Edited Transcript of
"Karnataka Bank Limited Q4FY23 Earnings Conference Call"
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MANAGEMENT: **MR. SEKHAR RAO – MANAGING DIRECTOR AND CEO (INTERIM)**
MR. BALACHANDRA Y V – CHIEF OPERATING OFFICER
MR. GOKULDAS PAI – CHIEF BUSINESS OFFICER
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Moderator: Ladies and gentlemen, good day, and welcome to Karnataka Bank's Q4 F.Y. 2023 Audited Earnings Conference Call hosted by Karnataka Bank. As a reminder, all participant lines will be in listen-only mode, and you will be able to ask questions after the presentation concludes. If you need assistance during the conference, please signal an operator by pressing the star and zero on a touchstone phone. Please note that this conference is being recorded.

On behalf of Karnataka Bank, today's call is attended by Mr. Sekhar Rao, Managing Director, and Chief Executive Officer (Interim); Mr. Balachandra Y V, Chief Operating Officer; Mr. Gokuldas Pai, Chief Business Officer; and Mr. Abhishek S. Bagchi, Chief Financial Officer. I now hand the conference over to Mr. Sekhar Rao, to give his opening remarks before the Q&A session. Thank you, and over to you, sir.

Sekhar Rao: Thank you. Hello everyone thank you for taking the time to join this call. A very good evening, and welcome to this conference call discussing the results of Karnataka Bank for the quarter and the year ended 31st of March, 2023. Currently, I'm serving as the Interim MD and CEO, and other colleagues have also joined the call. I took on the role of Executive Director of the Bank on the 1st of February and have been operating as the Interim CEO since mid-April.

As you might know, the bank has identified the new MD and CEO, Mr. Srikrishnan Harihara Sarma, whose appointment has been approved by the Reserve Bank of India (RBI). Before being selected for Karnataka Bank, he served at Jio Payments Bank, was an entrepreneur, and part of the founding team at HDFC. Given his impressive credentials, we're thrilled to welcome him on board. This marks an important shift for the bank, as for the first time, we're appointing an industry veteran from outside the organization as the Managing Director and CEO.

Regarding the financial performance of the past year, as you're aware, it saw one of the sharpest monetary tightening and highest inflation rates in economic history. Central banks worldwide, including India, responded with aggressive rate hikes. The U.S. led the way with around 475 basis points, while the RBI raised the repo rate by 250 basis points. This both benefited and tightened operations for banks, presenting both advantages and challenges.

Moreover, many banks, including ours, have focused on digitization, and we anticipate this trend to accelerate. On the economic front, concerns predominantly lie in potential job displacement due to automation and digitization, risks related to climate change, the rise of the gig economy, and remote work. These are emerging trends, but it's still early to predict their full impact.

Our financial performance has significantly improved, and for the first time, our bank has declared a net profit in four figures. It stands at INR 1,180 crores, which is nearly INR 100 crores per month. Coincidentally, we're celebrating our centenary year, and we believe this achievement is the greatest tribute we can offer to our founding fathers. We're delighted to announce this result.

Regarding various business strategies, some of which we've already begun to implement, include a sharper focus on retail lending, portfolio optimization, and digital origination. We've laid the groundwork in these areas and plan to build upon it moving forward.

The net profit for Q4 was around INR 353.75 crores, a year-on-year growth of 171.39%. Last year in the same quarter, it was INR 130.34 Cr. Another important point to note is that other income, excluding depreciation and trading profit, also stood at INR 1,155.50 crores. This also represented a healthy 15% increase over the last year.

During the quarter, the operating profit exhibited a growth rate of 80.41%. Net interest income during the quarter rose by 31%, and for the full year, 27.86%. We've seen improvement in our NIM, reaching 3.87%, compared to 3.25% for the quarter ended March '22. For the full year, it rose from 3.18% to 3.70%, a healthy increase of 52 basis points. The ROA during the quarter increased from 0.56% to a record high of 1.4%. For the full year, it stood at 1.21%. ROE rose from 7.42% to 17.61%.

Gross NPA is at INR 2,292.91 crores, slightly up from INR 2,250.82 crores. This was primarily due to some accelerated provisioning and quicker recognition of NPAs that we did in Q4 since our balance sheet was very healthy. In percentage terms, it's down to 3.74% from 3.90%. This accelerated provisioning is a one-time exercise, and it will contribute to the bank's overall health. As for net NPA, it has reduced to INR 1,021 crores from INR 1,376.97 crores, a healthy reduction of 25.83 basis points.

Turning to the slippage ratio, last March, it was 3.11%, and this year, it's 3.31%. The reason is, as I stated earlier, because of the accelerated actions that we took. The provision coverage ratio is a healthy 81%, compared to 73.47% last year. Cost-to-income has moderated to 47.14% from 52.57%. The interesting point to note on the accelerated provisions is out of the INR 328.82 crores of provisioning that we did during the quarter, almost INR 249.14 crores is the accelerated provision, and the balance is as per IRAC norms.

The overall business turnover reached a new high of INR 1,47,319.63 crores, just short of INR 1,50,000 crores, with a growth rate of 7.40%. Despite deposits growing at 8.68%, we didn't observe significant movement of deposits from CASA to term deposits, which was a trend in the market. We managed to protect our CASA franchise. In fact, our Savings Bank account franchise has the most competitive deposit cost in the industry at around 2.91%.

The Credit-Deposit (CD) ratio has marginally decreased to 69% from 71%. But this was a deliberate decision that we made. In the rising interest rate environment, we managed to retain our CASA market share. The yield on advances during the full year has improved by 57 bps, up from 8.84% to 9.41%. The cost of deposit for the last year is down slightly from 4.66% to 4.62%.

The other positive news is our Board has proposed a dividend of 50%, subject to shareholders' approval. I firmly believe that we are poised for an impressive launch from here to ensure business excellence during FY '23-'24, particularly in the area of growth in advances, which could outpace industry growth rates. We also expect significant improvement in asset quality. Our technology initiatives are being strengthened further. Our technology budget for the upcoming year has increased by almost 80%.

