"City Union Bank Limited 3QFY23 Results Conference Call"

February 11, 2023

MANAGEMENT: **MR. N. KAMAKODI – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER – CITY UNION BANK LIMITED**
MR. V. RAMESH – CHIEF FINANCIAL OFFICER – CITY UNION BANK LIMITED

MODERATOR: **MR. PRABAL GANDHI – AMBIT CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to City Union Bank 3QFY23 Results Conference Call, hosted by Ambit Capital. 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 touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Prabal Gandhi from Ambit Capital. Thank you and over to you, sir.

Prabal Gandhi Thank you, Tanvi. Good evening, everyone. On behalf of Ambit Capital, I once again welcome you all for 3Q earnings call of City Union Bank. We have with us Dr. N Kamakodi, MD and CEO, and Mr. V. Ramesh, CFO. And without further ado, I'll hand over the call to Mr. N. Kamakodi for his opening remarks. Post which, we can open the floor for Q&A. Thank you and over to you, sir.

N. Kamakodi: Good evening, everyone. Hearty welcome to all of you for this con call to discuss unaudited financial results for City Union Bank for the third quarter ended 31, December 2022. Board approved the results today and I assume you all have received the copies of the results and the presentation.

Before going to our business performance, I would like to discuss two things about which we had received multiple calls from the investor and analyst community. First, on the recent RBI inspection report and divergence of NPA for the financial year 2022. You may be aware that we had to report similar divergence, which happened in 2016-17. After that, there was no instance of divergence that needed disclosure till 2021. Even the inspection report of our bank, which was obtained through RTI and made public recently, also revealed the divergence was well below the tolerance level. So we had our last RBI inspection on financial year '19, after which there was no on-site inspection by RBI for financial year '20 and financial year '21.

RBI vide their circular dated 14, September 2020 issued notification to the banks to migrate to live marking upgradation of NPA accounts on daily basis starting from July '21. We have moved to live marking/ live upgradation of non-performing assets within the stipulated time period as prescribed by the RBI. Since our NPA marking was automated, we had not expected much of divergence. But in the recent inspection conducted by RBI pertaining to financial year 2022, there were few cases of divergence which was identified and all the cases identified as divergence by RBI was not just because of 90 days overdue, but because of various interpretation issues.

The divergence in additional gross NPA for the said financial year as per the RBI report was INR 259 crores. The gross NPA as on 31, March 2022 as reported by the bank was INR 1,933 crores and as assessed by RBI it was INR 2,192 crores. And the net NPA on 31, March 2022 as assessed by RBI was INR 1,450 crores against INR 1,191 crores as reported by the bank amounting to overall divergence of INR 259 crores.

The bank has held a specific NPA provision of INR 742 crores as on 31, March 2022 and provision assessed by RBI for NPA provision requirement was INR 782 crores with an additional provisional requirement of INR 40 crores for the divergence marked account. The reported net profit for the year 31, March 2022 was INR 760 crores by the bank and after adjusted this divergence was INR 719 crores.

As per RBI circular, banks should disclose divergence if either or both of the following conditions are satisfied:

The additional provisioning requirement for NPAs assessed by RBI exceeds 10% of the reported profit before provisions and contingencies for the reference period.

The additional gross NPA identified by the RBI exceeds 15% of the published incremental gross NPA for the reference period.

As per the above ceiling, 15% of the NPAs worked out to INR 191 crores and since additional gross NPA divergence assessed by RBI was INR 259 crores, we had to make disclosure on divergence which we reported to stock exchange on 20, December 2022.

As stated earlier, the divergence was not because of 90-day norms, but due to various reasons including the difference in the interpretation of guidelines and things like that. For example some of the issues happened in the restructured accounts, particularly on the eligibility for the restructuring. For example couple of restructured accounts where the sanction conditions were not fulfilled within stipulated timelines, were marked as divergence.

But we thought that though the conditions were fulfilled before the audit and so we had taken them as eligible cases for the divergence. Similarly in couple of cases borrowers closed their account by transferring funds from their sister concerns and we had given credit subsequently, which was not accepted and hence the divergence was marked.

Similarly for a couple of cases, you have a rule that any account in SMA 2 is not eligible for your restructuring. While calculating the number of days during the RBI moratorium and subsequently the Supreme Court moratorium, we had not counted the number of days. But the interpretation given was that as per the Supreme Court moratorium, the days will run and SMA needs to be calculated by that number. And these two, three such of items, they were nearly 70% of the divergence that was reported.

So we have already started taking corrective steps on that and subsequently few jewel loan accounts and other smaller accounts were also marked and all those things have been now taken into account. Also we wish to bring to your attention that out of the divergence of INR

259 crores, 13 borrowers whose balance was more than INR 1 crores amount to about 89% or INR 230 crores and the balance INR 29 crores constitute about 218 borrowers where outstanding was less than INR 1 crores.

Out of this 13 borrower account above INR 1 crores, four accounts amounting to INR 60 crores was classified as NPA by us in the first half and two accounts amounting to INR 4 crores were closed as on date. Hence, the balance of divergence above INR 1 crores category is INR 160 crores from seven accounts, which were now recognized during this quarter as NPAs.

