"Federal Bank Q4 FY'20 Earning Conference Call

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Moderator: Ladies and gentlemen, good day and welcome to the Federal Bank Q4 FY'20 Earning Call. 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 would now like to hand the conference over to Mr. Shyam Srinivasan – M.D. and CEO. Thank you and over to you, Mr. Shyam Srinivasan.

Shyam Srinivasan: Thank you and good afternoon everybody. And I hope everybody is safe, wherever you are and able to cope well with the challenges of the world so to say. We are gathered to have a conversation about our Q4 outcomes and more importantly the way forward. I am just trying to reflect back on 26th February, when we had our 'Analyst Day' in Mumbai and we came away quite encouraged that we had given a good narration of ourselves and many of you are probably on the call today had a good sense of our plans and the way forward. While our direction has not changed, certainly the challenges that we have faced with today we have not visualized then and consequently the mid-course corrections have been quite daunting.

That said, I do believe that Q4 given all the challenges was fairly strong operationally. We had some gains, some challenges. Whatever gains that we got, we made sure that it helps us strengthen the balance sheet and position the bank for whatever challenges or environmental issues that may crop up or that we are faced with.

A quick two line update on the COVID impact on the bank: No different from any other organization in the country. We have had distinct set of issues in terms of people having to work from home. Quite happily and interestingly, we quickly rearranged ourselves that in today looks like we have done it all our lives, people have got used to working from home, in particularly, our teams in Mumbai and other large metros have had to literally sort of do everything from afar and even the Q4 results including our auditors, board members, everybody from multiple locations, it is looking like it is a seamless process and everything is tracking quite on plan in that count.

In terms of our business situation, in terms of the momentum, our belief is that Q4 in particular till about 10th of March or first week of March, we were coursing quite well on all the areas that we have sort of chosen to put our attention around wherever our growth was, containment of cost as also, most importantly and crucially, the marked improvements in credit quality and the recoveries, it was growing well, unfortunately the last three, three and a half weeks had challenges and that did dent our numbers. But we have created a war chest by having some gains on the treasury and investment side which came in handy to make sure that we can substantially increase our provision cover and enhance our coverage ratios and strengthen the balance sheet in a manner that we had not done before so that sort of positions us very strongly as we enter what arguably is one of the toughest times in any of our lives.

Most conversations in most organizations are around the banks, are around the portfolio quality, the prospective dent that it can make on both financial outcomes and need for capital. We do not know. We have no clue how bad or how good it is going to be. We just know that about 35% of our book is in moratorium, we sliced it, diced it in many ways. We have a sense of how we can deal with it. But the outcomes are not necessarily predictable. But I think we are positioning ourselves well to make sure that we can deal with all the challenges that are likely to come up.

In terms of numbers, I am not getting into any of them. I think you all had an opportunity to look at our deck. Operating profit was clearly the highest all time ever at Rs.959 crores. The gross and net NPA both have had a material improvement which I think is a tribute to our multi-year focus on being conservative in credit standards and ensuring that the quality of the book is quite robust. Our stressed asset portfolio is at an all-time low at 1.28%. Liquidity, which is a strength of our bank, at the end of the year was 185% and now it is well over 200%.

Liability Franchise: Through any period in any look, we have had a good quality liability franchise and all of it is granular. Many of you have been reporting that we are top quartile or top two, three banks in terms of the richness of the liability franchise that is continuing even through the first two months of this financial year we have seen good quality growth both domestic and non-resident client deposits and I believe that it will continue.

Our focus around digital enhanced during the COVID even more. Our capabilities match the best. Our digital transaction volume has picked up both for individuals and for corporate as you see in the slide.

So, on balance, credit growth for the year was about 11%, deposit growth was about 13%. Both of them were marked by the last two, three weeks slowdown, otherwise it could have fit the mid-teens, but that is just a data point.

Growth in areas that we have put our focus around retail, gold, did well. We consciously for almost four quarters have been slowing down the mid and higher ticket credits and that is visible in the numbers. Business Banking saw some pick up towards the second half of the financial year. We will see how that plays out as things sort of shape up. Other income, in particular treasury, had a very strong year both through one-off opportunities as also structurally organically things that have done have gone well. We have made substantial provisions for wage increase on account of the negotiations that are going on. The yield fall has resulted in treasury gains but equally some cost impact on pensioning which also is provided for. Despite that the cost-income ratio is at 50%.

I will draw your attention to our slide on our deck which is just an explanation of how the year may have looked if the events of the last two, three weeks did not come true, but we still had the one-off gains and the one-off impact. We would have still had quite close to what we believe was something that was in striking distance of delivering in the last quarter well over 1% ROA which is what we had sort of geared all year for. But that is wishful thinking, that is unfortunately it did not happen but I think the underlying momentum, the market permitting, we have the capabilities, we have demonstrated and the year ahead will be all about ensuring we conserve, preserve, hold on to the good stuff that we have been doing, ensure that we are opportunistically picking up lending opportunities. Gold loans look like a nice place to be. Our momentum has picked up quite materially. Corporate selectively we are doing. Cross-selling to existing customers based on data mining is well under way. And the government guarantee schemes where there are opportunities we will sort of lead into that.

So, let me just summarize by saying we exited Q4 operationally strong, well provided for, whatever one-off opportunities we got, we could gain from, we set that aside and ensured that we strengthened the book. We have reasonable look into book that has taken the moratorium of about 35%. The most heartening aspect of that is the SMA book as of two days back is at 0.7% which is Rs.840 crores out of the entire book, and that is out of which Rs.303 crores we provided through the special COVID provisions. We are preparing to make sure that between Q1 and Q2 of this year which is likely to be lower, no provisions in a normal sense because of the moratorium and the consequence of it, we will substantially build up provisioning to make sure that we are well positioned and our capital adequacy continues to be strong at 14.35% and since there was no dividend payout in FY'20, all of that has been ploughed back into capital. So it is 14.35% CRAR and our stress test point out that as the year rolls by we will still be good to run the business without going into additional capital requirements for at least 12 to 15-months as we see, but these are unprecedented times, we are preparing for being nimble and right up there to do the best possible in the current situation.

