"Federal Bank Limited Q4 FY17 Earnings Conference Call"

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Moderator: Good day Ladies and Gentlemen, and a very warm welcome to the Federal Bank Q4 FY17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Rajanarayanan, Investors Relations Head from Federal Bank. Thank you and over to you, Sir.

Rajanarayanan Nerlakat: Good afternoon everybody and welcome to Q4 Earnings Call of Federal Bank. With me are Mr. Shyam Srinivasan – MD and CEO; Mr. Ashutosh Khajuria – ED and CFO; Mr. Ganesh Sankaran – Executive Director; Ms. Shalini Warrier – COO; Mr. Sumit Kakkar – CCO; Mr. Girish Kumar Ganapathy – General Manager, and other senior executives. Over to Mr. Shyam Srinivasan.

Shyam Srinivasan: Very good afternoon everybody, like Raj mentioned the entire senior team is there. As normal practice, I will just give a very brief update on the quarter that went by and importantly our hope and aspirations for the year ahead, and then we will take questions and clarify things that people may want to know. As a matter of process, I think the Investor Deck is already on the public domain and all information that we wanted to share in terms of the highlights are very much there, but I will just stress on a few of them which we are both energized and inspired by.

The growth that began at the backend of FY16 has been sequentially strengthening and Q4 was yet another good quarter. Overall, business momentum was strong, credit growth was north of 26% for the full year and importantly in an environment that has been seeing stress, that has been seeing banks report higher NPAs, we are quite pleased that our efforts of many years has come to bear and our slippages have held in and around the 250 crore mark. This quarter in particular was amongst the lowest at 244 crores and it is important that it continues to be equally sort of split across different segments of the bank and we do not see either a geographical or sector or business led bias on that.

In Quarter-4, the slippages the 244 crores had about 55 crores retail, 30 crores in Agri, 37 crores in Corporate and about a 122 crores in SME. From a growth standpoint of view, Q4 by itself had credit growth of little over 5%, annualized run rate of about 21%. The Q3 and Q2 in particular when we had a portfolio transaction was close to 30%-odd, so the weighted average credit growth of the bank was 26%. Split Retail, SME, Corporate all saw handsome growth. Retail was 27% annualized, SME was 18% annualized and Corporate was north of 30%, so we had good growth all across and as you will see, the growth has been in the segments and the credit ratings that we would like it to be.

From a financial standpoint – the net interest income, the operating profit were all the all-time high, operating profit at 549 crores, net income at 842 crores were all-time high. These have happened on the back of many quarters of regular growth and more importantly the even pacing of growth and broad basing of growth has helped us keep the interest margins up, also because of the lower slippages, the revenue impact on account of lower slippages was lower. On balance, Q4 FY17 encouraging year, inspiring year, the bank has positioned for a strong FY18.

We have invested in people, process, and putting many building blocks in place. We believe that FY18 should start seeing this trajectory get better as we go into different businesses. We are also reorganizing ourselves in terms of how we go to market. We put in a very formidable RM team when Ganesh joined us about a year-and-a-half ago. We are now strengthening that and getting a little more granular on how we go to market in the mid-market, which is really the strength of the bank, so we are using the branch network more sharply to do our business banking, getting in to a very organized commercial banking structure which is also RM led, which will start mimicking our corporate banking structures. There is a fair amount of distribution leverage that is going to set in what was already commenced, we will start building up in FY18. On the back of all this and a fairly encouraging Q4, we believe that FY18 should start seeing this kind of momentum and keep improving here on. Those are the sort of headline opening points, happy for us to lead into it with questions.

Moderator: Thank you. Ladies and Gentlemen, we will now begin with the question and answer session. We will take the first question from the line of Nilesh Parikh from Edelweiss Securities. Please go ahead.

Nilesh Parikh: Just wanted to, we have got limited time to view the presentation, but in terms of the capital raising, starting off with the capital raising, just wanted to hear your thoughts in terms of the future prospects, getting into FY and we have kind of consumed capital quite fast over the last one-and-a-half to two years, so just wanted to hear your thoughts in terms of your plans for the capital raising going forward?

Shyam Srinivasan: The board has approved the first step of the process. We need to get the shareholder approval, which we will in the due course. Like you pointed out, our capital consumption is about 30 odd basis points every quarter and we think at this run rate, we may need capital going into FY19, so we are preparing for that. In the course of this financial year over the coming months, we will decide on time, instrument, and how. We are getting our act ready for that. What is important is we have not gone into the market for long. We believe that both our performance and our incremental view on the market and the consumption of good capital, we will need to raise money, therefore, we are getting our act ready for it. In the course of the coming months, we will see that happen.

Nilesh Parikh: In terms of the growth prospects, to be kind of have a strong year for the full year every quarter we have kind of seen that build up, so we are pretty confident in terms of this trajectory carrying on for an extended period of time?

Shyam Srinivasan: Absolutely yes.

Moderator: Thank you. We will take the next question from the line of Rakesh Jhunjhunwala from Rare Enterprises. Please go ahead.

Rakesh Jhunjhunwala: What I want to understand is the cost to income ratio is still very high at 51%, so what is the trajectory, you think you can reduce it in the next year to come?

