

“Karnataka Bank Limited Q1 FY ‘19 Earnings Conference Call”

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MANAGEMENT: **MR. MAHABALESHWARA M. S. – MD AND CEO, KARNATAKA BANK LIMITED**
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MODERATOR: **MR. AALOK SHAH – CENTRUM BROKING LIMITED**

Moderator: Ladies and Gentlemen, Good Day and Welcome to The Karnataka Bank Limited Q1 FY ‘19 Earnings Conference Call hosted by Centrum Broking 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 ‘*’ and then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Aalok Shah from Centrum Broking Limited. Thank you and over to you, Mr. Shah.

Aalok Shah: Thanks, Janis. Good Morning all. On behalf of Centrum Broking, we welcome you for Karnataka Bank’s Q1 FY ‘18 Results. On the management side today, we have MD and CEO – Mr. Mahabaleshwara M. S., the CFO – Mr. Y. V. Balachandra, and other Senior Management Team.

Without taking much of your time, I hand over the call to Sir to brief us about the results and his strategy forward. Thank you and over to you, Sir.

Mahabaleshwara M. S.: Good Morning and Welcome to this first concall of current Financial Year wherein I will be pleased to brief you about the Q1 earnings of our bank, i.e., Karnataka Bank. Friends, the overall business sentiments appear to be credit positive and the characteristic feature of our Q1 performance is that we have been able to clock highest CD ratio after 1948. In the year 1948, our CD ratio was 80%, so this is after that whatever the 76.1% that we have clocked, this is the highest and of course you all know that this is the highest ever quarterly

profit and there are positive signs of moderating NPAs and I also have encouraging business numbers. We have already uploaded our quarterly performance analysis on our website, so I would briefly touch upon the growth numbers, profit numbers, asset quality, and of course some points on the employee productivity as well. The growth numbers, the deposits grew at a rate of 11.56%, advances we have been able to maintain our good traction at 24.28%, and turnover grew at a rate of 16.72%. As I said, the CD ratio has reached a new high of 76.10%, and of course, CASA there is slight decline from 27.99% as of March 2018 to 27.35%. As far as the profit numbers are concerned, our interest income has grown by 5.79% YOY and NII has been consistent at 10.40%.

Other income even though there is degrowth to 3.95%, in that trading profit has come down drastically from 75.28 crores to 6.25 crores during the current year compared to about a year back period, so there is a 91.70% decline, but silver line is that our fee-based income, we have been able to consistently get it at around above 40%, this time also it has grown at 42.53%. About a year back, it was at 142.11 crores, now at 202.55 crores, so as a result total income has grown at a rate of 4.43%. The best part is operating expenses, we have been able to contain it to below 7.11%, so there is a decrease in the operating expenses to an extent of 7.11%, so this was mainly driven by the establishment expenses reduction, so it has gone down by 19.58%, so the net result that is operating profit has gone up by 19.11%. Net profit as I said, this is at all-time high of 163.24 crores with a growth rate of 21.96%, so our NIM has moderated at 3%, about a year back 2.97%, and of course March '18, it was at all-time high of 3.54% because there was one extraordinary item from the interest on the IT, income tax related issues, so that type of things are not there this time, it is at around 3%. Our return on asset has also gone up from 0.83% to 0.91% and ROE from 10.25% about a year back to 11.89%.

As far as the asset quality is concerned, GNPA appeared to have been moderated so compared to the previous quarter 2376 crores, now it is at 2296.53 crores, so percent terms is 4.92% previous quarter to current quarter 4.72%; however, about a year back it was at 4.34%. By and large, we have been able to manage it at around 4%. NNPA has also shown positive traction from 3.20% about a year back, now it is at 2.92% whereas about a quarter back that is as of March 2018, it was at 2.96%. The slippage ratio which was at 1.38% about a year back and 2.88% about a quarter back has now come down to 0.59%. NPA provision has also slightly come down. Of course, about a year back, the NPA provision was 196.59 crores. Last quarter, that is, Q4 of FY '19, it was 590.38 crores and this quarter

it has again moderated at 193.78 crores. As a result, the credit cost which was at 0.51% about a year back which has gone up to 1.25% during the previous quarter has now moderated at 0.41%. Our provision coverage ratio has gone up from 52.02% about a year back to 54.56% during March '18 to 57.21% at present. As far as the NPA additions are concerned, there is 269.82 crores addition, so this addition was 497.94 crores about a year back and 1037.38 crores as of March 2018, so now again has moderated at 269.82 crores, so there is a reduction of NPA by 349.36 crores of which 80.18 crores is the recovery and upgradation, 269.18 crores is the technical write-off.

As far as employee productivity is concerned, so our number of operating profit for employee which was at 3.87 lakhs about a year back has gone up to 4.52 lakhs. Operating profit per branch which was at 40.27 lakhs about a year back has now gone up to 45.71 lakhs. Business for employee which was at 11.84 crores about a year back has gone up to 13.54 crores and similarly business for branch which was at 123.16 crores has gone up to 136.87 crores, and most importantly it is cost-to-income ratio which was at 51.75% about a year back has now improved to 45.54% , so these are some of the Q1 business numbers. Of course, you all know that we are on our transformation journey called KBL Vikas; of course it is a long-term aspirational journey of Karnataka Bank to prepare the bank for its centenary year. Our bank was started in the year 1924, so 2024 is our centenary year. With that intention, we have plans to see it as the bank of the future, which would be regarded as one of the finest banks in the banking industry, so that is why we have partnered with BCG. Here this is total transformation and inclusive transformation to realize our dream of becoming a big bank, strong bank as well as one of the vibrant banks.

