"Federal Bank Limited Q2 FY23 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Q2 FY '23 Earnings Conference Call of The Federal Bank Limited. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Souvik Roy – Head (Investor Relations), The Federal Bank Limited. Thank you, and over to you, sir.

Souvik Roy: Thank you so much, Aman. Good evening, everyone, and thanks for joining us on this call to discuss our Q2 numbers. I'm sure you all had a chance to go through our numbers and our investor deck for the quarter that went by. This has been a very good quarter for the Bank. We continue to move forward with clarity and intent in a quarter, whether external signals were sort of mixed.

We saw strong momentum in credit growth, which was across business verticals. Our balance sheet crossed the milestone figure of Rs. 3.5 lakh crore. We also clocked the highest-ever operating profit, highest-ever net profit. We saw better NIMs, better asset quality and a multiyear high of ROA and ROE. We continued to grow faster and gain market share in our identified segments that provided us better risk-adjusted returns.

On call today, we have our MD – Mr. Shyam Srinivasan; our EDs – Mr. Ashutosh Khajuria and Ms. Shalini Warrier; along with our Group President – Mr. Harsh Dugar; and our CFO – Mr. Venkatraman Venkateswaran; along with other senior officials of the Bank.

Without further ado, I would hand it over to our MD for his opening remarks, and we will follow it up with a question-and-answer session. Thank you so much, and over to you, sir.

Shyam Srinivasan: Thanks, Souvik, and good evening, everybody, for coming on the call. Like Souvik pointed out, we did have a good quarter. I'm sure you've all had a chance to look through the numbers. Our net profit at Rs. 704 crore was clearly the highest ever in the history of the Bank. And that's something that we hope will be I can say in every call that this quarter was the highest. That suggests the trend lines are encouraging. Our underlying momentum is strong. It's been broad-based and widely between both wholesale and retail, we've been able to see traction across, and market share gains are visible on the credit side.

I'm not going to elaborate on the external environment, and the world is going through turbulence. Most of you are smarter and have a better sense of it and have great analytical skills and knowledge of that. I'd only say that from our point of view, our efforts have been strong, will continue to be stronger and better in the quarters ahead. We are encouraged by the quarters that have gone by. The team remains quite focused on what we should accomplish.

At the beginning of this financial year, we had said that our focus remains to ensure that our ROA expansion is well and truly on course. And the exit ROA, we thought we would be around the 1.15% mark, and I'm happy that we are able to upfront that. And therefore, we are thinking that this year the 1.15% will be more like 1.2% for the full year, with an exit rate closer to 1.25%. And those improvements are driven broad-based across income expansion, material and well-managed cost structure, and our strong area being credit portfolio management is playing out quite well.

So, I think on this call, instead of me speaking for long, we'll be happy to take questions. It's suffice to say that it's been a good quarter. We are encouraged by the developments. We are mindful of the challenges in the environment. But it has been no different for very long. I think the Bank is well equipped to deal with these challenges. We haven't been very extravagant on underwriting credits that are dangerous. So, I think we will live through tough phases and continue to grow. There are challenges in the environment on ensuring that the deposit growth is good enough to match the credit demand. We think we have good and well-constructed models that will help us deliver on both credit and deposit growth.

So, without much ado, let me just hand it over back to the operator and request questions to come in. And like Souvik mentioned, the entire senior team is with me on the call. We'll be able to answer questions of any nature that comes through this call. So, thank you very much, and good luck.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Marookh Adajania from Nuvama.

Marookh Adajania: Sir, my first question is on your outlook for margins, given that deposit growth for the whole sector is kind of lagging loan growth. So, how do you see margins pan out in the next 2 to 3 quarters? And also given that some of the MCLR book will not yet be repriced. So, that is my first question.

Shyam Srinivasan: I think, Marookh, the answer is you saw Q2, the margin expansion play through. 65% of our book is either external benchmark and/or MCLR linked, and we pass through, particularly on the repo rate almost instantly as the MPC announces rate on a T+1 basis. This quarter, we saw the benefit of it, all the increases of the Q1 play through. So, our margin expansion is driven by not just the rate increase, but also by the average earning assets. It's also influenced by lower slippages. So, a combination of that should help us deliver on the margin number, which we've been guiding for. And at the opening of the call, I did mention that our ROA expansion is more visible and that's driven by margin expansion and margin expansion, we've been guiding for something for the full year around 3.25%, and we believe that will be closer to 3.30% now.

Marookh Adajania: That's for the full year, but you've already hit that rate this quarter.

Shyam Srinivasan: Yes. But we have a lag of the first quarter to catch up, right? For the full year rate to be 3.25% plus.

Marookh Adajania: Sir, my next question is, if at all, there could be any quantification in terms of contribution of your fintech partnerships to total deposits or liabilities or even assets, if at all, any such number would be available?

Shyam Srinivasan: In the interest of privacy of our partners, we don't share those numbers. But you may have seen in the deck, the numbers we have shared is sort of indexed, and you'll see a very rapid growth. But I can also point out, you would have seen in our deck, the other income and particularly card fee income growing up quite substantially. The run rate, as you know, we have a very effective partnership on the credit side with one of the fintechs, which is doing remarkably well. So, that is kicking in on the other income and the fee income side. On the liability side, we are building up a large base of clients' balances. On the incremental flow of deposits on savings, we are seeing about 10% to 12% of incremental deposit come through the fintech partnerships.

Marookh Adajania: So, it's 10% to 12% of the deposits?

Shyam Srinivasan: Of the incremental flow.