For borrowers less than INR 1 crores 218 accounts, 1 account was marked NPA during H1 financial year '23 and 55 accounts were closed till date amounting to about INR 9 crores. Hence the balance divergence in this category of INR 20 crores is also now recognized as NPA in this quarter. So the net effect on the NPA to be marked by the bank comes to INR 186 crores as said above and out of INR 186 crores, account worth of INR 47 crores got upgraded as standard during Q3 FY '23. And hence out of INR 439 crores slippage for Q3 financial year '23, INR 140 crores is basically because of the divergence.

The second item for which we were getting repeated calls was for the recent RBI discussion paper on the expected loss method approach for loan loss provisioning by the bank. As you all know, all banks are already submitting pro forma Ind AS financial starting from financial year 2019 as advised by the regulator and these financials were based on IFRS regime and each bank is having its own method to calculate ECL-based on historical loss data. We have also done our own calculations using our past historical data and probability of default and loss given default.

We have also made our own calculations. And as per our past collection pattern, we have seen the recovery from the NPA accounts typically faced a haircut of maybe between 25% and 35% at an aggregated level. And the difference between the existing NPA norms and ECL-based approach for the past four years in a cumulative manner, the difference is less than INR 100 crores. And in our experience, the provision which were held by the bank, PCR, there is a general consensus that it is going to decide the impact on what is going to happen when the final guidelines will come on the ECL method.

As you all know, we have about 60% to 70% of provision coverage ratio after taking into account keeping the technical return of provision also. And basically, it's better on our interest to slowly and steadily increase the PCR coverage. We have also increased PCR coverage by 3%, 4% in this quarter. The exact impact because of the ECL thing will be known only after the final guidelines are issued. We do foresee that after moving to ECL regime, we may require maybe a total of maybe around INR 200 crores maximum, which will be adjusted against CET-1 capital and which will be spread over a period of five years as per the transitional arrangement given by the RBI.

So year-over-year the impact could be about approximately INR 40 crores to INR 50 crores or maybe about INR 10 to INR 15 crores for the quarter. So based on our overall profitability, the total impact because of this, we don't expect that to be a very significantly large amount. I think it should be very well within the capacity to manage on an overall basis.

Now let us move to our financial performance. We shared with you all the following expectations for financial year '23 during earlier concall.

In the earlier concalls we said on growth parameter, we will try to push the growth pedal and achieve 15% to 18% credit growth for the financial year '23, and we had projected that the investment cycle will start from the Q3 financial year 2023. But you might have heard even during the last week RBI policy, the capacity utilization is still around 75% only and the investment cycle is getting delayed. So there could be few months of delay in growth whatever we had projected and it could be a shade lower. But overall things are slowly progressing, but not to that level we are expecting. But things are definitely improving, there is no doubt about it.

And the questions that repeatedly coming is that some banks are showing 18%, 20% growth rate coming from the various segments, more on the consumption side. Even some banks are showing higher growth rate in the SME front and all. What is that? Why our numbers are lower and all? As in the past, we had been very clear that we need to get a comfort on everything, all ecosystem favorable for the growth and all. You are also having systemic deposit growth is not very high. So it is not right to push for growth rate particularly when you have lower deposit growth rate in the system. So we will take all parameters into account. As I told you that we still have capacity to grow by INR 3,000 crores-plus without increasing our deposits, which will be pushing our credit deposit ratio over 90% and all, but we are not -- our risk appetite don't allow us to push so far.

So we are looking into the matter and whenever we feel things have ripened for the growth, we will be pushing hard, but we are keeping everything ready for the growth rate. The expected overall slippages we expected that to be in the range of around 2.5% for the current year. But due to the divergence, slightly slippage has increased.

So we expect the overall slippage for the current year should be between maybe 2.5% to 2.8%. It should be coming to the 2% to 2.5% going forward. And I think we should be having all the repayment of restructured loans also coming in this year. But overall, things should be coming to the pre-COVID level in financial year '23-'24 and things should moderate below pre-COVID level by '24-'25 on as is where is condition and we expect things would be progressing that way.

Net interest margin currently is staying around 4%, we said it will stay around 3.85% to 4%. I think currently it is that level. But there is one more item here. Here some amount of interest income particularly from the gold loan interest of close to about INR 32 crores have not been recognized this year. The interest income on advances for Q3 was on a lower side to the tune of INR 32 crores mainly because of the non-recognition of interest subvention of KCC agri loan. These loans were given to borrowers of animal husbandry, fisheries and other agricultural and allied activities in rural and the semi-urban areas and these loans are collateralized by the gold. The prescribed LTV is maintained and we have given the subsidy to them upfront to these customers when they close the accounts within one-year period. We used to submit our clients' subvention portion to the government on a half yearly basis.

Basically what happened was that during the current inspection, though it is opined that the end use of this gold loan have gone properly, they have given some observation that there is a deficiency in linking the scale of finance to these gold loans. Scale of finance is something where every district level consultative committee, they give how much loan can be given for a cow or how much loan can be given for one acre of the land or something like that.

So basically all these loans are between INR 1.6 lakhs and INR 2 lakhs. So we have to now work out and show to them and our estimation is that though these borrower is well within this the scale of finance; proper recording and proper paper work is missing and we have been asked to correct that, audit that and ensure that the interest subvention which is partnered with the farmers and borrowers follow the guidelines properly and after that only, we will be getting our own reimbursement from the government.

