"Karur Vysya Bank
Q2 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Karur Vysya Bank Q2 FY2020 Earnings Conference Call hosted by Spark Capital Advisors. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*"then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhinesh Vijayaraj from Spark Capital Advisors. Thank you and over to you!

Abhinesh Vijayaraj: Thank you Steven. Good afternoon to everyone on the call. On behalf of Spark Capital, I welcome you to the 2Q FY2020 earnings call of Karur Vysya Bank. We have with us today the management team of KVB represented by the MD & CEO Mr. Seshadri, President & COO Mr. Natarajan, General Manager & CFO Mr. Sivarama Prasad and Company Secretary Mr. Srinivasa Rao. I now request Mr. Seshadri to take us through the highlights of the quarter gone by after which we will open the floor for questions. Over to you Sir!

P.R. Seshadri: Thank you very much Abhinesh. Good afternoon everybody on the call. Thank you very much for taking the time to join us on this call today.

As you are aware Karur Vysya Bank has been going through a process of transformation over the last couple of years. The last quarter was a period where many of the new initiatives that we have taken have sort of started bearing fruit and basically the transformation process that we had started two years ago is now beginning to enter a phase where the rewards of the transformation should start flowing through as we go forward.

To start with the digital platform that we had started work on actually in October of 2017 and the first product became live in March of 2018 that is now stable, about 90% of our loans both on the retail and commercial side are going through that platform all the way up to Rs.15 Crores. The retail application flow continues to be strong. Our retail applications that we managed on the system were about doubled, the current rate is that the application flow will double over this year as compared to the prior year. The small business loan, which is a transition that we are trying to do with respect to our branches grew by about 85% quarter-on-quarter that is Q2 over Q1 of this year and we launched a new digital jewel loan product that has enabled us to start growing our jewel loan proposition as well. We moved from being a single distribution company, which is doing everything out of our branches to a company that has multiple distribution arms, so our branches, which used to be the only method of delivering service products and services to our customers is now one of four distinct distribution architectures that we have available within the company. The branch is now focused on liability, which is deposits and current accounts and savings account and on retail loans and small ticket commercial business. When I say small ticket it is lesser than Rs.2 Crores. We established in April of this year something called a business banking unit, which has now been in existence for six months. These are specialist bankers who service small and medium tier SME businesses and this has now been in operation for six months and it is now again beginning to yield results as we go forward.

The corporate business unit is something that has been in existence for a while. This is the entity through which we manage our corporate relationships and the large SME type of customers. We have also been working since January of this year in creating a bank within a bank, which we have called NEO it is what we call KVB NEO. The last quarter was the first quarter of operation of KVB NEO. KVB NEO is a new channel that we have set up, which will enable us to tap the existing distribution architecture within the country, i.e., direct sales of its agencies, loan aggregators, entities that are present on the web and were harvesting customer information and thereafter directing them to banks, etc., and finally KVB NEO was the entity that was going to help us with the co-origination platform that we set up. Co-origination is a mechanism by which we deal with other NBFC and we tie our system with their system and we are in a position to jointly originate customers and host those customers jointly as well. A portion of the asset is being kept by us and a portion kept by the other entity. You may have seen a few weeks or so ago a press release that talked about our co-origination agreement with Home Credit. Home Credit is a multinational consumer finance company. The arrangement with Home Credit enables Home Credit systems to talk directly with our systems. The information that Home Credit is capturing about customers is transferred to our systems. Our systems run the scorecard, do the background checks, interface with a variety of external entities to understand as much detail about the customer as can be found out electronically and we either approve or decline a customer within the space of 60 seconds and post that the loan gets booked both on our system as well as on Home Credit system and if we decline obviously the loan is booked directly by Home Credit if we approve it is jointly shared. That is the kind of infrastructure that we have been working on and that is now live. We have four such relationships live at this point in time. We also have the capability of switching on other relationships within a month’s time, so the infrastructure has been setup in such a fashion that co-origination can be switched on and off reasonably quickly from our side. So NEO is an entity that it has taken us sometime to build the team. We have hired experienced hands from the market. NEO actually comes, the people within the team are specialists and they are sales, business, products, risk, and underwriting and analytics kind of specialist. The entity has been now live for one month. It booked its first loan in July and in the last quarter, it booked about Rs.145 Crores worth of loans, so we are very happy with the progress that all of these new initiatives have made. We think that the current run rate of origination on the NEO front is roughly approximately Rs.200 Crores a month in new applications, obviously the approval rates will be lower than one and therefore a portion of the Rs.200 Crores will be something that we can book. We think that this is infinitely scalable and it will give us the ability to originate both retail as well as commercial loans in large quantities as we go forward.

