“Lakshmi Vilas Bank Limited Q3 FY-18 Earnings Conference Call”

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MANAGEMENT: MR. P. MUKHERJEE- MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER, LAKSHMI VILAS BANK LIMITED.

Moderator: Ladies and gentlemen good day and welcome to Lakshmi Vilas Bank Limited Q3 FY18 Earnings Conference Call. As a remainder all participants' 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 '*' and then '0' on your touchtone phone. Please note this conference is being recorded. I now hand the conference over to Mr. P. Mukherjee- MD and CEO, Lakshmi Vilas Bank Limited. Thank you and over to you sir.

P. Mukherjee: Thank you. Ladies and gentlemen welcome to the Lakshmi Vilas Bank Q3 Analyst Call. You would have by now received our press release too and therefore would be aware of the results by now. I propose to discuss some of the salient points with you.

The bank has been trying to raise capital for quite some time now. We were able to raise a very small amount through a QIP issuance at the end of calendar year 2016. That was the first time ever that the bank had accessed the public markets. Since that amount was not sufficient to support sustained growth, it was decided to raise capital through a rights issuance. We were glad to report that the rights issuance received good response from the bank's shareholders. In the meanwhile, in the absence of fresh capital we had been forced to stifle growth in the balance sheet during Q2 and Q3. However, in late December once we had adequate clarities on the capital raising we grew the book somewhat largely with the help of short term assets.

The business mix of the bank stood at 55,851 crores against 47,465 crores in the corresponding quarter in the previous year. The balance sheet size stood at 40,597 crores. The lending book was at 25,231 crores reflecting growth of 8.68% over the corresponding period in the previous year. Deposits grew 10.34% to Rs. 30,620 crores out of this CASA grew 9.08% to 6,480 crores. I must mention here this is the number for the quarter end. On a daily average basis CASA was at 20.40% while at the quarter end it was 21.17%. It may be noted that the daily average number for the corresponding quarter of the previous year was 18.93% and I would like to remind you that that was the peak of the demonetization period too. Total revenue for the quarter came in at Rs. 818 crores against Rs. 879 crores in the corresponding quarter of the previous year. I need to highlight here that the lending book had been flat for most part of the Q2 and Q3. Over and above that, there have been slippages in the book. The Treasury, which has contributed handsomely in previous quarter, also saw pressure on valuations. The combined impact of all this has been lower interest income from advances and a resulted lower operating income. As a result, the operating profit fell sharply to 46.12 crores from Rs. 171.45 crores.

Net interest income for the quarter was Rs. 220 crores against Rs. 191 crores in the corresponding quarter in the previous year. In keeping with the overall interest rate movements over the last year, the net interest margin came in at 2.63 a drop of about 9 basis points over the previous year. Other income dropped to 27.34 crores against Rs. 150.22 crores in Q3 of the previous year. This is mainly on account of loss from the debt portfolio of Rs.38 crores during this quarter as against a quarterly profit of Rs. 100 crores in the previous year. Operating expenses for the quarter grew 18.6% to Rs. 200.89 crores.

I will take you to provisions. Provisions for the quarter for bad loans came in at 97.30 crores this is against 38.28 crores in the corresponding period of the previous year. Obviously, the combined impact of the fall in income and additional provisions has severely impacted the bottom line. We reported a net loss of Rs. 39.23 crores against a profit of Rs. 78.38 crores in the previous year. The gross NPLs came in at 5.66% that is up from 2.78% in the previous year. Sequentially, it is marginally up from 5.50% in September. Net NPLs were at 4.27% again up sharply from 1.82% in the previous year though sequentially actually marginally lower from the 4.33% in September. The provision coverage ratio is at 46.75%.