Once we complete that paper work to the satisfaction of the regulator, we should be getting that money which would be happening as soon as possible. So without taking that into account itself, the net interest margin has come in that range whatever we had given to you earlier.

The RoA we said it will be reaching 1.5%. So even though the quarterly RoA is lower, nine months RoA is 1.5% as declared in the past.

The cost to income ratio has also come below the numbers whatever we had shared. Because the interest rate is increasing so in this quarter the actuarial calculation showed that whatever provisions we had made for the leave encashment during the first two quarters itself is sufficient for the third quarter also. Hence we had not made a provision for leave encashment in this quarter, which has helped us to show lower employee cost this time.

And overall, the deposits are just a shade below the INR 50,000 crores mark. Credit grew by 12% to INR 43,000 crores, 12% growth between 31, December 2022 to 31, December 2021. Overall business grew by 9%. CASA recorded 5% growth.

We could see migration from the CASA to the term deposits after the deposit rate started increasing. Gross profit for the Q3-to-Q3 showed a growth rate of 35% between Q3-and-Q3. Net profit increased by 21 % from INR 196 crores to INR 218 crores. RoA for nine months stands at 1.51% against 1.32% for nine months last year. Net interest margin for nine months is at 3.97%.

Gross NPA stands at 4.62% and net NPA at 2.69 %. Regarding the SpiceJet, they are paying as per the schedule. They have repaid so far INR 34.4 crores and current outstanding is INR 65.6 crores. Final installment is scheduled to be received by June 2023. We had reversed a surplus provision of INR 25 crores earmarked for this. The slippage during the Q3 financial year '23 is INR 439 crores and, as explained earlier, it comes from both our normal usual slippages and because of the divergence.

In Q3 we had a total recovery and upgradation to the tune of INR 257 crores comprising of INR 173 crores from live accounts and INR 84 crores from the technically written-off accounts compared to INR 186 crores comprising of INR 134 crores from the live accounts and INR 52 crores from technically written-off account in Q3 financial year '22.

The current SMA 2 number stands at 2.19%, which includes accounts from ECLGS, restructured and other regular accounts. Cost to income ratio for nine months is at 38% against 41.41% for the corresponding year.

The capital adequacy ratio for the bank stood at 20.47% as on 31, December 2022 vis-a-vis 19.39% for the corresponding period last year. We have not diluted any capital in the last eight years and last time we raised funds was during July financial year 2014 using QIP to the tune of INR 350 crores. After that, the entire increase in the book value, everything is through plough-back of profit.

The operating profit for the third quarter was at INR 497 crores against INR 370 crores for the same period showing 35% growth rate. Total provision made during Q3 financial year '23 was INR 279 crores against INR 173 crores for the corresponding period last year. The net profit for Q3 financial year '23 was at INR 218 crores vis-a-vis INR 196 crores during Q3 financial year '22 with a growth of 11%. Starting from the Q4 financial year '22, we have been achieving quarterly PAT of INR 200-plus crores on a continuous basis. The nine months profit crossed INR 700-plus crores.

We opened 25 branches during the Q3 and the total number of branches currently at 752 branches. And we opened our 500th branch in Tamil Nadu during this quarter. On SR front, the outstanding is only INR 1.2 crores, since we have written off INR 79 crores of SR, which have crossed eight years of limit and for which the provisions had already been made.

I'm also glad to share with you that we had recently got six awards in the past three months, two from BFSI and four from IBA. The key point to note here is that most of the awards are for the technology related initiatives.

We have completed the technical integration with the brand new e-filing portal TIN2.0 www.eportal.incometax.gov.in making it one of the few private sector banks to be fully integrated with the new income tax department portal. Now our customers, individual as well as corporates, can pay their direct taxes by selecting CUB in the existing account maintained with CUB. This enables the tax payment process simple, instant, convenient for its customers.

So with this solution going live, bank's continuing to be one of the few private sector banks with this service. Indirect taxes, including GST payments, was enabled for CUB customers earlier. With the above facilities, long-standing requirement of our customers is accomplished by enabling tax payments through the branches, net-banking and mobile banking.

To sum up for the financial year '22-'23, as I told you things are improving, but the investment cycle starting is getting delayed by maybe few months.

The capacity utilization still reported to be by 75 percentage. So there is some delay in our comfort to push the growth pedal fully and go for the growth. Our slippage ratio was around 2 percentage till financial year '19 and during financial year '20 it increased to 3.2 percentage and stayed around 3 percentage till last year. We expect the overall slippages for the current year, for financial year '23 will be in the level of 2.5% to 2.8%. So for next year, it should be below 2.5 percentage and probably moving towards the pre-COVID level in stages.

Provision coverage ratio improved to 67 percentage and maybe we are looking to take it to the 70%-plus as quick as possible over the next couple of quarters or so. The net interest margin will stay around the current levels. RoA also to stay around the current level that is 1.5% for the financial year.

The cost to income ratio also should stay around 40% as we have seen in the past, maybe 40% to 42% in the absence of higher treasury income. So overall despite this minor setback, we feel we should be able to cross this period almost on line with whatever we have shared with you all during the earlier quarters. So we hope the things should be particularly on the general economy front take a better shape going forward and we hope to see better-and-better results as we move forward.