Some of the major intervention areas that we have identified for this transformation journey is Credit, HR, digital and IT, efficiency management, and of course stakeholder value creation, so during this last six months period we have started implementing certain intervention areas. Some of the major intervention areas under the transformation journey is that our home loan new delivery module with revamped sourcing, processing, and disbursement capabilities driven by IT is already rolled out and we are in the process of rolling out our MSME loan delivery module also and we have already finalized some of the fintech and start-ups for our collaboration, and there is a comprehensive IT infrastructure and organizational restructuring. Of course, we are going to open a digital centre of excellence preferably most probably in Bangalore very shortly, and we will also come out with DG branches, which are totally electronically managed sort of kiosk and other things,

and there is a comprehensive collection mechanism. The asset portfolio quality is one of the major issues which we are trying our level best to ease out, so hence we are in the process of revamping our entire collection mechanism and by the end of this month, that is July end, we should be in a position to have entire our asset portfolio covered under this comprehensive collection mechanism, which would have both soft collection mechanism as well as hard collection mechanism. We are also going to install one of the state of the art contact centres and we are also preparing to have our wholly-owned subsidiary to provide backend support system and as far as HR is concerned, there will be a comprehensive ESCDS, that is, Employee Satisfaction and Career Development System that is also putting in place powered by our HRMS platform.

As far as our growth ambition for the current financial year as well as outlook for FY '19 is concerned, we are trying our level best to sustain the growth numbers that is the business growth of around 18% plus, advances growth of around 20% plus, and we will be very active in customer on-boarding, both for our asset portfolio as well as liability portfolio and digital penetration is one of the areas which will continue to engage our attention in the sense on-boarding of eligible customers for all the E-banking facilities and implementation of comprehensive recovery mechanism that is the collection mechanism and as far as NPAs are concerned, we will strive hard to improve the GNPA to around 4% and NNPA to around 2%, and of course implementation of all the transformation initiatives are on our prime agenda. With this, even though we are optimistic of future, we are equally prepared to face any bumpy ride because I am equally aware that India is getting for its general election in the year 2019, so there could be some external announcements which could also affect the banking sector, so internally we are prepared and taking care of all the required things to ensure a good future for the bank. With this, I would Welcome any questions on the Q1 earnings.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. We take the first question from the line of Jai Mundra from B&K Securities. Please go ahead.

Jai Mundra: Sir, first we wanted to know if you can provide some breakup of the fee income, which for the last two quarters has been doing very good growth, so if you can provide within the fee line item, how much is the commission exchange brokerage and any other line item and what is that is driving so much growth?

Mahabaleshwara M. S.: We have revisited our entire fee-based income, so that is by last quarter also, we had shown 49% growth. I see on loans have shown some positive traction, I see on SB and current accounts, service and processing charges, commission on BG and LC, of course our RTGS net commission addressing this. Similarly, there is good traction in our locker rent, ATM commission, commission from our POS machine, so this is one area where there has been significant growth, so these are the things which are contributing because earlier in the traditional banking base, it was all along the DD commission, the BPC commission and all, so now it is getting replaced with the new-age banking products.

Jai Mundra: Sir, anything if you can share in terms of, if there is any rise in the third-party distribution fee or ATM interchange?

Mahabaleshwara M. S.: Mr. Mundhra, this other income is incidented to our core business.

Jai Mundra: Sir, for going ahead how do you see the traction in this line item, I mean we have revisited our charges I believe in last quarter?

Mahabaleshwara M. S.: This year I think we should be able to get about not less than 30%, so going forward I am hoping that it would sustain at around 20% to 25%.

Jai Mundra: Sir, in terms of slippages, if you can break down in terms of Agri and corporate or MSME, because there was some worry on the Agri loan waiver scheme announced by the State of Karnataka, and secondly, if we have taken any RBI dispensation on MSME 180 days?

Mahabaleshwara M. S.: NPA addition as I said around 269.82 crores, this is the gross slippage. Of that, Agri is 74.99 crores, MSME is around 79.18 crores, export sector 51.90, automobile 15.97, and all other sundries, as I said it appears to have been moderated. As far as your second question is concerned MSME dispensation, so we have to take it because there is no other option because otherwise those accounts are not eligible to be considered under dispensation and they are considering a stress in that portfolio, the Government and Reserve Bank of India have come out with that, so we have around 319 crores portfolio in the MSME dispensation, so here what happened is all the units are functioning well and they do have the surplus to repay, but since they are having some liquidity crunch, they have decided to utilize the 90 days window to utilize that amount for the working capital purposes, so we are in touch with all those MSME dispensation borrowers and as such we are not seeing any major stress in that even though there has been some dispensation extended as per the regulators direction.