So I am not going to take much more than this. The slides we have tried to make it very explicit and the best disclosure that we can offer. Between me, Ashutosh, Harsh, Babu, Anand, Nilufer… I think Shalini is not able to dial in, other team members, we will be happy to take questions, clarify to everybody. So once again thank you for dialing in and I do hope everybody is safe and happy to take questions. So operator you may open it.

Moderator: Thank you very much. Ladies and gentlemen. We will now begin the question-answer session. The first question from the line of Jay Mundhra from B&K Securities. Please go ahead.

Jai Mundhra: Sir, first question is you have mentioned in your slide that you have sliced and diced portfolio for moratorium and you have classified into red, green and orange. So can you provide some quantitative aspect there in these three categories – low risk, medium risk, high risk?

Shyam Srinivasan: I intentionally did not provide numbers in that because it is dynamic. It is a model we are using, using all these parameters, we are putting it into multi-varied model, putting it into our prediction engine which brings out by each product category, what is low risk, medium risk, high risk and then we look at the probability of default of each of these and then we work our collection strategy. But at this juncture, it may not be very clear because there is not much data that has changed in the last 45-days. What really will be visible as we go into Q2 and then only we will be able to. That is why I guess the earlier slide of the moratorium book is this, the current SMA book is this and we have to see how this evolves over the next 60-days. So I think we can give a better line of sight on this as we go into Q2 or probably in August, September only then. At this point in time, we have internal measure based on which our collection efforts have been directed. But I do not think we can give a very meaningful number into this, but we have a sense of it. I think it could be something that we can share as we get into Q2.

Jai Mundhra: Now the moratorium has been extended by three more months, allowed by RBI, so how are you approaching - are you giving again three months moratorium by default or what is the moratorium policy that the bank has adopted for further moratorium?

Shyam Srinivasan: I think our moratorium policy is consistent; we have both an opt-in and opt-out model for the different businesses. We have not seen any change in the last two weeks of that. I do believe that as moratorium-II sort of kicks in, in the week-1 of June, you may see people either seeking to do. Our sense so far is there was a rush for moratorium in the early stages. I think people are seeing that it is an expensive choice to take a moratorium unless they are really pushed and want to keep cash in hand. That is why this 35 number of ours have been swinging wildly, it was not 45 or 50 which came to 35 or 25 became 35, it has been in that zone. My sense and I could be wrong, we will see, I would think this would remain mean more or less consistent with this number even in Q2 because I think people are realizing that there is a cost of holding out for too long. So if they can afford and if the economic activity picks up in select places, some cash flows are coming in. My sense is people will pay and try to get out of moratorium because there is a cost of it.

Jai Mundhra: So now with MSME Guarantee Scheme, operational guidelines are already in. Once you start giving the loans to the borrowers which are in business banking and qualified let us say in commercial banking, ideally they should come out of moratorium, all the technically speaking or how would it be?

Ashutosh Khajuria: So they will remain in moratorium. Moratorium is for repayment of the installments that are fallen due. So even otherwise when you structure the loan and all that, you will have a four year loan in which there would be a moratorium. So based on the projections and the viability of that particular process or that particular unit, it would be decided how much… I think this is the general moratorium; it would last up to 31st August. So when you give this particular loan going by conditionalities of that of a four year loan and all, for that additional part which is guaranteed, you can have the moratorium there and this would continue up to August, so both would be there.

Moderator: Thank you. The next question is from the line of Nitin Aggarwal from Motilal Oswal. Please go ahead.

Nitin Aggarwal: I have a couple of questions around moratorium again. While you have said that this book has not moved wild. If you can just give some approximate numbers as to how much this book was as on April end, because many other banks have reported numbers as on April…

Ashutosh Khajuria: The numbers that have been given in our presentation are as on 25th May numbers. These are not 30th April or these are not 31st March numbers.

Nitin Aggarwal: So my question was how much approximately would this have been around April end, 35 I understand is current number?

Shyam Srinivasan: It did not move much. I think it would have been 34…at the peak it was about 38% is my recollection. That is why I said swing is not very much.

Nitin Aggarwal: Any pending cases there on which we still need to decide?

Shyam Srinivasan: At this point in time, no.

Ashutosh Khajuria: Because it is getting over on 30th of May in another two days, day after tomorrow, first set is going to be over. Now from 1st June we will have to observe afresh anybody would like to extend that. If we just see the SMA book and all, it is that 840 crores, so people have been paying, even in normal times used to have somewhere around 1.5% SMA book and all and this is less than 1%.

Nitin Aggarwal: On your interaction with customers, does it look like the customers are looking forward to further relaxations or interest waivers as interest for six months get piled up and they will be regularizing the account despite resuming business operations?

Ashutosh Khajuria: Very difficult to predict because that would be a prophecy that one can make, but we never know because how is the situation turns out. If you go back to 1918 and 1920 Spanish flu and all, the second wave was more dangerous and all. So I think destruction of wealth wise and all that. I do not know, I mean, lots of lessons would have been learned from that particular episode and definitely those learning would have been put to use on this one and therefore the casualties are lower and therefore all sorts of precautions are being taken and probably people would not be as sort of reckless in all which they were in 1918 to 1920 when the relaxations were made after the lockdown and all. So I do not think it is going to be that worst, but then I think very difficult to predict you know how it is going to happen. But based on that engine and all which Shyam has discussed, we would be periodically recalibrating predictions and all.

Shyam Srinivasan: Nitin, I will just try and expand on what Ashutosh mentioned. The short point is it is difficult to make a very generic prediction. If you ask us anecdotally…Harsh is also on the line, some of our business heads are on the line, we have had many kinds of conversations with different segments and the truth is some segments themselves are facing their suppliers or their buyers giving them cues. If a textile exporter is suddenly getting a force majeure from their buyer overseas, then their commitment that they made 10-days back could change. We have heard some customers say that the overseas orders in markets like Italy have started picking up and therefore their lubrication has started. We have also heard customers who said their buyer in the UK has applied force majeure and said that they are not able to take off their stock and therefore the supplier here to deal with his own problem. So it is kind of mixed and I would think particularly for ticket say more than Rs.10 crores, Rs.20 crores, it is a very bespoke client-to-client solution, so the entire RM community for the last 60, and I would think for the next 120-days, a big part of their role is a very close engagement with client and structuring it in such a way that we are able to make sure that the client and the bank does not get into any agony. Easier to say but that is what our teams are doing.