While there have been many positive outcomes, there have also been lessons learnt. The key here is to recognize these and begin working on improvements, clearly demonstrating our intent. In this regard, I wanted to share some of the major initiatives we've already launched. Our organizational structure, which I mentioned in a media interview earlier today, has been realigned. We've made it more linear, with an intensified focus on retail, branch banking, and product management. The product management will, of course, support the sales verticals.

We've benchmarked our gold loan and housing loan products to make them more competitive in terms of features and pricing. We're already seeing the early signs of success from this. We're improving our underwriting capabilities, both in terms of efficiency and capacity. We're increasing the number of retail hubs from 3 to 5, with plans to expand to 8.

One more promise I want to make to all of you is that we plan to increase our interaction with you and seek your feedback on an ongoing basis, rather than just once a year. With this, I open the floor for questions.

Moderator: We have the first question from the line of Sushil Choksey from Indus Equity Advisors.

Sushil Choksey: Congratulations to Karnataka Bank on the centenary celebration and the performance which you achieved in F.Y. '23 Sekhar. Referring to the comments which you made in media and right now of your joining the bank this year and the new M.D. coming in, what is the broader vision of Karnataka Bank in terms of perspective which you would like to see over a period of 1 decade or two decades because it's one bank which has never lost money in any of the financial years of last 100?

Sekhar Rao: As we see it, while we aren't planning for a decade out, it's clear that we have a robust network. We are a recognized brand in Karnataka and in markets where we operate. We have significant presence in cities beyond Karnataka, including Mumbai, Delhi, Hyderabad, and Chennai. We have a great deal of customer goodwill and we plan to leverage this to increase our focus on retail. We've already made several strides in this direction. Firstly, we have revised our organizational structure to make it more retail-centric, establishing a dedicated retail advances vertical and a branch banking vertical to take advantage of our network of over 900 branches.

Secondly, we're refining our credit underwriting processes to improve turnaround times. At present, 85% of the loans we originate are digitally underwritten. We intend to deepen this process to further enhance customer experience. We're also increasing capacity by adding two more retail credit hubs immediately, which will process loans up to the value of INR 2.5 crores. This will eventually increase to 8 hubs. Given these capacity enhancements and the investments we're making in technology, we hope to see a significant uptick in our retail market share.

Additionally, we've initiated another important project - setting up analytics centre of excellence. With a large customer base of 1.3 million customers, in fact, out of a bankable population of 458 million, 1 out of every 40 customers bank with Karnataka

Bank. This analytics centre will use data analytics to enhance our understanding of our customers, propensity modelling for preapproved loans, and cross-selling. Our current product penetration is between 1.5 to 2, and we plan to increase it further. These are some of the strategies and thoughts that we are rolling out for the next three years.

Sushil Choksey: Okay. My follow-up question is a couple of points that you've highlighted. So what is your expectation on NIM, cost of funds, and ROE for coming years? What kind of provisions have you taken or have you taken some provisions for slippages. And what was the provision for mark-to-market and treasury?

Sekhar Rao: So yes, you will likely see some moderation in Net Interest Margins (NIMs), which will reflect in Net Interest Income (NII). However, we are optimistic that this will be offset by a change in product mix, business growth, and other income. Return on Assets (ROAs) and Return on Equity (ROEs) will be marginally higher than current levels. As you can see, our provisioning has already exceeded 80%.

Our Non-Performing Assets (NPA) provisioning is also quite robust. We will continue to make provisions as needed, and we expect it to be somewhere between 81% and 85% as the year progresses. We have also seen a significant reduction in our restructured book, which has been beneficial. Nearly 90% of the restructured accounts are repaying their loans, which is a reassuring sign.

Last year, the rising interest rate scenario did not provide much opportunity for trading profits. However, we are already seeing green shoots of that in Q1. As we speak, we have a depreciation benefit, which will be one of the narratives that will unfold during the current year. But this will not be unique to us; in fact, most banks should benefit from this.

Sushil Choksey: Okay. But if you can highlight as what you said, some accelerated provision was made in the quarter. And what was mark-to-market loss?

Sekhar Rao: Say, for example, the mark-to-market last year was around INR 180-plus crores. This is already captured in the balance sheet. This year, we anticipate an improvement and a write-back there. As for accelerated provisions, the specific number I have on hand pertains to Q4. Out of the INR 328.82 crores, we allocated INR 249.14 crores for accelerated provisions. Clearly, we've leveraged the health of the balance sheet to make the correct decisions regarding provisioning.

Sushil Choksey: What was the reason for this accelerated provision?

Sekhar Rao: So, there were multiple factors involved. Wherever we identified some stressed accounts, and also in some places where the fair sale value changes occurred, a combination of these factors led us to make the decision to set aside these additional provisions.

Sushil Choksey: My last question. What would be your kind of credit growth aspirations, the industry is talking about 12% to 14% across private or public sector banks. What would be an aspirational number at Karnataka Bank for the year?

Sekhar Rao: So, we would beat the industry growth rate this year.

Moderator: We have the next question from the line of Sarvesh Gupta from Maximal Capital.

Sarvesh Gupta: So, on accelerated provisions as a follow-up. So basically, you are saying that out of the INR330-odd crores provisions, INR250 crores was sort of more than what we were required to take, and we took it because we had healthy profitability for the year and the quarter?

Sekhar Rao: Yes, yes. That would be the right assessment of that. So close to INR79 crores as per IRAC and balance on account of accelerated provisions.

Sarvesh Gupta: So ideally, these will not recur in the coming years. This INR250 crores?

Sekhar Rao: Yes, these will not recur in the coming years. And these are one-offs. So whenever you see an opportunity, you take these measures as a prudent measure.

Sarvesh Gupta: And on our restructured book, so that came down from, let's say, INR41 crores, INR42 crores of standard restructured which was there last year. Now we have around, I think, INR2,500 crores odd. And this reduction also contributed to, let's say, INR800 crores of gross NPA out of the INR1,800 crores of the slippage. So further, how much can we expect this year against this INR800 crore which has come from this book?