- Jai Mundra:** Agri, Sir, and these Agri slippages of 75 crores roughly, that includes everything which was impacted by the waiver, so would that be fair or you believe the impact of waiver could come in next quarter?
- Mahabaleshwara M. S.:** This recognition of NPA is hugely based on the IRAC norms, so we have not considered the waiver related issue at all, so as far as waiver is concerned everyday Government of Karnataka is coming out with new clarifications, yesterday also they said even for the regular accounts are also eligible, so at this moment I think it may be inappropriate on my part to comment on that, let us have the clarity from there, so that is why we have treated entire agricultural advances as per the IRAC norms only without accounting for the waiver-related issues.
- Moderator:** Thank you. We take the next question from the line of Roshan Chutkey from ICICI Prudential Asset Management. Please go ahead.
- Roshan Chutkey:** Sir, few questions on NII growth, can you comment on the NII growth on comparison to the loan growth?
- Mahabaleshwara M. S.:** NII has gone up by 10.40% and I am confident that we should be able to sustain this growth because our CD ratio has also been improving and in that some of the core sectors like MSME we have been able to grow at a rate of around 29.89%, housing has grown at 16.62, and our mortgage-backed loan especially LAP has grown at a rate of 42.92, lease discount at a rate of 24.96, Agri at a rate of 15.04 since there is good monsoons, I am optimistic of the credit growth as well as the NII.
- Roshan Chutkey:** If your loan growth is pretty strong, is there a yield pressure, why is the NII, where is the disparity, why is the NII growth much weaker than the loan growth?
- Mahabaleshwara M. S.:** As I said, there has been MSME dispensation, so we have not reckoned any interest on that thing, so that is one thing wherein we have some headroom, once these things come to the mainstream...
- Roshan Chutkey:** Sir, how much is the interest reversal on that?
- Mahabaleshwara M. S.:** 319. That type of issues are there, so going forward definitely NII will improve, but this is the starting point.

Moderator: Thank you. We take the next question from the line of Ayushi Mohta from CD Equisearch. Please go ahead.

Ayushi Mohta: Sir, how would you explain interest on advances which has grown by 16.4% in comparison to your loans and advances growth last quarter?

Mahabaleshwara M. S.: Our low yielding advances are getting re-priced comparatively at a higher level in the sense during the last three quarters, we have made upward revision in our MCLR, so keeping that in mind definitely there will be increased interest income hereafter and I am not seeing much pressure as far as the interest income is concerned because two things are happening simultaneously, one is the advances is growing at a healthy rate of 20% plus and interest is also getting re-priced at an favorable rate for us.

Ayushi Mohta: Sir, you said last year quarters you have made upward revision in?

Mahabaleshwara M. S.: MCLR.

Ayushi Mohta: Sir, but yields on advances have also grown from 9.29% last year to 10.22% in this quarter?

Mahabaleshwara M. S.: Last year, we had about 5000 to 6000 crores low-yielding advances, whereas the credit risk was less at around 20% or 30%, but interest rate was also less, so during this quarter majority of that is already re-priced at comparatively higher rate, so that is one of the reasons why last quarter the yield on advances had come down and looking forward I think it should help us in getting improved yield on advances.

Ayushi Mohta: No, but last quarter yield on advances have increased, it has not come down?

Mahabaleshwara M. S.: No, yield on advances has come down, 9.29% whereas June '17 it was at 10.22 % and March 2018 it was at 9.47%, so this is in fact one of the lowest yield on advances quarter, 9.29%. Fortunately, the cost of deposit had also come down, this is also one of the lowest that is 5.84 was March '18, now we are able to manage it at the same level, 5.88%.

Ayushi Mohta: Sir, why has your employee cost come down year-on-year?

Mahabaleshwara M. S.: There was some write back on the superannuation benefits around 21 crores.

- Moderator:** Thank you. We take the next question from the line of Umang Shah from SAIF Partners. Please go ahead.
- Umang Shah:** Sir, there is a rumor about RBI coming out with the NCLT three list, do we see any stress coming on from that?
- Mahabaleshwara M. S.:** I do not want to respond to any rumors, but as far as my NCLT portfolio is concerned, now I have already provided 76% for that and in fact this quarter alone I have provided another 80 crores that is the position of my NCLT account, so in going forward there is very bright possibility of these accounts getting resolved under IBC and NCLT route, so at that time I hope we will definitely get back this release of this provision.
- Umang Shah:** Sir, have we sold any portfolio to ARC?
- Mahabaleshwara M. S.:** No.
- Umang Shah:** Do we have any security receipts in our investment book?
- Mahabaleshwara M. S.:** In our investment book, the security receipt portfolio is 441.23 crores. It was at 446.88 crores as of March '18, so there is some release in that portfolio, it is now at 441.23 crores.
- Umang Shah:** Sir, what is the expected sort of recovery or do we see any provisioning on this?
- Mahabaleshwara M. S.:** For this 441 crores, we have a provision of 69 crores as per the regulatory requirement, adequate provision is made, so going forward if the resolution happens we will be benefited that is all. These are all the hidden sources, one is NCLT, second one is security receipts, and third one is our written-off portfolio. We are continuously working on that, so as and when the things turn positive, we will get the benefit.
- Umang Shah:** You will see a recovery from the 441 crore minus 69 crores portfolio as well?
- Mahabaleshwara M. S.:** Definitely.
- Umang Shah:** Could we have a quantum of the recovery expected from this?
- Mahabaleshwara M. S.:** We have expectations, but we may not be able to quantify it but things are happening positively in these three portfolios as I said SR, written off, and NCLT-related resolutions.