On page nine of your deck is a new slide, which we introduced to show to you that our portfolio performance has been improving. The through-the-door quality of our loans is improving. The way to read this slide, this slide is what we call a month on book analysis so there are two parameters. Six months on book or 12 months on book and when we say month on book it basically means any loan let us say done in January how does it perform either up to July or up to the next January, so six months or 12 months thereafter and what we are measuring here is something called ever 30 plus, which means any loan if it ever goes into SMA1 ever goes it could come back subsequently, but once its goes into SMA1 for once it goes into the numerator and the original principle of all such loans that became SMA1 at any point in time is put into the numerator and in the denominator if the original principle of all the loans disbursed in that particularly quote. Now we have not given to you the exact ever 30 plus numbers at 6 and 12 MOB over time. What we have done is we have normalized it for September. So let us take an example. Let us say in September we did 100 loans and just for the purpose of making it very simple in the example let us say each loan was only Rs.1 and let us say in six months 10 of those loans became SMA1 and in 12 months 20 of them became SMA1 right. These are 20 distinct loans. So the ever 30 plus at six months six MOB will be 10% and ever 30 plus at 12 MOB will be 20%. Now if I use that same analogy if the September 2015 number for the portfolio was 10% ever 30 plus today it is 4.5% so it has dropped by more than half on a portfolio level. At the retail product level it has dropped by more than four times. It has dropped to one fourth of what it used to be. If it was 10% in March, in September 2015 it is now 2.4% and similarly on the commercial side it has dropped from 10% to 4.8%. The 10% is not a real number this is just to show how this thing is computed. The reason why we included this slide is to tell you that we have been as a bank taking reasonable amount of precaution when it comes to on boarding new credit customers and we have changed our credit schemes. We have tightened the way we underwrite loans and that is being reflected in the ever 30 numbers that you can see here and you can see a consistent improvement in performance. It is more market in retail than either the portfolio or commercial levels, but that just gives us more work to do and we are sure that as we fine tune our score cards, as we fine tune our underwriting processes, these will improve even more. The reason the retail numbers are markedly superior is that the loans that we booked on the retail front from March 2018 to March 2019 these are all digital, so a vast majority of the loans during that period had switched to digital and the impact of the digital underwriting is to a degree flowing through and the reason why the data ends in March 2019 is because we need six months to plot the next one of the data points, so the portfolio needs to age for either six months or 12 months.

On the commercial side the new to bank business was introduced in September and effectively went live in October of last year and therefore that much vintage that is available for us to show the improvement and we believe that as time goes forward our investment in our credit infrastructure and architecture will start flowing through.

Coming to this we also on page 11 of our deck talk to you about something that we have been engaged in over the last six months or thereabout, which is the centralization of our operations function. I am happy to tell you that we are making very, very significant progress on the op centralization piece. I think this is critical for turning us into a modern bank. Historically we have been very; very branch dependent for most of our operations and what that does is that it brings in a level of operational risk that perhaps can be best avoided. The other thing that it does is brings in nonuniformity in processes and end result so what we are now trying to do is to pluck operations that are best performed outside of the branch, we are pulling them out of the branch and pushing them into a centralized location and to the extent possible we are automating them. The operational centralization I will give you an example of what we intend to do with the centralization. For example currently when an outward clearing cheque is dropped into one of our cheque clearing boxes the cheque is scanned at the branch and data entered at the branch. Now if it is a very busy branch like some of our industrial centre branches it can occupy one of our officers or clerks for may be three quarters of the day. What we now do, what we are intending to do once the centralization settles down is only the scanning happens at the branch. The data entry happens centrally thereby freeing up the time at the branch to service customers and sell more products. I will give you another example. We have a process something called concurrent checking so that when a transaction happens it is checked concurrently by somebody else to see whether a mistake is being made or not. This is in addition to the make a checkout function that is customary in every bank. The concurrent checking process occupies roughly a tenth of our manpower at any point in time in the branches. What we have done is we are one of the first few banks to try and automate the concurrent checking process through a robotic process automation technology. We have standardized the application forms that all the forms in the branches. The system has been modified so that the day book can be enlarged to take into account other entries that are needed for the automation process. Once the day is over every challan, every piece of paper in the bank is scanned and the system runs the automated concurrent checking process to check whether a particular transaction has the requisite paper work or not and has the requisite authorization or not and it throws up exceptions that can be then tracked at a central location. This is expected to increase A the control that we have on the branches and B it is likely to throw up a lot of extra manpower in the branch that can be used to do other things like servicing customers and selling other products. In a nutshell the operation centralization process is likely to release cost as far as we are concerned, increase standardization, repeatability, control and reduce operational risk. So for the quarter as I said the quarter that has just gone by is a quarter of consolidation. All of these new things have gone live. At the same time, we continue to derisk our portfolio. You will see in the numbers that our corporate portfolio has reduced so as our commercial portfolio that is largely on account of reductions on our bigger ticket commercial on account of the changes that we have made to the organizational structure. Our retail continues to grow really well. The agri business is largely stable. While we have exited a couple of lines of business on agriculture, but having said that the gold loan business has sort of stepped in and enabled us to grow the agri book during the quarter. During the quarter we also as I said gone live on four co-origination partnerships and we have set up the infrastructure to enable us to partner with other entities and the time taken to market would be less than a month with the new technology that has already been deployed.

From a portfolio standpoint, the new to bank business as I have already pointed out is performing significantly better than the older vintages. Our legacy issues are continuing to be dealt with and we think that at this point in time we are reaching hopefully towards the end of the legacy related problems that we have as an institution. During the quarter, we as you would have already noted provided quite aggressively. As a consequence both our gross and net NPA reduced from 9.17% has gone down to 8.89% and the net NPA is down from 4.98% to 4.5%. We have been very, very systematic in increasing our provision coverage ratio. We had already informed you that we would be building very substantial provision coverage during the year and we continue to push the provision that is being held and I am happy to tell you that during the quarter our provision coverage ratio, which is defined as provisions held by gross NPA the way we all of you define it crossed 50%. So we are now at about 50.6% and at this level given the nature of the assets that we have in the nonperforming asset pool we believe that we are getting pretty close to the level where very large quantum on incremental provisioning will probably not be required, but having said that we are committed to increase provisioning to get to about 55% to 60% or thereabouts. At the RBI PCR level we are close now to 62%, which is a very substantial increase from where we were even four or five quarters ago.