Shyam Srinivasan: Rakesh, like I mentioned on an earlier call also, of course last time was a little inflated because of the one-off impact of almost 40 odd crores on account of demonetization. That has more or less normalized in this quarter and you saw it trend down to 51. We believe another 100-150 basis points is what it will improve on the back of both sort of efficiency as also income growth. There are certain areas that we want to invest behind, which we will in the course of FY18 and FY19. Our steady state between 48 and 49 or close to 50 would be what we see given the fact that we have a lot of activities and investments that we need to do, but it will be calibrated as always back of growth and I had mentioned three years back that we will taper down our branch growth once we see certain critical mark and that is playing through, that is why you have seen sharp growth in the credit and particular to then new geographies now more established. We see that stabilizing, as we see that stabilizing and revenue kicking in, we will put in our next level of spends, so between 49, 50, 51 is where we see it at least for the next two years.

Rakesh Jhunjhunwala: Another thing is, there is some press report that you are selling a stake in your NBFC, so what is the progress on that?

Shyam Srinivasan: We are not selling, we are bringing an investor into the, we are exploring and we are in dialogue, we have a process that is running and that may take another three months for it to mature, so there is a very active dialogue going on and a price discovery and a business model discovery that is going on. The NBFC by itself has had a record year, has doubled its book and is looking to do that again.

Rakesh Jhunjhunwala: What is the, you do not give the NBFC to consolidated results?

Shyam Srinivasan: At this juncture, it is very small. The impact is not material to the overall numbers, but they have turned around quite considerably. Book is about a little over a 1000 crores, profitability is around 20 crores.

Rakesh Jhunjhunwala: What about this, your insurance company?

Shyam Srinivasan: That is three-way partnership between Federal Bank, IDBI and AGS. AGS is the international partners looking to explore whether they have an opportunity to increase stake. There also there is a price discovery process underway. The two Indian banks are now looking to see how each one will dilute at what price point, so there is entire elaborate process that is just being kicked up, and therefore, we think in about three-four months, some clarity will emerge.

Rakesh Jhunjhunwala: What is our stake?

Shyam Srinivasan: 26% is the Federal Bank stake in IDBI Federal. IDBI Federal has an AUM of 6000 crores has been profitable for the last three to four years and is a highly solvent company.

Rakesh Jhunjhunwala: What is the growth rate?

Shyam Srinivasan: They had one of the best growth this year, they grew 30%.

Moderator: Thank you. We will take the next question from the line of Kaitav Shah from SBICAP Securities. Please go ahead.

Kaitav Shah: Sir, while your credit cost is a low-hanging fruit for you to kind of improve upon on the ROA, what are the low-hanging fruits do you think are kind of still there over a one to one-and-a-half year timeframe to take the ROA north towards your intended target?

Shyam Srinivasan: I think I do not want to be facetious, there are no low-hanging fruits in India less for anybody to just pluck off. Everything is a lot of effort and I think, yes, credit improvement is one, but that apart the regularity of growth of our credit, and therefore, the NII is a crucial one. Second is obvious one is about fee income, and in terms of fee income, there is the progress but unfortunately when something goes up, something comes down which some of the factors are not entirely in the control of the bank, particularly when you talk of interest rates and the treasury rated gains, so for us if we pick our other income up, there are a few more elements. If you see the stuff that is directly in the control where the elasticity to effort is high, the bank has done quite well in FY17. We think that will keep pace or gather pace if we go into FY18. Our GIFT city opportunity is now maturing quite well and that may give us an opportunity to look at some fee income opportunities. We have done $200 odd million of the book, we think that book will double as we go into FY18, so there are many dials that we are dialing up and we think the sort of culmination of all that will start seeing the growth in other income, and therefore, the ROA improvement will play through in addition to efficiency pushing up our digital journey on which we have a lot of intensity and focus and we do reasonably well with all our offerings and as we go into FY18 those will be the principal focus areas.

Moderator: Thank you. We will take the next question from the line of Nagraj Chandrashekaran from Laburnum Capital. Please go ahead.

Nagraj Chandrashekaran: Just continuing on the previous question, the other part of improving ROAs would be your strength of course, just could you talk us through some banks saw a continued improvement in CASA into this quarter as well, you saw a slight decline. Is there a possibility of increasing CASA, what is your strategy here and what is the possibility of lowering your cost to deposits from where you are right now?

Shyam Srinivasan: CASA did not decline, as a ratio it did, absolute terms continued to grow. Reason it declined because we had some healthy one off large ticket term which came in, so it generally flatted the denominator, to that extent the ratio of CASA looked lower. Having said that, we are most keen to make sure that our CASA ratio nudges closer to 35%. The rate of growth in NR despite whatever is happening in the market is turning out quite well for us. We are gaining share consistently. Our NR market share of remittances into India is touching 15% now, and therefore, that will continue to be one driver of low cost deposit growth. In addition to that as we have expanded our footprint across the length and breadth of the country and branches outside our home market are now between three and four years, the rate of growth of low cost deposit there is quite handsome and we see that growth is outstripping our core home market growth as volume kicks in that should be another driver and as we go into the whole payroll strategy driven by the fact that we are tapping into large corporate and ensuring there is a very active relationship model, we believe that should be another driver and the last is the active focus on digital, so all of this will give us the lift in terms of our low cost deposits and we will try and take that closer to 35% as the year progresses.

Nagraj Chandrashekaran: Secondly, you talked about reaching certain profit and efficiency targets before you start really leveraging on OPEX to grow branch network, what should that be in terms of productivity per branch or profit per branch or profit per employee according to you?