Moderator: Thank you. We take the next question from the line of Sudhir Mahajan from Spark Capital. Please go ahead.

Sudhir Mahajan: I have got couple of questions, one is about the corporate banking there is a loss about 16 crores?

Mahabaleshwara M. S.: That is segment reporting.

Sudhir Mahajan: I understand but we are still not been able to set right this corporate banking which we are still going in a loss on that?

Mahabaleshwara M. S.: It is not like that, last quarter if you see it was at 47 crores or so, it has come down to around 17 crores, so segment reporting it will have that same color, but now what is happening is as I said the interest rate is getting re-priced upwardly, so going forward I think we should be able to address that issue also. The plus point there is Sudhir, I think you may be aware of that, corporate segment majority of that is externally rated wherein we have an advantage of risk weight. If it is AAA and AA, even 20% type of things, so we should be able to trade off that is why we have been focusing on that portfolio as well.

Sudhir Mahajan: A lot of other banks are getting out of corporate banking whereas HDFC Bank is getting into corporate banking in a big way, so there must be something that they are getting in at this level and we are making a loss at this level, so that was the main thing which I was trying to check out on? Sir, the next part is on this recoveries, could you just talk about that again and especially about that NCLT cases that you have got about three cases which you said is stuck there and the more important, what is the thing on that fraud account of yours, Gitanjali, is there any resolution or is it been totally written off?

Mahabaleshwara M. S.: From our side we have technically written off, but resolution is also happening and this NCLT cases as I said we already have a provision of more than 76% as of now. During this quarter alone, we have provided around 80 crores, so some aggressive provisioning is also made and future when this issue is resolved, this is eligible for this also.

Sudhir Mahajan: About the recoveries for the year and the future for the recoveries in the current year?

Mahabaleshwara M. S.: Overall recovery or under the NCLT cases?

Sudhir Mahajan: Overall.

Mahabaleshwara M. S.: Overall recovery that is what I said, we are putting in very effective recovery mechanism for our entire portfolio itself. This is mainly to tackle two issues, one is to recover the dues on or before the due dates. Second one is to avoid any further slippages. What the message I have sent to the field level functionaries is that not only avoiding the slippage from the stressed category to the NPA, but also you should ensure that the advances would not slip to our stressed category at all, so that is why we will be in a position to put in place a very comprehensive recovery mechanism by this month end, so their individual account wise the global recovery strategy, the account recovery strategy we will be having that, so going forward of course we have to resolve the loan waiver related issues of the agriculture sector, we have to resolve the MSME dispensation related issues, but for those issues the rest appear to be on the normal track.

Sudhir Mahajan: What have been the recoveries for this quarter, Sir, I missed out the number?

Mahabaleshwara M. S.: Recovery in the NPA portfolio, there was as I said addition of 269.82 crores, after recovery and upgradation is 80.18 crores, this was at 48.94 crores about a year back.

Sudhir Mahajan: You think this recovery is because of the bankruptcy code and IBC, is there thing of people coming to settle or anything like that?

Mahabaleshwara M. S.: Definitely, it is moving in the right direction because the system itself is acting in unison and definitely I think it is a very big positive step, but big problem is adhering to the timelines, so if the entire system adheres to the timeline, it is definitely sending a positive signal to the banking sector.

Moderator: Thank you. We take the next question from the line of Hruhyam Verma from Augmen Catalyst. Please go ahead.

Hruhyam Verma: Sir, I had three questions regarding the advances, first basically our advances as we close the year last at about 47,251 crores I guess around, so this quarter it is around 47,731 crores, so what happened there, why was there less growth here?

Mahabaleshwara M. S.: About a year back, we were at 38,405.29 crores, now our advances is at 47,731.23 crores whereas as of March 2018, it was at 47,251 crores, so there is a positive traction. YOY 24.28% growth is there, so that is what I said since we are focusing on all the growth areas in the advances, we should be able to sustain a growth of 20% plus during the current FY.

Hruhyam Verma: Sir, out of this total advances, how much would be the corporate book?

Mahabaleshwara M. S.: Corporate, there are many definitions, what definition we follow is up to 5 crores irrespective of the fact, it is treated as retail and any advances given above 5 crores even if you are extended with 5 crores above 5 crores loan, you are treated as a corporate, so that is the definition that we are adopting in the banking sector that is as per BASEL-III, so from that point of view we have 5 crores and above advances at 55.21% whereas retail, that is, less than 5 crores at 44.79%, but if you look into the definition of the corporate that is public and private limited company and all such things, I think we are at around 10,000 crores, that means around 25% to 30% of our total advances.

Hruhyam Verma: That would be of corporate book if we go by the definition?

Mahabaleshwara M. S.: Yeah.

Hruhyam Verma: Sir, how much would be the consortium lending in this particular corporate book?