We continue to launch new products. We launched the bullion business, which is basically the metals trading business. We will hope to go live in Q4 2020. This is to take advantage of the current exposures that we have in the gold industry and as a consequence and ensure that we tap the full profit pool that exists in that segment the team that will manage this has come in very, very highly skilled team has been hired, they are in the process of setting up the technology and other backbone, the technology backbone that is required to get this live. So with that I will stop and I am very, very happy together with my colleagues here to answer any questions that you may have.

Moderator: Thank you very much. We will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Gaurav Agarwal from E&R Advisors. Please go ahead.

Gaurav Agarwal: Good afternoon Sir Gaurav here. Sir on slide number 47 where you have disclosed portfolio performance about SMA1, SMA2 and SMA30+ so I understand that you have shared the historical context of the same like if it was 100 on March 31, 2017 now it is only 37%, but it would be very helpful if you can share the absolute numbers as on date, how much is SMA1 and SMA2 outstanding that would really help us to understand your portfolio quality?

P.R. Seshadri: Gaurav I think that is a very good thing. We will debate that internally and we will come back and give you the number. We will release it more generally after discussion at our end.

Gaurav Agarwal: Sure great. Sir one of the banks in your region the PSU Bank, Indian Bank they have disclosed or mentioned quite a big list for the SME so it is not kind of a stress list, but it is kind of a watch list kind of thing where they have a deadline till January or March 2020 so do you have any such kind of SME pool, which is in your watch list and where you have taken some advantage from RBI and you are monitoring it aggressively?

P.R. Seshadri: Our SME pool performance is improving. Now if you were to look at page 47 the one that you talked to you will notice that absolute balance in terms of has dropped so SMA30+, which is a line in the middle, was 46 on June 30, 2019 and now 45 right so it has dropped marginally. If you will look through the debt you will notice that 30+ in our corporate book has actually grown a little bit. The offset lies largely in SME so the SME performance is improving and we believe that most of the large ticket SME flows that we had to suffer are already behind us and we think that the second two quarters will be significantly better than what we have seen so far and therefore we are not looking at any aggressive rewrites nor are we putting together a long list of potential customers that can give us a problem.

Gaurav Agarwal: Lastly Sir if you can help me with your guidance for FY2020 in terms of loan growth what is your expectation?

P.R. Seshadri: Basically the biggest challenge that we face as an institution today is on growth and that challenge is coming up essentially because of the fact that we are degrowing particular sections of our book, so we are degrowing on our corporate side and select large ticket SME commercial also we have a negative bias and therefore we are not aggressively pursuing those, so we are trying to make up that by retail and by small ticket commercial and so far our sales architecture has not been able to deliver the throughput that is necessary to make up the difference even though retail grew ex-IBPC at about 28% even then we are not able to make up the difference because of the low base on the retail side. The good news is that on the commercial side we on the small ticket commercial with our business banking units now getting stabilized our branches are now focusing only small ticket commercial. In Q1, the total volume of loans that we booked rather on Q2 we almost doubled what we booked in Q1. Our run rate in Q3 is looking quite positive and the momentum seems to be quite strong. For this year, we think that anyway this is the busy season and growth should come back, but we think that our growth will be moderate as we go forward. I think about 10% year-on-year is something that we can aim to achieve. The good news is that our balance sheet is strong. We have got 16% CRAR, we are now adequately provided as far as I can see on the provision coverage front and our systems are now stable, so we think that we have a reasonable shot of getting there and the new distribution architectures that we have setup have now started producing, so we should be able to see the incremental throughput come through.

Gaurav Agarwal: Great Sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Akash Dantani from HDFC Securities. Please go ahead.

Akash Dantani: Good evening and thank you for taking my questions. My first question sort of dates back to the guided slippages that you spoke about in 3Q FY2019 that was about Rs.18.5 billion gross right?

P.R. Seshadri: Correct.

Akash Dantani: Yes so I believe out of that we have seen about and this was over the next five quarters from that time and we have seen about Rs.16 billion since?

P.R. Seshadri: That is right.

Akash Dantani: So just wanted to get your thoughts on this in terms of how is there more stress that you are seeing and how are you looking at the situation?

P.R. Seshadri: Our current view is as follows. We think that the 1850 number that we gave you we will probably miss and we will probably end at 2200 there will be a miss of approximately Rs.350 Crores, but we think that on a net basis we will probably be better than what we had or informed you earlier when we said. We said that we will be Rs.1100 Crores for four or five quarters we will be substantially lower than that as we go forward because our recoveries are now coming in stronger than what we had anticipated at that point in time and therefore on a net basis we should be significantly better than what we have guided.

Akash Dantani: My next question is could you quantify the write offs for the quarter please?

Sivarama Prasad: Akash, Prasad here, out of the total reduction Rs.620 Crores is the total reduction and out of that cash recovery is Rs.195 Crores and the write off is around Rs.230 Crores that is from the existing provisions the write off is around Rs.230 Crores, so total deduction is Rs.620 Crores, remaining on upgradation.

Akash Dantani: Sir my next question is on slide nine where you have given this new disclosure on the ever 30 plus?

P.R. Seshadri: Correct.