Shyam Srinivasan: It is not just one metric, we have sort of granularly captured by geography, by the catchment in which those branches are metrics we have setup for and those also drive back into number of people we put in this branch, square foot per branch and the traffic that the branch attracts, so we have created certain metrics, and in most cases, particularly the newer geographies where we have added over 400 branches and prior to this year three-four years, they are all beginning to touch those parameters. We have a very active dashboard that tracks the performance by location, by investments made and to that extent, it is not a blanket we will not spend. We will spend based on this calibrated to this. At an aggregate level, between branch and digital, the bias is more digital at this point in time. We believe that there is more work to be done on that count. Equally, more juice to be extracted from our existing footprint.

Moderator: Thank you. We will take the next question from the line of Renish Patel from Antique stock broking. Please go ahead.

Renish Patel: Sir, couple of questions one is on the other operating cost part, so we have witnessed a very sharp Q2 growth in other operating cost from 260 crore last quarter to almost 310 crore this quarter, so is there any one off since given, we have not added any incremental branch during the quarter?

Ashutosh Khajuria: Actually, we had large service charges that are classified under this operating expenses. This is nothing but the inorganic part of portfolio that was taken in Quarter-2 and 3 and on that as a servicing agent, we have to pay back and which is classified under this, so this you can net off against NII because on one hand, we are earning interest, on the other hand these services charges are to be paid to the seller of the portfolio.

Rinesh Patel: Okay, so as and when we buy some portfolio, this cost might?

Shyam Srinivasan: We have not done in Q4 because it was done in, but the answer is yes, if there is a portfolio buy, yes.

Rinesh Patel: When it will reflect in the same quarter or in the subsequent quarters?

Ashutosh Khajuria: It starts immediately because it was done in the end of Quarter-2 and end of Quarter-3 so the Quarter-2 impact had come in Quarter-3 and Quarter-3 impact both two and three came in Quarter-4.

Rinesh Patel: Secondly on this Digi-Gold which we have launched recently, can you please throw some light how this product is different from our earlier product and what kind of traction we are seeing on this particular product?

Shyam Srinivasan: Early to give you a feedback on the volumes. As a concept, it is something that we are quite inspired by and it is seeing some kind of field confidence because it makes the customer's life much easier. Volumes, we are not able to share as of now because I do not think it is any material lift in volume. With Akshaya Tritiya today and tomorrow, I am hoping that something will kick in, we expect this to happen, but as an offering it is quite interesting, because it leverages the whole digital capability of the bank.

Rinesh Patel: Exactly when did we launch this product?

Shyam Srinivasan: Three weeks back.

Moderator: Thank you. We will take the next question from the line of Girish Raj from Quest Investments. Please go ahead.

Girish Raj: In the investor presentation, the other income does not add up to 1081 crores, so what is the difference of 30 crores?

Shyam Srinivasan: We will ask somebody to check back and advice you.

Girish Raj: Second question is on the employee expenses, can you please explain the movement from second quarter to fourth quarter?

Ashutosh Khajuria: Actually, yields have gone up vis-à-vis Quarter-3 to Quarter-4 and a majority of our staff is covered by the IBA pattern in which lots of good chunk of employees are covered under pension, those who have joined before 1/04/2010, so for that actuarial calculation is done so when the yields fall, you have to provide more, when your yields go up, you get a write-back, so it is nothing but, instead of the pro rata provision for Q4, we had a write-back, so as a net result of that you would have seen staff expenses going down.

Girish Raj: How do you quantify a 50 BPS impact?

Ashutosh Khajuria: This entire calculation is done on the basis of a discount rate and that discount rate derives the number required for the entire year. In the beginning, we make an estimate which is spread over four quarters which is reviewed every quarter end and finally when the final number because on March 31 you will know what is the rate for the remaining age and all that, so we are into 15-22 age group, gratuity is 21-22 and for pension, it is 14-15, so based on that it comes.

Girish Raj: Assuming the yield remains wherever it is, this run rate would continue?

Ashutosh Khajuria: We will have single digit growth in staff expenses. On account of this, if there is no change then it will remain a single digit growth in staff expenses.

Girish Raj: The final book keeping is movement in the GNPA, so slippages we know, recovery upgrade sale to ARC write-off, any number?

Shyam Srinivasan: Sale to ARC is about 318 crores.

Girish Raj: Recovery?

Shyam Srinivasan: Recovery is 62, upgrade 88, write-off 18 for this quarter.

Girish Raj: Any explanation on the other income?

Ashutosh Khajuria: These card related expenses we used to have Visa and all those fees and all, in earlier quarters it used to be netted, so you had that on the expenses side as well as on income side. In this quarter, we have segregated it because that was the suggestion given by the auditor, so that may be showing the 50 crore difference in other income.

Moderator: Thank you. We will take the next question from the line of Ankit Choudhary from Equirus Securities. Please go ahead.

Ankit Choudhary: My one question is regarding this market risk, so while the market risk is going up quite a good spike from quarter-on-quarter?

Ashutosh Khajuria: On what basis you are mentioning that?

Ankit Choudhary: In the PO1, there is a market credit risk market risk, so the market risk has gone highest almost 20-25% from December quarter, you people have invested in some very risky bonds or something?

Ashutosh Khajuria: Absolutely not, we do not have any investment in non-SLR or any such portfolio, I will just come back on that.

Moderator: Thank you. We have the next question from the line of Krishnan from SBICAP Securities. Please go ahead.

Krishnan: Two questions from my side, number one, what is the incremental customer profile that you are adding to your banks both through SME and Retail,Kerala and outside kerala, and just wanted to understand your retail portfolio the other component in your retail portfolio has grown quite exponentially, just wanted to understand what all is made of this?

