

Finally, before I conclude, we are operating in a challenging environment. The newspapers are full of news, which suddenly has swung to be negative. Under those circumstances, as I have said earlier, we have seen a few of these items that are coming out into the open now a little earlier than many in the marketplace and we have been tightening our belt. The aim is to ensure that the credit that we take onboard has the ability to payback over a period of time and that the quality on the book remains reasonable. With that in mind, the new origination has been put through credit screens that have changed constantly over the last six or eight months and the NEO vintages are performing significantly better than the older vintages. However, that has made it difficult for us under the circumstances to show growth in two areas, one being the commercial and the other being the corporate and as I said on commercial, we think on the smaller ticket stuff, we are now getting very significant throughput through our systems. We should start showing growth there, but there may not be offsetting growths on the large ticket stuff. So we are watching this environment very, very closely. We are setting ourselves up in such a fashion that we cleaned up the book; the balance sheet is now substantially cleaned. We have ensured that we have enough liquidity; we have the capital which is roughly at 16% now on a risk weighted basis for growth. The question now is when does one push the pedal and get the growth in to the door and while we wait for the environment to reach a place where one has the confidence to push the growth aggressively, we are setting in place all the tools and technologies that are required to enable us to take advantage of the opportunity when it does come.

With that, let me thank you once again for joining this call. I am very, very happy to answer any questions you may have in as much detail as one can muster during one of these calls. So thank you very much.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Prashant Poddar from Abu Dhabi Investment Authority. Please go ahead.

Prashant Poddar: Thank you very much Sir and thank you for the very impressive initial discussion and the presentation as well. We are very happy with the way you have kind of slowed down everything while you have focused on quality. Sir, my first question is on deposits. You have been saying that deposits is the key focus area for financing the growth and while term deposits you said have grown and I have do not have quarterly comparison, Q-o-Q comparison, but on a year-on-year basis, it still looks quite low compared to the size of the balance sheet that we have. So what else are we doing in terms of deposits focused to be able to grow that to let us say mid ten’s for a small bank like ours?

P.R. Seshadri: I think the deposit bits can be broken up into two parts. One is the CASA piece, which is the demand and savings deposit and the time deposit. So far, if you would go back a couple of quarters, you will notice that the time deposit growth for us was very, very minimal. We were growing at 1%, 2% at that level basically because we had no place to deploy those deposits whereas we were focusing on trying to grow CASA. So this quarter, our CASA on averages, our demand deposits have grown year-on-year about 9% and savings deposit on average is, not end of period, end of period are actually not as good as the averages, average savings deposits have grown 10%. From our point of view, while this is not the level where we would like it to be, given the current systems, process, and technologies in place, these are reasonable growth rates. This particular quarter, I understand from the market there has been degrowth for many of our competitors on the CASA side. That may not be generic, but in our case we have grown and we are noticing significantly more competition for CASA as we go into this quarter than we were a couple of quarters ago. So on the CASA side is where we intend now to focus. We have been over the last 18 months or 24 months, exclusively focused on the digital front for our assets. So we have built what we think is an industry leading digital platform for loans. Now we want to build industry leading digital platform for liabilities, mostly on the transaction liability side and that is the next big exercise that we have intend to take up which will then ensure that the CASA growth is at levels which are expected for a small bank like ours.

On the term deposit side, we have grown approximately 8% from last year 40310 to 43371. Let me just give you the number as at the end of last quarter. So at the end of last quarter, we were at 41953, so we have grown about 1500 Crores or thereabouts. Without changing interest rates, merely by pushing our branches to go and get us a little bit more deposit because we believe that under difficult conditions, one needs to be more liquid than less liquid. Even though we did not have visibility as to where, what kind of loan assets we would grow with this. So the net result now is our treasury assets have increased quite considerably as you would notice treasury assets merely in the form of market related papers that we are holding has grown by about 2100 Crores and bank balances which are in the nature of dollar related transactions which we have entered into fully which gives us a slight uptick that those have also risen by about 2000 Crores. So we now have about 4000 Crores worth of liquidity that we will use as we go forward. We think that the market will give us opportunities and there are significant amount of one time opportunities that come along and that is the reason why we did it. We will ensure that we dial this forward or dial it back based on what our expectation of the market is. So I do not know if that answers you question in the direction that you asked and I am happy to provide any clarification.

Prashant Poddar: That is helpful Sir. On margins, we understand that part of the impact could be because of this additional liquidity. Could you help us understand what could be the margin trajectory for the full year?