Nitin Aggarwal: My last question is around the retail segment. Now that segment in absolute terms contributes the most to the moratorium book. So if you can give some more color on different segments within that, say gold loans or housing, LAP and so as to how much of this is coming in from opt in and how much from opt out because I believe the proportion of moratorium would be starkly different between the two stage?

Shyam Srinivasan: Nitin, the gold loan book is in a nice place. There is no challenge on the gold loan book. We are quite happy with that. And the retail, loan against property, home loan which are the dominant part of our retail book is secured, the moratorium is 38%, and that is a book that we have cut into much more because it is data amenable, we have put the decision engine on it, we have got the kind of dimension of the kind of book that it would be, roughly I would say about 6-7% of that book which is the sharpest part of it which needs great attention. The rest would fall in the low or very medium category. So the high risk part of it is between 5% and 7% that needs attention and focus, but since it is a secured, our unsecured book is very small and that is the book that is sold to existing customers, so we are not seeing much stress on that. But that said, it was good for three months. Will it be good for six months? Will it be good for nine months? We will have to see. So we are watching closely the progress on that. But yeah, you could say 5% to 7% of the retail book is where the greatest attention will be.

Ashutosh Khajuria: Additionally, the LGD is lowest in our retail book basically because as Shyam has said, it is all secured, we do not have too much of unsecured. So whether it is gold or housing loan or LAP or whatever it is, our past five, six years suggest this.

Moderator: Thank you. The next question is from the line of Venkat Subramanian from Organic Capital. Please go ahead.

V Subramanian: A couple of questions. How comfortable are you with the sovereign guarantee for MSME because there are conflicting opinions with respect to how it is structured. Are there challenges with respect to how it is put through?

Shyam Srinivasan: Venkat, the CGTMSE scheme, that is a reference from the past. Like any other insurance program, always ways to decline a claim, like check was not done properly, your submission quality was poor, or this feature was not met and therefore we have not had the best of experiences on CGTMSE and hence our use of that scheme has been quite limited. I do not want to be negative about it. We just have to deal with this on a case-to-case basis. So have I got a highest sense of comfort? No. Is it a scheme that we will pursue very closely? Yes. And we have to structure it in such a way that we document where we use our learnings from the past to make sure that the recoverability is high. We also know that the time for recovery even if the guarantee is assured and the money has to come, is not like, you pay and you get immediately kind of thing. It will take its course. So we just have to prepare for that.

Ashutosh Khajuria: But one positive point is three-fourth of the money is coming to you within a defined period and the rest of it can go on and all. That is an additional comfort and all. So , you do not require any capital charge for that. So risk weight is zero on one hand and therefore probably they have created a separate trust for that. That could be the reason.

V Subramanian: I think it is most useful for us because our exposure to MSME is fairly high. So, how do we intend using this just now given all our reservations and all our learnings?

Shyam Srinivasan: I think these both businesses, business banking and commercial banking are RM-led businesses. So, we have mined that, we have got a pre-approved credit clearance on who we can make offers to and the RMs or the teams that are working in the branches are reaching out and working with clients. So it is not like you walk in and demand. It is pretty clear we go to the client.

V Subramanian: Secondly, Shyam, what is the status of your extension with the RBI?

Shyam Srinivasan: It is waiting for the regulator to clear. Our letter is with RBI for about two months now, I think since March 25th or so. So we hope sometime in the next two months…I do not know, with RBI, it comes when it comes, right, but there are no negative signs. So, we hope it will come.

Moderator: Thank you. The next question is from the line of Mayuri Yadav from Equentis. Please go ahead

Mayuri Yadav: Sir, just some data related question. If you can just help me reconcile the numbers on Slide #3 and Slide #13, where we have given a break up of one-off cases. We have mentioned an additional credit provision of Rs.167 crores and COVID provision of Rs.93 crores which again is broken up into Rs.30 crores and Rs.63 crores for the COVID provision. So, if I just look at the provision data for Q4, there is a loan loss provision of Rs.417 crores and there is a standard account provision of Rs.102 crores. So just want to understand how this Rs.167 crores and Rs.93 crores are accounted in your provision, if you can help me understand that data please?

Shyam Srinivasan: The Rs.167 crores is part of the Rs.417 crores, the Rs.93 crores is part of the Rs.102 crores, Rs.102 crores is the standard asset provision, the COVID provision of Rs.93 crores come under the standard asset provision. We held some of the standard asset provision because of asset growth.

Mayuri Yadav: So this additional credit provision of Rs.167 crores primarily is what is reflected in our PCR growth for the quarter itself which we have taken?

Shyam Srinivasan: The increased provisions we have made are to ensure that we strengthen our coverage from 45-point something to 53-point something.

Mayuri Yadav: And sir, this additional provision for employee cost of Rs.120 crores you mentioned in your opening remarks about the pensioning provision for the employees that have been done for the quarter. Just want to understand that for the last two to three quarters, we have seen the employee cost going up. Correct me if I am wrong. It is also largely to do with your pension provisioning that you have been doing. So, is this over or is it likely to continue in future as well?

Ashutosh Khajuria: It is directly linked to what type of treasury gains you make. If the yields fall, your bond get appreciated and you book profit there, and on the other hand, when the yields fall, your actuarial calculation for your future liability which is on account of superannuation and pension gratuity, leave encashment, all those payments is there, so when the yields fall, so you said "how much more is it over", depends on what is your prediction of how many basis points the yield would fall from here. So easy to say that 10-year yield would go to 4%. Probably additional provision would be required on the employee cost, but then we would make some

Shyam Srinivasan: Two points just to build on Ashutosh's -- One is generally the gain is 2.5x to 3x of the expense on the yield pensioning, right. That said, pensioning cost is captured then and there. The yield gain depends whether you sell or not. So it is not necessarily one-to-one matched up. In this quarter, it is matched up because we sold, and we also provided. May not on a regular basis. We may choose not to sell, we may hold on to the gain, but the pensioning is a must. So, we will provide for it.