We had slippages of about 286 crores on a gross basis during the quarter; the largest among the slippages is a Coral Sector Account of about 90 crores. The next highest is a Pharma Packaging Company exposure of about Rs. 65 crores. There was another account in the Infra sector, a roads account of about 26 crores too. So, rest were all relatively small accounts well frankly lakhs or single digit crores a lot of them adding up. I will refer you to my statement made at the last results conference where I had said that our Watch List of troubled accounts was then at around Rs. 1,750 crores. I must tell you that the slippages that we have reported during this quarter are mainly from that Watch List. Consequently, that list has also lightened somewhat to around Rs. 1,560 crores. I may remind you that these include restructured accounts, SDRs, S4As, 525s and SMA2s, some of these are only SMA2s as a matter of it I have nothing in 525s actually. As a consequence of the drop in income, the cost to income ratio for the quarter was 81.33% obviously up very sharply from the 49.70% reported earlier. We ended the quarter with a CET 1 at 7.88% within the overall capital adequacy of 9.75%. This, of course does not take into consideration the amount of Rs. 786 crores raised through the rights issuance which was completed in the first week of January. Post-completion of allotment process under rights issuance, the CRAR would have been about 300 basis points higher.

If I come to Return on Assets, as a result of the loss the ROA shows a negative (-) 4.2% against 2.72% last year. The running ROA for the three quarters comes to 2.14%. Return on Equity similarly, the ROE comes to a negative (-) 8.07% against 18.18% in the previous year. The running ROE for the 3 quarters comes to about 2.54%.

A few statistics, we now have 519 branches, including 2 personal banking branches and 981 ATMs in across 16 states and 1 Union Territory. We do not have any un-amortized amount of provision for past sales to ARCs. There are 5 accounts under SDR amounting to Rs. 275 crores and these are all included in the Watch List that I mentioned earlier. Similarly, I have one account under S4A process amounting to about Rs. 14 crores and it is also included in the Watch List. I have about 602 crores of restructured accounts and these are also in the Watch List. I will stop here at this moment and I would be glad to answer any questions that you might have.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. We have our first question from the line of Alok Shah from Centrum Broking. Please go ahead.

Alok Shah: I have a question to you in terms of the slippages, the quarter- on- quarter that number has been coming down and so is your Watch List portfolio. How do we look at slippages' run rate incrementally and the second question would be in terms of recovery and upgrades, how would those numbers look like?

P. Mukherjee: Well Alok, as far as slippages are concerned it will be difficult for me to put a timeline on the slippages, if you will appreciate and as I mentioned we have sort of isolated the accounts where we anticipate problems and we have been constantly working on those. I am happy to report at least that the slippages that have happened largely from the Watch List and as a consequence the Watch List over the last 3 quarters has come down by about 1000 crores. If you remember, in March when I had first announced the Watch List, it was about 2500 crores and then in subsequent quarters it has come down and in 3 quarters we are now down to about a little over 1500 crores. Now I really cannot say that the run rate is going to be uniform and that the same amount would fall again. But then I have very little control over certain slippages and since these are all relatively large accounts on very often part of consortia and so on. Frankly, when they slip they will slip my sense is these will slip over the next may be 4- 6 quarters.

Now as far as recoveries and so all is concerned just for the statistics books our slippages during the quarter were about 286 crores. We reduced NPAs during the quarter to the extent of 136 crores. I am actually able to give some greater color on that actual cash recoveries were about 64 crores and about 72 crores were largely on account of up gradation of accounts.

Alok Shah: And sir could you please help us with the stock of SMA2, because the numbers that you kind of disclosed in terms of SDRs for restructuring, is the estimate to book somewhere closer to 600 odd crores?

P. Mukherjee: Well, it is like the SMA book is variable, it moves by the day so to say, depending on how people pay and so on. So it is very difficult to put a number to it. At its best it could actually come down to maybe 200- 300 whereas it's something like 1000 crores or so. I am unable to really give you a fair sense of what the average SMA would be like. But you will also appreciate that S4As and the SDRs are under SMA so that will give you a sense of the sort of book I could be working with.

Alok Shah: Coming on the balance sheet side how are now looking at growth, given that money has come in and the way potentially things could happen?