Sekhar Rao: Regarding this restructured book, like I said, almost 90% of these accounts are repaying, and we only see stress in about 8% of them. Therefore, I would estimate that we will need to implement enhanced measures on about INR200 crores. The positive aspect is that most of our portfolios are backed by bankable securities, so we are confident about recovery in that area as well.

Additionally, you should know that the figure of INR2,570 crores is based on the RBI classification, which includes related accounts as well. So, the core restructured book is actually lower than this.

Sarvesh Gupta: Okay. So basically, what you are saying is that so in F.Y. '22, we had an opening balance of, let's say, INR4,000 crores, and 20% of that slipped into NPA, right, INR800 crores. Now out of the remaining INR2,500 crores, you are saying 10% can slip?

Sekhar Rao: See, in reality, we've seen around INR630.51 crores precisely, that has slipped into NPA from this amount. This was primarily due to the fallout from the COVID situation. However, we're noticing an improvement in this portfolio. As for our projections, we're fairly confident that the actual outcome will align very closely with what we're currently predicting.

Sarvesh Gupta: So 90% is well taken care of because there is an element of SMA-2 also in the current standard also restructured, right? So you feel that only 10% will slip from here?

Sekhar Rao: Restructured accounts, are divided into three categories: the first category contains accounts that have overflow; the second category includes accounts that are making regular payments; and the third category encompasses accounts that are making payments but with a slight delay. The combination of all these three categories constitutes around 90% of the total, and the remaining accounts represent about 8%.

Sarvesh Gupta: Okay. And the other thing, sir, is the growth on the overall credit side. So I think this year, we did only 5%, 6%. And even if I just look at the retail, which is where we were supposed to grow, that also is at 11%, 12%. So both are lower than the industry growth rates significantly, overall, as well as the retail piece. So what gives us the confidence that we will be able to match the industry growth on an overall number because we have not been able to match even the retail growth number for this year compared to the industry and most of the players?

Sekhar Rao: Yes. There are several key points to be noted here. Firstly, we were experiencing a growth rate of around 12% until about Q3. However, we consciously decided to slow down in Q4. The idea was to retire advances that had lower yields than Government Securities (G-Secs) yields. The solid state of our balance sheet gave us the opportunity to make this decision. While it might have seemed to negatively impact our growth rate, it indeed helped us improve our bottom line, as this money was redeployed in higher yielding instruments.

Secondly, we now have a clear understanding of what drives retail growth. Our pricing and product construct were slightly out of sync with current market trends. Take gold loans, for example, we have now revamped our product to make it simpler. Previously, we didn't have a bullet loan product, but now we have introduced one.

Our home loan prices were not in line with the market rate. Currently, we are offering a headline home loan pricing of 8.75% for someone with a CIBIL score of more than 800. We are speeding up our processing through our digital journey, enhancing our capacity in terms of underwriting capability and Turnaround Time (TAT).

We have a significant presence in most of our markets in the mid-corporate lending to the builder and promoter segment. Despite this, we never leveraged this for builder tie-ups on the retail side. Now we're moving in a very calculated manner. In fact, over the last quarter, more than 300 properties in Bangalore have been assessed, valued, and preapproved by our bank.

These measures, the structured approach, and our plan to deploy nearly 200 people on the ground for home loans give us confidence that we can accelerate in the retail front. These diverse measures give us confidence that we can speed up on the retail front. We have shown this in earlier years. In fact, when we offered competitive pricing, our home loan and retail portfolios grew faster than market rates.

Sarvesh Gupta: Okay. Sir, on your ROA. So your pre-tax ROA might have increased by, let's say, 90 basis points or something like that for this year. And the NIM alone contributed to more than half of it. So NIM expanded by, let's say, 52 basis points. So how much of a mean reversion is possible in your NIM going forward, especially as we see that your cost of deposits has actually gone down this year by four basis points, even in a year when interest rates are moving up?

And now, that same benefit you will not get when the interest rates move down if they were to move down. But you are also guiding for an increase in ROA instead of any decrease. But most of the increase in ROA has actually come from your NIM. So what is that conservative or how should we take your ROA guidance and include the NIM guidance?

Sekhar Rao: So, our ROA guidance will be trending around current levels with a possible slight increase, but largely it will stay around the current levels. He mentioned that NIMs will not reach the current year levels and will be within a range of 3.5% to 3.7%. The compression in NIMs will be offset by an increase in our growth and a change in our product mix. The treasury part of our business will start to contribute more this year, and signs of this are already visible. Both trading profits are expected to improve, which will keep our ROA largely protected. The factors contributing to ROA might change slightly, but the overall output will remain around these levels.

Sarvesh Gupta: And NIM should trend in a similar range as where we are right now at 3.87%?

Sekhar Rao: Yes. I said it would be range-bound between, on the optimistic side to around 3.7%, on the pessimistic side 3.5%.

Sarvesh Gupta: Okay. And what is your estimated number on cost-to-income and the OPEX side, sir?

Sekhar Rao: For the cost-to-income ratio, we anticipate a very slight marginal increase. This rise will be due to some provisions made for wage revisions and substantial technology spending, most of which has been budgeted for and already accounted for. We have also incurred some of the capital expenditure already. Consequently, you might notice a fluctuation in the current operating expense levels, possibly within a range of plus or minus 1% to 1.5%.

Moderator: We have the next question from the line of Manish Dhariwal from Fiducia Capital.

Manish Dhariwal: Yes. So there are a lot of reasons for celebration at Karnataka Bank. So it's a centenary year. Then a management change. And you have come out with fantastic numbers. So congratulations for all of that.

Now my whole concern or the question is surrounding the growth, which is not coming at a high credit loss. So while Karnataka Bank is a good brand surrounding Karnataka and other places, but then I think the other banks also are claiming the same. And the confidence that the management has expressed about growing higher than the industry is something that if you could maybe give more insight. And what do we understand about the credit costs going ahead? How would one look at that? So growth is in sync with the emerging credit cost.