Mayuri Yadav: Our NR deposits for the quarter has seen a very healthy growth on QoQ basis, approximately around 6%. What has contributed to this? And given our higher dependence on Middle East remittances, what is your outlook given the environment and the probable job losses in Middle East?

Shyam Srinivasan: If you tracked us for long, you would realize that every time there is some kind of disarray in any of the overseas markets, in particular Middle East, we benefit because the remittances increase. So that is one of the reasons. Second is when there is instability elsewhere, people send money to the safest bank and we happen to be one of the safest banks, so we get a large share or a larger share of it. And we are increasing our share of remittances from about 6% to 7% five years back to now 16% to 17% of India's remittances flowing through Federal Bank. And that continues. So generally, we are a larger market share player, more stable. Middle East instability gives money flow. Now will this continue forever? We will speak for it to happen, but you know how things are. If things dry up and situation gets worse, we will get better before it gets worse because initially when there is a problem, money flows in. After then for a while it may dry up. At this juncture, we see even in the first two months of this financial year, it is growing quite well.

Moderator: Thank you. The next question is from the line of Mona Khetan from Dolat Capital. Please go ahead.

Mona Khetan: So firstly, do we hold any floating provisions in our books currently?

Shyam Srinivasan: A very small number, in the 2-digit crores.

Mona Khetan: What percentage of the portfolio will be eligible for the MSME Guarantee Scheme, because I understand that apart from business banking and commercial banking some part of the corporate book may also be eligible for the same?

Shyam Srinivasan: Part that is eligible for that comes under commercial bank. Roughly about Rs.16,000 crores to 18,000 crores of our book is eligible.

Mona Khetan: Including agri gold loans, what would be your total gold loan portfolio?

Ashutosh Khajuria: Rs.9,300 crores.

Mona Khetan: On the OPEX side, I just want to check, what is the kind of flexibility we have given that in the current environment, there might be some impact on the top line?

Shyam Srinivasan: Non-wage. every line of the bank is flexible. Variable compensation, rentals, volume-related costs, renegotiating every other contract, and we believe we have a green structure on that, we have seen some gains on the rentals renegotiation and certain decisions of deferring spend are very much in line.

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

Renish: Sir, quick two questions. So one is again on the moratorium. So within retail, so sir our 50% of the book is into home loan and some part of it is in the gold loan also. So this number looks slightly on the higher side. So if you can just qualitatively comment on the portion which is under moratorium in terms of the customer segment or how we have arrived at this 38% within retail considering 50% of the book is home loan? So this looks slightly on higher side because almost 50% of the book is under the home loan piece. So just trying to get a sense what sort of customers are opting for moratorium or what sort of stress you see in this retail book?

Shyam Srinivasan: The stress part I mentioned. We have used the decision engine. We have got low, medium, high risks… and high I said including 5% and 7% of that Rs.14,271 crores. That is what it is. Nilufer or Babu, do you want to give more texture if you have any?

Ashutosh Khajuria: I can simply say that irrespective of the borrower is salaried or self-employed; this particular classification is different to going for this moratorium. So probably even if their salaries are getting credited and all, they would like to retain the balances in their operative account rather than paying EMI because this facility is available. Some are changing from that, saying no, no, we will pay and all that. So that is always happening. As Shyam had said, at peak the moratorium percentage had gone to 38%, now reduced to around 35% or so. So, I think initially opting and then again opting out, all these things are happening. So those who have availed moratorium are for sure stressed. There is uncertainty for which they are keeping some liquidity available with them.

Renish: As per our analysis, we feel 5-7% would…

Shyam Srinivasan: Let me just give you one data point, Renish, which may help you since you have asked for. The home loan plus LAP put together is about Rs.12,000 crores. Out of that, about Rs.3,000 crores is the NR customers and the rest are domestic customers. That is just the data point for you if you want some analysis to be done on that.

Renish: Second on this CGTMSE thing. So you mentioned that we will assess account-by-account. But as per the operational guidelines, if they opt out, so does it mean we have to offer to all our clients or how we are looking at internally?

Shyam Srinivasan: No, I think if you read this carefully, it says credit prudence to be applied by the banks. So, we will apply the prudence. I know our prudence is visible in every decision of ours in credit.

Renish: Lastly, on the gold loan piece. As you have rightly mentioned in PPT as well that near-term we are going to focus on this book. So any number you want to put to that in terms of growth or strategy?

Shyam Srinivasan: We have quite an ambitious plan, Renish. When we come out with our results for Q1 in middle of July or last week of July, I think we will be able to share traction, but I am happy that there is good progress.

Renish: So even as you speak today, you are saying there is a good traction in gold loans?

Shyam Srinivasan: Yes, we are seeing good traction.

Ashutosh Khajuria: I gave you Rs.9,300 crores was the March end number.

Renish: So April, May has been good in terms of gold loan growth?

Shyam Srinivasan: April is less. May has been good.

Moderator: Thank you. The next question is from the line of Gurpreet Arora from Aviva India. Please go ahead.

Gurpreet Arora: On Slide #15, on the left side where you mentioned the external rating of corporate advances, what is the denominator or the chunk of that corporate advances you are talking about?

Anand Chugh: Slide #5 which gives the total of corporate advances, which is Rs.50,725 crores, that is the denominator.

Gurpreet Arora: And what would be others part which you mentioned at the bottom right?

Anand Chugh: Others part is 7% of that. That is further blown up into FB internal ratings. Rs.50,000 crores is given an internal rating for that.

Gurpreet Arora: How much of our NBFC and HFC book is under moratorium?

Shyam Srinivasan: I would not have because we have not offered it at scale.

Ashutosh Khajuria: NBFC is very small.

Shyam Srinivasan: Just to an earlier point, I think the slide around corporate book moratorium is 22%, that itself explains that a low part of the 20%, very low part of the book is NBFC, HFC.