Akash Dantani: Right now if I look at for the portfolio as a whole and for commercial if I look at the dark green line, which is the 12 MOB should that not be above the light green line that speaks MOB logically because you will have a great percentage that crosses that mark at any point in time?

P.R. Seshadri: Not necessary because we have normalized it to September of 2015. So normally if I were just giving you the 12 MOB and 6 MOB line, the 12 MOB will always be higher than the 6 MOB line.

Akash Dantani: Because this is like an index number?

P.R. Seshadri: Correct this is like an index number, so my 12 MOB has actually improved more than my 6 MOB has improved that is what it means.

Akash Dantani: One last question if I could squeeze in sorry two data questions what would be the sales to ARCs during the quarter and the quantum of restructuring might be?

P.R. Seshadri: Restructuring is not material. The sale to ARC is roughly Rs.192 Crores.

Akash Dantani: This is during the quarter?

P.R. Seshadri: That is right.

Akash Dantani: Great. That is it from my end. Thank you very much.

Moderator: Thank you. The next question is from the line of Anuj Tulsiram from Contrarian Value. Please go ahead.

Anuj Tulsiram: Thank you. First of all it was lovely experience attending your last AGM so thanks a lot for that. My first question is on corporate advances can you please help us understand what percentage of standard advances are rated BB and below and if possible what is the percentage of NPA for corporate advances more than Rs.100 Crores?

P.R. Seshadri: Sorry could you repeat the second question. We seemed to have lost you there Mr. Tulsiram?

Anuj Tulsiram: What is the percentage of NPA for corporate advances more than Rs.100 Crores?

P.R. Seshadri: With respect to the external rating I think we will start disclosing it as we go forward. I do not have readily at hand. It is one item that we have not disclosed, but we will start putting it together from the next analyst presentation so that it is available to everybody. I do want to make one point that our definition of corporate is any loan that is greater than Rs.25 Crores and any place where the turnover is greater than Rs.150 Crores or where a consortium is involved. So it is a very liberal definition of corporate and does have quite a few small entities in it. Therefore the rating profiles may be lower than other entities who are disclosing the rating structure for their corporate pool, but having said that we will try and ensure that it comes into your next analyst deck. With respect to your second question, which is what proportion of my losses or NPAs is coming from greater than Rs.100 Crores. Out of the corporate loss pool or NPA pool, I would suspect that a fair proportion may be 50% to 60% and this is off the cup number is actually these large ticket, so the large ticket are disproportionately giving us pain, which is why there is this slide, which shows the total exposure to the large tickets and our bias is to reduce that as we go forward.

Anuj Tulsiram: Fine. Sir the next question is on the priority sector in the agriculture loan, recently one of the top four private banks mentioned that the reason for high NPA in agriculture is that some of the banks have done bulky crop loans based on nearly security of the agriculture land, so I just want to ask do we have any such bulky agriculture loan and also related to this are NPAs in the priority sector has been much higher than our peers so what is going to be our strategy for the priority sector loans going forward?

P.R. Seshadri: With respect to agriculture, the NPA that you see here is on some warehouse loans given to farmers where we have unfortunately had an incidence where the stocks that were purportedly there were not really there. This is a product that we have since stopped doing. We took the decision a couple of quarters ago that portfolio has now shrunk to approximately Rs.2 billion and we think will run off without any further losses. We do not have any other form of loss that we normally take on agriculture. Our book in direct agricultural advance is quite small and contained. A vast majority of the agriculture book is actually gold loans given to agriculturist and therefore a very, very low risk. If you were to go back and trace the performance on the bank on agriculture for four or five quarters or six quarters you will notice that the net incremental NPA that is accruing on this book is very small. So as a management team we are reasonably comfortable with this book. We are watching the warehouse loan or the margin loan product that we have very closely and we are running it down, so we expect it to run down completely in the next four or five months and post that we have no intention of taking exposures of that nature. Whatever losses that we had to take on the warehouse side, I think are substantially done and therefore no incremental losses should come forward should accrue to us. No incremental material losses should accrue to us as we go forward.

Anuj Tulsiram: The related question was what is the strategy for priority sector loans going forward do we need to add any new segments like tractors or CVs or we go to the existing products?

P.R. Seshadri: As of this moment, we are good with the existing products. From a management team standpoint, we are trying to fix our nonpriority business at this point. We seem to have started gaining traction on the agricultural gold loan business. As I said we have grown about Rs.240 Crores most of which is in the agricultural gold loan business and that gives us enough cover to keep ourselves at 18% for our direct agri. We do have some optionality of lending to the microfinance companies, so we are cautiously exploring how we could do joint lending together with a bunch of other microfinance companies so that is the other thing that we are lending. Between the two of them, I think we should be fully covered for meeting our agriculture related target with the RBI.

Anuj Tulsiram: Sir for the last two years you are growing only on four states I think AP, Karnataka, Tamil Nadu and Maharashtra, but the advances are not growing in the other regions so what is the strategy for the rest of the states, are we planning to shut down the branches in the rest of the states or taking a pause, what exactly is the strategy?

P.R. Seshadri: Our strategy is to refocus ourselves to be a South and West Bank so we believe that is our core area of strength. If you were to look at our balance sheet on the asset side, 85% of our assets are in our areas of strength, which is Southern India, but 85% of our NPAs are outside of that area.

Anuj Tulsiram: 85% is outside the South and West?

