



“J&K Bank Q1 FY23 Earnings Conference Call”

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**MANAGEMENT: MR. BALDEV PRAKASH – MD & CEO, J&K BANK
ALONGWITH THE MANAGEMENT TEAM**

MODERATOR: MR. RENISH BHUVA – ICICI SECURITIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the J&K Bank Q1 FY23 Earnings Conference Call hosted by ICICI Securities.

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 ‘*’ and then ‘0’ on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Renish Bhuva. Thank you and over to you.

Renish Bhuva: Yes. Hi, Mike. First of all, apology for slight delay. Good morning, everyone. Welcome to J&K Bank Q1 FY23 Earnings Conference Call. From the management team we have with us today, Mr. Baldev Prakash – MD and CEO, and the entire senior management team. I will now request Mr. Baldev sir to take us through the brief highlights of Q1 FY23 results and then we will open the floor for Q&A. Over to you, sir.

Baldev Prakash: Thank you, Renish. A very good morning and warm welcome to all the participants.

Despite the continuing geo-political strife and inflationary pressures, the onset of the year has seen some positive developments as well. The economic growth is witnessing some uptick especially in the services sector owing to easing of pandemic woes. Other sectors also held firm despite the adverse headwinds. While uncertainty still looms, most economists predict a better future. The three recent rate hikes totaling 140 basis points by RBI due to elevated inflation which remains above the tolerance level of 6% resulted in MTM losses for most of the banks during Q1 when the yields surged to as high as 7.50% for 10-year benchmark. However, the rate hike was well anticipated and already discounted and as such did not bring much selling pressure in the capital market.

At our home-turf – JK & Ladakh – an accelerated level of activity is being observed. The mainstay of the economy – tourism – is witnessing an unprecedented growth with over 10 million tourists visiting J&K during the first seven months (Jan – July) of the year. The large tourist influx is causing revival of tourism & related activities like Hotels, Restaurants, taxi / shikara operators, house-boats, handicrafts and resulting in creation of employment for significant populace. Building of infrastructure – Roads, Rail Links, Tunnels – for maintaining all-weather connectivity with the rest of the country is also catalyzing economic development in the UT. Spurred by the Center’s industrial package of Rs. 28400 crores providing capital / interest subsidy plus other incentives and supplemented by the enabling industrial policy of the UT, the government has received investment proposals of over Rs. 50,000 crores from large domestic and global investors / industrialists. Out of these proposals, the government has already allotted industrial land for projects worth Rs. 36,000 crores. The industrial development is expected to create 4 lakh employment opportunities in the UT.

The other major sector of the JK economy i.e. agriculture - or more precisely commercial horticulture – is also expected to do better this year owing to favourable weather conditions, availability of large number of controlled atmosphere (CA) stores for postharvest stage, better logistics availability for transportation to various mandis of the country.

The anticipated surge in economic development in the Bank’s backyard is bound to create a fast-moving cycle of investments-finance-savings. The Bank with its outreach, familiarity, brand acceptance is poised to be the major beneficiary of this hyper-development phase.

The government employees and pensioners of J&K and Ladakh remain a substantial and focus customer segment of the Bank contributing significantly to the deposit and loan book of the Bank. The Bank besides maintaining salary and pension accounts of this segment provides a bouquet of customized personal loan products with lowest delinquency.

In the rest of the country, owing to our small size and limited presence, we have to play selectively – selective markets & selective segment – to increase our share of the pie. This shall mostly be achieved through collaborations – tie-ups with reputed builders for home loans, engagement of DSAs, collaborative models with Fintechs – and large ticket lending to PSUs and good rated corporates to increase volumes. We are looking at increasing the contribution from Rest of India to the Bank’s overall loan book to about 40% in the short to-medium term and take it to 50% level in the longer term. This shall ensure diversification of our credit portfolio, mitigation of concentration risk and reduce over reliance on one region. The Bank shall reposition itself as a pan-India player with a regional dominance.