Shyam Srinivasan: First question first, in terms of the client profile that we are adding to the bank, the first part is that we are adding a significant amount of new business in the geographies that are relatively new to the bank and that profile of customer is more salaried than self-employed on the Retail side. On the SME side, profile of clients is still naturally by the nature of the business, business oriented, but now we are getting a width in geography as opposed to concentration in one geography, so if we look at our SME book today, it is equally weighted between what we call network one and network two, so client profile ex-Kerala is turning out to be more salaried and therefore, their demands and their servicing of them requires a different range of offing and which is what we are focused on. Purchase of portfolio in housing which we bought in Q2.

Krishnan: Why is that classified as others and not within mortgage or?

Shyam Srinivasan: Some parts of the portfolio is a lumpy portfolio where the client is still in the sellers portfolio, but is deemed as Retail. We are now working with them to transfer them to our, the client itself has moved to us. As the client gets booked on to our system, it will convert into Retail client for the banks. One purchase we made, all clients have been converted to Federal Bank clients and be serviced directly by us, the other one is like Ashutosh explained for an earlier question, there is portfolio purchase and there is a servicing cost.

Krishnan: Is this based on the incremental client profile that is being added, just wanted to understand if the potential of the new customers that you are adding significantly better than your existing customer base which was say more concentrated on SMEs as well as on Retail, are you able to mine these customers a lot better, would you typically be a primary bank already there, could you throw some color on this?

Shyam Srinivasan: When you are dealing with corporate payroll clients, invariably we are not bank number one, especially there is a new employee and therefore starting out on career, there we are empanelled and we have become one more of the bank. It is a lot of hard work to convert them to become full bank customers, and therefore, we are getting into a very active campaign, why settle for less. Federal Bank is your best bet and we are hitting the market very soon with strong messaging, strong offering and deep distribution.

Krishnan: The reason I asked this is in order to get the incremental ROE from every new customer that you are adding, are you having to spend a lot more and that is where I am saying that is?

Shyam Srinivasan: I get your question, I just want to sort of not make light of this. The answer is nothing is going to be easy for any bank. Even the best banks in India they can say anything is not going to be easy. Nobody is at the wheel sleeping, not for us for sure, so there is a lot of hard work, lot of ground work, lot of cross sell, lot of mining, lot of being at the customer's doorstep electronically or physically and it is going to be a lot of effort to get the second and the third product from the same customer even for the best bank and I challenge that.

Moderator: Thank you. We will take the next question from the line of Cyrus Dabhoy from Anand Rathi. Please go ahead.

Cyrus Dabhoy: Just want to understand within the corporate book, which verticals or industries are you seeing a lot of growth traction in, what kind of external ratings typically are there on these accounts and therefore, what kind of impact do you see on your yields on advances for next 12 to 18 months?

Shyam Srinivasan: The yields on advances have been trending in the 10 point something and we think that will continue. The credit choices we are making are clearly in the higher end of the spectrum, definitely investment grade and above and all growth is coming there. We have been quite fastidious in saying no to any other kind of growth. The driver of that growth is largely because we are very actively in the market and many of our competitors are relatively distracted with many other things, so our belief is volume and the regularity of the volume is a big driver instead of back-ended growth, we want to see it more consistently and regularly, I have been saying that for four-five quarters and it has been happening. Yields per ticket, we have to be very competitive in pricing, it is impossible to get lot of *malai* in these deals, but the cross sell and the efforts like I mentioned are large part of our non-Kerala growth is payroll and salary, very pleased that the corporate relationships that we are putting in are allowing us at least to break in to this corporate to get their employee payrolls, so with our digital offerings, with our retail distribution, we are seeing traction into that, that is how our incremental growth is coming in the salary segment.

Cyrus Dabhoy: Right, but within the corporate book, I mean if you are going higher up in the rating scale, are you attempting to do more granular accounts because typically the high you go, you will get more lumpy?

Ganesh Sankaran: Corporate is not only higher as we have explained on several previous occasions, the wholesale bank is comprised of institutional clients, large corporate clients, top clients, mid-corporate, middle market clients, local corporate clients, this is a huge spectrum, and therefore, the guiding principle for choosing a client in any of this category is he should be well rated and he should meet our credit threshold, so that is the only thing that we are fussy about and we are able to price the assets differently, local corporate will get price differently compared to a large corporate compared to institutional client and we are able to churn our facilities better, so that explains why our yields are what it is.

Cyrus Dabhoy: The loan portfolio mix going forward?

Ganesh Sankaran: One-third, one-third, one-third has been our stated position that one-third wholesale, one-third middle market, and one-third Retail, give or take some percentage points here and there based on that we see opportunities in a given quarter at a point in time, it may get changed, but the broad mix is likely to remain the same.

Shyam Srinivasan: In the investor deck, you may see the mix in loan book. The only thing I want to point out is the SME is carved out from Agri to that extent the Retail and Agri being merged, you will see a higher share for Retail-Agri, but if you back that out, it is actually one-third, one-third, one-third.

Cyrus Dabhoy: Right, and guidance on loan growth and credit cost?

Shyam Srinivasan: We would like to see this financial year repeat or improve, but 20 odd percent of credit growth, credit cost is a function of our continuing improvement in slippages barring one or two blips here and there, the credit cost will trend in the same trajectory that we are on.

Ashutosh Khajuria: Coming back to question on market risk related, risk weighted assets where the rise is of 800 crores, that is into three different segments, one is because of high liquidity, some investments have been made in high quality short term treasury instruments, and therefore, you know the trading book size has increased and the other one is because of the sale to ARC, SRs have come. These are the main two. Ultimately, the third one also is an outcome of that basically credit substitute investments and some money market instruments as well, which is a subset of first class one. These are top notch A1+ type of instruments except SRs.