Mahabaleshwara M. S.: We have 74 accounts under consortium, so consortium lending I will get back to you with correct numbers, sorry, right now off hand I do not have.

Hruhyam Verma: These 74 accounts that you have mentioned so basically would that be more of where we have some sayin it or we would be the majority of the lead banker?

Mahabaleshwara M. S.: No, we do not have majority stake at all, that is why we are slowly reducing our exposure in the consortium, but wherever we are taking exposure under consortium invariably they are AAA or AA rated type of accounts, the exact number I will give you later.

Hruhyam Verma: In this quarter, have we done consortium lending?

Mahabaleshwara M. S.: No new arrangements, we are focusing more on core banking that too ticket size of 75 lakhs to 50 crores, not more than that.

Hruhyam Verma: Sir, our other income if we see last quarter, I mean last year it was 217 crores, last quarter it was 94 crores and this quarter it is 208 crores, so was that a one off, I mean last quarter and last year or?

Mahabaleshwara M. S.: Yeah, that is what I mentioned in my briefing, this other income has two portfolios, one is the trading profit, the another one is the fee-based income, so trading you know that is

always one-off item, so last year June '17 we have been able to get about 75.28 crores profit from the trading business whereas this year, it is only 6.25 crores but the most interesting thing is the fee-based income in the other income part, last year it was 142.11 crores, this year 202.55 crores. We have been able to make good of that, so here the growth rate is 42.53%, so we will continue to focus on this particular portfolio that is the fee-based income which would give us a consistent income in future as well.

Moderator: Thank you. The next question from the line of Himanshu Upadhyay from DHFL Pramerica. Please go ahead.

Himanshu Upadhyay: My question is on the advances side, we have seen a pretty strong growth on the corporate side means nearly 40%, what is driving it and can you give some granularity on what ticket sizes are growing in which segment of the market you are trying to target in that?

Mahabaleshwara M. S.: Here, I have already briefed you about the definition of the corporate, 5 crores and above is taken into account that is why it is being said like that. Otherwise, if you really apply the market definition for the corporate and all there is no significant traction, but however, we are focusing more on the ticket size of 35 lakhs to 50 crores that is why I said our MSME has seen a growth rate of 29.89%, even our housing loan portfolio under the new delivery model is 16.62% and we are focusing more on mortgage-backed loans, that is LAP, lease discount and all which are showing a traction of around 30% plus together, so this being the position that is why I am optimistic of sustaining this growth. The corporate and all at one particular score may give about 500 crores, 300 crores and we may not be able to sustain that type of growth, so we are reorienting our position.

Himanshu Upadhyay: I agree to it, but despite if we see that 5 crores and above loan, which is more of an mid-size companies which you are targeting?

Mahabaleshwara M. S.: A good number of credits are coming in that sector. Last time also I have shared this particular reality, so many banks are put under this PCA norms and they have good customers who are showing interest in shifting their dealings to other banks which are taking immediate credit decisions and considering that we are encashing that opportunity by putting in good number of filters as well.

Himanshu Upadhyay: You think that segment above 5 to 50 crores, so can you give an idea of between this 5 to 50 crores, what is the segment, how much growth is in terms of loan has happened, let us say between 5 and 50 crores?

Mahabaleshwara M. S.: Right now, I will make a note of it to provide.

Himanshu Upadhyay: We have stated that we are doing a lot of loan against, not loan but mortgage-backed loans, so can you give those would be generally below 5 crores, between 35 to 5 crores?

Mahabaleshwara M. S.: Here ticket size varies from 5 to 50, one or two cases about 100 crores as well, so that is the basically the least discount supported by the mortgage of the property as well. Otherwise, loan against properties also we are focusing. Here there are two things, one is the good income generation for servicing the debt, second one is adequate collateral security.

Himanshu Upadhyay: This mortgage which you are saying again, it is the mortgages factories and all those, you are saying?

Mahabaleshwara M. S.: Basically, the commercial properties like malls or something like that business houses, like that, it not necessarily be the factories.

Himanshu Upadhyay: Builder type of financing?

Mahabaleshwara M. S.: Yeah, that also we have, but minor.

Himanshu Upadhyay: If you can give some details in the next time on the corporate advances what the structure means like the breakup what we have in the, it would be helpful like on page 18 for retail type of things, that would be helpful.

Mahabaleshwara M. S.: Noted, Sir.

Moderator: Thank you. The next question is from the line of Prakash from Edelweiss. Please go ahead.

Prakash: Sir, couple of questions, one when I look at your disclosure on margins, so this time you have reported a 3% margins which was 2.97 in Q1 FY '18, but when I look at your Q1 FY '18 presentation, it was reported as 2.64, has there been any change in reporting format or?

Mahabaleshwara M. S.: I think it is 2.97, if there is any change I do not know. Is it reported as 2.64?

Prakash: Yes, Q1 FY '18 presentation.

Mahabaleshwara M. S.: We will come back with reconciliation, whether it is 2.64 or 2.97, you are saying 2.64?

Prakash: Yeah, that is why there is significant difference in loan growth and net interest margin if I look at from YOY basis.

Mahabaleshwara M. S.: Yeah.