So with this overview, I open myself for the questions. So you can now ask questions.

Moderator: The first question is from the line of Prakhar Agarwal from Elara Capital.

Prakhar Agarwal: Just three questions from my end. First, when you talked about 15% to 18% growth and falling short this year, what would be in your sense the target for next year and what should ideally be industry growth for you to achieve that target? This is my first question.

N. Kamakodi: Please repeat the question and ask one-by-one. First question, please.

Prakhar Agarwal: So I'm saying, sir, when you talked about falling short of 15% to 18% growth target that you set for this year. For next year, what is ideally our growth target? And to achieve that growth target, what is essentially industry growth that you're probably foreseeing for next year financial year FY '24?

N. Kamakodi: I will be able to answer this question more clearly along with my next quarter results. There are few assumptions, which needs to get firmed up. There are definitely issues with the overall growth and deposit growth and if you try to push for the growth at this point of time without corresponding deposit growth in the system, so you will be hit. So we are very clear, it has to be balanced. Even though I have another INR 3,000 crores worth of surplus funds and I can go for growth without going for additional deposits, I will be using it only when the deposit growth is also at the side.

So I will be in a position to answer your question in a more precise manner along with the Q4 results because anything I give you now, because for example when I gave 15% to 18% growth, I clearly said I was expecting the investment cycle to pick up from the month of December. There is a clear cut 10% gap and currently you are just closer to the pre-COVID number.

And any prediction without having these firm answers, it is not going to take us anywhere. So let us wait for the fourth quarter to make that number. But what I can clearly say is that I will be having a growth rate, my expectation is that it will definitely be in double digits. Should not be lower than the current growth rate whatever we are seeing. But more precise number we should be in a position to see it around the same -- along with our fourth quarter results.

Prakhar Agarwal: Sir, second question in terms of the lending yields and probably interest rate movement. So if I were to exclude the current rate hike, which has been taken in terms of repo, before that there were around 225 basis points rise in the systemic rates. What sort of lending rate hike that you have seen in your customer base? So against this 225 basis points, how much have you been able to pass through your customers?

N. Kamakodi: See, the overall taking apart from the gold loan side, we were able to take about 1% to 1.5% was what we were able to share and we are planning to go for another 25 basis point hike after the current RBI hike. The 0.25%, 25 basis point may take maybe 15 basis point, 20 basis point ultimately it may get the transformed to. So overall transmission could be around 50% to 60% of the increased rates.

Prakhar Agarwal: And sir, the last question is on asset quality and some bit on clarification on what you said about INR 32 crores. So on asset quality even if I were to just knock off the INR 146 crores net impact that you talked about because of divergence, then also we are running on a higher end in terms of our guidance that we talked about. Plus the fact that we have also stated that in FY '24 as well we will probably move step towards our earlier pre-COVID run rate of around 2%. Why is that conservatism? Is that something from restructured pool anticipated and that's why you're probably assuming a cautious stance or how to read about it?

N. Kamakodi: See, basically how it works is for example for the first three quarters taking out this what you call your incremental slippages, you might have seen the slippage for the first quarter for the financial year was INR 270 crores, INR 261 crores for the second quarter, and if you leave the

RBI divergence mark, it is about INR 280 crores to INR 290 crores for the current quarter. And we have clearly told that we should be having around 2.5% for the current year. Apart from that divergence mark, the overall numbers are coming to our expectations.

So as we have given in the past, going forward then it has to get reduced to 2% to 2.5% and then below 2%. As per our expectation, we should be getting closer to the pre-COVID level slippages towards the second half of the next year, after which it should stabilize. So I am assuming that pre-COVID level is the regular slippages so I'm keeping that and the trend is that incrementally the overall numbers are moderating. This is what we are expecting.

Prakhar Agarwal: One last thing, sir, on this INR 32 crores impact that you've probably spoken about and lack of paperwork that you essentially said. Sir, is there any lapses in process as to why this thing of INR 32 crores? Ideally we are having a larger portfolio, but then of this INR 32 crores alone, why is that the paper work and all this stuff has happened? Just wanted to get your sense.

N. Kamakodi: Let me clearly give you that. See, basically what happens is that there are two things here. One, accepting that as the agricultural loan with proper end use, and number two is the scale of finance. So it has been clearly accepted that they are all agricultural loans and there is no questions raised about the end use itself is a big thing for us. This is point number one.

Point number two is basically the calculations for some of them were basically like these things had not found their place into the system. So for the small ticket loans of INR 1.6 lakhs to INR 2 lakhs bucket, though it was ensured that the end was verified capturing that in the paper with the calculation and including in the system did not happen. Subsequently, we in fact made a test case understanding of whether have we funded anything which is beyond the scale of finance but we are very much satisfied with the compliance. The problem is only in properly entering the scale of finance into the system to ensure that. But overall, our back of the envelope calculation says the funding whatever we had done is very well within the scale or finance that is stipulated. So there is a lapse in capturing that in the system.

It was not anticipated in since the audit happens at the branch level and the auditor verifies that, he finds that and he gives a certificate and it was going on for a long time. So it was capturing that in the system and doing a proper math in the paper which was missing is something which we have to improve and we have already started taking steps on that.

Moderator: The next question is from the line of Renish Bhuva from ICICI Securities.