Sekhar Rao: So I believe your question has two parts. One is about your growth concerns, and the second on the credit cost. I largely answered what we are doing on the retail credit growth side, a series of measures, including product rejig, organization structure, capacity building, investing in technology, and so on and so forth, which is pretty much a standard playbook.

We enjoy significant goodwill in the markets where we operate, and we will continue to capitalize on this. We have a robust network of 900 branches, as well as a tooth-to-tail ratio exceeding 85%, signifying that a large proportion of our employees operate from branches. We utilize this presence in terms of both people and infrastructure to drive our growth. I have already detailed specific initiatives in response to a previous question.

As for your mention of credit costs, there was a one-time operation in Q4 due to accelerated provisioning and the Gross Non-Performing Assets (GNPA) decisions we made. However, going forward, we expect to maintain levels consistent with those seen in other quarters. Thus, we anticipate an average of around 0.25 to 0.30.

Manish Dhariwal: Okay. See, I was also talking in the line of a recent communication which has come out from the RBI saying that there has been some smart way of hiding NPAs and all that. So basically, see, the level at which retail is getting credit, ultimately, the pain has to come. And there are some institutions that have been like doing retail for a long time. There are some institutions like ours that have recently kind of started focusing on the retail side. So how is it that we are kind of ensuring that it doesn't come to bite us, so maybe close too ahead.

Sekhar Rao: I'm not sure I fully understood the first part of your question where you hinted at potential concealment of non-performing assets (NPAs) and RBI's guidance on that matter. In fact, we have chosen to be transparent and have gone ahead and disclosed this information. In an abundance of caution, we have taken prudent measures such as accelerated provisioning.

To elaborate on the second part concerning the situation in Karnataka, there's been a trend following bank consolidation a few years back. Now, only two truly Karnataka domicile banks remain: Canara and Karnataka Bank. Given our 100-year legacy and the goodwill we've garnered from our customers, we're witnessing a significant movement of business and consolidation in our favour.

We have plans that extend beyond Karnataka, including the national retail rollout. However, within Karnataka, we're striving to be the bank of choice. We're actually preparing to launch a campaign titled "Namma Bank, Apna Bank" which translates to "Our Bank." This campaign will leverage the sentiment of being a preferred bank in Karnataka.

With these measures and others that we will implement, we are confident that we can regain our esteemed position as the bank of choice in Karnataka.

Moderator: We have the next question from the line Chintan Shah from ICIC Securities.

Chintan Shah: Congratulations on a good set of numbers. One, two questions from my end. Sir, firstly, in terms of our loan book, in terms of fixed and floating, how much percentage of our book will be pegged rate and floating, if you could help with those numbers?

Sekhar Rao: To help you understand the proportion of floating to fixed-rate loans in our portfolio, here's the breakdown. About 79% of our loans have a floating interest rate. The details are as follows: about 1% are linked to the base rate, 22% are linked to the Marginal Cost of Funds Based Lending Rate (MCLR), and the majority, approximately 56%, are linked to the External Benchmark Lending Rate (EBLR). Loans tied to the T-bill rate make up around 1.28% and fixed-rate loans make up the remaining 21%.

Chintan Shah: 21%, okay. Sure. So got it. And so, sir, as we anticipated that the decline in the interest rate going ahead, there could be some pressure on the NIM. So in terms of our borrowing side, how much hike is expected? Are any tentative hikes expected in the borrowing cost from here on? Any plans of raising the deposit rate further from here on? Or are we at the peak rates as of now, considering the current RBI rate?

Sekhar Rao: I believe that the interest rates will now moderate. We won't see the previous rates of around 7.7% to 7.8%. Currently, our headline rate for a year stands at 7.3%. We anticipate a fluctuation of plus or minus 5 to 10 basis points, but no major changes beyond that. Such adjustments will be dictated by market opportunities and our liquidity needs. At present, our liquidity position is comfortable.

Chintan Shah: Sure, sure. So this is on the growth side, sir. It will largely be driven by the retail piece, right, if I'm not wrong?

Sekhar Rao: Yes. Credit growth will be strategically on the retail piece. But we will take tactical calls as and when required on the corporate and mid-corporate pieces as well.

Chintan Shah: Sure. And sir, you mentioned 1 to 1.5 percent plus/minus on the OPEX. So that was the opex-to-asset ratio, right, or cost-to-income?

Sekhar Rao: Cost-to-income.

Chintan Shah: Okay, okay. Cost-to-income. got it. And also, on the recovery in TWO, so I think we have seen quite a steep recovery in TWO for us as well as for the system during this year. So what is the expectation of this, any recovery in of accounts expected in the next year? Any ballpark number which you're expecting for that?

Sekhar Rao: Our Technical Write-Off (TWO) in the fiscal year before last was approximately INR 246 cr. In the last fiscal year, it was around INR 283 cr. Currently, we have a TWO book of INR 3,043 cr. We anticipate TWO recoveries at around the same levels as last year. An estimate between INR 250 to 275 cr would be reasonable.

Chintan Shah: Okay. 250 to 275. Sure, sir.

Moderator: We have the next question from the line of Jai Mundhra from ICICI Securities.

Jai Mundhra: Sir, I wanted to get your views on the retail strategy, right? So if you can elaborate on that? You have said that retail is going to be the key driver for growth, and that is where you want to sort of increase the product per customer as well. You clearly have a retail franchise in terms of customers. But I wanted to check what is your, let's say, key target segment. Is it going to be a self-employed segment? Or do you have any vision for, let's say, prime salaried customers also?

And then the associated question would be that what is it that probably will give us the right to win in this segment? And maybe the last thing is that usually, retail comes with a higher opex, at least in the initial phase. Where are we in that investment phase with respect to retail business?

Sekhar Rao: Yes, I did explain our retail strategy in detail earlier in the call when Mr. Sushil first posed the question. However, I'll be happy to go over it again. Essentially, any retail strategy hinges on a combination of pricing, distribution, and speed, specifically, Turnaround Time (TAT). For now, we are customer sub-segment agnostic; meaning, if our loans are priced attractively, underwritten quickly, and their overall features are customer-friendly, we foresee significant low-hanging fruit.