Prakash: Second Sir, is on CASA, we have seen over last three to four quarters even on SA, your run rate has been pretty soft, what is our outlook and strategy going forward on this front?

Mahabaleshwara M. S.: Yeah, we have been aiming to have a CASA of around 30%, I think it should happen within another two to three years. We are not very ambitious about increasing it above 30%, but that may not happen for a bank of our size and segment, so what is happening is we are focusing more on customer on-boarding activities, so during the current quarter we have on-boarded about 1,71,580 accounts whereas in the last year it was 1,62,720 accounts, so there is some positive traction. The SA deduction is mainly on account of the MSME related current accounts wherein they have kept some balance in as of March the surplus amount, so generally in the first quarter they utilize it and as and when the subsidy and other related things get credited, there will be improvement in the balance, so that maybe one type of development, otherwise I think we should be able to sustain this CASA percentage as such.

Prakash: Sir, when you look at your corporate advances, around 6.27 percentage commercial real estate exposure, can I have some sense on the behavior of the same and what is this related to?

Mahabaleshwara M. S.: Commercial Real Estate fund based, we have total exposure of 5.95% compared to our total advances and here we have an NPA of 78.34 crores, that is, 2.70% to this particular sector, around 5.95% amounts to 2896 crores Commercial Real Estate exposure of that NPA is 78.34 crores.

Moderator: Thank you. We take the next question from the line of Sri Karthik from Investec Capital. Please go ahead.

Sri Karthik: Sir, I have couple of questions, I wanted to get a sense as to what are the changes which have happened over the last 12 months since you have joined and any update in terms of

the progress? The second question is relating to the corporate rating profile which you disclose in your presentation. The BB and below, the sub investment grade portfolio which is close to about Rs. 24 billion increased from Rs. 20 billion last quarter, I wanted to see what is leading to this downgrade to the rating profile and what proportion of this is under risk in terms of turning into NPA, and third is I missed your earlier point on the SME dispensation, maybe if you could elaborate a little bit more?

Mahabaleshwara M. S.: The major development that had happened ever since I assumed the role of MD and CEO is we have boldly embarked upon our transformation journey and lot of fundamental changes in the look and feel of the bank is on the way and that is what I have highlighted in my briefing as such, and as far as advances underrated sector is concerned, AAA is at 12.31%, AA is at 9.85%, A is 3.04, and BBB 4.37 and BB is 3.67, so there is a small portion of B1.19, but that is also performing advances, so D is hardly 0.98% less than 1%, so as of now around 35.41% of our total portfolio is coming under the external rated advances. I think about a year back it was somewhere around 24%. As far as MSME dispensation is concerned, we have a portfolio of around 319 crores as of now, so this advances we are in regular touch with concerned borrowers and they have shown inclination to utilize this 90 to 180 days concept by utilizing the surplus for our working capital purposes and by and large there may not be any big surprises from the MSME dispensation portfolio going forward.

Sri Karthik: My question is BB and B is about 2400 crores and what we have observed for other banks is that this portfolio typically tends to become NPA over a period of time, so what do you think is the probability within this pool to turn into NPA?

Mahabaleshwara M. S.: Historically, this is at the same level, not a big difference. What happens is in our bank we have good accounts which are Proprietor oriented or the partnership oriented those, in the BBB we have 38, BB we have 36 borrowers, so these are all the long-standing customers either individual or the partnership driven accounts and whatever may be their best financial results, they may not get high rating, so that is why I said there is no any stress in that portfolio even though it is rated as BBB and BB, but the corporate we are taking only AAA and AA exposures.

Moderator: Thank you. We take the next question from the line of Siddhart Singh from Ceiling Capital. Please go ahead.

Siddhart Singh: Sir, I wanted to understand a little bit about just the competitive intensity and how it is changing in your market, so while PSU banks obviously are strong, it is also almost all of the old regional private banks are playing very active, everybody has got proven management, so how you are competing with them and then obviously there is HDFC, ICICI, Axis all obviously want to come and claim your market, so what are your defenses against these guys?

Mahabaleshwara M. S.: I do not believe in competition, but we have full faith in collaboration and cooperation so we are not a competitor either for the nationalized bank sector or even for the new generation private sector banks, they have their own areas of advantages as well as disadvantages, so we will be focusing on our nice areas as per our transformation journey, so we have already identified certain focus points for that so which we feel that that will further improve our fundamentals and eventually result in enhanced stakeholders value, so that is a long-term ambition and we have already started taking baby steps in that direction, and definitely going forward, I think we should be able to live up to the best occasion.

Siddhart Singh: Sir, in your assessment what are your core strengths?

Mahabaleshwara M. S.: Our core strength is our employees and our own customers, so we are banking on our customers and we have also identified about 10 to 12 potential states for the expansion of the business and certain growth areas both in the asset side as well as the liability side as well as the para-banking activities, we have already identified, so gradually we will be implementing all those initiatives.

Siddhart Singh: The employees are able to sell better when there is a proposal from another regional bank or when there is a proposal from HDFC or the employees from your bank is to sell the product better or is it that your customer relationship is so strong, they do not look at other banks, what really keeps success factor for you going forward?