P.R. Seshadri: 85% is outside of South. West we still consider our core area, but only 15% of our NPAs may be not 15% maybe 20% to 25%. I will do the right math and we will tell you, but it is an 80:20 broadly that kind of pareto kind of number so because of that we are saying that our competencies in terms of underwriting, in terms of ensuring that collection happens seems to be more biased towards South and West and therefore we are refocusing on South and West. We do have substantial presence in Delhi. Delhi is an outlier where we will continue to do a very, very substantial business. At this point in time, we are not thinking of reducing our network elsewhere. We want to refocus network our branches in other places to do more savings and transactional banking type of products and be focused on the lending side.

Anuj Tulsiram: Sir the last question can you share some numbers for the new customer acquisitions over the last two years across retail advances, CASA and SME?

P.R. Seshadri: We will put that in the next deck Mr. Tulsiram.

Anuj Tulsiram: Thanks a lot and that is it.

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

Abhijeet Vara: Thanks for taking my question. I wanted to clarify one number Sir. The slippages if you look at the slippage number gross slippage number you said it is Rs.500 Crores right on slide 49 for Q2 and Q1 I already have it is Rs.474 Crores, but if I look at the subsequent slide in Q2 presentation slide 50, it does not add up to the H1 slippage number Rs.891 Crores?

Sivarama Prasad: It will not add up because what happens is that in the six months period the account actually is upgraded or recovered it will not come.

Natarajan: Even that way reductions will not add up because same account will not be accounted twice.

Sivarama Prasad: It will not be just simple arithmetically addition will not happen. In between the half year that is one quarter it can be there and the next quarter if it is recovered six months period it will not be there so this quarter wise it will give a correct picture of the slippages.

Abhijeet Vara: That is about Rs.80 Crores is the gap Sir that is why you have upgraded is it?

Sivarama Prasad: Correct. That will come under the upgradations Rs.500 Crores plus Rs.474 Crores is Rs.974 Crores has become Rs.891 Crores. I agree with you.

Abhijeet Vara: What is the PCR, current level of PCR is sufficient as per your estimate or do you want to take it to higher level?

P.R. Seshadri: We are committed to taking it to about 55%. We believe that we are now getting close to a point where the loss given default is basically covered by the current provisions that we are holding, but just to be amply safe, we intend to take the PCR. This is the street PCR not the RBI PCR just for clarity. We are committed to taking it upwards to about 55%.

Abhijeet Vara: Sir just one last question from our side. Just wanted to understand in terms of if you look at the portfolio level we have improved the granularity of the portfolio across the corporate and retail level in terms of in our presentation also we have shown in terms of ticket size and all, but Sir if you look at our yields that does not seem to improve that much, so any thought process on that if you can give us some understanding and some guidance in terms of how you see your yields and advances going ahead please? Thanks.

P.R. Seshadri: On the yields front, the results for the last couple of quarters have been impacted by excess liquidity that we are carrying. Our treasury assets, which used to be about Rs.15,000 Crores are now effectively at about Rs.21,000 Crores. In this presentation, they have reflected about Rs.18,000 odd Crores because there is another Rs.3000 Crores, which is basically rupee placements through the FX route, which is not classed under the treasury side so we have become over liquid and our asset book is not growing, so we are temporarily paying a price for lower yields on a treasury side. We think that as growth returns the true underlying yield, which we believe should be north of 4% for us NIM will start coming back so two things have happened. You can see that our CD ratio is down. You can also see very substantial increase in treasury assets in the presentation itself and both of these that are driving the NIM down. As we become more granular, we will get higher yields as you rightly pointed out and those will start following through and you will be able to see the incoming. You should be able to see that in the financials. One of the things that we did debate is whether to put out a slide on what our booking yields are, but then we decided against it, but we can reconsider and we can tell you at what rate we are booking on a weighted average basis across the four products, so that you can track it. The only thing is that will have no correlation between the actual yield because of the fact that there is a portfolio and various factors impact the yield including NPA accretion.

Abhijeet Vara: Just wanted to understand any timeline Sir for this when we will see the surplus liquidity getting converted into loans and in this year or some kind of understanding because our retail if you see our advances have been flat?

P.R. Seshadri: Yes our advances have been flat and to a degree it is deliberate given the environment that we are operating in and the fact that we want to grow only our granular book, so you can see that our corporate book has shrunk quite nicely. It is now only 27% of the total advance. Retail has become 24%. The only thing that we are trying to reverse now is our commercial book where the shrinkage has come largely on the bigger ticket commercial because they tend to behave worse than the smaller ticket commercial, so we think that this remaining six months, which is the busy season we should start seeing some credit uptake. As you recall, we sort of came to you and told you that we were seeing stress in our market place and in our portfolio way back in February of this year. We are hopeful that over the next six months we should be able to grow the book because now our distribution architecture is better placed to start pushing volumes at a granular level so I think as I was saying year-on-year growth of approximately 10% should be possible for us by the end of this year and that will enable us to put out approximately another Rs.4000 Crores or thereabouts. Our excess liquidity that we are sitting on right now is about Rs.6000 Crores, so all of it will not go away, but a great majority of it will go away. The only issue now is that liquidity continues to flood the banking system for alternate places to put in and any therefore incremental liquidity that we are going to access we are intending to access at a lower rate.

Moderator: Thank you. Sir seems like we lost the connection from Mr. Vara. We move to the next question, which is from line of Pranav Mehta from Value Quest. Please go ahead.