Capitalizing on the emerging opportunities, realizing the corporate objectives, maintaining the customer centric approach and taking on the competition require a well reinforced institutional framework – capacity, capability and the infrastructure. We too have taken a number of transformative and strategic initiatives – augmenting capital base, organizational restructuring, succession planning, capacity building, business process reengineering, etc – to succeed in this highly competitive arena.

Last year we augmented our capital (T1 & T2) by fresh infusion of Rs. 1100 crores and total plow-back of profit (Rs. 500 Crore). This year also we are planning to raise up to Rs. 2000 Crores in tranches (T2 of Rs. 1500 Crore and CET-1 of Rs. 500 crore). The T2 issuance may be in the 2nd and 3rd quarter while the CET-1 raise may happen in the latter part of the FY. Internal accruals are also expected to be at a higher level this fiscal.

Let me inform all the stakeholders that during the June quarter, the Bank migrated to the latest version of core banking solution i.e Finacle 10 to pave way for the other major initiatives on BPR, Data Analytics, CRM, Fintech engagement, intelligent Decision Support system, etc. With this migration, the Bank has joined the league of top banks using the upgraded version which offers multiple additional functionalities including API integration with more security features. As had been the experience of other banks during such migration, we too encountered some

intermittent disruptions during the process which had some bearing on the business and customer service temporarily. The new version has mostly stabilized and the Bank is ready to fully leverage the system and realize the embedded benefits.

Now quickly on to the numbers for Q1, the Bank has clocked a YoY growth of 6% in Deposits and 8% in Advances. J&K UT which contributes 88% of Deposits, 72% Advances and 82% overall business of the Bank has registered 6% growth in Deposits and 10% in Advances. Growth recorded in Ladakh UT is impressive with Deposits growing at 11% and Advances at 19% over the year. Rest of India continues to record positive growth in Advances for second consecutive quarter, albeit moderated on account of some large NPAs amounting to about Rs. 250 Crores getting adjusted during the quarter. The Bank continues to maintain CASA of over 55% and consequently the cost of deposits remained at 3.60% compared to 3.67% Q1 last year and 3.58% in March Qr. NIM is also maintained at a healthy level of 3.46% in line with our guidance.

The overall operating results have registered marked improvement – Net Interest Income increasing by 7% on YoY and 6% on QoQ basis; Operating Income up by 4% YoY and 6% QoQ; with PAT growth of 59% on YoY and 48% on sequential basis. Employee expenditure was bound to come down on sequential basis owing to the one-off provision made in last quarter. However, the non-employee OPEX has also significantly come down by 12% compared to the previous quarter – the result being that Cost-to-Income ratio which was hovering well above 70% levels for three consecutive quarters has moderated to below this threshold and our endeavor shall be to bring it down to about 60% by the year end and to industry average in the next 1 to 2 years.

On the Asset Quality side, the Gross NPA ratio has improved when compared with June 2021 level but it has worsened on sequential basis. The Finacle-10 migration issues played some spoilsport affecting upgrade of NPAs. However, post stabilization of the system there has been significant improvement in the NPA numbers. Pertinently, last year the Bank had technically written off NPAs aggregating to Rs. 760 crores during Q2 which had brought down the GNPA figure. During June quarter, 3 large advances aggregating to around Rs. 250 crore got adjusted and a good number of NPAs are expected to get resolved in the near-term. The Bank continues to maintain provision coverage ratio in excess of 80%. The credit cost for the quarter was well below 1%.

Capital Adequacy ratio is above 13% without reckoning the quarterly PAT reckoning whereof would result in an improvement of over 20 basis points in CRAR.

On the Treasury Operations front we were able to stave off MTM losses as we had, in anticipation of hardening of yields, maintained a fairly small trading book and the investments under the AFS category were mainly in T-Bills under SLR and Certificate of Deposits (CDs) under non-SLR. We were on the positive side of the curve and still have adequate short-term

surplus that can be deployed at better yields. Yield on investments has improved by 8 basis points sequentially (QoQ).