Currently, we have approximately 13 million customers, 70% of whom are active. At present, these customers are banking with other institutions for some of their products. So, one of our initial measures will be to address this.

Additionally, we are working to improve our salary proposition. Until now, our salary proposition has been just a standalone savings account. Like most banks, we are introducing a bundled salary product that combines a savings account, locker, fee discounts, and special pricing on asset products. However, as you might be aware, building a salary franchise does take some time. So initially, we will be largely sub-segment agnostic, capitalizing on the opportunities created by improvements in the three aforementioned areas.

As for products, we are focusing on home loans, gold loans, and agri loans with strategic partnerships. For instance, we have put a couple of large alliances in place that will facilitate scaling up our agribusiness. These are the areas where we anticipate significant action moving forward.

Jai Mundhra: Right, sir. And, sir, in terms of investment in retail, right? So all the retail is high touch, lower ticket size relative to corporate, SME, and more effort involved. So where are we in terms of this investment phase? Or is it more likely that the OPEX growth will be at least for the next 6 to 12 months will be much higher than the loan growth as you build the processes, systems, etcetera?

Sekhar Rao: That's a great question, and it allows me to emphasize a key point. I believe our franchise is currently underleveraged. We have 901 branches, and we are in the process of reorganizing our retail hubs, growing from three to five, and eventually to eight. These will be operating out of our existing regional offices, so we don't foresee incurring additional costs.

Previously, we undertook a transformation journey with the help of BCG, a journey we called KBL VIKAAS, which digitalized most of our loan underwriting. The infrastructure is in place, the scoring models are established, and the underwriting team is ready. The point being, the entire operating expense has already been spent, and we are in possession of an underleveraged franchise. We'll continue to make improvements in our product, process, and policy areas.

Additionally, we are following the standard playbook: we have created an associate company, KBL Services, which will employ field staff for builder tie-ups and employee at automobile showrooms.

So, we don't expect a significant increase in operating expenses. Yes, there will be some investment in terms of staffing for field work, but they operate largely on a high variable, low fixed model, and their compensation will be outcome-linked.

Jai Mundhra: Right. And, sir, any talent gap that you see at the current juncture for all these initiatives to play out? Have you identified any talent gap at the existing mid-management level?

Sekhar Rao: We recently restructured our organization to make it more linear. You may be familiar with this structure from your experience with ICICI Bank and other such groups, where you have branch banking, retail assets, etc. Our structure is aligned with that of product verticals.

We've identified certain talent gaps, specifically in middle and senior roles in technology, transaction banking, and product management, as well as some areas of risk. These are the areas where we plan to augment our talent pool through lateral hiring.

Jai Mundhra: Right. And lastly, on commercial/SME, MSME piece, right? So retail, you elaborated. Corporate, you had said that the stance would be more opportunistic. On commercial/SME, how are you seeing things panning out because large private banks they have become very aggressive in this space. So do you, what kind of, let's say, priorities or aspirations do you have in SME/commercial segment?

Sekhar Rao: We already have a significant presence in the MSME/SME sector, with 30% of our portfolio situated there. This is one area where older private sector banks often have an advantage over newer ones, because the MSME/SME sector is heavily reliant on relationships. In the operating model of newer private sector banks, a large part of these businesses is centralized, and branches are more or less agnostic to the MSME customer, serving primarily as points of transaction or service.

In contrast, our model ensures that the MSME customer is not just serviced by the branch, but is also 'owned' by the branch, providing a considerable level of comfort for the MSME. Moreover, our legacy as a bank is advantageous because a large percentage of our branch staff and branch managers are able to understand credit and carry out basic underwriting tasks, such as drafting Credit Appraisal Memorandums (CAMs). This is one of our core strengths, and we aim to leverage this to further strengthen our position in the MSME sector.

One clear area for improvement is our pricing structures and product propositions. To address this, we're developing products specifically for the contractor segment and other sector-specific products. These efforts will assist us in solidifying our position in the MSME space.

Jai Mundhra: Right. No, no, I understand, sir. We have a very good legacy and a very decent, let's say, presence in the SME space. I wanted to check. As you said, retail is going to be the key driver. Would the same hold true for SMEs also, so that is what I wanted to check.

Sekhar Rao: I would like to respond to this in the following way: the MSME sector is currently like a cash cow for us, whereas the retail sector is the star that we are aiming to nurture. We will, of course, continue to invest our energies in the MSME sector because it's an area that we understand well. However, given our extensive presence and potential in the retail sector, we intend to scale up and build upon it. This explains the increased intensity in our retail sector initiatives.

Moderator: We have the next question from the line of Hitendra Gupta from Systematix Shares.

Hitendra Gupta: Congratulations on the good set of numbers. I have just two questions. One is with regard to the appointment of Mr. Sarma. So when will he be assuming the charge?

Sekhar Rao: Yes. He will be assuming charge shortly. In fact, the selection was made almost a couple of months or a little more than that back. And as you know, there's a process of RBI approval, which has been received.

Hitendra Gupta: Okay. So his involvement right now is nothing as of now?

Sekhar Rao: As of now, of course yes.

Hitendra Gupta: Yes. And my other question is with regard to the loan growth, sorry, the average loan ticket size. So what is the average ticket size for your different segments like retail, mid-corporate, and large corporates?

Sekhar Rao: So retail, including agri, is INR 9.67 lakhs. Mid-corporate would be around INR16.13 crores. Large corporate would be around INR150 crores to INR170 crores.

Hitendra Gupta: Okay. So no, no, I was referring to your slide. On Slide #21, it was retail was INR9.96 crores. So I was just wondering whether it's INR9.96 crores or INR9.69.

Sekhar Rao: It is INR 0.10 crores.

Hitendra Gupta: INR 0.10 crores, yes. And what kind of growth can we expect in terms of NII going forward?

Sekhar Rao: So yes. I have said, will be range bound. NII would be aligned to top-line predictions that we have predicted.

Hitendra Gupta: What would be that, sir?