Pranav Mehta: I had a question on your guidance on gross and net slippages, so as you said we are expecting around 350 Crores higher gross slippages compared to earlier, so if you can just explain from where are we seeing this incremental stress, are there some large ticket accounts, which you think might turn into NPA or is it more spread out and second on the net number where you have said that recoveries will be better than what you are earlier estimating, so are we factoring in some large ticket resolution from IBC proceedings or again this is more like granular and well spread out?

P.R. Seshadri: With respect to the slippages number, the slippage number is one of the items that has driven the slippage upwards is the large finance companies that is in distress to whom we have a reasonably large exposure, which is well known to all of you and this was signaled earlier that when we made our competition we have not taken it into account, but having said that that has happened and we have also got one asset, which was restructured asset, which was disclosed in our analyst presentation about 75 Crores, 5/25 restructuring of the past, which has now unfortunately also slipped so between the two entities it is about 230 Crores or so of items that we have not anticipated, so when I had subsequently spoken to all of you I have said that look the large NBFC we will be able to manage and in my own mind I was thinking about on a net basis because our recoveries have become significantly better than what they used to be. Now from a recovery standpoint two things have happened, many of our assets have aged from the time when they became an NPA and the SARFAESI process if all goes well takes about 270 days for you to be able to action the collateral. Normally 270 is the ideal timespan, but if you are lucky you get in about 18 months or thereabout 15 to 18 months if you can access the collateral and sell it that is the length of time that it takes and fair amount of our commercial business, which became NPAs last year have now reached that point and therefore we are getting a fairly substantial quantum of recoveries from there. With respect to NCLT processes we are not recovering anything on the NCLT front because some of our assets are getting adjudicated and being closed through the NCLT process. Having said that we do think that a couple of assets going forward from now to the end of this financial year. We will go through the NCLT process and where our recoveries will not be very spectacular, but they will come off, the NPA number will come off even though it will put a strain on the provisioning numbers that we will have to accommodate, so under those circumstances we believe that the net NPA number will be much lower than the 1100 number that we have told to you earlier. I trust that answered the question.

Pranav Mehta: Thank you and all the best.

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

Pranav Tendulkar: Thanks a lot. First of all congratulations to show the courage to degrew the corporate book. Second of all I have a question that after two quarters, your Tier-1 is stagnant at around Rs.6240 Crores, any reason where this profit is going and Tier-1 is not increasing?

Sivarama Prasad: During the period we cannot.

P.R. Seshadri: We do not increase the Tier-1; we have increased only at the end of the period.

Sivarama Prasad: As per guidelines Pranav.

Pranav Tendulkar: Okay that is one. Second is, can you just explain me who shares the risk in the new co-lending model that you have entered, how is the risk shared?

P.R. Seshadri: The risk is shared in the proportion in which the loan is shared, I have got 80% of the loan I am taking 80% of the risk so that means I have to ensure that I do my own homework properly and which is why all of the systems we do what is called a test validate scale model, which is basically we test a proposition, so we originate with somebody for some time, we look at that portfolio performance over a period of time, validate performance and then start scaling, so the risk is borne by us in proportion to the loan that we take.

Pranav Tendulkar: And what is the specialization that Home Credit India brings?

P.R. Seshadri: Home Credit India is like Bajaj Finserv, they are in the same space similar business model, Home Credit India is actually a check company headquartered in **(inaudible) 52:17** they are very big in China, they present in across Asia pacific I think most market we are present along with an India business. The balance sheet was about Rs.7000 Crores or thereabout of small ticket loans AKA Bajaj.

Pranav Tendulkar: Basically they are technical and analytical firm.

P.R. Seshadri: Correct.

Pranav Tendulkar: Okay, second thing is, can you just tell me out of the total branches, how many branches are now getting measured on the other income and especially retail other income in that case, so distribution income of AMC or life or general insurance and what is the matrices that you are now tracking at, how are they panning out?

P.R. Seshadri: I will answer that question by again saying we will start putting those numbers into the next deck, it is not readily available to hand. The revenue streams that are coming out of insurance sales, etc, has been going quite nicely for us, we have moved from being a single provider company i.e., our life used to be provided by one company, non-life used to be provided by one company and the health used to be provided by only one company. We have now moved to multiple relationships and we are getting very, very significant throughput across the multiple relationships that we have, but this information at a branch level I am not carrying with me at this point in time, so we will try and figure out how to include it in the deck as we go forward.

Pranav Tendulkar: Right, so out of 770 branches roughly that we have, all branches have this capability now?

P.R. Seshadri: We have 2000 people who are trained to sell insurance, so 2000 of my employees have passed the IRDA exam and we have certify to offer insurance as a product. About 18 months ago it was only about 500 employees across the company. So we have quadrupled our sales force capacity, what is not happened is we have not quadrupled our sales, because our folks have to get used to the sales process, they have to start approaching customers and offering the product, but the aim is to go there, so we are engaging with all the insurance providers taking their help so that we can push this. So right now, our focus is on retail selling, historically in the bank insurance selling and was very tightly coupled with a loan business. We are now decoupling it and selling it to our much larger retail base because sales, which are coupled with the loans business, are susceptible to misselling, but in spite of the fact that we are moving our transitioning the model, we are continuing to get growth and we will put those numbers in the next quarter.

Pranav Tendulkar: Right, also congrats on the slide of SMA1 SMA2, how they are panning, that is a great slide to have. Just one question, in this base that you have assumed is the absolute base or is it percent base, percent of the loan outstanding and then for example, SMA1 is 1% and now it has become 0.45%.