Renish Bhuva: Sir, just a question. So one is on the steady-state ROA metric. So we have been always maintaining this 1.5% RoA all over this year. But now if one is to assume this ECL framework will be the new guidelines, would that impact our steady-state RoA assumption or we'll be able to compensate with any other line item in the P&L?

N. Kamakodi: See, the INR 10 crores difference, our calculation shows it should not affect our RoA metrics because of the ECL.

Renish Bhuva: Sir, and secondly, this is just a clarification. So this quarter our staff cost is lower because we have not provided for the leave encashment. So any particular reason why we have not provided this quarter?

N. Kamakodi: Because of the increase in the overall rate, the actuarial calculations came out saying that whatever we had provided during the first and second quarter itself is sufficient to take care of the third quarter also.

Moderator: The next question is from the line of VP Rajesh from Banyan Capital Advisors.

VP Rajesh: My question is regarding the gold loan book, what kind of growth are you expecting in that book in fiscal year '24? And secondly, if you can just comment on the market environment. Are you gaining market share from some of the NBFCs or is it just there is a lot of stress in the system that's why people are coming to get the loan against gold?

N. Kamakodi: See, the gold loan growth between December '21 and December '22 is about 30% growth. Overall, currently 25% of our total loan portfolio is gold loan, which was 21% during the same period last year. So we had about INR 1,800 crores growth, which works out to about 17%, 18% to 20% growth. So honestly speaking, looks like the pattern is that we should be having the similar growth or even slightly more during the next financial year is what we are expecting.

See, basically how we are managing is we go for gold loans at places where we don't have other things to do. Our risk-adjusted return in the regular advances is a shade better than the gold loan front. At the same time, gold loans give advantage on the capital adequacy front. That's why we currently have over 20% Tier 1 ratio.

If we are able to grow our regular advances, the growth rate of gold loans will take a back seat. If we are not comfortable in growing the SME segment, we try to grow the gold loan portfolio which once again is going to be determined to some extent by how the systemic deposit growth will increase. So we will get a clarity on exact expectations along with our fourth quarter results regarding the growth expectation for the next year.

VP Rajesh: And my second question related to the same topic was do you think you are gaining market share? And what is the typical gold loan size that we are issuing to customers and what is the tenure of those loans?

N. Kamakodi: The segment is between INR 1.5 lakhs and INR 2 lakhs for the agri loan and around INR 1 to INR 1.5 lakhs for the non-agri personal gold loan. We don't look or give focus too much into the market share per se. So basically we grow our book depending upon our convenience and our comfort, which we think is in the best interest for the overall balance sheet growth and our own earning metrics of the bank. So we don't try to push things. The market share is something which has not been a consideration on these things.

VP Rajesh: And typically, what is the yield on these loans?

N. Kamakodi: Typically, around you have a range of 8% to 9% depending upon the agri, non-agri, KCC, various portions are there. It should be close to 9%.

Moderator: The next question is from the line of Rohan Mandora from Equirus Securities.

Rohan Mandora: Sir, in the comments you had indicated that we have a translation of around 100 basis points to 150 basis points on the ex-gold loan book. But if I look at the year-on-year number, there's a decline, even in 2Q there was a decline and even in 3Q there was a decline. So just wanted to understand is it that there are renegotiations happening on the spreads or how should one look at the movement on yield on advances overall?

N. Kamakodi: See, here you have what you call one particular item. The gold loan is something which has to some extent altered the yield. Gold loan segment is something which is around 9% which is pulling down the average. So overall in non-gold loan portion, we are able to take that to whatever thing. For example, first quarter our overall yield was only 9.04%. We could see about 35 basis point incremental growth for the second quarter. Now if it had not been there, there could have been a few more issues. So the negotiations definitely happened. That's why I said the overall pass on about 50% of the hike to the regular borrowers.

Rohan Mandora: But sir, if you look at on a year-on-year basis excluding the gold loan book also, if 100 basis point has increased, then there should have been some increase on a year-on-year basis. But sequential there's an uptick in 2Q?

N. Kamakodi: That's what I said. Since for example the gold loan segment is separate and non-gold loan segment is separate, you don't see the incremental item to gold loan directly getting benefited because it is given on a fixed rate. So whatever things we are able to pass on to the non-gold loan is something which I'm telling.

Rohan Mandora: What was the yield on the non-gold loan portfolio and how would it have moved in the last two, three quarters?

N. Kamakodi: It's about 70 basis points, 1% is what we have seen in that.

Rohan Mandora: Second one, sir, in terms of the deposits, if I look at this quarter sequentially, it has been broadly flattish. So just wanted to understand are there challenges in raising deposit or is it some like we were slower strategically to raise deposits? Just your comments over there.

N. Kamakodi: Yes. This time the things started to grow only towards the quarter end. We are seeing good growth after the first quarter and we could see migration of from the CASA to the term deposit when we increase the term deposit rate in the third quarter. So that's what our expectation is that we should be getting our clarity and overall there should be sufficient deposit growth to take care of our advance growth rate to be double digit.

Rohan Mandora: And sir, in terms of contraction on maturity of deposits, what proportion of deposits would reprice over next one year?