Sekhar Rao: It will be ahead of market rates currently, a comfortable guess would be around a 15% to 18% increase in NII.

Moderator: We have the next question from the line of Rakesh Kumar from B&K Securities.

Rakesh Kumar: So the first question is with respect to total cash balances, the income on the cash balances is gaining no interest income. But we have a total on an average, we are holding close to around INR5,500 crores, and our income is slightly low. So other than CRR, are we not like earning anything on the call money market or other markets, money markets?

Sekhar Rao: No, of course, we are earning on-call money. We have excess SLR. So while the cash with RBI is strict as per requirement, the balance is deployed in suitable money market instruments. And yes, currently, we do have excess SLR, which we recognize.

Rakesh Kumar: No, sir. What is the total income that we have accrued in this quarter from cash balances?

Sekhar Rao: Let me get back to you on this as we go through the other questions. I'll very quickly get back to you on the income from cash balances.

Rakesh Kumar: Because for the year, I see it is INR1.58 crores for this F.Y. '23. And for this quarter, it is INR0.2 crores.

Sekhar Rao: Yes. I'll come back to that question very soon.

Rakesh Kumar: Sure, sir. Secondly, sir, can we give 2 or 3 reasons why there is close to around a 40 bps rise in the yield on advances this quarter? So like, what is the change that we have seen in the loan portfolio mix that has led to this kind of a jump? Like if we see like, as you mentioned, the loan breakup thing on the like floating and fixed and all those things. So based on that, yield movement should not have been close to 40 bps this quarter. So if you can explain the reason why this rise in yield was there?

Sekhar Rao: Regarding the improvement in yield, it is primarily due to the decision we made in Q4 to retire some low-yielding advances. This was a proactive measure taken because these advances were generating lower returns, even below the T-bill rate. Consequently, this had an impact on our overall yields, which increased. However, it's important to note that this was a one-time action that we had to take at a certain point. We had to choose between keeping these on our books, which would have affected our Net Interest Margin (NIM), or retiring them and reallocating the funds to better-yielding instruments.

As for the composition of our spread in March '23, let me provide the figures you asked for. Currently, our retail plus agri segment accounts for around 50% of our portfolio, mid-corporate stands at 30%, and the large corporate segment represents approximately 20%. In December '22, the figures were slightly different, with retail plus agri at 48%, mid-corporate at 29%, and large corporate at 23%. These changes in composition have subsequently impacted our NIM.

Rakesh Kumar: Okay. And like during the call, if you can just highlight the reason the yield on the cash balances other than CRR.

Sekhar Rao: Yes, I'll quickly get back to you.

Moderator: We have the next question from the line of Saket Kapoor from Kapoor & Company.

Saket Kapoor: Sir, could you first provide some insight into the Return on Assets (ROA) situation? We concluded Q4 with a ROA of 1.4%, and our average for Fiscal Year '23 was 1.21%. What trajectory should we anticipate for the ROA? Regarding the Net Interest Margin (NIM), I understand from your comments that it will range between 3.5% and 3.7%.

Sekhar Rao: I believe I've addressed the ROA trajectory as well. We anticipate it to remain relatively steady, around the current year's level, with a slight increase on the optimistic side. Therefore, we do not foresee any significant surge in ROA moving forward.

Saket Kapoor: So this 1.2% will be maintained. 1.4% was an anomaly for the fourth quarter then.

Sekhar Rao: Yes, it will be. I earlier also during the call, gave a number, and we would be around that level.

Saket Kapoor: 1.2%?

Sekhar Rao: Yes. Slightly more than 1.2%, yes.

Saket Kapoor: Okay, sir. And for the capital raising part, sir, currently, we have a CRR of about 17.45%. So what is the outlook on the capital raising exercise? Anything you would like to share?

Sekhar Rao: Regarding capital raising, we are currently in a comfortable position. However, our evaluation of this matter will be based on our growth trajectory. The next capital raise that we undertake will consider two significant factors. Firstly, we will assess the capital needed to support our growth ambitions. Secondly, we will consider any changes in accounting standards, particularly those related to Expected Credit Loss (ECL) and other relevant factors that you may be aware of. Taking these factors into account, we may choose to expedite our capital raising plans or delay them accordingly.

Saket Kapoor: Sir, on the ECL front, I would like to throw what is your primary observation on the same. And how is that notification, if and when implemented, would impact our numbers?

Sekhar Rao: So I think that there's a transcript of yesterday's RBI organized meeting for Directors of Private Banks, in the Q&A session, if you go through the transcript, from what we understand, even they are looking at a 3 to 5 year horizon. And beyond that, we would not want to hazard a guess.

Saket Kapoor: So, taking into account our book, what should be the impact? If that is spread over a period of 3 to 5 years, what should be an annual impact?

Sekhar Rao: So I wouldn't want to comment on it right now because there are 2, 3 moving aspects within ECL itself on how to recognize, whether we'll be completely aligned to global standards, or we will have our own parameters. So unless there is ample clarity on the same, I wouldn't want to kind of comment on that right now.

Saket Kapoor: Sir, a small point on the book value and the dividend payout. Firstly, on the book value part. Sir, currently also, the market is not giving the right valuation. So I think a lot of effort has gone over the last 1.5 years by our early CMD also. And currently also, when we'll be interacting with the new CMD in the next call, we hope that steps will be taken to increase your stakeholders' value also. We are trading well below even on time, I think INR260, INR265 is the bank, and we are currently at INR150. So there should be a concerted effort wherein value creation for the stakeholders should be the upmost task there.

Sekhar Rao: Yes, we'll hope for the best. There are a few aspects to consider. Firstly, our bank does not have a specific promoter, and institutional holdings stand at approximately 30%, while retail ownership comprises around 70%. Controlling certain aspects of retail ownership can be challenging. Nevertheless, we remain committed to delivering strong performance, and through our continued efforts, we anticipate improvements in this regard. We also rely on the support of your community, including stakeholders like yourself, to assist us in addressing these aspects.