Marookh Adajania: Incremental deposits. Yes. Okay. And sir, my last question is on your employee expenses. So, obviously, your employee expenses have seen a modest growth. Last quarter, there was a degrowth. This quarter, there's not too much growth also because interest rates are rising. But just in terms of the retiral benefits, so what percentage of your total employees would be unionized and receiving definite benefits?

Shyam Srinivasan: I think, Marookh, we have said that all our workforce who joined us after April 1, 2010, which is about 7,500 employees or more, are on NPS scheme. So, that's a defined contribution. Prior to that is defined benefit. That's about 3,500 to 4,000 employees.

Marookh Adajania: So, 3,500 to 4,000 employees. Okay. Got it.

Shyam Srinivasan: Maybe less. Maybe 3,000.

Management: Sir, 3,900.

Shyam Srinivasan: Yes. Okay.

Moderator: The next question is from the line of Kashyap Javeri from Emkay Investment Managers. Please go ahead.

Kashyap Javeri: I have just 1 question. If I look at your margins this quarter, because of the increase in the yield on advances, higher than the cost of deposit, we have seen a fair bit of margin expansion here. But next year when the deposit rate takes a lead over the yield in terms of probable increase, what are the levers available to maintain margins at the current levels?

Shyam Srinivasan: So, I think the answer to that is partly in the question, right, in the sense that as the rate increase happens, the credit pass-through is higher and faster. So, deposits will lag. So, if you talk of the next 12 months and assume there are 2 rate increases or whatever the rate increases are there, that will pass through, right? And with average rate increases, yield increases, slippages have been well controlled. So, the reversal of interest income will be lower, and it will accommodate whatever the increased deposit costs are. So, the blended mix and which we are not going over the top and saying margin expansion is endless.

Kashyap Javeri: But given the levers that you mentioned about, would we be able to retain the margins where they are?

Shyam Srinivasan: When I've given a guidance that's what I'm saying. I said we are at around 3.30% this quarter, and we think the full year number will be 3.27% to 3.30% suggests that we will, right? I think we have a slide on showing the mix of business also in the investor deck, how some of our newer higher-margin businesses are beginning to take shape and traction is coming through and what share of new business they are and what share of the new income they are. There's a pie diagram.

Kashyap Javeri: Yes. And if I can just squeeze in one more question. I think your fee income this quarter has also seen a strong growth. What would be the reason for, let's say, something like loan processing fees and all jumping fairly high and what's the outlook for next year?

Shyam Srinivasan: Consistent. If you've seen our fee income, particularly since you mentioned loan processing fees, it's been growing up. And as volume of credit picks up, that is directly reflective of it. And as we do good business on the corporate side, they are able to generate fee income on the corporate side, particularly when you're lending to top corporates or very good corporates where pricing on the credit side is challenged where our teams are able to get constructive fee income from the customers on a blended basis.

Kashyap Javeri: And just like the yield on advances, on the fee side also, the scale is tilted in our favor, it's easy to pass on the fees? I mean there is no competition undercutting on that side either?

Shyam Srinivasan: I'm sure you have been in the market long. There's nothing that is free or easy, boss. Everything is a lot of our negotiation and client engagement, but it also ensures that the relationship and the capability of the teams on the ground, I would believe that it can't be easy.

Moderator: The next question is from the line of Sagar Shah from PhillipCapital. Please go ahead.

Sagar Shah: Good evening, sir. Actually, I had just a couple of questions. My first question was related to our average cost on borrowings and deposits actually. It has gone up by around only 20 bps to around 4.4%. And in the last quarter, you had guided that in spite of the 90 bps in repo rate hike, on the savings, we had passed down around only 25 bps due to the change in the yields by the ALM Committee. So, going ahead, do you see our average cost on borrowings and deposits going up in the H2 FY '23?

And my second question was that if you compare our deposit growth actually as compared to March '22 and H1 FY '23, our deposit growth has lagged actually the advances growth. So, do you expect our deposit growth to be better in H2 FY '23 versus H1? These are my 2 questions.

Shyam Srinivasan: No, I think the deposit growth lagging H1, I mean the credit growth is an industry phenomenon, and we have to be balanced about pricing for deposits and calibrating the cost of resources, which we do constantly, the team continuously evaluates at what price point. And when we are at a CD ratio in the late 70s, early 80s, we have enough opportunity to grow. As we get closer to the mid-80s, we have to be sort of build for pricing for deposits to grow that and fund our credit growth. So, as we look into the quarters 3 and 4, we believe deposit growth will be maybe early teens and credit growth will be in the late teens.

So, between a mix of borrowings, to fund the credit growth borrowings and deposits, we should be able to ensure that the book remains well taken care of. Cost of deposits between Q1 and Q2, I think you also asked about the savings. We don't visualize passing on all the rate increase to the savings rate. It's reasonably price-elastic. Term tends to be more price-elastic. So, we are pricing term appropriately. In certain tenures, we remain attractive, but we don't think we will be sort of leading the price war. We will be quite competitive but selective.

Sagar Shah: So, how much do you think our cost on borrowings and deposits on the blended level will go up going ahead?

Shyam Srinivasan: I may not be able to answer that. I think the answer would be the overall NIM number is where I mentioned a factoring in of the increase in cost of resources will be. May I request you to go on mute, I think you are in some public place, please? Yes, go ahead. Go ahead, please, operator.

Moderator: The next question is from the line of Simran from Omkara Capital. Please go ahead.

SimranJeet Singh: There are 2 questions which I want to ask. First of all, in the gold loan segment, what's the trend going there in this particular business segment? Means, how the customers are giving back money to you? And means, I'm asking in terms of the NPAs in the gold loan segment. And secondly, how is the trend in the SME segment in the southern region of the country?