P. Mukherjee: For me, I would like to put it Alok obviously, I had my business plans for the FY 18 and you are all aware this we have already chalked out our course for not just FY 18 but right up to FY 26 so to say. Obviously there was a bit of a hiccup this year and we have slowed down from our original business plan. The way I see it is I hope to catch up with my business plan by 2020. I expect the bank would probably catch up by 2020, subject to of course such appropriate moments funding ourselves appropriately. In the meanwhile, in the near future I think you would expect us to go in the region of about 15-20%.

Moderator: Thank you sir. We have the next question from the line of Jai Mundhra from B&K Securities. Please go ahead.

Jai Mundhra: First is a request to make the investor presentation more relevant. So, there are a lot of things which we actually miss on our investor deck. There is no breakup of the loan book, no asset quality; there is no movement of slippages. So that actually takes unnecessarily time out of this con call or analyst meet.

P. Mukherjee: I appreciate it Jai. We will ensure that. We will do that over the next few days itself.

Jai Mundhra: You explain the movement of NPAs. In terms of growth, our focus was more on let us say, reducing some sort of wholesale dependence and growing more in terms of retail and SME. Can you provide kind of what has been the status so far in terms of the underlying demand and our target to that extent? So one of course, from this quarter perspective and going forward also.

P. Mukherjee: I will answer you like this Jai, in the first place, the focus very clearly is on MSME and retail business growth. But both of these, we have actually completely revamped within the bank and the new structure is taking its time to shall we say gather roots. And as I mentioned earlier in my opening remarks over the last 6 months quite frankly we have been somewhat static in the book and in the short term if I need to pump up the book just to boost interest income one has to again go back to the corporate side. So thus if you ask me in short thus far the growth has been largely on the corporate side as far as visible growth is concerned. But what is happening is slowly but surely the retail and SME book is beginning to gather steam.

Jai Mundhra: And in terms of let us say capability building for retail and MSME growth, do you think we are fairly positioned on the capacity building in chasing that retail and SME growth. I mean we have a differentiated branch model where in branch are only servicing point so that is one and in terms of, because given there is a lot of competition in retail and SME how well-positioned are we in chasing them?

P. Mukherjee: This is of course, you will appreciate that this is work in process. In terms of capacity building, it is an ongoing process and considerable work has been put in over the last year. Large number of relationship managers have been brought on board, feet on street has been activated considerably, inter disciplinary teams have been created so even the retail feet on street are now across selling a number of products of the bank, are providing a lot of leads for the other businesses. So in terms of our gearing up for the growth and for the new model I think we are well on course. Incidentally I must mention that my colleagues, the Head of Retail Banking and the Chief Risk Officer Mr. Sridhar, the Head of Retail Banking Mr. Vidhyasagar are here and they will also contribute from time to time in answering your questions. Just infact point that I had omitted, I think this will help you understand for retail business growth we have carved out two retail asset centers one in Chennai and the other in Bangalore. So these retail asset centers will actually be handling the bulk of the credit appraisal so that would be mostly like an assembly line work. In order to bring in business, quite frankly, we anticipate a 3-

pronged system. So the bank has an excellent branch franchise so we expect the branch network itself will provide at least one third of the business that I will have. Another third will probably come from the direct sales teams that we have put in place who are bringing in references and a third will come from our partner networks like dealers and so on. So, quite frankly, I am quite optimistic that once we approve all the systems and processes things will ramp up quite rapidly.

Jai Mundhra: Within retail sir, which product, what is the current mix as of now in terms of home loan, personal loan, auto etc and do you think the retail by all of it would be growing or there would be some product which would in the initial phase that will drive growth and how would it look like?

P. Mukherjee: So its retail that we will grow and within retail home loans will be the ones that will grow fastest for me. Subsequently, you will see that our two-wheeler- four wheeler financing will gradually pick up steam and over time here I must tell you that it will take a bit of time, once our systems have suitably stabilized and the necessary confidence comes in we will then get into unsecured personal loans. I imagine around that time you will also see us coming up with our own credit card. But that I imagine is probably a few years away.