Mahabaleshwara M. S.: We are fully convinced about our strength and we are committed to keep up our identity.

Siddhart Singh: Sir, you made one point in your commentary about reduction in establishment cost of about 19%, can you throw some more light on that please?

Mahabaleshwara M. S.: Establishment, here what happened is the Establishment which was at 137.41 has come down to 110.50, this is mainly because of write back of superannuation benefits around 21 crores.

Siddhart Singh: This should be thought of more as a one-off because the interest rate changes?

Mahabaleshwara M. S.: This establishment cost may slightly go up because the bipartite settlement is going on, so that being the case, we have already made required provision for that also keeping that in mind because the revised salary is applicable from first half November 2017, so adequate provision is being made on month-on-month basis.

Moderator: Thank you. We take the next question from the line of Sangam Iyer from Subhkam Ventures. Please go ahead.

Sangam Iyer: Sir, just wanted to check with you, you indicated that part of your books were actually shifting from low yielding to high yielding MCLR, right?

Mahabaleshwara M. S.: Yeah.

Sangam Iyer: But when I look at your yield on advances, they have been progressively coming down, is there any large chunk of your book still sitting on low yielding category, could you just clarify on that, as and when the shift happens, your yield should slowly but steadily start moving up right?

Mahabaleshwara M. S.: That is correct, that is what I said, most probably this quarter it appeared to have bottomed out at 9.29% because about previous quarter it was at 9.47%, here what happened is I said I have MSME dispensation book of around 319 crores, on that we have not recognized any interest, so that is the major thing. Whatever the re-pricing has happened that is all during this quarter it has happened and the result is going to be seen in the next quarter.

Sangam Iyer: But Sir, MSME the 319 crores at best you would have recognized maybe 7-8 crores or 10 crores this quarter, not more than that, that should not move the needle significantly from what we have seen given the kind of loan book growth that we are seeing at around 24%, so that is why I am trying to just look at it on a sequential basis in terms of the yields dropping in spite of the fact that we have been progressively moving towards a higher yielding assets or re-pricing on the MCLR front?

Mahabaleshwara M. S.: This benefit it will not be immediate, as and when they mature it will get re-priced, so re-pricing we will not be having a cut off rate or something like that. When that particular account due date appears, then it will get either repaid or re-priced.

Sangam Iyer: Sir, what percentage of your book is still on the low yielding one or yet to be re-priced?

Mahabaleshwara M. S.: Maybe around 8000 crores.

Sangam Iyer: Any timeline for this to be getting re-priced?

Mahabaleshwara M. S.: Maybe within another six months period, everyday it is happening now.

Sangam Iyer: Basically, by this year-end it should get completed by third quarter?

Mahabaleshwara M. S.: Yes. In fact we are in touch with them also, so in midway if there is any possibility of upward movement, we are also exploring that growth, but the success rate is not that encouraging in that level, so we will have to wait till the due date.

Sangam Iyer: Sir, given this prospects going forward, from 9.24 for this quarter, where do we see the yields moving, do we see a 5 to 10 basis points improvement in the yields coming in or this is more a steady state yield that one should be looking at, how should one look at our?

Mahabaleshwara M. S.: We are looking at around 9.50% by the end of this financial year and cost of deposit also maybe somewhere around 6%, so 6% to 9.5%, around 3.5% spread is appear to be reasonable for the current FY.

Moderator: Thank you. We take the next question from the line of Vaibhav Badjate from HNI Investments. Please go ahead.

Vaibhav Badjate: Sir, in our annual report there is a schedule 16 called operating expenses and in that schedule, there is a line item called other expenditure and I just wanted to focus on that number, so that number in last two years have grown from 161 crores in FY '15 to around 402 crores in FY '17, now that is quite a substantial jump given the size of our bank and I just wanted to understand what line items are there within that is moving the needle so much?

Mahabaleshwara M. S.: In the other expenditure we have taken the ATM expenses, rent, taxes, and lighting and our property insurance expenses and repairs and maintenance, postage, telegram, and

telephone, transport and travelling, printing and stationary, large charges, advertisement and publicity, and of course auditors fee, directors fee, and generator maintenance, all the miscellaneous items, car and others, PA to executives, RSIL amortization charges and all such things, remittance expenses, these are all the routine banking things, say for example remissions, our postage telegram, ATM expenses is also considered under the other expenses and the other income.

Vaibhav Badjate: That said, you have listed the item that is what I was actually coming to, now apart from all these items which are already listed in the schedule, there is a separate line item within schedule 16, which is the last number in the schedule 16, which is called other expenditure?

Mahabaleshwara M. S.: What is the amount mentioned there?

Vaibhav Badjate: Amount of other expenditure in schedule 16, so schedule 16 has 12 subheads and other expenditure it is kind of increased from 161 crores to 401 crores from FY'15 to FY '17?

Mahabaleshwara M. S.: I think you are referring to our annual accounts that is position as of March 2018?

Vaibhav Badjate: No, I am referring to Financial Year 17 annual report?

Y. V. Balachandra: Are you are referring to '17-18?

Vaibhav Badjate: No, '16-17.