P.R. Seshadri: That is percentages, so ever 30% plus if you can see on the slide, so it is the percentage base.

Pranav Tendulkar: That is the great news actually. Thanks a lot.

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

Abhijeet Vara: Sir, one just clarification, this SMA1, SMA2, the increase Q-on-Q, it includes the large NBFC in the 525 accounts which slipped is it, that was an SMA1, SMA2 in Q2 is it?

P.R. Seshadri: Which slide are you referring to Abhijeet?

Abhijeet Vara: Sir, you have given SMA1 and SMA2 number right?

P.R. Seshadri: In the corporates slide, so this number is as of September 30, 2019, the items that are slipped are already slipped.

Abhijeet Vara: I wanted to understand the numbers, which you mentioned Rs.250 Crores that is already in this SMA1, SMA2?

P.R. Seshadri: It is already in the NPA.

Abhijeet Vara: NPA as on date, but it was there in 1.8%, which is noted and second thing I wanted to check Sir, the recoveries, which are happening, suppose these last ticket slippages continue to happen and there we have seen recoveries are even though they are lumpy they are quite delayed, from that perspective also are you confident that the recovery space will continue in the second half?

P.R. Seshadri: We are betting on the smaller ticket recoveries, so we have broken up the recoveries into two parts where the customers coming and giving me the money and where the recovery is happening through some other process like the NCLT process. The NCLT process is where the larger ticket elements are concerned, there we have a couple of loans, which are already NPA and deep NPA over a long period of time, which we think will get resolved through the NCLT process and as I mentioned unfortunately the recovery percentages will not be very great, but it will go off from the NPA number as we go forward, but larger pool of cash recoveries are going to come from the smaller ticket, which are of more recent vintage and which have become NPA more recently where we have good real estate collateral against it that is where majority of this new recovery stream, this uptick in recovery stream that we are seeing is coming from.

Abhijeet Vara: So around Rs.150 Crores, Rs.200 Crores per quarter that can continue?

P.R. Seshadri: That is our belief.

Abhijeet Vara: Sure Sir. Thanks.

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

Renish Bhuva: Thanks for taking my question. One question is on the personal loan side, so we have been seeing very sharp growth in that segment, so just wanted to get a sense whether all the personal loans are inhouse source or these are the sourced by a third party model or where we have a co-lending in place and if it is inhouse sourced, what sort of filtering criteria we use to ensure we maintain the good credit quality?

P.R. Seshadri: Thank you Renish. Majority of the personal loan growth that you are seeing here is inhouse sourced, our business model does not enable us to use DSAs very aggressively, we do have a few but, vast majority or whatever you see here the growth that you see here hitherto is inhouse sourced. The credit schemes that we use are we have now score cards in operation for all our products, these are professionally built score cards, which have been validated and more importantly we are able to see the results of the credit that we are underwriting using the score card, actually if you see page 9 of the deck you can see that the most improved portfolio performance is actually coming from retail, which is our first fastest growing book as well, so we actually are connected to every information sourced in the country, in fact we validate every piece of information that we can get one way or the other, we hit NSDL to check for pan validity, we are using the bureaus to provide us with fraud detection algorithm, etc, etc, so it is a complicated question that you asked Renish, but all I can say is that we have a fairly robust mechanism of improving or ensuring the underlying book is of decent quality. Now I want to make one point here we are doing full income loans, so we are doing what was traditionally a banking segment product, so we do not do any surrogate income, we do not do banking surrogate, so the entire industry is working on all kinds of surrogate based lending, which we have so far stayed away from, so this is full docs with full income and as a consequence the performance has also been very good. We are now as I said our business model is to test a proposition, validate it over time and scale it, so in February last year we started testing pre-approved on our base, we ran a test of Rs.25 Crores so in the grand scheme of thing not a very big test. Today is November, out of Rs.25 Crores we got 3 lakhs of rupees in SMA 1 so given that we consider that test to be a success, now we are going to scale that whether we have a whole bunch of tests that was in operation and we are coming to a point where we have the ability to start scaling on those tests, which is what gives us comfort that we should be able to start growing now.

Renish Bhuva: And Sir Majority of these personal loans would be towards the existing customers?

P.R. Seshadri: Yes two thirds of them will be existing customers, one-third may be new customers and majority of the personal loan book is basically home loan, you can see page 36. My personal book is actually quite smaller, personal loan, which is unsecured personal loan very small, we are still testing it; you can see we have grown from about Rs.300 Crores to Rs.500 Crores, only Rs.200 Crores we have grown. We believe in testing validating and scaling we are still in the testing validating phase; we will now start scaling this book.

Renish Bhuva: Got it Sir.

Moderator: Thank you. The next question is from the line of Rohan Mandora from Equirus Securities. Please go ahead.

Rohan Mandora: Sir question is with respect to the slide #9 where you have given 30 plus for the six and 12 months MOB so just wanted to understand what will be the vintage wise trend in this for the portfolio, which were posted in March 2017, March 2018, these are cumulative impact it may not be directly comparable to September 2018 number?

P.R. Seshadri: These are vintages boss so I have explained here that the point September 15, 2019 include assets that were originated from April, May, June, July, August, September or 2015 then we age them for six months and 12 months. Each point here is directly comparable so after 12 months let us say delinquency in September 2015 was 10% just for the purpose of argument. Today the segment of loans booked in September 2018, which is from April 2018 to September 2018 after 12 months have only 4.8% delinquencies so these are directly comparable that is why we put this chart. These are vintage curves basically.