Jai Mundhra: And what is the size of current retail loan book and how is it bifurcated into?

P. Mukherjee: About 8% of my book.

Jai Mundhra: So that is the, 8% of….

P. Mukherjee: The retail loan book is about 8% of my book and within that, of course, about a half would be home loans and close to about 30- 40% would be jewel loans.

Jai Mundhra: And this Lakshmi business credit, that is clubbed in SME, right?

P. Mukherjee: That is correct.

Jai Mundhra: And how much is the quantum there and any issues you are facing there because that is primarily kind of a loan against property product, so there has been some negative news about LAP.

P. Mukherjee: It is not actually LAP; LAP is a separate product for us, but Lakshmi business loans is actually is a thriving product as far as we are concerned. It is a relatively simplified structure which therefore gives a lot of comfort to the customer and to that extent our experience has been that LBC contributes about a third of my MSME book.

Jai Mundhra: And as a percentage of overall loan book, this would be how much sir?

P. Mukherjee: MSME itself is about 18% of my total loan book, so about 7% or whatever.

Moderator: Thank you sir. We have our next question from the line of Ravikanth Bhatt from Emkay Global. Please go ahead.

Ravikanth Bhatt: Good afternoon sirs, I missed your initial commentary so not sure if you have already addressed it. But my question was relating to the other income within that you have reported a negative trading profit, so I presume this is all out of sale of debt securities?

P. Mukherjee: That is correct.

Ravikanth Bhatt: And even after selling these at a loss you still had something left on which you had a MTM which you have reported on the provisioning line, correct?

P. Mukherjee: That is right.

Ravikanth Bhatt: Would there have been more adverse moment given that the yeilds have hardened 40 basis points at least since the close of the quarter.

P. Mukherjee: Well that is true but at the same time in course of the quarter the bank booked substantial loses so treasury has been quite proactive and has worked quite a bit to reduce the size of the book.

Ravikanth Bhatt: Right, no my question is so would you have something similar to report again I mean if the yields remain where they are, would you be still reporting something similar in Q4.

P. Mukherjee: I have spent a lifetime in the markets I would not like to venture out this early to talk about the quarter end.

Ravikanth Bhatt: No worries. The second question is relating to the fees in one of our previous interactions, you did mention the work which you are doing on the fees side, notably the bank guarantee etc with some of your existing clients, excluding the tradings thing we can see that the other income has moved up impressively. So if you could just share some insights on the progress that you have made over there, the client coverage that you have done and the kind of success that you might have had?

P. Mukherjee: Sure certainly I would be delighted to answer that. Well, it's like this clearly the transaction banking group is focused on beading the non-fund based businesses, particularly the LCs and the guarantees where we were relatively inactive in the past. At the same time you will appreciate that of course, you mentioned that you missed my initial comments I did mention that owing to the fact that I was relatively capital strapped for the bulk of Q2 and Q3 we actually stifled the credit growth of the bank. And to that extent credit exposures were minimized and as a result, the opportunity to bring in fresh LCs and guarantees were also to some extent stifled. It is my expectation that going forward you will see reasonably robust increase in that. But what is most important for us is that the momentum has been generated, the overall consciousness within the bank for this sort of business has increased and this is not all over the retail bank itself focus is substantially now on recovering its dues, its fees from locker rents and so on those lockers form an important part of our business. Particularly post demonetization the PoS business, the Point of Sale terminals have gained currency substantially and we have more than double the amount of PoS machines that we have out in PoS terminals that we have out in the market. So that is contributing to us both in terms of fees as well as floats so that is also helping us quite a bit. The focus on third party product sales is also there and we have been seeing adequate traction out there. So all in all I am rather hopeful that fees will increasingly form an important component revenue for us.

Moderator: Thank you sir. We have our next question from the line of Siji Phillip from Religare Securities. Please go ahead.