N. Kamakodi: You will always have not less than 2/3 of your term deposits, I mean maybe about 75% of the deposits will be. The preferred duration for the term deposits will be one year. So let's say, 70%, 75% of your term deposits will be repricing within one year.

Rohan Mandora: And sir, just lastly, on the comments around the growth due to weakness in capex. So just wanted to understand in the segment where we cater to like how one, because if you look at the commentary from others in the consumption link sector, there's a reasonable capex happening with respect to replacement capex and some capacity enhancement. So when you're saying that RBI report the capital utilization is 75% and typically we see capex coming in at 85%. So would that be a fair assessment that even in next year it will be difficult to get capex linked growth for us or should we consider that the capex link demand for us is slightly leading from the overall growth from the larger companies? What is our historical experience here?

N. Kamakodi: Yes. What we see as a trend now is whatever request we get from the SME front on investment in the fixed assets, most of the things are now -- they have started to happen on the solar and the non-conventional energy thing, which is not directly linked with the capacity utilization. This probably acts as a substitute for their energy cost. But our experience is that once things have stabilized after coming back to the pre-COVID level, if things happen, for example our expectation was that these things should have started somewhere in the middle of the last year, but the war, oil, price inflation and macroeconomic instability postponed that and we expected that to start by December.

Now also we are not seeing whatever we wanted to see in December. But once things start improving, it should happen very fast. So let us wait and see. Like overall as we are hearing why are you waiting to go for fixed assets or something you hear even during the budget speech and all to the private sector. Looks like when it turns, the turning has to happen really quickly.

Moderator: The next question is from the line of Gaurav Jani from Prabhudas Lilladher.

Gaurav Jani: Sir, just firstly on the related to loan and deposit growth. So what sort of an LDR can we stretch ourselves to?

N. Kamakodi: Theoretically if you ask, you can stretch up to 90%. That you can do only when you are 100% comfort that you are going to be there only for two quarters. Beyond the third quarter, you will get back to that 85%. Running with 90% LDR for a longer time is not advisable. So that is not in the long-term interest of the bank. Theoretically, you can increase it to 90% when you get clarity and the comfort that you are going to be there only for two quarters.

Gaurav Jani: Sir, where I'm coming from is actually that if you look at FY '23 and then compare with '24, you will actually need to maintain a 87% LDR, the deposit growth has to actually exceed the loan growth in '24. So I'm just wondering as to how would we sort of achieve that?

N. Kamakodi: No, not exactly. If incremental thing has to be at not less than 85% or so. As I told you, I have surplus liquidity of INR 3,000 crores, which I have. So I can take a call depending upon the general economic environment where I feel that I can increase and accelerate and I should be able to come back in the next couple of quarters. Incremental LDR of 85% will do even to maintain the LDR at the current level.

Gaurav Jani: Sir, secondly, on this item of INR 32 crores. So can you expect this entire amount to be recognized in Q4?

N. Kamakodi: Yes. We are actually working for it. There is a process so we have to complete the paperwork which has to be audited, which has to be then given to the regulator for inspection. So we hope it should be completed before the current year and we have to wait and see. We are working with that deadline only.

Gaurav Jani: So the point being that the interest income would be normalized in Q4 and over and above that, there will be an INR 32 crores of additional interest that will be recognized, right?

N. Kamakodi: Yes. If the process gets completed as per the comfort and the confidence of the regulator before audit, that should be the position.

Gaurav Jani: Sir, lastly, you mentioned that PCR would sort of -- now we would start building up on the PCR. So any specific targets we have over the next few years as to what sort of level do we take the PCR to? And hence will sort of credit costs remain a bit elevated?

N. Kamakodi: See, it's not very high or I mean have any major disturbance to your RoA calculations. So my internal target will be to take PCR with the technical write-off to 70% and maybe without technical write-off to 50%. We are just about 3%, 4% away from that number and smoothly it should sail trough.

Gaurav Jani: So by '24 and safe to assume that you will reach this 50%?

N. Kamakodi: Maybe even before that.

Moderator: The next question is from the line of Jai Mundhra from B&K Securities.

Jai Mundhra: Most of the questions have been answered, sir. Just one question. So sir, in your opening remarks, you mentioned on ECL that you have come at a number of INR 200 crores, which would suffice for you to transition to ECL. I wanted to get an understanding, sir, I mean what is the maths behind that INR 200 crores number? INR 200 crores is roughly 10% of your GNPA. So if I were to do, then your specific PCR will rise from 43% to maybe 53%. How are you sort of arriving at that shortfall? That is the only question.

N. Kamakodi: See, basically the thing is that on ECL method, you have both probability of default and loss on default. So on loss on default already as we have told, the haircut is maybe about 30%. If you just take that number, our provision already whatever we have should be sufficient to take care of whatever losses that could potentially come because of the default. So on that spirit, you should not be requiring any incremental thing. But at the same time, sometimes if you read the circular, you will feel that your provision you have to make even more than the advances whatever you have.

So if there is even SMA 0 or SMA 1 you have to make, even if you give an interest rate concession you have to make. Like that there are lot of numbers, which have been basically given. So taking into account all these things on a continuous basis and also once again these numbers on the PCRs, they are all interconnected to a greater extent. So taking all these things into account, this is purely a back of the envelope calculation taking into account actual loss on NPA accounts and expected loss -- after the SMA 0, SMA 1, SMA 2 accounts after becoming NPA, how much of that becomes NPA. After taking all these things into account and all, that number is arrived at a broader level.