P.R. Seshadri: On the margin front, our commentary has been consistently that we have pricing power. So, in fact on page 6 we have give you what through the door weighted average yields are on the various loans that we are booking. On the retail, last quarter we booked at 1177 and commercial we booked at 12. So we are working on 500 basis points to 600 basis points spread on these asset categories. These are what is coming through our new technology driven platform where full risk based pricing is in operation.

As the throughput on these channel increases, we believe that would translate into wider spreads for us as a company. Our view is that we have pricing power, it has not yet been fully flushed out nor fully demonstrate to the market, but we think we are reasonably confident that that will happen as we go forward.

With respect to last quarter, our NIMS came in at 3.49%. So you have to look at NIMS on a sequential basis, you have to compare it against Q4 of last year so that you understand what happened over this one quarter. It was 388 last quarter so there is a reduction of 39 basis points.

Now when you look at it on a sequential basis, here is what we find. First is that in the 388, we had a small component which was of a non-repeatable nature in the 388 which accounts for about 8 basis points, so you need to remove 8 basis points, so you come to like-for-like comparison of 380 to 349, so that is a 31 basis points difference. There is a 6 basis points increase in cost of funds that we have reports. So out of 31, 6 is answered by the increase in cost of funds on account of the increase in the time deposit that we have brought to our book. There is 4000 Crores of investment book that has changed or increased during this period. That has an impact, we have computed, not to minus approximately 6 basis points. So now you are down to 12 basis points between the two of them, so out of the 31 basis points, that explains 12.

There are incremental reversals this quarter over the prior quarter which accounts for roughly 4 basis points. In this quarter, we had some advances which were agricultural advances where interest for a longer period of time has been reversed and as a consequence, the reversal amounts were larger than the prior quarter. We have now accounted for 16 basis points out of the 31. Then there is carrying impact of IVPCs which as you would have noticed now we are reducing. That is another 4 or 5 basis points, which leaves us with about 10 basis points which is something that we are still thinking through as to how to explain this reduction and we think that that is a complex set of issues that are difficult to pin down all at once.

So, that is the reason and as I had said earlier, we are reasonably confident that we have pricing power and that we should be able to push this going forward. So our spread is not an area of concern, our area of concern as an institution, something that I tell everybody that I meet are two, one is to ensure that the portfolio quality continues to improve and the second is finding the right growth opportunities for the institution. NIM is not an area that we are overly worried about.

Prashant Poddar: Sir, one last question on asset quality. Given the newspapers you read are similar to the ones we read and obviously there are a lot of challenges all around in various sectors in India and slowly large banks have started questioning about some slow down as well, but not like big slow down, but some slow down at least and in that environment, we are trying to build up our growth from the earlier levels. Given our exposures to sectors like textiles, commercial real estate and NBFC, in NBFCs you have seen some 36% growth year-on-year as well. Are there rising risks on the existing portfolio and with that question if you could help us understand what are the incremental tightening that you have said on the screens that you have made to ensure that some of these things do not hurt you?

P.R. Seshadri: With respect to NBFCs, we are among the least exposed banks. Our total exposure is about 4%. If you were to compare us to pier banks you would find that our exposure is actually quite minimal. Most of our exposure is to Southern Indian institutions. Many of them are in the business of given gold loans where there is very limited asset liability mismatch and there is also a very significant component of security available. So we believe that those are amongst the NBFC space. They provide some kind of safe harbor and lending to them is not a problem.

With respect to commercial real estate, our exposure to large developers is very limited. This is an amalgam of very many things that is put into this box of commercial real estate. In fact, we must grow it up and provide information to you as to what represents loans to developers and what represents loans to individuals who are buying a third house or somebody building a hotel and so on and so forth, a small hotel in Southern Indian town etc, etc., So whilst the numbers that you are seeing is 2700 Crores or thereabouts, you will notice that the total quanta is reasonably static, it has not really grown. It is an area that we have been focused on. Our developer exposure is very, very, very limited. There are some. There is only one exposure that we have which is greater than a 100 Crores, one particular individual or one entity where we have given a loan greater than 100 Crores there is only one exposure of that type. The total developer exposure is something that we will probably in the next deck. We will make that available saying hey! This is what you have given as developer exposure, but it is the number that we are reasonably comfortable with at this point in time. We do not see any stress on this sector, wherever we have lend, the exposure is also more in Southern India as opposed to Northern and Western India and they are much smaller in ticket. So while we are aware of the real estate problems, as of this moment, we do not see any reason to believe that there is stress on this CRE book of ours, but next time around, we will ensure that the CRE bubble is blown up and we give you as much detail as it is possible so that it sort of obviates the question. Our aim has been to provide as much transparency as possible and we will provide that information so that it is easily accessible.