Moderator: Thank you. We will take the next question from the line Jehan Bhadha from JM Financial. Please go ahead.

Jehan Bhadha: Sir, right now we are witnessing a major drought situation in Kerala and drought is very severe, so have we witnessed any sort of signs in our Retail portfolio or in the SME side?

Shyam Srinivasan: Thankfully nothing as yet. Even in the quarter that went by, there was a minor uptake in Agri from about 16-18 crores gone to 30 crores. I think that will stabilize and more clearer picture will emerge only at the end of Q2 for us to know whether there is anything, what is the area of close watch. There is lot of activity from the bank side to make sure that the impact is almost not there, but I am unable to give any more texture till we see how things shape up, but there is nothing to suggest that there is a problem.

Moderator: Thank you. We will take the next question from the line of Abhishek Saraf from Deutsche Bank. Please go ahead.

Abhishek Saraf: Just on ARC things, you said that 318 crore was the asset which was sold to ARC, just some color on that, what was the gross number and what was already provided on that and in terms of how much was received in terms of cash and SR, and second question is on margin guidance, if you can just give us what you are looking for in FY18 and 19 and branch expansion that you are looking for in next two years?

Ashutosh Khajuria: Cash is 15%, there is no single major account as such. There are about 15-16 accounts. I think the largest would have been of the 40 crores, so that is there and it has not been sold at discount, it is at par.

Shyam Srinivasan: In terms of margin guidance, we have traditionally held 3.2 to 3.25 as our margin run rate. We would certainly want to repeat our FY17 momentum, but for now we will say that between 320-325 was where the margins will be. Expansion of branches is highly related to where how we see the efficiencies of the bank kick in. We certainly do not have any plans for the next six months from that point of view, I would think the full financial year, but I am also saying that we will watch how things shape up, but that is not a high priority getting more from what we have already invested and is absolute high priority, investing in digital and RM strategies that we have across businesses are the other high energy activities. Distribution for Retail in addition to the bank zone sales channel, bank zone branches is also the 100% subsidiary that we have to fire that up, which has done well in FY17, we think that will carry on.

Abhishek Saraf: Just on this margin thing, I see that your cost of funds have been declining very steadily and now 6.12%, so do you think that this would have now bottomed or you see further cuts happening here?

Ashutosh Khajuria: Hopefully may be 5-10 basis points reduction may happen, possibility may be there, but that all depends on how the environment outside shapes up as far as the interest rates are concerned, so it would be a function of where the monitory authority takes the interface to, so we do not want to comment beyond that.

Moderator: Thank you. We will take the next question from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: Sir, on the NBFC subsidiary that you have, can you outline what exactly is involved in and how much of the capital invested in that, what is the book size of that subsidiary, and any plans to sell a stake in that subsidiary?

Shyam Srinivasan: Capital is about 200 crores, the book is a little over a 1000 crores, and the company has done well in doubling its book looking to grow more than double in FY18, potential is there. We are looking for an investor, a partner and an investor, dialogues are there. There is a board approved process that is very much underway. We think we will have full line of sight by H1 of FY18.

Ashutosh Khajuria: Just wanted to clarify, there is no disinvestment on our part, we are just looking at partner to infuse more capital because the growth is quite steep in that subsidiary, so if there is a suitable partner, we would welcome that, otherwise, we will capitalize it.

Amit Premchandani: Just trying to understand, which kind of book you grow in that subsidiary which you cannot grow in the parent bank or you are avoiding to grow in that bank?

Shyam Srinivasan: There are construction finance, some segments of loan against property, gold loans by itself, they do on their book and they also do distribution for the parent bank for home loans and personal loans.

Ashutosh Khajuria: Geographically, they do not do any business in our home market, Kerala, so there is no overlap in our Kerala segment.

Amit Premchandani: Any regulatory arbitrage involved which you generally use through NBFC route or it is just?

Shyam Srinivasan: Nothing.

Amit Premchandani: Any thoughts on the capital requirement of the bank?

Shyam Srinivasan: Yes, we are taking necessary shareholder approvals, the board has approved and the process is just beginning. In the course of FY18, based on course and momentum, we will work out quantum, instrument, and we are very much active in that space. For the coming months, we will see some clarity emerge.

Amit Premchandani: Final question on the Retail, the bank has managed to grow the wholesale quite aggressively after the equipment from outside, can we see something on the Retail front generally because as of now your growth is coming largely through buyouts, so can we see significant organic growth also coming in from the retail front and do you require to hire people in that segment?

Shyam Srinivasan: Organically, retail grew 18%. This is after virtually flat gold loan book. In terms of skilling and training our people and getting the relevant sort of market competencies, very much underway. It is not about recruiting from outside or within, there is a good team and surely Retail growth will start nudging 20% plus without the purchase of portfolios, portfolio purchase will help further.

Moderator: Thank you. We will take the next question from the line of Mb Mahesh from Kotak Securities. Please go ahead.

Mb Mahesh: Just a few data keeping questions, tax rate at 40%, what is driving that?

Shyam Srinivasan: There was some deferred tax payment that had to be made so that would have added a few percentage points to the tax, otherwise, it is a normal tax rate of 35%.

Mb Mahesh: The second is on the security receipts, the net addition to security receipts was about 170 crores, you made a total transaction of worth slightly over 300, at 15% pay off that means you got about a fresh addition of 270, that will imply a reduction of about 100 odd crores in the current quarter, what would drive that?

Ashutosh Khajuria: It is happening in some of the accounts, but not 100 crores.