Shyam Srinivasan: Gold loan continues to be reasonably strong. NPAs, as you know, is very negligible. More than NPA, I think it's really the fraud that we should worry about in gold loans, and that continues to be strong. Did you say what is the growth in gold loan? Other than the NPA quality, was there a question on gold loan?

SimranJeet Singh: Yes. I'm asking about the quality of the customers, means, in terms of the repayments in the gold loan.

Shyam Srinivasan: Eventually, that's a take on credit quality. Gold continues to be very robust and strong in terms of credit quality, except there is an odd instance of fraud or something like that that we have to watch out for. That continues to be pretty okay. SME business, did you want to know about what, the quality?

SimranJeet Singh: No. I want to understand more about your particular region because you're operating from Kerala and that is the main geographical thing.

Shyam Srinivasan: I would encourage you not to view it, we are operating from Kerala and that's not the way to look at it.

SimranJeet Singh: No. I'm just asking from that point.

Shyam Srinivasan: No. I'm only sharing with you. The business growth in commercial banking and business banking is fairly widely spread, and I don't see any geographical behavioral difference, except in the past, if there were some geographies that were affected either by some floods or local events. Thankfully, in the recent past, there has been nothing unique that I could call out in any one geography to suggest that some geography is facing greater stress or otherwise. Thankfully, the COVID-related supports have worked well, and we are not seeing any alarming trends and even the restructured books are behaving reasonably well, along expected lines.

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

Nitin Aggarwal: Two questions. Firstly, on, like, personal loan segment has reported very sharp growth this quarter, it's almost 75%. So, how do you see this trending for the year?

Shyam Srinivasan: Shalini, would you want to take the personal loan? I would think it includes the credit card fees also.

Shalini Warrier: Yes, sir. That particular number that you're referring to includes the credit card ones, both personal loans and credit cards put together have shown a significant growth, as you rightly indicated. I think a couple of things. One, obviously, our credit card business is relatively more nascent. We started in mid of last year to about September of last year. And between us and our fintech partners, we're doing quite well on the credit card front.

Personal loans is something we've been conscious about and how do we kind of calibrate our personal loan growth from a risk appetite perspective. It's only very, very recently in September that we've started doing some new-to-Bank personal loan bookings. So, on a low base, you will see an increased growth. The higher focus for us is to make sure that credit card grows well, which will happen over the coming quarters. But Nitin, remember that this is coming off a very low base. So, percentages can be a little misleading, actually.

Nitin Aggarwal: Right. Of course, I understand. I mean I was just trying to assess as to where can we be in the next 1 or 2 years if we….

Shyam Srinivasan: Nitin, it's growing well. It's a focus for the Bank, and we think we will continue to give it high attention.

Nitin Aggarwal: Sure, sir. And sir, secondly, on the wholesale portfolio, wherein we have seen a pretty healthy pickup in growth until last year around 10%, now we're closer to 20 plus. And so, we were earlier cautious on growing this portfolio owing to concerns on the price side. So, if you can suggest now which verticals are driving the growth in corporate segment and how are the pricing trends now?

Shyam Srinivasan: Harsh, you want to go?

Harsh Dugar: Yes. The pricing is much saner today than it was about 6 months back. That's partly because of the correction of the demand-supply situation. The surplus liquidity in the system was upwards of Rs. 8 lakh crore for a very long time, which today has come down to Rs. 1 lakh crore plus interest rates have hardened. And third and most importantly, credit offtake has improved. So, between these 3 factors, the pricing power and especially the pricing of the most finely priced assets has actually been more than the repo hike in the range of 225 basis points. So, the sanity is coming back in the market, the correction, which was long due has come in, plus the credit offtake has improved. So, these are the 2 factors which are guiding in terms of a better growth and expansion in the NIM as well.

Nitin Aggarwal: And any select segments, verticals you want to highlight behind this growth?

Harsh Dugar: As of now, working capital has been the one which has been building more demand on. But on the CAPEX side, there's very clear uptick and interest coming in over there as well. So, we do see the rebound being robust and steady over the years. Sectorally, if you look at it, I think it's been across. We're seeing this with auto. We're seeing this with seafood. We're seeing this in renewables. We're seeing this with chemicals. So, there are quite a few broad-based sectors which are coming over here. No particular sectors which I would define over here. It's pretty broad-based.

Nitin Aggarwal: And last question is on the divergence between the credit and deposit growth. While you have talked about the focus on liabilities and like you will not participate in the rate sort of war there. But how do you plan to mobilize deposits to support this growth momentum? And in context to the recent INR depreciation, how are the trends on the NRE deposit growth side, NRE franchise side?

Shyam Srinivasan: On the NR, we are seeing remarkable inflows. I think we've shared this in the deck. Our remittance share has gone up even further to 22%. I think the last time we spoke we were in the late teens. So, almost every passing quarter, we are gaining share, which is a very significant development. But all of it is not translating to deposits. I think there is a revenge spending going on by the NRIs. So, it could be seasonal. So, we'll have to see how that plays out. So, our deposit growth is sort of predicated on a bunch of stuff. One is wherever required, we'll be competitive in pricing. It will continue to be as granular as possible. NR is beginning to show higher traction in terms of remittance, and it only leads to deposit flow.

Domestic deposits is growing quite nicely. We are expanding our footprint even further. Even in the first half, we added about 25 or 35 branches. We believe we'll add another 30, 40 branches this year. So, between branch expansion, our fintech partnerships beginning to mature, our NR remittances, pricing appropriately on term and selectively borrowing, we will be able to meet our credit demands.