Jai Mundhra: So more from Stage 1 to Stage 2 sort of an account, right? Mostly on SMA where you may be doing only standard assets provisioning wherein that you may have to increase the provisioning?

N. Kamakodi: Yes. See as I told you, if you take purely like there are two things. One is the probability of default and number two, loss on default. So loss on default finally, ultimately, we see, we are able to have this 30% haircut. So on that basis, for example the current level should be sufficient to take care of this.

So since so many things have basically come and I have also given you from 2019 onwards the difference between the cumulative provision whatever we have made based on IFRS norms and based on Ind AS are not very different and all. So as you said, you can say okay, it's a worst-come-worst 10% extra provisioning and cushion you are creating and which will be falling into taking care of all these other items which banks have to recognize.

Jai Mundhra: And secondly, sir, in the RBI policy meeting, they had mentioned that the banks now need to rationalize the Penal provisions. If you can quantify, sir, what is the amount of money that we have collected through Penal interest and what is our policy? Because we probably have SMA customers, do we charge Penal interest to them and what would be the total such penalty for FY '22 or maybe nine months?

N. Kamakodi: See, basically there are two things. When I actually listen to that presentation, it was more where basically pointed towards the Penal charges on takeover. But other Penal charges, I don't expect any major thing will come in. The exact quantification we will be in a position to say only after seeing the ultimate circular. I mean I don't feel that we are overcharging and all on that front. Let us see after the arrival of the circular.

Moderator: The next question is from the line of Prakhar Agarwal from Elara Capital.

Prakhar Agarwal: Just two, three questions again. First, a follow-up on the previous question on ECL assumptions. When we made these ECL assumptions, have we taken 2 years, 2.5 years data during COVID or possibly we have taken that as an outlier and based on our ECL estimates, we have not taken those into consideration which is first?

N. Kamakodi: Basically, since we started with the 2019, the consideration was even two years before the COVID.

Prakhar Agarwal: So we are taking from 2017 and until date?

N. Kamakodi: Something like that. And this particular exact quantification can be given only after seeing the final RBI circular. This is the preliminary estimate.

Prakhar Agarwal: Sir, second thing on your deposit side. So possibly what is the strategy going ahead on deposit, because are we seeing another rate hike on the deposit side or what is the strategy in terms of how to go about that deposit piece for us?

N. Kamakodi: At this point of time we don't expect any deposit rate hike. Exact position probably, the fourth quarter and even first quarter are going to be extremely crucial on understanding the quantum of rate hike.

Prakhar Agarwal: And sir, just last question on this provisions. If I were to just look at the composition of provisions. So there are a couple of write-backs which has happened during this quarter. One possibly you highlighted that you have written back something on SpiceJet if I'm not wrong? Can you again mention the quantum of that particular write-back and what is the other write-back that probably you are seeing on P&L when we see the provision composition?

N. Kamakodi: See here, INR 25 crores write-back from the SpiceJet front.

Prakhar Agarwal: And the balance INR 15 crores?

N. Kamakodi: INR 15 crores, this is from the standard assets write-back. When the standard assets became NPA, on gross basis it had to be reversed and NPA provision had to be made.

Moderator: The next question is from the line of Darpin Shah from Haitong India.

Darpin Shah: Sir, just again on the provisioning bit. So when you mentioned you want to increase the coverage ratios to 50% on a calculated basis, are you assuming the write-backs from SpiceJet as well?

N. Kamakodi: Yes, definitely.

Darpin Shah: So you expect this account to be completely nil by June next year, if I'm not wrong? So by then, all the INR 75 crores reversal will happen and thus the impact on P&L will be relatively lesser by that quarter. Is that understanding fair?

N. Kamakodi: Yes. You can assume that way. See, whether we are doing that amount or taking that into pool or taking from the P&L, those things are a matter of speculation. But what is clear is that if the repayment of SpiceJet is going as per whatever it has happened, it is expected to close the entire outstanding by June and the entire amount will be available for appropriation.

Darpin Shah: And that is where your confidence on 1.5% RoA is derived from, right?

N. Kamakodi: See, I have equal confidence on the increased NPA recovery also.

Darpin Shah: And sir, again on growth. While we see that we need to see lot of things falling in place, but industry as a whole has been growing at a much faster pace. So don't you have a feeling that you are missing on something?

N. Kamakodi: See, the issue is if you grow, you outgrow your deposit for a prolonged period of time, it is going to create other problems in the future. So we will take everything into account and take a balanced approach. Particularly one of the most important thing that is needed is not getting carried away by what others are doing. Precisely because of that only we survived many shocks in the past. Whenever we were not comfortable and we have to be cautious and we have to be careful in particularly treading this situation. And for example, the same thing, the call which we took in not getting into the consortiums and corporate lending, the same questions were asked that we were losing some opportunity.

Similarly, there could be short-term opportunities that may be lost, but those things can be covered up at any point of time. But it will be too risky to push for growth when many parameters which are not exactly falling online. Particularly at this particular point of time the investment cycle has not started and there is a huge gap in the system between the deposits and advances.