Rohan Mandora: Okay I earlier understood that March 2015 whatever loans were disbursed up till now if there was Rs.100 worth of 30 plus in the last four years so that understanding is correct and that is only at the end of six months and 12 months, what is the amount that you were taking?

P.R. Seshadri: Correct.

Rohan Mandora: Got Sir and I was just asking on this arrangement that we have done on KVB NEO so what are the commercial terms in terms of fee sharing and income sharing?

P.R. Seshadri: KVB NEO has employees of KVB boss it is just a bank within a bank.

Rohan Mandora: What was the four arrangements tie-up that we have done under KVB?

P.R. Seshadri: Fee sharing so we share proportionately the fee between the two of us, obviously because they are the originators of the customer, they tend to get a larger share of the fee than we do and also we pay them a small fee for the collection cost that are involved in the collection aspect. I have not had liberty to disclose exact numbers here, but we will try and see, all four of these arrangements now are in the test/validation phase and we probably have Rs.20 Crores or Rs.30 Crores worth of these assets on our book right now, we are watching that performance and then we will start scaling them over time, but we have the ability to do so, so basically the yield on all of this depends upon the time of risk that we are taking and all of these are unsecured assets that we are bringing into book and on an aggregated basis I would think that these will be yielding us somewhere between 13% and 14% coupon and the cost of customer may be in 16%, 17%, 18% range so that is the kind of spread sharing that we are doing.

Rohan Mandora: Thanks a lot Sir.

Moderator: Thank you. The next question is from the line of Yash Agrawal from JM Financial. Please go ahead.

Yash Agrawal: On your margins what is the excess drag on this Rs.6000 Crores liquidity that you are holding what is the quantum and secondly the cost of funds would have moved up sharply in the past two quarters, what is the reason behind this?

P.R. Seshadri: Cost of funds have not moved up sharply, just moved up marginally so we used to be in the 5.8 range now we are in the range of 5.85 this quarter, we have taken action now to bring down our cost, deposit pricing has come off over the last couple of months and we will continue to moderate the deposit rate. The exact yield drag that is accruing from the excess liquidity is not available with me at this point in time and perhaps we can again, we have been progressively increasing the disclosure that we have been making, we will try and start disclosing that as well as we go forward.

Yash Agrawal: What yield is deployed at 6%, 7%, and 8%?

P.R. Seshadri: That becomes as I said that information in a form that can be shared is not available with me because these are deployed at various points in time and the markets have been moving over that period of time so at this juncture what yield that has been deployed is not readily available but we can make it available as we go forward.

Yash Agrawal: See these two accounts that we spoke about finance company and the structure this quarter is it Q2 Sir?

P.R. Seshadri: Yes.

Yash Agrawal: Okay. Thank you.

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

Anuj Sharma: First question is on the fee income, we seem to have lost traction on fee income, and I would have presumed that these would be low, which you could have pushed up easily, what is your thought and where are the key challenges in fee income?

P.R. Seshadri: Fee income traction that we are seeing a little bit of gap on is largely coming from the fees that we used to charge on asset customers. There are two or three areas where we are having a little bit of a challenge. First on the asset customers because the bulk large ticket assets who are also tending to be the larger fee payers, we are off choice remaining staying away from them. The second area where we are having a little bit of a challenge is on the nonfunded business because the nonfunded business largely is a space of most of our customers on the nonfunded side used to be government contractors or large entities that were into the infrastructure space and as we have sort of moved away from financing infrastructure in large measure, the non-funded book has started shrinking for us so two of those are put together is where you are seeing a slight reduction in fee income. We think that the fee income in Q3 and Q4 will sort of moderate back to reasonably normal level given the fact that there will be a catch up on fees that we failed to sort of charge thus far and also there may have been delays in our renewal of accounts, etc., once those get renewed the full quantum 12 months fees can be charged so given all of that at this point in time while we are watching this really closely we are not very, very worried on fee front, we think that we should be back in track.

Anuj Sharma: And Sir secondly you spoke of number of productivity initiatives including digital and reduction of duplication job where most of these people would be redeployed and when do we see the productivity showing up in the cost-to-income ratio?

P.R. Seshadri: The centralization project will release a lot of manpower in the branches. Right now almost all our operations is done at the branch level, which is very expensive method of doing operations, branch is expensive real estate keeping operations in the branch is the last thing one should be doing so what is going to do is release a bunch of people at the branch, these folks will have to be repurpose to sell our products or otherwise engage with customers so that we can deep in relationships with existing customers. Our estimation is that roughly tenth of the branch force, which is currently engaged in operational activity can get freed and that is the aim that we have. As I said in this slide, there are 170 tasks, these are tasks performed at the branch level and 60 operational processes, which have been identified for centralization. By the end of this financial year all of it would have happened so progressively we should start releasing people in the branch and those should get translated into incremental sales force capacity. Now there is one hurdle that we will have to cross, which is that these folks that we are releasing at the branch have historically not done sales type of jobs, they have historically been more involved in operational activities and therefore they will need to be retrained and repurposed for the new sales related activities that we intend for them, how many of them will be competent to do this is a question that will have to answer as we go forward.

Anuj Sharma: All right Sir. Thank you.

Moderator: Thank you. As there are no further questions ladies and gentlemen on behalf of Spark Capital Advisors that concludes this conference. Thank you for joining us. You may now disconnect your lines.