Mb Mahesh: We started off with 614 for the quarter, you have indicated that 318 crores of sales and a 15% cash payout, so that 85% that means you got about 270 crores worth of SRs?

Ashutosh Khajuria: 318 is the gross NPA amount because you are seeing it from the movement of NPA side, but there has been provision. After the provision, you will have the NBV, net book value, from that net book value, you have to take 85% as the SR subscribed by us and 15% by the ARC in cash.

Mb Mahesh: That amount would be around 200 odd crores?

Ashutosh Khajuria: Yeah, would be around that, because good chunk of provision was already in all these accounts.

Mb Mahesh: The third one is on the service charges which you had alluded earlier, what would be the quantum because last quarter we had 20 crores charges related to demonetization, which I assume will not be there this quarter, so if I look at the moment between 2Q and 4Q, it still appears to be reasonably large.

Ashutosh Khajuria: There was portfolio buying the month of December; for that, the service charges paid to the servicing agent was only for one month. In this quarter, it is for entire three months and whatever was bought in Quarter-2, that also entire amount is there, so it is gradually increasing because the impact of Quarter-2 purchase and Quarter-3 purchase has come fully in Quarter-4, it was actually Quarter-3, it was almost zero in Quarter-2 because it happened in the last week of September.

Mb Mahesh: Are you quantifying this amount?

Ashutosh Khajuria: Yes.

Mb Mahesh: How much would that be?

Ashutosh Khajuria: 25 crores for this quarter. There are two things which I have said, one is the service charge, the other one is grossing of the card fees and card charges, so you have debit and credit earlier netted of, now it is gross, so you will have that higher on operating expenses and you will have a higher other income on the other side.

Moderator: Thank you. We will take the next question from the line of Gaurav Ved from Ved Capital Advisors. Please go ahead.

Gaurav Ved: Sir, you said in the beginning of last year that the perfect storm for the bank is behind and we embark on a new journey of consistent and predictable growth, so I would like to congratulate you and your entire team for delivering great turnaround performance for FY2017, so I would like to know over medium term, if you can show some color where do you see banks in terms of broad numbers like ROA credit growth, gross and net NPA, so if you can just throw some color on that it would be highly appreciated?

Shyam Srinivasan: Thank you so much for reminding us and making us feel good for honoring our commitment we made. Certainly, the trajectory of the bank is to keep this metabolic rate shifting up. I would not want to give you a forward-looking view in terms of what the book would be and what ROA. For sure, I mentioned last year in FY17 when we began on many cause and meetings with our investors, our foremost is to get back to some of the exit ratios of FY15 in terms of ROA, ROE and that should be a two-year journey as we began FY17, so we will certainly look to deliver on that count in FY18, which I must add is not going to be an easy task because the work that is required to ensure that the cross over into 1.1 of ROA and ROE of 12% plus are high priorities and those would be the deliverables for the bank. How it will happen, I think we have spent a fair amount of time talking about the segments that you will pursue, the businesses that we will pursue and the geographies we will pursue, and importantly the efficiencies that will kick into the bank. What we are greatly inspired by the fact that the predictability of the book, the rate of slippages are all very much in the zone we want it to be, and therefore, the ability of the bank to direct its attention on growth and put in more energy on those areas are now getting further reinforced, so to answer to question, we believe that in the year I hope you will be able to quote us next year and feel good that we have all said and delivered is about yet another strong and consistent performance and in some sense where I said in earlier part of the call, why settle for less, come to Federal Bank.

Gaurav Veda: My second question is on slide #10 on asset quality, compared to Q3 on Federal Bank fourth bucket, there is an increase from 20 to 24%, so can you please throw some color on it, Sir?

Ganesh Sankaran: When we migrated to RAM, we developed a single-scale rating, we mapped the existing exposure to a single scale rating, so that is the revised representation of this.

Moderator: Thank you. We have the next question from the line of Manisha Purwal from Taurus Mutual Fund. Please go ahead.

Manisha Purwal: Sir, just a small continuation of the previous call only, now that we have delivered on the growth that we had already promised, so I just wanted to understand that this new growth a good portion of it is coming out from the buyout, so how do we assess the asset quality of this, in the sense is there a seasoning that we need to wait for before understanding what quality of book is this or?

Shyam Srinivasan: I will answer that, but just to clarify of our incremental growth, only 3.5 thousand crores is buyout, so the growth is not only on account of buyout, it is a 25% of our incremental growth, ex-buyout, our credit growth is 21% but that said the books that we buy are seasoned and there are certain guidelines which we follow, minimally one year at least it should be on the originator’s books and they are rated instruments and we buy after a fair amount of due diligence and we have partner agreements in terms of consequences of any issues on the accounts.

Manisha Purwal: Sir, small data point on your exposure to middle east on your advances side, can I get a number in the sense how much of these advances could be on account of exposure?

Shyam Srinivasan: Exposure to middle east is not there, it is the customers who are in middle east who have Indian loans, so that would be roughly of the credit book in Kerala about 30% of the Kerala book would be the exposure, about 5000 crores would be the credit exposure to clients who live and work in the middle east.

Just to clarify, maybe I overstated the number, it will be lower than 5000 crores to the earlier question.

Moderator: Thank you. We have the next question from the line of Sanket Chheda from IDFC Securities. Please go ahead.

Sanket Chheda: Sir, I just wanted to know the amount that slipped from the structured book this quarter?

Shyam Srinivasan: 37.

Sanket Chheda: Sir, can you throw some color on the standard restructured book outstanding like which sector it belongs to, what is the biggest?