We maintain our guidance on growth & profitability as communicated during my previous interaction with you.

We acknowledge your guidance, support and trust and we expect it to continue in the coming days.

I will be glad to have your questions now. Thank you very much.

Moderator: We will now begin the question-and-answer session. We have the first question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal: I have two questions. First on the asset quality and second on the OPEX. So, on asset quality, sir, we have seen the increase in NPA both especially in the J&K book. So, you commented in press release that due to migration to the system, we have seen some increase in NPA. So, first, how is the progress on the recovery of these NPA? And you maintained the 6% gross NPA guidance. So, given the Quarter 1 trajectory, do you see a material risk to that number to achieve?

Baldev Prakash: See, on 30th of June, our March '22 figure of NPA was 11,117 and 30th of June, we had increased from 11,117 to 11,545. And on 31st of July, this figure has come down to 11,159. That means almost up to the March level. So, this was a basically temporary phenomenon of three days when the system was not available and the teams at the branches were not able to do the transactions in the account. So, this was only a temporary thing and we are confident that we will be able to maintain the guidance of 6%.

Manish Ostwal: Second, sir, on operating expenses side, we have seen the 23% decline on quarter-to-quarter basis and the main decline component is employee cost. So, what has been done in this during the quarter and how the operating cost look like going ahead?

Baldev Prakash: As I have discussed in my briefing also, there are number of steps which have been taken on to ensure that the cost ratio remains around 65% and then by the end of this year to around 60%. Basically, one is that all the investments which were related to employee benefit have been deployed effectively more profitably in line with the market returns and then various other steps have been taken like wherever the branches were having more space and the employee strength was less, so that space has been released. And relating to medical benefits also now the dependable list of the staff is being verified so that there is no extra expenditure on LFC and medical bills. So, these are the few steps which have been taken which have resulted in better cost to income ratio mainly on account of staff expenses.

Management And Manish, one thing, because you are talking of Q-over-Q, I was talking of sequential numbers. So, we had already told you last time also that there was a one-off expansion we had

provided for this superannuation of our leave salary and medical allowances. So, that we had expense of 271 crores. That was a one-off expenditure in the Q4 of last year that had actually taken the employee cost higher. Now that because that has already been amortized in the previous quarter. We had already given the guidance also that going forward, this cost won't be there and there will be moderation in the employee cost on account of that and the moderation that you are seeing is on account of that also.

Manish Ostwal: And given the commentary on your initial comments about the state, J&K State, we expect the asset quality, especially J&K State to improve coming quarters and for that all the best to the J&K team. Thank You

Baldev Prakash: Thank you Manish.

Moderator: We have the next question from the line of Vaibhav from Honesty and Integrity Investment. Please go ahead.

Vaibhav Badjatya: Thanks for providing the opportunity. Good to see finally top management in place after a long time. So, in terms of our, you know, in last Con Call also, you have highlighted that the major cost to income drag is coming from outside J&K, and also you have highlighted that outside J&K we are going to focus on retail, MSME, SME portfolio. So, just want to understand what has driven your choice that we want to be in retail, MSME and SME kind of portfolio and you know, entire range of products portfolio that is available including corporate. So, what has driven that preference?

Baldev Prakash: Vaibhav, one is that as we have our experience working in the rest of India portfolio, in the previous years, I think we have to be little careful in selection of the borrowers there in that territory. So, that is the experience is driving that. And another thing is that since I have been working in Mumbai for quite a long time, and I have experience of working with the corporates also and the retail segments, particularly in Maharashtra, I personally have worked a lot in Mumbai as well as in Pune market and Nagpur market also. So, that has given me confidence of diversification in home loan.

So, these are the basically two areas where we think that we are confident of booking the quality business, and we are not going all hope for in the business. We are only looking for the good rated companies and the government PSUs. And our growth basically in the last one quarter has been on account of these major corporates only who are very good rated or the public sector units.