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

Renish Bhuva: So, sir, first question is on the sort of sustainability of this current loan growth momentum. So, of course, the recovery has been broad-based and most of the segments are growing in 15% to 20% range. But if I have to look at, let's say, from next couple of years' perspective, which segment do you feel will drive the growth?

Shyam Srinivasan: Renish, I think it would be inappropriate to talk 2 years in a very turbulent environment. I think our line of sight is 2, 3 quarters. Not that we are not looking beyond, but the business is that we sowed our seed sometime back have all started flowering. That's why in our investor deck, we've started calling that out. I think Slide #29 captures that. And therefore, that is a promising new opportunity. We think that's scalable. Those are segments that have potential, where we have low penetration in the country. We have low share. And we believe we've built expertise to grow these segments.

So, I do think in the coming quarters, the year ahead, these will be relatively higher margin businesses too and not to suggest that they won't get disintermediated. But I think this will remain higher margins. So, our belief is that as we scale into these, credit growth of this kind of order of magnitude is possible. I always caveat it by saying the environment should not become counterproductive. As long as it's supportive, yes. I feel we've demonstrated reasonable clarity around growing without trying to be too cowboyish in our approach.

Renish Bhuva: Yes. I mean that has been the core strength of our franchise. So, sir, any broad, let's say, range do we have in mind that this CV/CE, MSME, credit card, which is currently contributing 20% to the loan book, is there any number?

Shyam Srinivasan: Renish, that is the incremental flow. It is not on the stock.

Renish Bhuva: So, that should remain in that range or quarter-by-quarter, it should increase?

Shyam Srinivasan: Incremental flow, it will increase. On the stock, it will still be reasonably small. But on the flow, it will increase, go to 25%.

Renish Bhuva: Got it, sir. And just sir, again, sorry to coming back to the NIM question. But if I look at the balance sheet mix over the last, let's say, 2, 3 quarters, our borrowing has gone up from around Rs. 8,000 crore to Rs. 20,000 crore now, which is essentially suggesting that we are funding the incremental growth via borrowing. So, if you can just broadly highlight, is there any rate differentiation between cost of deposits and cost of borrowing?

Shyam Srinivasan: Yes, I think in the beginning of calendar '22 and middle of calendar '22, we did see the war on deposits and the pricing ware for deposits. We've identified some relatively lower cost borrowing opportunities, which are CRR and SLR free and we borrowed. But that is a point in time that cannot be sustained because you won't get the money at that kind of pricing sustained basis. So, we did get a 3-year money, we locked in and it enabled credit growth. As we see, that's why I said we continuously calibrate deposit growth between paying top dollar versus these opportunities, and we'll keep blending that up.

Renish Bhuva: Got it. And just a follow-up on that. So, sir, we are already at, let's say, a peak CD ratio of 85%, okay? And we might accelerate deposit mobilization in coming quarters. So, of course, next couple of quarters, you clearly said that margins will remain around 3.25% to 3.3%, but on a sustainable basis, keeping in mind the peak CD ratio, of course, as well as the high yielding products start contributing to incremental growth. So, on a sustainable basis, where do you see our margin settling down, sir?

Shyam Srinivasan: Somewhere in the 3.30s is where we are working on, hopefully improving, but 3.30s, which you would notice is higher than what I've been guiding in the past quarters.

Renish Bhuva: Absolutely. So, that is why, sir, I was just trying to reconfirm that next couple of quarters 3.30% will be, let's say, the benchmark. And going ahead, it should at least remain at that range, is what the working we are as a plan.

Shyam Srinivasan: Yes.

Moderator: The next question is from the line of Kaushik Poddar from KB Capital Markets Private Limited. Please go ahead.

Kaushik Poddar: Shyam, you seemed to have ticked all the boxes. Is there any other box, which remain unticked? That's the questions #1 And question #2 is, in the results, for the note number, just a minute, I think Note #8 or something that talks about the resolution assets and you have given the breakup and all those things. So, if you can explain that note?

Shyam Srinivasan: Venkat, you have the results document in front of you? I don't. Venkat?

V. Venkateswaran: I do have it.

Kaushik Poddar: Yes. It's Note #8, yes, on the resolution plan. But first about the boxes that remain unticked.

Shyam Srinivasan: Yes, I think, Kaushik, unfortunately, this is not a static list, right? It keeps changing. And you, as an investor, will demand more. We, as a leader, will demand more. So, it's a continuous journey. But yes, we would like to make sure that the 1.2% ROA becomes 1.25%, the NIM improves. We are pushing on all the buttons. And I think we are on course. At least, the team is marching to a rhythm, and we believe we are doing the right things. As you may have observed over the years, we won't do the wrong things, that I can assure.

Kaushik Poddar: Come again, I didn't get that.

Shyam Srinivasan: I said, you may have observed over the years, we won't do the wrong things, and I assure you that, I said. And certainly, yes, we are pushing on all the buttons.

Kaushik Poddar: Okay. And this cost-to-income ratio has improved massively, I mean, do you see that at the 48% level or improving from there?

Shyam Srinivasan: No. Basically, we've upfronted 1 year of all our deliverables through this year. If you remember, we've said, by FY '24, we will get closer to 48. We've are upfronted. But that's also because income growth has been strong, and we've never been extravagant in costs. But as branch expansion increases, some of the deliverables that we need to put on the system side, somewhere in the 48 is what we are guiding for, between 48, 49.

Kaushik Poddar: Yes. And if you can explain that Note #8?

V. Venkateswaran: Yes, I can do that. This note is nothing but the RF 1 and 2 in terms of the exposure and what has turned into NPA and which are the accounts which have paid us. So, this is a format which has to be disclosed as per regulatory requirements. This is pertaining to RF 1 and 2.