Ashutosh Khajuria: Major portion of restructured book is already out. Now the new restructuring that is to be done may get added, there is an, nothing of consequence because all major once, we had almost half of it in the form of SEBs and all which all have got converted into bonds. In fact, our stock of restructuring emanated largely from 2012, 13, 14 times, I do not think anything in the last couple of years, we have an increase of significance.

Sanket Chheda: The SEB loans to have been converted into investment?

Ashutosh Khajuria: Half of it had gone only because of conversion into bonds.

Sanket Chheda: My question is the current outstanding restructured book, what will be the sectors that it caters to now, which will be the biggest sector in that likewise?

Ashutosh Khajuria: The slippage from the restructured book is 46.33 crores, 15 accounts mainly the SME and the corporate.

Shyam Srinivasan: Standard is 1282 crores, substandard is 372 crores, total is 1654 crores.

Sanket Chheda: That standard book of 1200 crores, what all sectors will be included in that?

Shyam Srinivasan: Iron and Steel and Air India.

Ganesh Sankaran: Sector, we do not have it offhand, we will pull it out but our larger point is, I think you are trying to infer whether there could be potential slippages from that in future. We do not have any large lumpy ticket in that.

Shyam Srinivasan: Air India, SEB, and Steel.

Sanket Chheda: Sir, last question on NIM, you said that your yields will be now around 10, so currently it is 10.3, and the cost of deposit to cost of fund is equal, whatever you have reported or what is the cost of funds in that case?

Ashutosh Khajuria: Cost of funds will be slightly lower than the cost of deposits because you have the capital and reserve also coming in to this.

Sanket Chheda: Any number you can give?

Ashutosh Khajuria: It is 6.12 is cost of deposit and overall these borrowings and all, it is 6.23 for cost of funds. The cost of fund this quarter is slightly higher than cost of deposits.

Sanket Chheda: My next question was that if cost of funds are 6.23 and yields you do not expect to go down by a big margin, you have already building up quite handsome relationship on corporate side on salary accounts, so I guess your CASA will be on upward, so why a conservative target on NIMs for next year like 3.2 to 3.25?

Shyam Srinivasan: I think this is the challenge for the bank in terms of as we keep pursuing the best customers, there is always a pricing pressure and as MCLR gets momentum and the base rate book starts shifting from base rate to MCLR, there is some pricing down of the existing stock that will happen. We have not yet reverted our base rate lower, 10 basis points.

Moderator: Thank you. The next question is from the line of Rahul Maheshwari from IDBI Mutual Funds. Please go ahead.

Rahul Maheshwari: I have two questions, first of all you just now said there would be pricing transition that would be taking place from base rate to MCLR, so today at present how much book is standing on the MCLR and base rate?

Shyam Srinivasan: Two-third has already been replaced, one third remains.

Rahul Maheshwari: In terms of any percentage, can you give a breakup?

Shyam Srinivasan: Two-third and one third, 65 and 35 you can take it approximately.

Rahul Maheshwari: In terms of the SME loans, the highest exposure is towards the wholesale trade and now the GST which is being to be implemented in June, so can you give some color on that, how it would pan out?

Shyam Srinivasan: We have evaluated, we do not see any significant impact on account of that.

Rahul Maheshwari: In wholesale portfolio regarding NBFCs, the collection efficiency had fallen down, are you finding the recovered kind of thing because your highest exposure is towards the NBFC in corporate?

Ashutosh Khajuria: Our exposure to NBFC is declining if you see on an incremental basis now, at a point in time was right probably. Second thing is the originators are all AA and above, we have not seen any impact.

Moderator: Thank you. The next question is from the line of Chinmaye Desai from Anvil Shares & Stock Broking. Please go ahead.

Chinmaye Desai: Actually, I wanted a couple of data points, could you give me the breakup of provisioning this quarter and the number of employees?

Ashutosh Khajuria: 11,593.

Chinmaye Desai: Sir, the breakup of provision?

Ashutosh Khajuria: Investment is 23, loan is 77, restructured account 5, and other purpose which is write-off of NPA that is 27 crores and rest is income tax.

Chinmaye Desai: Sir, what would be the impact of the RBI directive in terms of provisioning, are you expecting any?

Ashutosh Khajuria: We are not expecting any impact on that.

Shyam Srinivasan: Just to clarify on RBI, two circular of April 18th, one was around the incremental provisioning required for stressed assets even if they are standard and the second is around the diversion. First is to clarify on the diversion side, nothing for Federal Bank, and on the stressed assets or the so called stressed assets, it is a sector-based decision that the bank's board has to take. We have an exposure on telecom to the absolute blue chip, therefore, we do not visualize much even if you have to take a 0.25% on 1500 crores, that is the expectation that you can have in addition to the standard asset provision that we always make and part of it is any way non-fund.

Moderator: Thank you. We have the next question from the line of K. Poddar from KB Cap Markets. Please go ahead.

K. Poddar: Once you get the fund from new private placement or whatever you have proposed, do you plan to go for branch expansion because branch expansions have not happened for quite some time even with the funds that are supposed to come?

Shyam Srinivasan: Not in the near future. Our incremental investments in the near future from a physical infrastructure would be not in terms of branches would be more around the digital and the relationship management structure getting further enhanced and that is where all the distribution power is being put and NBFC which we have started now seeing traction. We are strengthening that particularly in geographies where our physical branch network is less.

Moderator: Thank you. We have the next question from the line of Rakesh Shinde from Asian Market Securities. Please go ahead.