Vaibhav Badjatya: I understand the corporate part of it, but from the last con call I got an impression that you will be more focused on retail, SME and MSME in outside J&K portfolio.

Baldev Prakash: Retail, our focus will be more on housing segment. Retail, we will be growing in housing. We have created the marketing team. We have revamped the scheme also, the structure also and the

DSA structure has been in place now. We are hopeful that housing will be an area in the retail which we are going to have be aggressive in the rest of India book.

Vaibhav Badjatya: I understand historical problems with J&K what has happened in the, you know, outside J&K State when we lend to large corporates. But I think the key issue is the credit discipline whether it's corporate, whether it's retail, whether it's SME, across every bank, you know, irrespective of the product you choose, if the credit discipline is not there, it will lead to problems, you know, later. So, what have we done to improve that in the bank? And what are we planning to do so that our discipline is up to mark?

Baldev Prakash: Vaibhav, you will be happy to know that in the last three months, how the credit dispenses will happen in the bank has been totally revamped. Now as per the industry standard, we have the teams of relationship manager and credit support officer. Earlier the system was that the credit portfolio, the small, small branches, everybody is handling a small number of accounts.

But instead of that we have created now the big branches, only the 15 branches pan-India, and those branches have been provided with the trained staff, senior people as well as two or three support staff that is CSOs. And this will be finally reporting to the credit head at the General Manager Office in rest of India also, Jammu division also, and Srinagar division also.

So, this has been done with well thought of strategy and based on my experience in my earlier assignments also, and I am sure that with the trained team, the specialized training has been arranged for these people. And with this, I think we will be able to focus more granularly in the corporate credit, as well as this will also give a boost to our retail because those branches which were having one or two big accounts and were only focused on serving those accounts, those accounts have been shifted to now they have been centralized, and the rest of the branches will be focused only on the retail growth. So, that has been our strategy. I am very confident that this strategy will give results.

Vaibhav Badjatya: And any kind of, you know, rationalization on the cost trend that you are looking in outside J&K portfolio to improve the cost to income ratio on that part of the business? Any kind of, you know, reduction in staff or something like that? Is that perceived?

Baldev Prakash: No, as of now there is no reduction of staff. There is no this thing, we are not curtailing the presence also. In fact, in the last quarter, we have operationalized three cluster offices, one in Lucknow, another in Chandigarh, and latest one on the 2nd of this August we have operationalized our cluster office at Bangalore. So, this is basically to focus on the retail segments in those territories because these territories offer a good scope of business.

Vaibhav Badjatya: Ok. That is it from my side. Thank You

Baldev Prakash: Thank you Vaibhav.

Moderator: We have the next question from the line of Sonaal from Bowhead. Please go ahead.

Sonaal: I wanted to know what would be your employee cost for the full year FY23?

Baldev Prakash: I will request my CFO Mr. Pratik to please take up this question.

Pratik Punjabi: The employee cost for the full year is in the range of 2,600 crores for the full year.

Sonaal: My second question would be what was your SMA-1 and SMA-2 for this quarter?

Baldev Prakash: Sonaal, the SMA numbers as on 30th June, these were in the SMA-2 we had 1,124 crores.

Sonaal: SMA-2 you are saying?

Baldev Prakash: SMA-2, 1,442 crores and SMA-1 was 3,800 crores.

Sonaal: 3,800 crores.

Baldev Prakash: Yes. 3,800 SMA-1, 1,440 SMA-2.

Sonaal: And can you give me the same numbers for 31st March as well please?

Baldev Prakash: March, we have actually given in the last call also, the numbers. So, you can write to us and we can mail you the numbers, the previous numbers as well.

Sonaal: But from what I recall, you didn't give the numbers in the last quarterly call.

Baldev Prakash: So, we can give the numbers and these have come down significantly from that.