Saket Kapoor: Sir, on the dividend payout, sir, we, this time, kept the payout ratio lower than what the payout was last year. So if you could give us an understanding of how we came to that figure of 50%, last year, it was INR4 on an EPS of INR16. And this year, we have made a record profit, and on an EPS of closer to INR38, the payout is INR5 per share. So if you could explain to us how did we conclude this payout, sir?

Sekhar Rao: I'm not sure how to react to this. I thought INR 5 was a very good number when compared to what's being announced elsewhere. And we were personally very elated at INR 5. Let us see how it goes going forward. My colleague is saying yeh dil mange more.

Saket Kapoor: But there has to be a formula on the basis of which the dividend is distributed to your shareholders, sir. It is not about the dil maange more concept, but there has to be something on a proportionate basis. On EPS of INR16, you are distributing INR4. And on EPS of INR37.6, you're INR5. So there has to be some understanding on the basis of which the dividend payout the Board has deliberated.

Sekhar Rao: So we've shored up well and we are at fairly decent capital adequacy norms. We have the flexibility to distribute significant dividends, enter the market to raise capital at discounted rates, and ensure our shareholders remain content. It's important to note that making decisions in this area requires a balanced approach, and there is no straightforward answer that fits all situations.

When determining the 50% threshold, we considered several factors, including the overall condition of our balance sheet, the construction of reserves, our growth aspirations, and the potential for future capital raising opportunities. Sustainability was also a key consideration. We arrived at this figure after careful evaluation, and we have received positive feedback from our existing shareholders regarding this decision.

Saket Kapoor: We hope for continued performance going ahead because it is the performance that is going to undermine all the principles going ahead. So we hope to look forward that the environment is conducive for us to report a continuous set of growth numbers. This should be the endeavour. Sir, we hope for that ahead.

Sekhar Rao: So, regarding cash with the RBI, the interest earned amounted to approximately INR 1.58 crores. However, the answer to this question is slightly more complex. The interest earned is influenced by various factors such as reverse repos, swap deals, and other considerations. Nonetheless, I hope this provides clarity on the earlier question raised. The amount of INR 1.58 crores represents the interest earned on balances with the RBI and other banks. It is worth noting that this figure appears lower compared to the previous year due to two factors. Firstly, during a portion of the year, particularly in Q3, we were on the borrowing side, which contributed to the muted interest earned figure.

Moderator: We will move to the next question from the line of Yashwant Kumar Thippeswamy, a private investor.

YashwantThippeswamy: Congratulations, Karnataka Bank team as a whole. It's a great job. So yes, my first question, I mean, quite a few people have already asked about the growth. We are targeting more than the industry growth. So I just wanted to get a little more details with respect to the last, I mean, two months. How has it been?

And the next question is on the establishment expenses. So do we foresee that it could continue in coming quarters as well?

Sekhar Rao: So, as we mentioned earlier in the call, we have observed positive indications of the changes we made on the retail side in the past two months, and we anticipate this momentum to continue. There has been increased activity in areas such as gold loans, home loans, and to some extent, the MSME space. We have implemented a robust agri co-lending model, and have already disbursed a significant amount through this arrangement. Additionally, we have more collaborations in the pipeline, which further enhances our excitement about the opportunities ahead.

Regarding operating expenses (opex), we anticipate an approximate increase ranging from 5% to 8% in the future. This is due to provisions we need to make for employee costs as we plan to open around 50 new branches. There is also heightened investment in technology. If our growth aspirations materialize according to plan, which we are already witnessing positive signs of, the OPEX increase is likely to be closer to 8%. Okay?

YashwantThippeswamy: Okay. I mean, the ballpark number is about 50-odd branches in this financial year?

Sekhar Rao: Yes.

YashwantThippeswamy: Is that what you said? Okay. Perfect. And coming to the other income part of it. So, I mean, I understand that the strategy is to focus more on retail and gold loans especially. So having said this, I understand that there should be a right balance in improving the other income as well. So are there any thoughts that are calling on that side?

Sekhar Rao: Yes, regarding other income, we have already achieved INR 1,155.60 crores, excluding trading profits and depreciation. This income is well-distributed across various categories. We have made good progress in terms of banking fees and commissions, while there are areas where we can improve, such as exchange profit and locker rentals. Additionally, we will focus more on third-party income, where we see significant opportunities emerging. With our maturing analytics capability, we expect our cross-selling models to fall into place effectively.

It is important to note that while there may be some slowdown in areas like debit cards and ATMs due to the impact of UPI, this will be offset by growth in transaction banking fee income and third-party fee income. We will also make tactical decisions regarding areas like locker rentals to optimize our overall performance.

YashwantThippeswamy: Okay. And I mean, I just wanted, I mean, this question.

Sekhar Rao: Sorry. Lastly, if we see the current trend of interest rates pan out, there will be a write-back of MTM and depreciation opportunities as well.

YashwantThippeswamy: Okay. So yes. This question is exclusively for you because you joined about three months back. So I just wanted to understand. Considering the strategy that you've got in like retail, increase in the retail portfolio. So I mean, this is referring to the 26 Slide number, and that is about the NPA breakup. So I see that the credit portfolio with respect to retail it's at 65%.

Sekhar Rao: The mentioned figure represents the proportion of NPAs in relation to the total NPA, including both retail and agri sectors. The higher proportion is influenced by various factors that occurred over the last two years, such as the rising interest rate scenario and the impact of the COVID-19 pandemic. However, we anticipate this proportion to gradually moderate in the future.

It is worth noting that a significant percentage of these NPAs is from the agri sector. Additionally, our retail portfolio constitutes almost 50% of our overall book, which is known for being a relatively high-yielding segment. While the ratio may stand out, we closely monitor this area and have a strong understanding of the business. Rest assured, this is an area we are well-versed in and will continue to focus on, as it plays a crucial role in achieving our growth aspirations.

YashwantThippeswamy: Yes, I get that. But my question is more of like, because we are targeting more of retail advances, increasing impact. So my question is more about whether the existing framework works out well with respect to arresting this NPA with respect to the retail portfolio. Or do you think that there have to be some more additions, I mean, additional criteria that need to be added to the existing framework in order to improvise and decrease or otherwise reduce the contribution from the retail side? That's my question.