Some growth you can grow in the short term by takeover from the other banks or from increasing your LDRs and all, but these and all can be only short-term strategies. But when you try to break the limitations of the overall metrics, the risk from that will be more outweighing the positive points on increase the profitability and things like that. So we will be taking this call in a gradual and cautious manner.

Darpin Shah: Sir, we really appreciate this. We have been conservative when it has paid us very well over the last five, seven, eight, 10 years. But the thing is the most conservative lenders on the street, the couple of largest banks even they were significantly aggressive. They have been saying that it is a central time for another credit cycle both in terms of growth and quality. So that is where I was coming in from. But I do get your point.

N. Kamakodi: See, they have a presence in the multiple states. So they may be seeing different opportunities at different places. And there will always be difference in their respective risk weights. So if they may be able to do certain things in a better way means, we have to respect that and see that. But I mean if I try to copy or try to do something because some other banks with different strength try to do something, it may not be good for the bank in a larger way. That's what I'm trying to say. So if they have better things, I mean let us respect that and see that.

Moderator: The next question is from the line of Akshay Doshi from InCred Capital.

Akshay Doshi: Sir, in the MSME segment which forms the majority of our book and sir, in budget '24, our FM has given a credit guarantee scheme through 9,000 corporates. So sir, I wanted to know that what will be the impact on our MSME business and our customers?

N. Kamakodi: See, we are also waiting for the fine prints. Whether it is exclusively for the existing, to what extent it will cover the existing CGTMSE or whether they are going to have different items, we have to see. So existing system roughly takes care of those exposures, which are less than INR 1 crores on non-collateralized lending. It will definitely help the MSMEs without much collateral, but having a proper business plan to use that and get access to the banking credit.

Akshay Doshi: Sir, and also I see in your presentation that you have made many partnership with the fintechs to increase your business digitally. So sir, wanted to get an idea that what percentage of your IT expense is to the total expense?

N. Kamakodi: See, total annual expense from both capital and revenue put together will be about INR 200 crores.

Akshay Doshi: Sir, no, I just wanted to know the proportion of your IT expense to total?

N. Kamakodi: Other data you have, you can make your own calculation. It roughly works out to about say 30% of the PAT.

Akshay Doshi: Sir, and do you have any plans to expand more in the states of Gujarat and Maharashtra to exclude the MSME business? And also wanted to know that what kind of yields are we earning on MSME and also do we wish to keep the MSME proportion at 50% also in FY '24?

N. Kamakodi: See yes, we opened about a handful of branches each in Rajasthan, Gujarat, and all we have done over a period of time. So as we have been repeatedly saying, we are better at the semi-urban and rural centers than at the metros and all. We will continue to do that. Regarding the proportion of this thing. Say for example, when I joined the bank, we had up to 14%, 15% gold loan which I reduced it to single digits, then it came back to 18%, 19%, once again got back to single digits, then it went back to 20%-plus currently.

So whenever we don't have, we feel other things are risky, we go with the gold loan. Even the current MSME loan overall we have MSME as per the definition of law on the Udyam Registration, already we have more than 50% MSME. The trading put together which both are considered as MSME as per the Act, it is over 50% even now.

Akshay Doshi: And sir, can you give the split of your floating and fixed as on Q3 FY '23?

N. Kamakodi: Except the gold loan, the other loans are by and large floating only.

Akshay Doshi: And sir, just to confirm one last thing that your total secured book so 100% of that is collateralized, I mean you have 100% collaterals, as you said?

N. Kamakodi: See, it cannot be said that having 100% of collateral on every debt. The secured lending is basically coming from the RBI definition of the secured credit. By and large we have not less than 75% or 80% collateral coverage to not less than 90% of the loan book.

Moderator: The next question is from the line of Gaurav Jani from Prabhudas Lilladher.

Gaurav Jani: Just one question regarding the restructured portfolio. From a peak of about INR 2,280 crores, the portfolio has reduced by about INR 545 crores or INR 550 crores. So can you split that between slippages and recoveries, please, out of the INR 550 crores?

N. Kamakodi: See, if you remember in the beginning of restructuring, I said 15% to 20% will go bad. Currently against the expectation of a 20% I have about 7% became NPA.

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

N. Kamakodi: Once again thank you all for attending this. The Q3 little bit the focus was more on the compliance and other issues and there were some issues with the investment cycle did not pick-up as we expected. But rest all things are positive only. And whatever we shared with you all regarding the growth, regarding the net interest margin and regarding the RoA in the earlier quarter, by and large things are online and we hope they will be on for the future also.

So almost everything is in the range whatever we had shared with you all. We may marginally fall short for the 15% to 18% growth rate. But still I think it's not bad, we should be able to take it forward once we get the right signalsl. Overall things are getting better-and-better, but may not be at the pace we expected during the last con call, but definitely the direction is very much positive and things are improving.

But on profitability front, we should be able to continue with whatever we have been doing and whatever we have been sharing. So with this, if you have any more questions particularly on the numbers, the contact details of Mr. Jayaram is already there in the presentation, you can get in touch with him. Any time you need any details, you can always get in touch with him. Once again thank you all for participating in this conference on Saturday. I hope going forward things should be improving and let us hope for the best going forward. Thank you, all.

Moderator: Thank you very much. On behalf of Ambit Capital, that concludes this conference. Thank you for joining us and you may now disconnect your lines.