Prashant Poddar: Thank you Sir. I will get back in the queue.

Moderator: Thank you. The next question is from the line of Umang Shah from SAIF Partners. Please go ahead.

Umang Shah: Mr. Seshadri thank you for taking our question, this is Umang from SAIF. The question is I would like to get your commentary on the asset quality on the commercial side to basically analyze it is 4.6%, we would love to hear some commentary from you on how you think about that number and if at all there is any negative surprises or any stress which we see developing in the LAP book?

P.R. Seshadri: Umang, it is a good question. Commercial annualized net slippage rate is 462. The good news is that when we look at our portfolio today, we find that the 30 plus is significantly lower now then where it used to be. The larger ticket customers who were stressed to the best of our knowledge, a very large chunk of them are already now recognized as NPA. Therefore on our view, is that on the commercial side, there will be a marked deceleration of NPA accretion because the total book size on which we could take NPAs has started coming off and coming off nicely. That is why I am saying that for the five quarter period when we said 1100 Crores of net NPA accretion, that still holds and if anything we have a fighting chance of being under that and while we want to keep that 1100 Crores total number at our disposal, but our aim is to see if we can get under it and one of the drivers of that will be reduced net NPA accretions coming from the commercial side. So the commercial side is actually three books. We will try and provide you details of the three books in as much granular details as possible so that you understand it. Our focus is on growing the smallest size book which is were we have the maximum pricing power and which is where exiting a transaction is also the easiest, which is why we have invested a great deal in technology so that we can improve operative efficiencies and we will also try and give you as much detail and colour as possible on the portfolios and their performance so that you can have a view as to how things will look as we go forward.

Umang Shah: Also if you look at the NPA numbers for the commercial piece is at 7.7%. Should we see this number trending southwards going forward and will it be more because of reduction in deficit or more because of improvement in recoveries?

P.R. Seshadri: We have now started getting pretty substantial recoveries so there will some impact on account of higher recoveries as the NPAs age and as the recovery process works. Forward flow itself will start reducing which means that you know items flowing through SMA1 and SMA2 into NPA that itself should stop dropping off is the view that we have because the visibility that we have is that majority of the stressed accounts have now been dealt with but given the environmental stresses that we currently have, there may be some incremental items that pop up, but keeping in view the portfolio as a whole, our belief as of this moment is that we will stick to our original commitment.

Umang Shah: Thank you so much. That is it from me.

Moderator: Thank you. The next question is from the line of Abhijeet Gaurav from Sundaram Mutual Fund. Please go ahead.

Abhijeet Gaurav: Thanks for taking my question. Sir my first question is on the textile book. If you could give us some clarity on how the stress levels are behaving. We have been reading some stress emerging in this particular book, also colour on the geography exposures within textile?

P.R. Seshadri: With respect to textiles, we have exposure in two geographies. One is Southern India and the other is in Gujarat. Majority of the exposure is in Southern India. We have been textile financier since the day the bank started and the experience on the textile front hitherto win reasonably well. There is also a deep institutional understanding of the textile business which many other institutions may not have. What various counts means is something that people in the organizational hierarchy understand, you know what are the different types of machines people understand. So given the reasonably high quality understanding that we have of the business, we think that the risk can be managed. We are aware that there is some news flow which is negative. Having said that, we are seeing that on our textile front, the balance sheets have actually started shrinking, it is not because we have exited customers, it is because customers are actually lowering utilization levels. We think we have a clutch of customers who are reasonable because most of these customers have been with us for a very, very long period of time. We do not at this point in time foresee anything negative coming our way immediately.

Abhijeet Gaurav: Sure Sir, that is comforting. Second question is on retial net slippages. It has sort of increase after a couple of quarters if you could give some colour for this and some one off which will stabilize in the coming quarters, what happened in this particular quarter, retail net slippage?

P.R. Seshadri: Retail net slippage, if you notice the prior quarter it was negative and this quarter it is a pretty significant 42 Crores amounting to 1.54%. As far as we see, it is a one timer. There were a few bigger ticket retail loans that flowed through. We do not think this is the natural order of things and therefore we are not particularly worried about it at this point in time. If you were to go back a few quarters also, you will find that very often it is near zero and therefore you know on an aggregated basis, this is not a cause of worry for us.