Shyam Srinivasan: Restructuring during COVID, Kaushik.

Kaushik Poddar: I think Rs. 138 crore have fallen into NPA. And do you see the similar kind of run rate every quarter or in that ballpark figure?

V. Venkateswaran: For the first half year it's Rs. 138 crore.

Kaushik Poddar: Yes. I mean do you see that at around Rs. 150 crore for the next half year also?

Shyam Srinivasan: See, it could be. It will be in our overall slippage number. In the first half, our overall slippages was about Rs. 800-odd crore, and in the second half, these overall slippages could be around Rs. 900 crore to Rs. 1,000 crore, and this will be within that.

Kaushik Poddar: Okay. So, this is part of that overall slippage, right?

Shyam Srinivasan: Yes. And we have made excess provisions. And thank you for pointing it out. We are carrying excess provisions on the restructured book. And also, this quarter, most of you would have observed, we have further increased our PCR by 250 basis points.

Kaushik Poddar: So, that includes that excess provision, right?

Shyam Srinivasan: No, that is separate. That's outside of it.

Kaushik Poddar: That's outside of it. Okay.

Ashutosh Khajuria: The provision is on standard assets, restructured standard assets. And provision coverage ratio is on NPAs.

Moderator: The next question is from the line of Lalitabh Shrivastawa from Anvil.

Lalitabh Shrivastawa: First of all, one thing I wanted to ask, if you can share the breakup of the provisioning expenses for this quarter? And yes, that's all.

Shyam Srinivasan: Do you want the breakup of provisions?

Lalitabh Shrivastawa: Yes, sir.

Shyam Srinivasan: I think it's there in the deck, right, Venkat?

V. Venkateswaran: Yes, it's there. I'm just looking at which page, I'll tell you.

Lalitabh Shrivastawa: Yes. I wanted to know this credit cost has gone up on a sequential basis. And so any comments you have on that?

Shyam Srinivasan: I mentioned just now that we've increased our provision coverage from 65% to 67.5%, that's Rs. 100 crore extra. Every 100 basis point is about Rs. 40 crore.

Ashutosh Khajuria: Gross NPA is Rs. 4,031 crore. So, every 1% would have Rs. 40 crore additional if you want to increase the coverage. And we have increased by about 2.5%.

Moderator: The next question is from the line of Subrat Dwivedi from SBI Life. Please go ahead.

Subrat Dwivedi: Two questions. First is, just wanted to know in terms of the increase in your cost of lending, how much has it been for retail and how much has it been for large corporate over the quarter?

Shyam Srinivasan: You mean the rate increase?

Subrat Dwivedi: Yes.

Shyam Srinivasan: I think between the 2 businesses, both have been able to pass on the rate increase of the 140 basis points, between 110 to 115 basis points have been passed on to on the lending side.

Subrat Dwivedi: Q-on-Q I was asking sequentially.

Shyam Srinivasan: Sequential what, rate increase?

Subrat Dwivedi: Yes.

Shyam Srinivasan: Yield has moved about 35 basis points, right, Venkat?

V. Venkateswaran: Yes, 36. Correct. Yes.

Subrat Dwivedi: No, sir. How much on the retail side and how much for large corporates?

Shyam Srinivasan: More or less equally weighted.

Subrat Dwivedi: And my second question is when you say that you have met some of the liability requirements through borrowing, opportunistic borrowings, what sort of borrowings were these?

Shyam Srinivasan: From financial institutions like SIDBI, NABARD.

Ashutosh Khajuria: Refinance, which is CRR, SLR free. No CRR, SLR applicable.

Moderator: The next question is from the line of Krishnan ASV from HDFC Securities. Please go ahead.

Krishnan ASV: So, Shyam, just wanted to understand your thoughts on the EBLR transmission a bit. You seem to have a lot of discretion on the deposit side in terms of not wanting to pass it on. And yet on the asset side, there seems infinite elasticity there. I just want to understand, does the RBI allow this? Could they be looking at this a lot more closely in terms of exercising discretion? And the second related question is at some stage, if it's kind of you're breaking the camel's back, do banks have discretion to typically not pass it on completely at all? So, if there's a 50 basis points increase in the repo rate, do banks, including Federal, have a choice to pass on only, say, 20 basis points out of that?

Shyam Srinivasan: No, I think it's a bunch of things, Krishnan. I don't think I can give an answer saying, yes or no. Every time there's an MPC and a rate change, we look at portfolio by portfolio, segment by segment, spread and then take a call. In certain areas, we may not be able to offer the entire increase. In certain areas, we may have to offer the entire increase. I don't think I have an answer saying yes or no, it's very nuanced, very layered. And for some ticket sizes, we may have passed on the entire also.

Krishnan ASV: And just between how this acts on the deposit side versus the loan side? On the deposit side, when you don't pass it on completely, it's obviously not hurting us right now, right?

Shyam Srinivasan: No, it's not like it's not hurting. There is a transmission delay, and there is the quantum that changes between credit and deposits.

Ashutosh Khajuria: Krishnan, if I may respond to your question further is that, that I think on the loan side, there is a mandatory linkage to external benchmark. So, you have for a particular segment like retail, MSME and all, you have to necessarily link your loan pricing to an external benchmark, unless it is fixed rate. Whereas on the deposit side, presently, there is no such a regulatory requirement of linking your deposit rate to any external benchmark or so.

So, therefore, savings Bank any day, like some banks who earlier had their savings Bank linked to repo have delinked it. So, that's the difference here. Dealing can decide based on how the competition is and how much you want to encourage the saver to put money with you because that's a very tough competition. And I would say, almost similar rate is passed on the term deposit side. If you see the way term deposits have moved from less than 5% or so to now nearly 7%. So, with 190 basis points hike, you have seen almost 200 basis points hike on the term deposit side.