Rakesh Shinde: Just wanted to know whether we have done any S4A, SDR or 5:25 during the quarter and any total outstanding on that?

Ashutosh Khajuria: About 100 crores odd in each must be the thing, it is very small, in Q4 nothing.

Rakesh Shinde: This quarter nothing, okay, and in Q2, we have talked about the couple of accounts from the Steel sector which was bothering us around 160 crore, so what is the status of those account?

Shyam Srinivasan: This is an account that it is tantalizingly teasing the bank, it is ending up resolving itself, there is some improvement in the steel sector, but it continues to be one account that is on our watch list now for a protracted period of time. We are watching it, we are trying to see fine solution.

Moderator: Thank you. We have the next question from the line of Pritesh Bumb from Prabhudas Lilladher. Please go ahead.

Pritesh Bumb: Sir, basically the breakup you gave on provision amounts to 132 crores so any 100 crores type of difference, any write-back, so 77 crores on the NPA side, 23 crores on the investment side and there was about 5 crores and 27 crores on restructured and others?

Shyam Srinivasan: Tax is 169 crores.

Pritesh Bumb: Provisioning excluding tax is about 122 crores, so that is the?

Ashutosh Khajuria: Only 10 crore write-back is there.

Pritesh Bumb: 10 crore, that will be on the ARC sale which we did.

Shyam Srinivasan: Standard asset write-back.

Pritesh Bumb: Okay, so that is the 10 crores?

Shyam Srinivasan: Yes.

Pritesh Bumb: Second, there is a good movement in the lower than BBB accounts to BBB, so is this the same you gave earlier on the other asset side, is the same reason for movement?

Shyam Srinivasan: Yes.

Pritesh Bumb: Internal classification has moved it up?

Shyam Srinivasan: Yes.

Pritesh Bumb: So that will have benefitted in the risk great assets as well?

Shyam Srinivasan: Yes.

Pritesh Bumb: Sir, can you just give the nature of fee income in the commissions, what kind of Retail and wholesale could have been contributing to that?

Shyam Srinivasan: We have seen an overall fee income growth basically the FX related is about 10% growth, the growth in terms of the PF, processing fee, is about 17%, growth in commission and brokerages is about 52% and this is broadly the incremental fee income, and between Retail, Corporate, and SME, the corporate would be because the growth and processing fee growth was significant there.

Ashutosh Khajuria: Total 24% excluding trading income.

Pritesh Bumb: My basic question was that is it more from cross sell or deals or how is the fee coming in?

Shyam Srinivasan: The growth being in processing fee is on the back of credit growth, that is more vanilla stuff. The split where 300 odd crores Retail as a composite of many things, Retail fee income includes insurance, investment, locker, brokerages, fee, card fee income, ATM fee, the whole gamut of things, that is where the Retail fee constitution. Cross sell if you say that, are we getting more from the same customer incrementally, answer is yes. When we are looking at the Retail insurance investment income is now 41 crores for the year out of the 300 crores, so that is the cross sell that you can directly attribute that has come from existing customers.

Pritesh Bumb: What I am trying to understand is Sir because of demonetization lot of banks have benefited on the cross sell?

Shyam Srinivasan: Let me explain, I think some of the banks that did very well on insurance on account of demonetization. We did not benefit anything on that count in FY17 partly because of the choice that the company and distributors made around it. Cash was not being accepted.

Moderator: Thank you. We will take the next question from the line of Jitendra Upadhyay from Athina Investments. Please go ahead.

Jitendra Upadhyay: Sir, actually I have two questions, first of all Sir, I would like to know about NPA movement, currently your gross NPA stood at 1727 and the four-quarter slippage is around 244, so Sir I would like to know about the difference between net NPA and gross NPA?

Ashutosh Khajuria: Opening of gross NPA is 1952, if you see for the quarter.

Jitendra Upadhyay: I am looking for the year, gross NPA around 1727, I would like to know about NPA movement for the year?

Shyam Srinivasan: 1668 was the opening one and accretions have been about 1100, reduction has been 32, recoveries have been 192, upgradation has been 269, write-off has been 236, sale to ARC has been 318, and final figure is 1727.

Jitendra Upadhyay: Second one for the fourth quarter, slippage is around 244, Sir, can I get the in terms of breakup as a recovery, upgradation, write-off, or sell to ARC if any?

Ashutosh Khajuria: Sale to ARC we already said 318, recovery 62, upgrade 18, fourth quarter.

Moderator: Thank you. We will take the next question from the line of Ami Parikh. Please go ahead.

Ami Parikh: Just wanted to understand what is your SME to book?

Shyam Srinivasan: We normally do not disclose the SME two book per se, but overall the SME two book and SME book has improved more than 30%.

Ami Parikh: From last quarter, which was 5% of the total book, so it has improved from that?

Shyam Srinivasan: Yes, it has, but materially.

Ami Parikh: Second question was on the rest book side, in the last quarter, the rest book was around 1450 crores, this quarter is around 1280 crores, so have we seen any upgradation over here or it has slipped into the SR?

Shyam Srinivasan: The question is has the restructured book, the flow of restructure.

Ami Parikh: Have we done any upgradation on the restructured book?

Shyam Srinivasan: 260 crores got upgraded.

Moderator: Thank you. Sir, this was the last question. I would like to hand the conference over to Mr. Rajanarayanan N for closing comments.

Rajanarayanan Nerlakat: Thank you all for patiently staying on the line, now you have heard our conference, so the line is, "Why Settle for Less, Settle for Federal Bank". Thank you, good day ahead.