Abhijeet Gaurav: Sure Sir, last question. In the opening commentary you said the new retail loans which are getting booked are 11.77% yields, just wanted to understand this is in the unsecured personal or which segment and what is the scope for this particular segment?

P.R. Seshadri: This is the weighted average. So LAP, home loan, unsecured personal, auto whatever we do, everything put together weighted average. We think that we are merely scratching the surface. For the first time we started doing things like pre-approved loans to our base and now that our analytic team is fully operational, so we are now reaching out to our customers and offering them loans basis on their liability history, basis the history they have with the bureau. These are things that as we go forward we will be able to do more, so given the size of our liability base which is roughly 8 million customers we think that we have significant headroom on the retail side.

On commercial, this is more on account of the fact that we are talking about small businesses where borrowing at this rate is reasonable because the alternative would be to borrow from a non-bank finance company at perhaps even a higher rate for this.

Abhijeet Gaurav: Sure Sir, I will get back in the queue, thank you.

Moderator: Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: Thanks for the opportunity Sir. In one of the slides the retail and commercial lending rates are mentioned at about 11% and above 12% respectively and most of the businesses coming, why are the margins still not showing any signs of improvement?

P.R. Seshadri: It is a very good question. The margins were showing signs of improvement up until last quarter. This quarter was a reversal. These do not represent the full book. Basically, we have four business lines. Agriculture is a business line where approximately 17% of our balance sheet is residing. Those are at low rates because we have to meet the 18% target that RBI sets on us. The retail stuff is at the rate that we showed you, which is good, but that is only 22% of the book. The commercial, the 12% is a good number, but that is a book that represents roughly, this is on the new vintages, the new origination, the historic book is at a significantly lower rate. So it is not immediately the transference from what we are originating now into the portfolio throughput will take some time as the newer vintages at these rates sort of become the dominant portfolio. Because of all of this, as the older vintages sort of go away and as the newer vintages come in, we think the spreads will rise. So up till last quarter, that story was holding. This quarter has been a blip which we are thinking is a one time blip and which we explained a little earlier what were the elements that led to the blip, but as I said, because of the measures that we have taken on the pricing front, we still believe that we have pricing power and that margins will grow.

Amit Premchandani: Just on the same question, yield on advance are at 9.61 and the incremental lending you would be doing on an average given your portfolio composition would be close to 11?

P.R. Seshadri: No, the corporate stuff will be lower, so depending upon what we are putting out in a particular quarter will be different. Let me just give you what was there in the last quarter, I have the numbers with me. In a month we are closer to about 1075 or thereabout. There is also the impact of the non accruing book, so we have a very large non accrual book which needs to be taken into consideration.

Amit Premchandani: You are saying incremental yields are at 1075 plus?

P.R. Seshadri: Correct.

Amit Premchandani: Okay, Sir on the stress part, after you have given a guidance two quarters back, there have been new stress emerging in the NBFC space, some of the large corporate groups and some of the eastern based corporate, even if you add all of them up, there is no significant exposure you have in all of them, because that was not a stress, or could have been a stress two quarters back?

P.R. Seshadri: The names that I have know of if you can, I cannot really name them in this call though I am aware of the names that you are taking about. The Eastern India ones one particular group we had exposure to a sister company or a subsidiary company of that Eastern India Company, which has interest in tea gardens. That is already an NPA and already provided for. With respect to manufactures of water tanks we have no exposure. With respect to a large housing finance company, which is currently in the news we have no exposure. We do have one exposure to one entity, which I think that is in the public domain and our exposure to one particular entity amounting to less than Rs.200 Crores, which we think will become an NPA and we will be in a position to manage as we go forward, but as we look at our balance sheet and as we look at the names that are coming through we fortunately at this present moment do not have significant funded exposure to the names that are doing the rounds.

Amit Premchandani: The Rs.200 Crores exposure that you are commenting on that is already part of whatever Rs.1100 Crores guidance that you are giving?

P.R. Seshadri: Yes.

Amit Premchandani: Thank you Sir. That is it from my side.

Moderator: Thank you. The next question is from the line of Roshan Chutkey from ICICI Prudential. Please go ahead.

Roshan Chutkey: Thanks for giving me the opportunity. Firstly on the core fee income can you explain the growth movement why there is a decline and the reasons around that and two I just wanted to understand this NIM movement better? You are talking about IBPC leading to reduction NIMs by about 4% to 6% if I got it right, so IBPC is a low yielding book right so if there is a reduction that should have helped us improve the NIMs what am I missing here?