Krishnan ASV: I get that. What I was trying to understand, I guess, Ashutosh, is more around the fact that on the loan side, at least, there is obviously a spread, right? And that spread ideally does not change. So, if a Krishnan was already pegged to repo plus, say, 200, 300, whatever that number was, that spread of 300 stays constant no matter what the RBI does, right? Or do you have discretion to bring that down if you believe that the risk is going up?

Shyam Srinivasan: No, the spread changes based on the risk profile of the customer. If the customer risk profile deteriorates, then the spread changes.

Ashutosh Khajuria: Spreads can change in 2 ways. One, if in case the credit quality deteriorates, you can increase the spread and all, like internal rating change or external rating change or something like that or some covenants being defaulted and all. On the other hand, on the deposit side, you have an external benchmark to which it could be linked. On the loan side, again, you can reduce the spread when the renewal happens or reset happens. So, it's not that if your account is performing very well, the right is there available with the Bank to reduce the spread. So, on both sides, you can increase it as well as you can decrease it subject to certain requirements. Otherwise, normally spread is nonnegotiable.

Krishnan ASV: Got it. Just the other thing was about it's not hurting us now. It's not on the P&L front that I meant, but the fact that because 90%-plus of the Bank's deposits are franchise deposits, in a manner of speaking, they keep coming no matter, they are kind of rate inelastic, right?

Shyam Srinivasan: Not all of it, Krishnan, but part of it is.

Ashutosh Khajuria: I would not agree. I think a good chunk of deposits these days are not rate inelastic. People demand, I mean, based on the competition that you are facing.

Moderator: The next question is from the line of Prashant Kumar from Sunidhi Securities. Please go ahead.

Prashant Kumar: And as per commentary most likely to continue further, I have a couple of questions. One is on the capital adequacy side. Actually, in last quarter, we have consumed roughly around 75 bps of CAR. So, just maintaining the current loan book growth, I already mentioned in last quarter that the Bank is going to raise Rs. 120 billion of fund, Rs. 40 billion and Rs. 80 billion of equity and debt. So, if you could give some that because I think that in this growth, maybe we have highly needed to raise in last of this financial year. So, first one is that, give some outlook.

And second is on asset quality side, the restructure book almost stable, but not has come down even in the better picture of economy. I mean MSME is doing better. But still, it has remained at the same level. But I mean it is not on the hurting level. I mean it is on very control as per the other banks, but if you could give some that when we will achieve the pre-COVID level on the specially restructured book side. Otherwise, asset quality on, I think, sir, it is very good.

Shyam Srinivasan: No, the restructured book, as the demand on it increases, the bulk of it will be in Q3 and Q4. So, we'll see that performance and how it's shaping up. And therefore, by end of financial year, you'll see a better sort of consistency versus a pre-COVID period. And on the first question, I think you mentioned about capital consumption. Yes, we think this financial year, when we put back our full year profits, as you know, the Q2 profits are not in the ratio. When we get back to a closing of financial year, we will get back somewhere near 14% CRAR and that's our model.

But having said that, in early financial year 2024, if situation is conducive, we can consider, but it's not in our planning horizon just now. And the Rs. 12,000 crore was an enabling resolution we took from shareholders should the need arise. I mentioned that in the last call also.

Moderator: We have the next question from the line of Mahesh M.B. from Kotak Securities. Please go ahead.

M. B. Mahesh: My first question is on the OPEX line, sir. I just wanted to understand the growth rate on the staff side, even if you adjust for the family pension has been on the lower side. Directionally, how are you seeing this number, especially with wage costs likely to be seeing a revision from the next wage settlement cycle. And also, correspondingly on the other OPEX line also has been quite high for the kind of loan growth that you're showing.

Shyam Srinivasan: There will continue to be this kind of run rate. Neither of them will dramatically alter. There are no one-offs, one way or the other. This trend line will continue.

M. B. Mahesh: There's no pension-related lower provisions, higher provisions in this quarter, right? Or is just a normal run rate at which you're running around?

Shyam Srinivasan: Nothing material. Venkat, would you want to answer that? Is there anything that uniquely different? Of course, yield related some benefits are there.

V. Venkateswaran: Largely driven, there's no one-offs or any material pension related. It's the normal run rate. And on the other OPEX, it's largely driven by volume-related costs.

M. B. Mahesh: Second question, sir, on the deposit side, again, sorry, this question has been asked repeatedly, but just kind of taking it again in a different way to look at it. Are there any segments within the deposit book that is seeing a slower growth in the sense that when you look at your, let's say, retail deposits or households, are they saving less, are they drawing down, corporate lending?

Shyam Srinivasan: NR savings, I mentioned is rate of remittance is much higher, rate of savings is lower.

M. B. Mahesh: That's on the savings side, right? On the deposit side?

Shyam Srinivasan: That’s what I’m saying, NR on the savings deposit.

M. B. Mahesh: On the term deposit side, sorry.

Shyam Srinivasan: Term deposit, we are not seeing anything different. It's price-elastic. And in segments that we are offering good pricing, we are seeing good traction.

Moderator: The next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Firstly, just to sum it up, sir, we are looking for an ROE exit of closer to 1.3% for FY '23 and NIMs inching up to 3.30%. This is what the sum and substance of the….

Shyam Srinivasan: No, I said ROA exit closer to 1.25%, not 1.3%, but yes, NIM of 3.3%, yes.