Moderator: Thank you. The next question is from the line of Anirvan Sarkar from Principal Asset Management. Please go ahead.

Anirvan Sarkar: Just one question. The moratorium-II, so is that applicable only to customers who had been granted moratorium-1 or is this applicable to customers who have taken loans in the interim as well, so for example, let us say, a customer who has taken a loan in April, would he or she be applicable for the moratorium-2?

Shyam Srinivasan: No, as of February 29, whoever is on the book.

Anirvan Sarkar: Okay, the same set of customers basically, who were eligible earlier, only they are eligible now?

Shyam Srinivasan: It is very unlike somebody will take a loan in April and will seek a moratorium, unless it is part of the contract with the client.

Anirvan Sarkar: And the other question is that, do we see any risk in our retail and SME book especially in accounts where there is some dependence on revenues from the Gulf region?

Shyam Srinivasan: Nothing to do with moratorium or otherwise. That is a risk that has always been in the bank, right, I mean, depends on how things shape up, but I...

Anirvan Sarkar: I mean, have we seen any worsening in the credit quality there or...?

Shyam Srinivasan: I am sure you guys are more aware than me. Last 50 days, no indication of anything because the moratorium is there. So we do not know whether he is going to pay or not, right. And you are seeing balances build up. If we scrub the existing customer against deposit balance they hold with us, more than 70% have more than one EMI available on their account.

Anirvan Sarkar: On the additional employee provisions, I think you mentioned that there is an element of provision made due to wage hike negotiation that is ongoing, is that correct? So how much are we building in, I mean, what kind of percentage increase are we thinking of?

Shyam Srinivasan: We are up-to-date as of March 31, we have provided for 15%. So, in this quarter, we provided for 29 months, 3% extra including March provision of 15%, so we provided Rs.45 crores or so.

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

Abhijit Bora: First question is, you did mention that Q1 and Q2 you will start building provisions aggressively. Just wanted to understand what are the LGD expectations from the accounts under moratorium, if you could give some broad estimates especially because some of these are secured portfolio?

Shyam Srinivasan: On IND AS, we have been doing for eight quarters. The LGD at a portfolio level is between 38% and 40% at a total portfolio level with retail being lower and the corporate being higher. Generally, we said if it worsens by 25%, we should be prepared. So, we are building up to 50s and early 50s coverage which is what we are working on.

Abhijit Bora: My second question is on the asset quality. I just wanted to understand your SMA numbers. Usually some of the banks have started taking COVID-related provisions on entire SMA book or just on SMA-2 as per RBI guidelines. So, you choose to build on it in Q1 and Q2 as well you have started in

Shyam Srinivasan: We will build more. If you take Rs.840 crores as the SMA book as of yesterday, we made Rs.93 crores provision which includes the Rs.300 crores which would have otherwise slipped if it had not got asset quality standstill.

Abhijit Bora: Why did you choose to increase borrowing QoQ when there is excess liquidity on the balance sheet? I can see deposits accruing much more than advances, but still borrowings are also going up. Any specific reason you are sort of increasing your liquidity levels much more?

Ashutosh Khajuria: I think there was a feeling that smaller banks will not get deposits and all. We saw a couple of banks having negative growth in deposits. So I mean, on one hand, we have not aggressively pushed it, but what we have done is we have curtailed our credit growth. So in the process, liquidity got built up. So our deposit growth if you see continues to be more or less what in previous years Q4 had been. And that is coming from resident depositors as well as NRE on both fronts. Our NRE deposit growth has been 14% YoY, the total deposit growth had been almost 13%, more or less, same growth in resident as well as in NRE. And NRE is your permanent, stable, retail granular deposit. Number one, say no to deposit, number two, you cannot pay higher than resident depositors. That is also a regulatory requirement. So, at the same cost at which you are getting resident deposit, you are also getting NRE deposits.

Shyam Srinivasan: The point that Ashutosh is making, borrowings were made in the beginning of the month. 29th February is when YES Bank had the problem. There was this fear that banks will not get deposits. Money was available. We took the money. At that time, nobody visualized we will choke the credit in the last two weeks of the quarter. I think between corporate and retail, clearly, we told the business guys, "No, do not do it now. You may get bank credits." I think corporate is at about Rs.1,000 crores, retail about Rs.400 crores.

Abhijit Bora: So deposits continue to accrue in Q1 at a much faster clip?

Shyam Srinivasan: Retail deposits are going well. Bulk deposits, we let go.

Ashutosh Khajuria: Bulk deposits all are sharply coming down.

Abhijit Bora: Sir, NIMs will be safeguarded by drop in cost of funds or will the NIMs be impacted because of excess liquidity on the balance sheet?

Shyam Srinivasan: Near-term NIMs will hold as in Q1 and Q2, because the credit that is neither growing nor falling and you are seeing the interest accrual happening. We cut our deposit rates, every time there is a rate cut. So we believe that NIMs will hold for Q1, Q2 with no contra revenue because of no slippages. Q3 onwards we will certainly revisit, but the business mix also changing. The gold loan business which is relatively higher margin is growing well. So we will see. I am making no commitment of how the Q3, Q4 will happen depending on environment shaping up.

Ashutosh Khajuria: And our savings bank is linked to repo rate. So, on ALM side also, we are balanced because on external benchmarking loans, we are giving against repo. So, on one hand, we are repo linked assets and on the other side, we are repo linked liabilities.

Moderator: Thank you. The next question is from the line of Rakesh Kumar from Elara Capital. Please go ahead.

Rakesh Kumar: Firstly, my question is pertaining to the strong growth that we witnessed in FY'17, '18 and '19 particularly in the corporate loan book. So, overall growth we had 26%, 25% and 20% in these three respective years and more in corporate loan and now we are also saying that LGD is higher on this portfolio. So considering that what happens post-November, because in the August the moratorium will get over and thereafter 90-days DPD would be there, so what probability of default we are looking at in the loans under moratorium in the corporate loan?