Siji Phillip: Just a question on the cost to income, so what is the outlook going forward on the cost to income?

P. Mukherjee: Well as I explained earlier, owing to the facts that I booked a loss my cost to income ratio went up quite substantially. For the 9-month period I had omitted to mention earlier the cost income ratio has been 56%. In fact, in September it was actually 49% so clearly the outlook is quite bright it is all a function of how I perform otherwise. My sense is in the medium to long term you will find us mostly near 50%.

Moderator: Thank you very. We have our next question from the line of Gaurav Jani from Centrum Broking. Please go ahead.

Gaurav Jani: Just an outlook on the credit cost going forward if you can?

P. Mukherjee: My sense is credit cost will start moderating from the next financial year and frankly it would work from both sides; A. lesser slippages and B. of course the book also beginning to grow quite a bit. I also sense that by then I would have largely handled the challenges of all the NCLT requirements, so my sense is on a stable basis I should start recovering to the original glide path that we had indicated. Our plan was that in over 5 years we should be down to 60 basis points. I think we will be able to get back to that part.

Gaurav Jani: Sure. Sir one more thing on the CASA front, we are probably as compared to our peers we are a bit lagging on there. Would appreciate if you could outline a path as to how do we achieve our CASA growth? Because I doubt you know that we aspire to have a robust branch expansion, right sir?

P. Mukherjee: Yes well I must tell you that if anything CASA has been the main silver lining in our performance over the last 9 months. And quite frankly we have done some rather good works there and CASA has now stabilized for the entire year on a daily average basis for the year the CASA average is somewhere in the region of about 19.5 which speaks volumes actually for the progress we have made there. My sense is CASA will continue to grow well particularly as you mentioned the branch network also helping there. More important retail bank is now focused much more on the products and services. As the retail bank is certainly focused on new products and services they are also working on further sub-segmentation of the customers. So specific propagations are constantly worked up on for different sets of customers including let us say senior citizens and teachers and professionals well including doctors and engineers and so on for students. These in themselves will certainly help us and I must mention that the bank has shifted focus considerably on monitoring the business on a cumulative daily average basis rather than on a month end or a quarter end basis. And as I mentioned a short while ago on a cumulative daily average basis for the entire year the CASA is somewhere in the region of 19.5% which you will appreciate is a significant improvement over what it used to be let us say 3 years ago when it was something like 13.80%.

Gaurav Jani: Sure sir. Just to take this forward, so going forward what sort of a daily average CASA are you targeting within about say 3 years?

P. Mukherjee: I would be very disappointed if I were to report CASA on a daily average basis anywhere less than 25% or 26 % in 3 years.

Gaurav Jani: Sure sir that sounds encouraging.

Moderator: Thank you sir. We have our next question from the line of Amit Singh from B&K Securities. Please go ahead.

Amit Singh: My first question is what is the sectoral break up of the Watch List?

P. Mukherjee: Amit it is actually very widely distributed but I might say that about 25% of it comes from the Iron and Steel, the metals portfolio and another about what 10 or 15 % would come from the Infra side.

Amit Singh: And sir what is the outstanding security receipts?

P. Mukherjee: Outstanding security receipts are about 350 crores or so I think. It is actually 329 crores.

Amit Singh: And sir what is the average cost of SA deposits?

P. Mukherjee: My average cost of savings bank would be somewhere about little over 5%, marginally over.

Moderator: Thank you. As we have no further questions, I now like to hand the conference over to Mr. P. Mukherjee for closing comments, over to you sir.

P. Mukherjee: Thank you once again. Well as I said earlier that under the circumstances it gives me some satisfaction that we managed to go through a very difficult quarter partly because of reasons beyond our control. Now that we have adequate capital under our belt, my sense is you will see added vibrancy in the day to day operations of the bank and I do look forward to at least reporting significant improvement in the operating profit of the bank in the coming quarters. Thank you very much.

Moderator: Thank you very much sir. Ladies and gentlemen, on behalf of Lakshmi Vilas Bank Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.