Saket Kapoor: And for the fundraising exercise, you just earlier commented that there is no plan at least for H2 to raise capital. We would be looking forward for fundraising only post our full year numbers are there. And then looking at the environment, we would be contemplating whether a fundraising could be the need of the hour.

Shyam Srinivasan: That is a fair assessment, yes.

Saket Kapoor: Now sir, coming to the line item of treasury income, sir. If we look at the treasury income partner, what is the contribution from G-Sec, sir, under this line item? How has the G-Sec portfolio performed and its contribution under the treasury fund segment? And what are the key parts of this treasury income of Rs. 671 crore?

Shyam Srinivasan: Ashutosh, do you want to go?

Ashutosh Khajuria: Yes, sure. See, the G-Sec contribution, I think, from the interest rate products, the contribution in first and second quarters has not been considerable. In first quarter, it was single digit. In second quarter also, it has been hardly Rs. 20 crore, Rs. 25 crore or so. But I mean, what is important is to is this is the time when it was required to protect the portfolio. So, from mark-to-market point of view, there had not been, as I shared with all of you in the first quarter itself after first quarter results, there had been a massive reduction in modified duration, which resulted in lower provisioning requirement in first quarter. And this quarter, the yields have actually been flat or rather they have come down a little bit because one sees only the benchmark. If you see the other papers and all, I mean, there has not been much of a change barring very short and all that. And therefore, our portfolio for second quarter, again, had some little bit of a couple of crore of write-back rather than providing. So, that's on the treasury fund, but there had been good earnings on noninterest rate-related products also like equity and all.

Shyam Srinivasan: And a very strong progress on the FX.

Ashutosh Khajuria: FX had been very strong, but FX is in core fee income because that's related to merchant transaction. Basically, with corporate credit growth, there had been more opportunities to provide the hedging and all that. And through that, there had been a good growth there.

Saket Kapoor: But sir, in the fee income part, we have, again, put a net profit figure of FOREX transaction at Rs. 94 crore. So, that is different.

Ashutosh Khajuria: Yes, that's what I'm talking about. Yes.

Saket Kapoor: And that is on account of the improved business transactions on the foreign exchange front?

Ashutosh Khajuria: Absolutely. We call it merchant FOREX. This is the profit related to our relationships.

Shyam Srinivasan: This is not proprietary trading. This is client-based income.

Ashutosh Khajuria: Client-based income.

Saket Kapoor: Okay. Client-based income. Sir, just wanted to understand the nature of the transaction. What service are we offering that results in these kinds of profit and whether these are sustainable numbers?

Ashutosh Khajuria: We are offering the entire range of hedging products, which are permitted by Reserve Bank of India with all required so-called mitigants like the customer appropriateness and all. So, based on that, the entire range, whatever is permitted to be offered in India is being offered.

Saket Kapoor: And what should be the value of the transaction, sir, on which we have booked this Rs. 94 crore of profit? How much is the business transacted on account of this FOREX side?

Ashutosh Khajuria: I need to check that because there had been a lot of volatility and all that. I think transactions have been quite high. I mean as far as the remittance is concerned, there also you have your counterparties like exchange houses and all. So, these are also, I mean, covering their transactions and all. So, there has been a mix of all that and because of volatility, there were other arbitrage opportunities as well. So, all put together, this comes to this number.

Saket Kapoor: Right, sir. So, last point is, sir, on the basis of the other income component or the fee income part, the line item of Rs. 540 crore, which we posted for this year, taking into account the composition, how likely is that this could be a sustainable number going ahead because it has various variables and parts to it? And how should one look going ahead?

Shyam Srinivasan: It’s granular, it’s structural and it’s consistent. Variability in that can be 5% this side, that side.

Saket Kapoor: Right, sir. And the last line item was on profit on sale of securities that was Rs. 70 crore, so that is a one-off item only.

Shyam Srinivasan: That could have had some recovery gains.

Ashutosh Khajuria: Yes, that's not entirely on account of profit on sale of investment. Let me clarify that, it has multiple things that other than this core fee income, I think you are talking of the difference between Rs. 610 crore and Rs. 540 crore.

Saket Kapoor: Yes, sir.

Ashutosh Khajuria: Rs. 540 crore being core fee income and Rs. 610 crore being noninterest income that includes dividend from associates and subsidiaries, that includes a recovery in written-off assets that has partly some profit on sale of investment, all put together, that number is Rs. 70 crore.

Saket Kapoor: Correct, sir. And anything you want to speak on the NPA front, sir, on whether where are we going to likely end the year on the gross and the net NPA front, the numbers which we are targeting?

Shyam Srinivasan: No, let me just close out. The beginning of the financial year, we had said that the full year slippages. If you remember, first quarter was about Rs. 450 crore. We said the full year slippages will be in that Rs. 450 crore times 4, around Rs. 1,800 crore. Second quarter was exceptionally good. We think Q3, Q4 will be between Rs. 900 crore to Rs. 1,000 crore for the rest of the FY. And a credit cost of around 50 to 55 basis points.

Saket Kapoor: On the percentage terms, sir, any ballpark which we are targeting to end the year or how the second half? We have a gross NPA of 2.46 and the net at 0.78.

Shyam Srinivasan: Yes. I think I've mentioned credit cost, 50 to 55 basis point, coverage ratio at 67.5%. We will seek to improve those, so it should only keep improving there or thereabouts.

Saket Kapoor: So, to conclude, sir, the trajectory is very strong and on the strong path, we are continuing to march ahead. The factor that has enabled us to post these numbers are gaining strength rather than being one-off. This will be the sum assumption?

Shyam Srinivasan: I would like to believe that. That's how I opened the call. It's broad-based, it's granular, it's organic, it's deep-rooted.