Y. V. Balachandra: We have one sundry item that is 28 crores and we have other items like commission paid and HD, dual appraisal fees, clearing of staff, subscription, brokerage and investment, all these are sundry items including as already told by our MD that there is also an element of conveyance allowances etc. Last year there was a one-off item during demonetization, we had incurred some expenditure in connection with transportation of that demonetized currency etc., that was one off event last time, that is also included under the others.

Moderator: Thank you. We take the next question from the line of Sachit Damani from IIFL Wealth. Please go ahead.

Sachit Damani: Just a couple of questions, what is our exposure to the power sector particularly those that are not an NPA, but there were some sort of stress and the second one is what is your PCR target going forward along with your credit cost and slippages outlook?

Mahabaleshwara M. S.: Power sector we have an exposure of 5.60%, so that is around 2724 crores and in this sector the slippage is 293 crores and we are not taking any big exposure in this sector, so in all probability it will hover around 5% to 6% only, and the major exposure in the power sector is all to the rated PSUs.

Sachit Damani: What is the non-NPA stress part in this?

Mahabaleshwara M. S.: The present stress is at 293 crores out of 2724 crores.

Sachit Damani: But that is the NPA, right?

Mahabaleshwara M. S.: That is NPA.

Sachit Damani: I am saying non-NPA apart from this, like is there any other stress?

Mahabaleshwara M. S.: All others are in standard category, they are not even in the S1 or S2 stressed category.

Sachit Damani: Any slippages expected in this now going forward?

Mahabaleshwara M. S.: No slippage is expected from that sector because these are all the major things exposure is in the public sector enterprises they are all AAA rated companies we have exposure, that is why I am so confident about that.

Sachit Damani: PCR target at the credit cost and slippages outlook?

Mahabaleshwara M. S.: That is what I said, the credit cost maybe around 0.5% going forward on quarterly basis and the provision coverage ratio also it may hover at around 55% to 57%.

Sachit Damani: What would be your SMA1 and SMA2 trend going forward?

Mahabaleshwara M. S.: Our opening balance in SMA was 420.93 crores and of that around 33 crores that means 7% is slipped to NPA, upgradation is 119.35 crores that means around 28.35% is upgraded from the opening stock and the recovery in the SMA which is continuing under SMA is around 4.76 crores, so the closing balance of the opening stock was 420.93 minus 263.78. There has been fresh addition of 462 crores excluding the MSME, so at present we are having about 726 crores in the SMA2, so historically what is happening is about 7% to 10% maximum is slipping to NPA and around 30% to 40% is upgrading, so that is quarter to quarter that type of movement is there and another 50% or so would continue under the SMA2 category alone, so around 7% to 10% slippage is from the SMA2 category and 30%

to 40% upgradation either to SMA1, SMA0 or also, and another 50% to 60% would always continue under the SMA2, so this is what we have now targeting under our collection mechanism to see that we minimize our exposure under SMA2 and not only SMA2 even under the SMA1.

Moderator: Thank you. We take the next question from the line of Rohit Balakrishnan from Vrddhi Capital. Please go ahead.

Rohit Balakrishnan: Sir, couple of questions, can you please explain what is your overall agricultural book and how much of that is exposed to Karnataka?

Mahabaleshwara M. S.: Our overall agriculture book is around 6000 crores, of that 6000 crores Karnataka alone we have around 3800 crores and in that 3800 crores, crop loan is 513.38 crores and of that crop loan the NPA crop loan, overdue crop loan, and restructured crop loan all put together is 178.19 crores, so this portfolio of 178.19 crores is now being considered by the State of Karnataka for its loan waiver, but anyhow we have made full provision as per the IRAC norms.

Rohit Balakrishnan: What about the loans which are not under NPA, they are not considered for the waiver?

Mahabaleshwara M. S.: NPA overdue crop loan and restructured crop loan, other than any loans which are NPA or overdue, other than the crop loans they are not considered in the first stage. What the Honorable Chief Minister had announced is, this is the first stage wherein he will be addressing the crop loan related issues and then he will focus on the other agricultural loans. It may be an ongoing process nobody knows.

Rohit Balakrishnan: The other question I had was in terms of your CIR ratio, so it is around 11.6% right now if I look at the numbers, so any plans of capital raising at this point of time, so any thoughts capital adequacy is about 11.6%?

Mahabaleshwara M. S.: This is an ongoing process, so every once in two years or three years generally we do come to the market, so this time also our ICAAC will be meeting on quarterly basis and they will take a call, so if our income earning capacity improves as it is seen during the current quarter, so naturally we will be able to re-plough this particular thing because this 11.60%, we have not factored in the net profit that we have earned in the Q1, if that is factored into then it will go to 11.90%, so that is accounted at the end of the year, so our ICAC will take a view and if at all anything is there, we will make an announcement.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to the management for their closing comments.

Mahabaleshwara M. S.: Thank you very much for showing keen interest and we will try our level best to come up to the expectations of our own as well as all our stakeholders. Karnataka Bank is the shareholder's bank driven by the power of its 8000 plus employees and we will continue to work on our strength as well as weaken our weaknesses. Thank you once again.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Centrum Broking Limited, we conclude today's conference. Thank you all for joining us and you may disconnect your lines now.