P.R. Seshadri: Very good question both of them. The reduction in the fees or the other income is on two counts. One is the total new facilities that we brought onto our book, which had significant fees components reduced during this quarter. There was also reduction in our non-funded books both LCs and guarantees have reduced and consequently the fees associated therewith have reduced. In the industry itself there has been a reduction in FX related transactions were we have a small share and we have been impacted as a consequence, so it is much of the reduction on the fees side is a risk related reduction because as we were unwilling to take certain risks, certain fees that came along with the risks did not come through. There are areas where we are actively reducing exposure especially on the non-funded side there again it had an impact on the fees that we were getting, so that is number one. Number two with respect to the NIM and that is something that we are looking at very closely. With respect to the NIM, the reason why I said the IBPC made a difference was that for a large portion of this quarter we were carrying a substantial amount of IBPC. If you recall at the end of Q4 we said that our IBPC was Rs.2050 Crores if I am not mistaken and that Rs.2050 Crores decayed over a period of time so fairly large portion of the time the Rs.2050 Crores would remain on my book and as a consequence of that Rs.2050 Crores because it is lower yielding it had a NIM drag. Because of the NIM drag now we are wondering whether we want to keep those assets on our book or not and that is a decision that we are taking, so that is the reason why there is a yield drag on account of this.

Roshan Chutkey: Sure. Thanks Sir.

Moderator: Thank you. The next question is from the line of Prashant Poddar from Abu Dhabi Investment Authority. Please go ahead.

Prashant Poddar: Actually my questions have gotten answered. Thank you Sir.

Moderator: Thank you. The next question is from the line of MB Mahesh from Kotak Securities. Please go ahead.

MB Mahesh: Good evening Sir. Just one question with respect to the exposure to NBFC that you have, did you explore any opportunity to buy out the retail assets out there?

P.R. Seshadri: We will have to buy it out together with the transfer of servicing. We should have done it earlier and I think we have not so far, so now with the current position it will probably be difficult, so we will have to go through the resolution route I guess and that is where we are at and given that alternative services were not readily available at that point in time, we had dropped it. Now we will have to figure out what to do with that asset. We are hoping that the outcome would not be as bad as some of the other NBFCs, but having said that, that is quite stressed.

MB Mahesh: Is it possible that you could have taken this option because some of the other banks did expose this and have had some success on changing the service as well? We have seen at least one to two transactions in the market?

P.R. Seshadri: Mahesh you are right. We should have thought this through and we should have seen whether it could be done. We had two concerns. One concern was whether it will be contested subsequently and what the legal position of that would be. That was number one. Number two was this whole whether the service change would actually work or not and whether there was an alternative servicer available and because of the bankruptcy remote and to make it bankruptcy remote we needed to do that otherwise we would have ended up in a worse position than being merely one of the folks waiting in queue, so given all of that we chose to wait it out so now we are looking at it very closely to figure out how to get out of that transaction.

MB Mahesh: Thanks Sir and one last question on the corporate accounts any broad visibility that you have right now on any resolutions around the corner because the reductions I think?

P.R. Seshadri: If you have any visibility you can tell me?

MB Mahesh: You are close to the ground Sir than us?

P.R. Seshadri: You are sitting in Mumbai my friend. I am in Karur. It is getting murkier and murkier unfortunately. I wish I could say that there was a positive momentum. From what we can see there is very limited positive momentum. It is becoming more and more complicated as it gets litigated more and more. We are hopeful that with the new ordinance, etc., when it comes in the process will get smoothened out a little bit. We expect one or two of our assets to get resolved because they are the final stage, but having said they have been in the final stage for a long time, so it is something that we have no control over. We are watching. We do not have as of yet any views on whether it will be done quickly or not.

MB Mahesh: As a followup ARC interest has come off remain the same or no change?

P.R. Seshadri: ARC interest, I think depends upon the asset and depends upon the nature of the disposition of the various constituents who have claims on the asset, so where there are very limited operational creditors I think there continues to be interest or there was interest and where the underlying is solid and there is the ability to actually liquidate the underlying at a reasonable price there is interest so the expectation of returns I think has gone up quite considerably on the ARC front and therefore the pricing that is available to the banks as a consequence come off that is where we are at.

MB Mahesh: Perfect Sir. Thanks. That is useful.

Moderator: Thank you. The next question is from the line of Bhavik Dave from Reliance Nippon Life Insurance. Please go ahead.