Sekhar Rao: So yes, of course. There is always room for improvement, and we have organized our operations to effectively manage our stressed portfolio. We have two key functions dedicated to this purpose: credit monitoring and recovery. In our credit monitoring department, we extensively leverage technology to track early warning signs and identify potential instances of stress. This enables us to take necessary actions at an early stage. If an account still slips into default or becomes an NPA, our credit recovery department steps in to initiate appropriate measures.

One positive aspect is that a significant portion of our loan portfolio is backed by security, and these are considered bankable securities. Historically, our ability to recover from such loans has been quite favourable, which provides us with a sense of reassurance. Additionally, we are establishing a comprehensive analytics shop. This initiative will enhance our surveillance and monitoring capabilities using AI and other advanced technologies. It will enable us to identify trends in the behaviour of our portfolio and proactively respond to them. I trust this addresses your question regarding our approach to managing the stressed portfolio.

YashwantThippeswamy: Sorry. Come again? I didn't get that.

Sekhar Rao: As mentioned earlier, we are in the process of establishing an Analytics Centre of Excellence (ACOE), which will enhance our capability to monitor accounts effectively. This dedicated centre will strengthen our early warning sign systems, allowing us to identify accounts showing signs of incipient stress at an early stage. Additionally, we are also enhancing our call centre capability, which will further improve our ability to track and monitor such accounts.

By combining these initiatives with the measures, we have already implemented, we are confident in our ability to effectively manage any potential NPAs or stressed assets that may arise. These efforts will enable us to proactively address emerging issues and take appropriate actions to mitigate risk.

Moderator: We have the next question from the line of Deb Bhattacharya from PNB MetLife India Insurance.

Deb Bhattacharya: Sir, just a couple of questions. So one is on the restructured accounts. So I just saw that the provision is around 10%. So in your opinion, what could be the percentage, are we like well provided there? Or would there be any further slippage or so just your view on that as well?

Sekhar Rao: So, our standard restructured provision stands slightly higher, approximately around 13%. We continuously assess the opportunity to increase provisioning whenever it is supported by our financials and considered a prudent decision, as we did in the fourth quarter. It is noteworthy that almost 90% of the restructured book is performing well, with customers repaying their obligations in the three mentioned buckets.

I stand corrected. The current provisioning stands at 10.31%. However, it is important to mention that the quality of the book has significantly improved. The restructured book currently amounts to INR 2,570 crores, and if we exclude related accounts, it comes down to approximately INR 2,070 crores. To provide further insights into this specific aspect, I will now pass the phone to my colleague, Mr. Abhishek Bagchi.

Abhishek Bagchi: Actually, to highlight the numbers, as the size has decreased in this quarter as compared to December, in this quarter, we have a reversal of provision. It is about INR25 crores. We have a reversal of the provision.

Sekhar Rao: So that's another reason why. So basically, there's been a reversal of provision, which is why this further looks at around 10.31%.

Deb Bhattacharya: Okay. But looking at the portfolio, you're like kind of okay with that number.

Sekhar Rao: Yes, we are comfortable at current levels. Yes.

Deb Bhattacharya: Okay. Okay. I think you mentioned that some of the portfolios were like for the low yielding. So was it more from the large corporate portfolio?

Sekhar Rao: Of course, it was from the large corporate and PSU portfolio.

Deb Bhattacharya: Okay, okay. So going forward, one is on the retail strategy that, so from a risk-weighted asset standpoint, would we kind of see an increasing risk on the book? Or you feel that, broadly we would be at the same level?

Sekhar Rao: It could be similar to lower levels because you also see gold loans playing out and home loans. So we would see this at around current levels to kind of reducing. That's where we are. So it's range-bound between somewhere if you see the risk-weighted assets, it's around INR53,000 crores right now against the December number of INR54,000 crores. So it is plus or minus INR1,000 crores. In terms of percentage, it would more or less be around the same area. Of course, it will grow in tandem with the growth that we demonstrate.

Deb Bhattacharya: Okay. So broadly, whatever the overall number for the bank, the weighted mix of these two would kind of be broadly the same from at an overall bank level?

Sekhar Rao: Yes.

Moderator: Ladies and gentlemen, we will take one last question from the line of Rakesh Kumar from B&K Securities.

Rakesh Kumar: I was a little confused when you replied saying that it is on the interbank some borrowing that we had taken. So in the interest expense lines, do we not include interbank borrowings and the RBI borrowings number? How do we do it? Like we net it off from the income line? Like, how do we do that? Because there is a separate line item in the interest expense for interbank borrowings.

Sekhar Rao: So I'll request my colleague, Mr. Abhishek, will take this question.

Abhishek Bagchi: Yes. I was answering on the interest income side. As majority part of this year it was on a borrowing side. So it is the income on the asset and the overnight market lending. That is the interest income I was referring to. Interest expenses are accounted for separately under the expenses schedule.

Sekhar Rao: Does that answer your question?

Rakesh Kumar: I think we can discuss it separately, sir.

Abhishek Bagchi: You can mail me across. And I'll be replying, Okay?

Rakesh Kumar: Sure, sir. Sure, sir.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to Mr. Sekhar Rao, MD, and CEO of Interim Karnataka Bank, for closing comments.

Sekhar Rao: Thank you, ladies and gentlemen, for being a part of this call. It's been a pleasure speaking to you. And a lot of insightful questions. We hope to build on these. We look forward to more frequent interactions with all of you instead of just this customary call at year-end. We once again thank you for your support and your compliments. Thank you, Ms. Melissa, for hosting us. Good evening, everyone. Thank you.

Moderator: Thank you, ladies and gentlemen, for joining us on this call. I would like to express my gratitude to Melissa for hosting us, and it has been a pleasure speaking with all of you. The questions and discussions have been insightful, and we aim to build upon them in the future. We look forward to more frequent interactions with all of you, rather than just the customary year-end call. Once again, we appreciate your support and compliments. Good evening, everyone. Thank you.

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