Moderator: The next question is from the line of Suraj Das from B&K Securities. Please go ahead.

Suraj Das: Yes. Sir, the first question is on the restructured book. If you can explain, I mean, how much of the book would be out of moratorium and as resumed billing? And how much percentage of the book is still under moratorium? And also, you mentioned some excess provision on the restructured book. If you can quantify what would be the excess provision on the restructured book? Yes, that is the first question.

Shyam Srinivasan: Yes, I think Venkat mentioned, Rs. 138 crore is the excess provision, more than the mandatory provision. So, we're holding close to Rs. 650 crore on the restructured book.

Suraj Das: And sir, how much percentage of the book would be out of moratorium and has resumed billing and what kind of slippages we are seeing from the book?

Shyam Srinivasan: Raj, if you're there on the line, I think in the coming 2 quarters, about between this quarter and the next close to Rs. 1,000 crore would come, right, Raj?

Rajanarayanan N: Rs. 300 crore plus Rs. 300 crore, sir.

Shyam Srinivasan: Rs. 600 crore.

Rajanarayanan N: Rs. 600 crore and 70% of the book has already come out for demand as on 30th of September. So, we've got only 30% of the book left to come out from moratorium.

Suraj Das: And sir, the second question is more of data-keeping. So, you have mentioned some during the call that around 65% of the loans are floating rate linked. If you can bifurcate that, how much would be the repo linked percent and how much would be the MCLR fixed rate and others?

Shyam Srinivasan: 50% is repo, 15% is MCLR, 25% is fixed, 10% is employee and fixed, so on and so forth.

Ashutosh Khajuria: And advances against deposits.

Moderator: The next question is from the line of Manish Shukla from Axis Capital. Please go ahead.

Manish Shukla: Sir, first question is that over the last few months, you've seen RBI make a lot of changes to regulations around fintechs. Has that made you revisit how you engage with fintechs?

Shyam Srinivasan: I think it's encouraged us. I've said this in every call. We believe very firmly in the fintech partnership model. We have created capabilities that are very fintech sort of enhancing. And which is why through all this process, we didn't see either a partner getting nervous or we getting nervous, and we are quite confident that this momentum will continue. We've looked at fintechs for liabilities differently from assets and all our top 4, 5 fintech partners, we have many, but the top 4, 5 are continuing to storm ahead. And we think that model works for us. We haven't been nervous by any of the changes. Some tweaking in relationship and pricing has been done. We're quite pleased with it. Shalini, you want to add, please?

Shalini Warrier: Yes, Shyam. Just to kind of expand that further. If you look at just the digital lending guidelines is one of the areas which have come up. Clearly, we believe that it has helped in terms of transparency from a customer standpoint and clarity on how the relationship should work and we've used that as a basis to kind of structure some of our fintech partnerships. You'll see in the investor deck, for example, one of the ones we launched towards the end of September, fully compliant with all the digital lending guidelines with the one with Paisabazaar.

So, the broader point is these regulations are actually quite useful in making sure we understand how the collaboration works and how the linkages work. We do believe that they're in the right direction, and they really reinforce our continued emphasis and strategy of fintechs.

Manish Shukla: Second question, Shyam, is that everything that you've discussed on the call so far, right, points towards a very benign environment, loan growth, margin, asset quality. What is it that worries you at this time?

Shyam Srinivasan: I think I've said this in every call. I'm a worrier. So, we worry about everything that can go wrong. And certainly, the thing that have looked robust, need not look robust. There can be some stress in the environment building. But I think structurally, we believe that the COVID has got both the Bank and the customers to navigate very tough periods. Those who have withstood the last 2 years, I think, can withstand any of the forthcoming stresses. So, that gives us the confidence. Yes, the war for deposits will intensify, but so will our abilities. So, am I worrying about everything? I think yes. But I think structurally, we are better off than we ever were.

Moderator: Our next question is from the line of Darpin Shah from Haitong India. Please go ahead.

Darpin Shah: Thanks, all my questions have been answered.

Shyam Srinivasan: Souvik, I think we should bring it to a close. Maybe one last question, please.

Souvik Roy: Sure, sir.

Moderator: Sure. We'll take the next question as the last question from the line of Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal: Sir, how much extra liquidity we'll be carrying at this point of time versus regulatory requirements?

Shyam Srinivasan: Meaningful.

Pankaj Agarwal: The reason I'm asking is that like for how much more you can grow your loan book without growing loan deposits? I think the mechanism…..

Shyam Srinivasan: I got the question. I said meaningful, we can grow credit. Like I have said at the beginning of the call, between a mix of deposits, borrowings, our own resources, I think credit growth of high-teens is possible.

Pankaj Agarwal: And that can last for another couple of quarters? I mean my broader question was that the gap between deposit growth and loan growth, I mean can it sustain for another 2 quarters?

Shyam Srinivasan: As a financial year, yes, we have a plan and we have the ability.

Moderator: Thank you. Ladies and gentlemen, that would be our last question for today. I would now like to hand the conference over to Mr. Souvik Roy for closing comments. Thank you, and over to you.

Souvik Roy: Thank you so much, Aman. And thanks again to all the participants who dialed in today on a Friday evening. If we've left any questions unanswered, we would be very happy to engage with you offline. With this, we'll close the call. Happy Diwali in advance and see you all on the other side of Q3. Thank you so much.

Shyam Srinivasan: Thanks, everybody. All the best and Happy Diwali.

Shalini Warrier: Thank you, everybody. Happy Diwali in advance.

Ashutosh Khajuria: Happy Diwali to everyone. Thank you.

Shalini Warrier: Bye.

Moderator: Ladies and gentlemen, on behalf of the Federal Bank Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.