Bhavik Dave: Sir, I just wanted to understand your view on your PCR so your PCR has come along really well from where we started and we are at 49% odd on the calculated basis? By the end of the year and like may be FY2021 what is the PCR that we are comfortable with? What is the number that we will want to be at when things normalize?

P.R. Seshadri: I think it is a good question. I think we will start becoming comfortable when we start hitting the 55% level or thereabouts. That way then we would be in with the pack of our pier banks and have decent PCR. Even now we are better than many of our contemporaries in Southern India. Our expectation was that we would take roughly Rs.1200 Crores of provisions over this year. This is what we have been indicating, but depending upon how the NPA accretion happens our provisioning will therefore change, but I think we will continue to provide aggressively such time as we get to about 55% and thereafter moderate a little bit as we go forward. That is our current thinking. Given the nature of the asset that are now forming a bulk of the NPA, so at 55% we think that at we have recoverability of at least 40% and therefore the uncovered items will be smaller.

Bhavik Dave: Sir what we are adding in the last like 12 months that we had spoken about what we are going to add in the next one year more or less is going to be more of commercial assets where the LGDs are quite low as compared to a corporate asset, so is there a requirement for a higher PCR would not be required right because if we see a southern based bank some of these banks have lower PCR because their quality of NPA is more towards the SME side or the commercial side where the LGDs are far better off than a large corporate accounts so like 55% would be a good enough PCR to be at right? That is the way you are thinking?

P.R. Seshadri: That is the view that we are currently have that we initially were targeting 60%, but now we are saying that as we get to 55% given the fact that the composition of the NPA is changing the share of the corporate is reducing and within the corporate the consortium related corporate a few of them have already gotten resolved and as a consequence even within the corporate we do have assets where we have solid collateral with us and therefore at 55% we would be reasonably comfortable. Our risk guys are actually going through that exercise as we speak to understand where what kind of levels would be ideal and we would be guided by them as we go forward.

Moderator: Thank you. The next question is from the line of Pranav Tendulkar from Rare Enterprises. Please go ahead.

Pranav Tendulkar: Thanks a lot and congratulations on a good show. I have a few balance sheet questions. First of all your borrowings have also increased from around Rs.1560 Crores to Rs.2700 Crores and on the other hand cash has increased from Rs.750 Crores to Rs.2865 Crores, so could not this cash be used to pay back borrowing and that could have resulted in a positive NIM?

P.R. Seshadri: It is a good question. The cash that you are referring to is the deposits with other banks. This is the dollar swap trade that we did because there is a momentary opportunity and this was essentially to deploy excess liquidity. As I explained earlier, we thought that as we get into a period where there is some stress, we wanted to stay liquid and we went out there in the market and garnered some deposits and when it came down to the time to deploy those deposits we found the situation on the ground to be a little bit more difficult than we thought it would be and therefore we moderated asset growth and because we moderated asset growth we were forced to redeploy through the treasury that is why the treasury assets have increased very dramatically and since the duration on those assets have been kept very, very low, the NIMs have come off and I have explained where the NIMs came off from, so that is the story.

Pranav Tendulkar: In this swap the income because of this swap in interest line or forex because forex has still not grown that much?

P.R. Seshadri: This is in the interest line and it is on an accrual basis so it will drip through.

Pranav Tendulkar: That could be one factor affecting the NIM?

P.R. Seshadri: Yes it is. The fact that our treasury assets have grown by Rs.4000 Crores quarter-on-quarter is one of the factors that is impacting the NIM?

Moderator: Thank you. The next question is from the line of Vikas Sharda from NT Asset. Please go ahead.

Vikas Sharda: Two questions. One is that for this full year what kind of loan growth would you be comfortable with and secondly you mentioned on the exit yield on the loans or base it on the new loans the yield is like closer to 10.75%, but if you adjust it for the gross NPA in the balance sheet does it come closer to your current average yield on the loans?

P.R. Seshadri: I think if you were to review the non yielding assets you will come to roughly the same number right, which is about 10.80% or thereabouts, which is a clear spread of about 480 basis points so this is because of the weighted average result coming from the agriculture where the yields are much lower than the other side, but as the commercial and retail books grows in share we think that the spreads will improve that is the point that we are trying to make and whatever we are originating now is giving me clean spread on a weighted average including agri and including corporate everything put together about 480 basis points. The cost of funding is about 580 so at 1080 we are still talked about actually 500 basis points. If you were to add the drag coming on account of SLR and CRR, etc., etc., that is about 20 to 25 basis points so net clean spread we are working at about 480, but there is huge yield drag on the nonperforming book, which is now a fairly substantial portion of the book and also the fact that this time we have a significant increase in our treasury book, which has dropped our NIM so as we go forward as we moderate the treasury book, our NIMs will come back closer to the 388 first that we showed in December quarter and as the higher yielding book comes through the door we think that the spreads will improve further so as I said earlier we are not worried about NIM at this stage. We are more worried about asset quality and growth the two areas that we mentioned earlier.