Shyam Srinivasan: We are at this juncture quite most sanguine about the corporate book because a), you would have seen the moratorium itself is only 20% and the book is 80% A or above and we have reasonable grip on that book. That said in the environment versions and things fall apart, then it is a different story. Whatever line of sight we have at this point in time, the corporate book looks reasonably under control. I pause when I say that because you do not know what things are in store, but we are not seeing any names at this point in time that is worrying other than the one name that is a

Middle East name which everybody is talking about which we have started building provisions for.

Rakesh Kumar: One more question that is pertaining to AS 15 provisions. So in previous quarter we had a feeling that the provisions related to terminal benefits obligations would be 7-8% of total OPEX, but it came out to be around more than 12% and obviously because GSec movement was very-very soft this time around, but what is the discount rate and rate of return on the plan assets that we have assumed now?

Ashutosh Khajuria: I think discount rate has been taken at 6.50% or something around that because that is for 22-years it is depending upon what is the average maturity period have taken for gratuity and pension. So that is that range. Because the money is placed with LIC and from LIC to buy annuity, so they declare every year. Till now they have been declaring in excess of 7% or so.

Moderator: Thank you. The next question is from the line of Sumeet Kariwala from Morgan Stanley. Please go ahead.

Sumeet Kariwala: You mentioned that the MSME portfolio has been reviewed and you have selected the entities where you will offer the 20% additional MSME funding. Wanted to check what percentage of MSME portfolio would that amount for?

Shyam Srinivasan: We think it may be about over six months period about Rs.2,000 crores is the potential that is there.

Sumeet Kariwala: You are saying your MSME portfolio worth Rs.2,000 crores is where you will provide additional significant funding or Rs.2,000 crores is the...

Shyam Srinivasan: Rs.2,000 crores is the lending opportunity over a 6-to-8-months period.

Sumeet Kariwala: The increase in market risk this quarter, was that quite meaningful because if I look at RWA, that has grown 6x versus loan book growth of 3%. So just trying to figure out, is it the market itself has gone up quite meaningfully this quarter?

Ashutosh Khajuria: I think market has still gone because we have invested in equity of a particular bank or so on which I think you have to provide higher risk weight.

Sumeet Kariwala: So that higher market risk weights will remain? Okay. Very clear.

Moderator: Thank you. The next question is from the line of Manish Shukla from Citigroup. Please go ahead.

Manish Shukla: On liquidity and LCR, just wanted to understand what is the thought process in the medium-term and the near-term because you have been carrying quite significant liquidity to 200%. While having good high liquidity is good, it also comes at a cost. So just wanted to get your thought around how you look at maybe in the near-term and then normalized liquidity?

Ashutosh Khajuria: So during this COVID period, I mean, till the dust settles or starts settling and all that, we would like to be having a higher liquidity even if there is some cost to it. That is a conscious decision and you would have seen our CD ratio also has fallen from nearly 84% to now 80% or so. So that is a choice. We have made to the highly liquid and all. As days go past and we see some sort of reduction in the uncertainty and all, we would start building up our credit portfolio. Once we have the liquidity, it is only a measure of pushing the paddle and growing your credit.

Manish Shukla: Traditionally, you have been at (+150%). Do you think that kind of stays, that would not...?

Shyam Srinivasan: We did 150% to 160% and that will be the steady state.

Ashutosh Khajuria: Average for Q4 has been 180%. Right now, it maybe 200%-plus.

Shyam Srinivasan: Uncertain times which may last for the next three to six months, it will be north of 160%.

Ashutosh Khajuria: Please remember this LCR number, fortunately, for us is higher because of the granularity of deposits. It is not a direct proportion of cost and all because (HQLA) High Quality Liquid Assets, most banks would have that 18% coming to them through a fall in LCR, where they can dip into, I mean, 15% of your NDTL is considered as HQLA from your SLR book and you can dip into your SLR to the extent of 3%, earlier it was 2%, now increased to 3%. You can borrow from RBI under MSF. So put together almost entire requirement of SLR now comes as an HQLA. So that would be the case with all the banks. What comes as a sort of benefit to us is that the outflow part in that, we have very small bulk deposit book and we have more of retail. That is considered as a stable deposit. That results in a higher ratio. So you will see all banks which are adding higher LCR, partly it is because their deposit profile is more retail in nature than bulk.

Manish Shukla: But, you any which ways meaningfully ahead most of the peer average even before they started.

Ashutosh Khajuria: 150%.

Manish Shukla:: Do you have any exposure to NMC and are you willing to quantify it?

Shyam Srinivasan: We do not have an exposure to NMC.

Ashutosh Khajuria: UAE Exchange.

Manish Shukla: Is it material enough to...?

Shyam Srinivasan: It is $20 million.

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

Darpin Shah: What I understand is you have made Rs.93 crores provision on COVID and your overall SMA book is almost Rs.840 crores. So you have provided 10% on it, correct?

Shyam Srinivasan: Yes, you can interpret that, Darpin.

Darpin Shah: So, which means we have not created any additional or ad hoc provisions for COVID-related impact which may come in next two, three or four quarters?

Shyam Srinivasan: We have increased our credit provisions. We see credit plus COVID provisions as one large chunk. Between the two, we have created good provision and increased our coverage and during the Q1, Q2, we will make appropriate provision.

Darpin Shah: You had mentioned that you have seen good inflows in retail deposits. Can you quantify for the first two months of the year?

Shyam Srinivasan: Normally, in a financial year, the first two months does not see much deposit growth. This time because of either remittance coming in or customers leaving their balances in their account and not taking it for spending, you see growth of about 2-2.5% on the retail deposit. Having said that, we have shared some corporate, bulk deposits and CDs.

Darpin Shah: If you can provide a breakup between how much of the book is linked to LCR, how much of the book is linked to external benchmark rates?

Ashutosh Khajuria: Every retail and MSME from 1st of October 2019 is to be linked with (EBM) external benchmarks. So the new book is being linked to that.

Shyam Srinivasan: Ashutosh, I have the number. The external benchmark is about 25% and base rate is about 5%. That is of course old. MCLR linked is about 40%.

Ashutosh Khajuria: The rest is fixed rate.

Moderator: Thank you. The next question is from the line of Abhishek Murarka from IIFL. Please go ahead.