Vikas Sharda: On the first question regarding the outlook for the loan growth for the year?

P.R. Seshadri: It is a difficult question to answer, Vikas because I think on the retail side we will continue to grow. On the retail side, we are not doing very much, but the way of unsecured just in case people are worried about that. We do have an unsecured proposition, but it is Rs.25 Crores to Rs.30 Crores of bookings a month on super prime bureau scores and going through a high quality score card. Most of it is housing so you will see that it is a very large chunk of it is housing. We have some pricing capabilities on the housing front, which are as yet untapped, which we will need to look at. We were waiting for volumes to come through before we started tapping the pricing side, so we think that if anything our growth will accelerate on the retail front. On the commercial side, we will get substantial growth on the small ticket size that we are now reasonably confident. I think this quarter we will originate twice on the small ticket size what we originated in the prior quarters, so in Q2 we will originate two times what we originated in Q1 on the small ticket machine processed commercial loans, but that is a small component of the total or rather that is approximately 50% to 60% of the total commercial business and on the bigger ticket stuff is where we have become quite risk averse at this point in time, so I think at this point we are just waiting and watching to see, which way the wind is blowing before we press the pedal on growth, but we will get normalized growth coming from utilization itself so 80% of facility both on corporate and commercial are working capital so utilization as they increase towards the quarter end that itself will give us some growth, but the new facilities that we put out is proving a little difficult for us to estimate, so low teens is what we were saying mid teens earlier, but now it is looks more like low teens in terms of growth.

Vikas Sharda: Got it. Thank you.

Moderator: Thank you. The next question is from the line of Anuj Sharma from M3 Investment. Please go ahead.

Anuj Sharma: My question is on your digital platform. Now that you are seeing efficiencies on this platform what is your assessment of the quality of the book being generated? The question is more in light of what risks do you see in this platform given that most of the parameters would be historical and environment is dynamic how do you keep tweaking this platform so that the book quality remains high? Thank you.

P.R. Seshadri: It is a very, very good question and in fact it is a risk that we run almost all scorecards are backward looking. Therefore they look through historical performance and on the basis of historical performance they predict the future so if a certain set of characteristics did well they will assume that those characteristics will do well in the future also so therefore if there is any change in the environment the efficacy of scorecards will reduce so that is a valid point. So, what we are doing right now is that we are looking to do the scorecard maintenances sooner than we would normally do so the only problem with this if there are a discontinuity of sufficiently large magnitude then the scorecards cannot be rebuilt basically. We do not believe that this is such a large discontinuity. We do not believe this is a 2007 to 2008 event. This is a liquidity driven slow down, which we think will hopefully come back and therefore are current view is that the scorecards will continue to be predictive, but as I said having said that we are relooking are scorecards sooner than we would normally relook.

Anuj Sharma: Thank you. Do you see any difference in the quality of book being generated let us suppose three months ago then what it is now through this process?

P.R. Seshadri: I can tell you the difference between the cohorts that were generated using the digital versus the cohorts that were generated without the digital because three months you cannot make out any trend in the lending business. It takes more time. The cohorts on the digital side are performing two to three times better than the cohorts on the non-digital side so far, so therefore there is a significant improvement in credit performance. All of this is caveated by the fact that these are all scorecard based and therefore if the environment changes very dramatically there may be a change in behavior, but we do not believe that such a dramatic environmental change has taken place.

Anuj Sharma: Sir thank you for your response. Thank you.

Moderator: Thank you. The next question is from the line of Anriban Sarkar from Principal Mutual Fund. Please go ahead. Mr. Sarkar your line is on talk mode. Kindly go ahead with your question. Due to no response from the current participant, we move to the next question, which is from the line of Pranav Tendulkar from Rare Enterprises. Please go ahead.

Pranav Tendulkar: In the retail assets particularly in vehicle loans and in educational loans there was a negative YoY growth, is there any risk perception that you are observing here?

P.R. Seshadri: It is not really risk perception, Pranav. This is more the fact that these are brutally competitive. Vehicle loans specifically are a brutally competitive business. It is very difficult to make money. We do not have the historical skills that HDFC Bank and the other biggies have, so by the time we really make money here and by the time you account for all the costs there is not much left over and so therefore we have sort of deemphasized it. We were more keen on doing stuffs where the P&L visibility was cleaner. With respect to educational loans, educational loans this is a specialist field. You need to have specialist architecture to do it. You need to understand, which schools to finance, which courses to finance so that the risk associated with it can be banished. We do not have that capability set. The products that we were doing were essentially those that were regulatory mandated and as such the performance on those products were not ideal so there has been a de-emphasis again of those loans.

Pranav Tendulkar: Sir in terms of your commentary you were again and again emphasizing on risk in that environment, so can you just highlight is it arising in corporate or MSME or SME portfolio or are you seeing an increasing one SMA1 and SMA2 in the retail and other parts of your business?

P.R. Seshadri: I will draw your attention to page 38 of our deck. You will notice this is a chart that we published last time around for the first time to indicate how our portfolio is doing. The idea was that we did not want to tell you what are SME1 and SME2 numbers were so we normalized it to March 31, 2017. What you will notice is that from a high of 184, it was 184% or whatever it used to be on March 31, 2017. Our SME2 dropped to 45% in absolute value terms by March 31, 2019, so that was the reasonably nice secular kind of movement and unfortunately that movement has now gone up. You can see a slight uptick. Our view was even at our focus on collection so high there will be a further reduction even though the numbers now are much better than they used to be in the past, the view was 45 we will start trending even further downwards. The good news is SMA1 has come off from where it used to be, but SMA2 has gone up a little bit. Now that is indicative of the fact that in spite of the fact that we have taken NPA, etc., etc., etc., so ideally your SMA1 and SMA2 shrinks as NPA cruise so under those circumstances our belief is that there is systemic issues, which people especially self employed people and businessmen are dealing with. We believe that this is under control. We have the infrastructure to manage it, but it is quite visible. Now if you are on the supply chain side, you can see it. If you have done a loan through an auto dealer you can see that the payment cycles are lengthening. You can see that their stock holding levels are increasing. You can see that the payment cycles of majority of the businesses are lengthening, so information is coming through at various levels. There is also a reduction in utilization of limits by businesses. Now reduction happens when people are belt tightening, when they are not growing their businesses. They are on overdraft account. When will you pay down that overdraft account? That is when you are not putting as much money either you are not buying as much raw material or you are not extending as much credit. Those are the two things that the overdraft account funds, so we have noticed a very significant reduction in limit utilization. All of these are indicative of where business confidence is a little lower than where it used to be.

Pranav Tendulkar: Is there any colour in terms of retail and Sir you have already highlighted SME, MSME and self employed, but is it also visible in salaried part of the business?

P.R. Seshadri: Not so far. We do not see any trends and our portfolio of retail is largely to our own banking customers so we expect it to behave reasonably well as we go forward. Only time will tell because the growth has only come in now.

Moderator: Mr. Tendulkar. Sorry Sir we request you to rejoin the queue please.

Moderator: Thank you. The next question is from the line of Aarsh Desai from Vallum Capital. Please go ahead.

Aarsh Desai: I just wanted to understand that someone who has taken a loan in the more traditional sense from your branch, what happens when he comes back for his working capital limit again? Is it repriced on the basis of the new platform?

P.R. Seshadri: It is repriced on the basis of the new platform and the one cycle of repricing is over, so the new platform was introduced for renewals first, so one cycle of repricing is over. The new platform also sort of segregates customers into desirables, the okay and stressed customers and our branches are now talking to the customers and ensuring that their behaviour changes, so that the platform treats more and more of them as desirable customers.

Aarsh Desai: My question is related to that only was you said that approximately 22% of your retail book is on this platform approximately what percentage of your SME book is now priced as per this platform and by when do you see the transition to be complete?

P.R. Seshadri: The retail book for the most part whatever new loans are coming are going through this platform. They may be the odd asset category, which is not covered under this system that is, but those are minor. For the most part retail is new book goes through this system. On a commercial side all loans under Rs.2 Crores go through this system. Anything above Rs.2 Crores will go through the standard processes that we have. Rs.2 Crores accounts for roughly 60% of our book, so roughly 60% of the balance sheet goes through this on the commercial side.

Aarsh Desai: Got it.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question. On behalf of Spark Capital Advisors that concludes this conference. Thank you for joining us and you may now disconnect your lines.