Abhishek Murarka: My question is on OPEX. If I knock off this Rs.120 crores, even then you are roughly at around Rs.800 crores overall quarterly run rate. For this current year, a), are you planning any particular cost saving in any particular line that you can share your plans about? And secondly, would we still expect around Rs.850 crores of quarterly run rate or should we expect that to subside?

Shyam Srinivasan: I think there are two parts to it. Like I mentioned, some part of the OPEX is variable, right, it is volume linked, it is either a debit card spend or sourcing and servicing of some of the assignment books, so if volumes come down, that will have a direct impact. Second, that which is variable and renegotiateable is we are renegotiating. So I would not put a number to it, but yes, we are targeting to see some meaningful reduction in our run rate between lower volume related as also renegotiated related. I think you will get a better sense of it as we come out of Q1.

Ashutosh Khajuria: All banks will have a 20% hike in deposit insurance fee. So from 10 paisa it has gone to 12 paisa. So in this financial year, all banks will have on their total deposit that much additional charge.

Abhishek Murarka: But sir, just to press upon it, ballpark what is that proportion of cost let us say if we just see non-staff expenses which is generally variable, so where you could expect the volumes dropping to have a natural impact?

Shyam Srinivasan: Your sales origination cost, your variable cost in...

Ashutosh Khajuria: Travel expenses.

Shyam Srinivasan: I have not seen a flight for two-and-a-half months. Unlikely I will see one for the next two I guess. I used to do four a week and I am sure many of the senior colleagues do. So there are lots of these which are perforce become reduction. So there will be a bunch of it. Every rental contract is negotiated. We have seen success on some of them. I am not quantifying anything yet because I would like to see it crystallized in the quarter.

Abhishek Murarka: And on the salary side, generally, how much is variable?

Shyam Srinivasan: The compensation structure is as follows: The variable part is either at the senior level, say the AVP and above which is incentive and that is entirely in our hands, if we do not perform, we do not pay. The fixed salary which is already in the run rate, that cannot go away. So roughly I would say about Rs.100 crores a month. So out of that, salary part will be close to Rs.80 crores, that would not change, about Rs.950 crores to Rs.1,000 crores a year would not change, everything else in the cost line is variable.

Abhishek Murarka: The other quick question I had was that in terms of provisions… again, I know you said that Q1, Q2, you will be making appropriate provision, but if we just sort of compare with your bank, some of them are holding around 100, 120 basis points of loan as contingency or floating provisions on the balance sheet. So any such number let us say maybe 50 basis points or something that you would look to build in the next six months say?

Shyam Srinivasan: I think let me just expand on that. Yes, some banks have taken a huge number and some banks have taken a different number. Between now Q1 and Q2, we will hopefully provide meaningfully because Q1 and Q2 otherwise there is no provisioning required, right. So, we will make a provision. So, it is in the run rate. We are not in a rush to show higher profitability, we are in a rush to strengthen the balance sheet.

Abhishek Murarka: Lastly, one clarification. I think you gave a number for the portfolio that is eligible under the new scheme, the CGTMSE scheme. Can you just repeat that?

Shyam Srinivasan: Rs.16,000 crores to Rs.18,000 crores is the universe. We think about Rs.2,000 crores is a lendable opportunity.

Moderator: Thank you. The next question is from the line of Nilanjan Karfa from IDFC Securities. Please go ahead.

Nilanjan Karfa: Look, we had built the business around making RMs and not opening branches. Do you think the new environment will have to make some changes to that business plan?

Shyam Srinivasan: In fact, I will not hesitate to say this is the best thing we have done and we will do more of it.

Nilanjan Karfa: Why do you say that, Shyam?

Shyam Srinivasan: Because the personal connect and the no physical infrastructure is helping us greatly and RMs are connecting quite well with clients, clients like the model and most importantly, I do not carry any fixed costs, and I have a lot of flex on how to reach out. And this whole new world of technology enabled to connect is helping greatly.

Ashutosh Khajuria: We are delivering our services and products at doorsteps. So I mean it when I say that. I think whether these are loan products or deposit products, on your desktop or at your doorstep, so whichever way you take it. So I think that does not need physical infrastructure to that extent. Yes, there should be presence for trust and sort of recognition of the brand and all that. For that, I think we have reasonable presence in the selected geographies. So, if at all we will open, we will choose the geographies where we want to be present and needed from the brand building point of view and all.

Nilanjan Karfa: So there was this plan of starting to open new branches right from this current FY'21 onwards?

Shyam Srinivasan: I said last year, we will do about 20, 25 and a similar number or a little more this year. Out of the 20, 25, I think 12 or 14 we opened. Then this COVID hit. So we froze. We do not visualize anything other than the ones that are contracted and work is underway which will happen when lockdown lifts. I do not think we will open anything for the next six to nine months till there is line of sight and clarity. Those are coming under the discretionary spends which we can hold off till clarity emerges.

Nilanjan Karfa: Shyam, I missed a data point you shared. You said something 5% to 7% is high risk. I just want to check what you talked about…

Shyam Srinivasan: I think on one of the questions, was to give some texture on the retail moratorium, I said Rs.14,000 crores or something is in the moratorium. The model shows between 5% and 7% will fall under the high risk.

Nilanjan Karfa: And would you qualify that this book is what is NR linked?

Shyam Srinivasan: No, it is not necessarily NR linked because the NR portfolio is about 25-30% of the retail portfolio.

Nilanjan Karfa: This is the first time I think we are seeing job related crisis as well.

Shyam Srinivasan: I think we should first not downplay this. It can be. I do not know what it will be. And I have always said this, right. There are two parts to the NR… and allow me the luxury of giving a little lecture around this. NR remittances have two types -- One is the must send home because people's choolha has to burn. The other is arbitrage seeking money. We have generally been a larger part of the must send home category. If those people lose jobs and they all return, near-term, there will be a higher flow which is what we are visualizing. If there is a massive job loss and that whole community of people are going to come back, there can be challenges, but we have seen that for now Kuwait war, Gulf war, I have seen this on many occasions, they come back and find a way to go back too, like for example, now there is a crazy demand for nurses in the UK, North America and they even reduced the criteria of that exam to encourage more people to come. So, there may be some resettlement that will happen. Early to tell. But, we will keep a very close watch. It does not mean that it would not be a problem. It does not mean that it won't be a problem and it will be a problem. We will have to deal with it.

Moderator: Thank you. The next question is from the line of Anand Laddha from HDFC Mutual Fund. Please go ahead.

Anand Laddha: Just two questions from my side. Just wanted to understand, Shyam, if I look at our margin, even though you had given a lot of explanation, as compared to last year, we are almost down 10 to 15 bps on the margin side from 3.15% to 3.04%. We have been growing retail and SME faster than the corporate loan book despite being gold loan growing, personal loan growing, we have not seen any improvement in the margin. If we have to see ROA improvement, we need to see higher margin as well. What is your outlook on the margin side?

Shyam Srinivasan: We are all in the same world. I do not believe any of us is in a cave. I think we must reset all aspirations of ROA differently from what we were on March 31. So I would not even venture to give any kind of guidance around that. Other than what I said is the mix of business is shifting; we are focusing around gold loan and I have always explained how the mix of margin happens, not only the rate of segment, it is also the slippages, as slippages come down, revenue reversals also change. There is a bunch of stuff happening. So, I would think it would be too early to give you any kind of guidance. I do believe that our mix of book is in a right place, incremental growth is coming from the right segments so far. Too hard to predict what FY'21 will look like. So far, our credit book was developing the way we would like it to be. That is why the stress level was relatively low. It is visible, right, if you saw our Q4 slippages, it was at a super place. And if COVID had not happened, we would have had the best ever quarter on slippages. So, the results are there. But that said, we will have to see how it shapes up. I would have normally argued that margins will improve because slippages will come down. But I cannot say that just now because how the market is shaping up. So I am making no commitment of what it will be, other than the business mix is in the right place. We will only push the businesses that have positive carry as we go ahead.

Anand Laddha: Second, on the AS 15 pension provision, if you can quantify what is the total provision you have done for FY'20? And within that, what proportion was a normalized pension provision and what was the additional provision because of the change in interest rate?

Shyam Srinivasan: I think our provision was about Rs.220 crores pensioning for the full year. Ashutosh, do you want to sort of expand on that?

Ashutosh Khajuria: I will have to see the break-up, but I think additional part is Rs.75 crores and I think this is almost like Rs.80-odd crores more than the December quarter.

Anand Laddha: Would it be fair to say out of Rs.220 crores, Rs.80 crores is the additional provision because of the change in interest rate?

Ashutosh Khajuria: You are just looking at one line pension. There is a pension, gratuity and leave encashments, all three put together….just a minute, let me find out in case there is…

Anand Laddha: What I wanted to understand is if interest rate remains flat for next year, what should be our normalized pension cost for next year -- is it Rs.220-odd crores or it would be again lower than...?

Ashutosh Khajuria: If interest rates are flat wherever they are, then it would stay flat this year.

Anand Laddha: So whenever there is a change in interest rate, we make one-time provision.

Ashutosh Khajuria: It is basically as on the balance sheet date. So, on 31st March where the yields are, based on that it is assumed there is a discount rate and based on that, the future actuarial requirements are calculated.

Anand Laddha: Suppose, this year, we did Rs.220 crores of provision and assuming suppose Rs.100 crores is one-off provision because of interest rate change. So next year if interest rate remains same, our provision or pension will come down to Rs.100 crores?

Ashutosh Khajuria: Yes, there have been some of the quarters where you would have seen the reversal also, where the staff cost have been negative, rather than growing because yields have gone up.

Anand Laddha: Shyam, Lastly, on the employee wage negotiation. So this 15% was negotiated pre-COVID and I believe things have changed post-COVID. Do you still believe that the 15% wage hike still holds or there will be a rethought on that? Lastly, on the fee income side, now since we have relationship management concept, do we expect SME business should sustain for us and therefore the fee income should sustain for us? Also, we have a very low proportion of fee from third-party distribution; therefore, a large part of fee income for us should be sustainable fee income.

Shyam Srinivasan: There are no one-offs is all I can say. We lost a lot of fee income because last three, four weeks of low or no business momentum. Fee income growth has been trending reasonably in the direction we would like, that will continue. Again, we must be mindful that the next two, three months… I would argue even six months may be very different and therefore it is hard to predict. If everything comes back bouncing, we will be back in full flow. So let us keep a close watch. On your question on wage negotiation, it is anybody's guess. It is a very arduous process from November 17 to May 20. Negotiations are underway. It was coming to a fruition in February which is where this number of 15% came up. Then COVID came. I would think that if at all there is a reduction, it will be prospective, not retrospective. We have provided for all retrospective. So we have no backlog and no baggage and therefore we can hope that prospective it may come down.

Ashutosh Khajuria: Wage negotiation, I mean, the implementation is due from 1st November 2017. You can say that for that period also you give a lower amount. Till February everything was okay.

Anand Laddha: No, I got the point, sir. I think it should be from prospective not from retrospective.

Moderator: Thank you. The last question is from the line of Dhaval Gada from DSP Investment. Please go ahead.

Dhaval Gada: Just two questions. First is if we were to not utilize the standstill, what would have been the additional slippage in the March quarter?

Shyam Srinivasan: Rs.303 crores.

Dhaval Gada: Second was, what is the direct and indirect exposure to travel and tourism sector since that would be one of the most impacted?

Shyam Srinivasan: Almost nothing.

Dhaval Gada: Lastly, any update on IDBI-Federal?

Shyam Srinivasan: We have a board approval to take it up to 4% additional depending on RBI clearing it and the price discovery that is happening in a conversation between AGS and IDBI. As they agree, we may come to a conclusion, once they make us an offer; we have an approval to go up by 4%, from 26 to 30. The EV of the company last value was Rs.2,000 crores.

Thank you, everybody. Thank you for dialing in. And as always, stay safe, and we hope to come back to you in July 15th or thereabouts when we do Q1 with hopefully a different world. Good luck.

Moderator: Thank you. On behalf of Federal Bank, we conclude today's conference. Thank you all for joining. You may now disconnect your lines.