Sonaal: So, SMA-2 1,440, SMA-1 3,800 crores.

Baldev Prakash: Yes.

Sonaal: And what I understand there is no major overlap between the restructured books and SMA. It's a small overlap.

Baldev Prakash: They are small. Restructured book we have around 3,000 crores.

Sonaal: Sir, in terms of your, you know, SMA-1, SMA-2 continues to be higher while you are saying Jammu and Kashmir economy is booming. I think this would be one of the highest SMAs still in the country among all banks. So, what gives you confidence that, you know, I mean, the asset quality whatever in case you are saying in spite of the such high SMA book in a book, you know,

and in general, we are a SME bank and across all banks, you know, the SME stress has been increasing. So, what are specific things which you are saying in spite of the SMA and this general trend of SMEs, you know, under lot of pressure across banks in India which gives you confidence that in our bank's case, you know, the NPAs will actually fall?

Baldev Prakash: Yes. Sonaal, see the trend which we see that in the month of March '22, we had a SMA-1 book of 9,400 crore against 3,800 crore this quarter And SMA-2, the book was 1037, and now it is 1442. Yet I will agree that the SMA got elevated by that, but lot of follow-up and lot of monitoring which we have done on SMAs and right at the level of MD, CEO, we are monitoring these accounts and wherever actually start to do including the actions under SARFAESI as well as the MIS, those actions are being taken. And I am sure that we are going to enforce the discipline among these borrowers. Yes, it is a journey. It will take some time.

Sonaal: But sir, the fact that SMA-2 is itself a large number and obviously people, you know, wouldn't have such a large number in spite of the measures you have been taking unless there is some issue, right? Or what is the flaw in my understanding?

Baldev Prakash: Now see we have done this book of government employees that sometimes if the salary is delayed one or two months, that book keeps to SMA-1 or SMA-2 sometimes, but those accounts are always very good accounts, slippage ratio is hardly anything there, but it is because of the delay in salary sometimes those books are behaving like this. But we are taking steps to see that one or two advance installments we are taking on those accounts also.

Sonaal: But from my understanding, at least in the past, you know, that was relatively a small number. I don't know about today, but in the past--

Baldev Prakash: Growing fast, Sonaal.

Sonaal: Sir, how much of your NPAs this quarter were from restructured & GECL books? And in your restructured book, how much of repayments have already started of principal, you know, the loans which were restructured?

Baldev Prakash: So, you are saying out of restructured book, what was the NPA this quarter?

Sonaal: No, sir. Out of the restructured book as well as from the GECL book. From the restructured book, I think you have given the NPA. From the GECL book, you know, how much NPA did flow from that part of the book? And considering we have a large GECL book, you know, what are your expectations from that and how much repayments have already started, you know?

Management We have a total book of GECL loans around 2,300 crores. We have a total loan book under GECL, it's 2,300 crores, out of which the outstanding as on 30th June and it was around 1,800 crores, and the bucket wise moratorium for GECL as on 30th June is up to three months it's only

1 crores and 10 months to 12 months, it's again 1 crore, and 13 months to 24 months, it's around 69 to 70 crores, and then above 24 months, it's around 400 crores.

Sonaal: The first part you said, you know, when you were explaining this 800 crores. What is 23 and then what is 800 crores?

Management No, 1,800 crores is the outstanding and 2,300 crores was the total GECL sanction.

Sonaal: And had any part of the loan book started repaying by June quarter?

Management Yes.

Sonaal: How much repayments would you have got in the June quarter from this GECL book? How much repayments from the ESG risk book?

Management We will give the details, sir.

Sonaal: And sir, you gave a guidance of GNPA falling to 6%. Is that because you will take some write-offs or you expect 2% reduction in the GNPA due to recoveries?

Management There are various things that we have taken into account, Sonaal. We are expecting the Gross NPA below 6%. I am seeing a total recovery of around 3,800 crores. So, cash recovery and through SARFESI sale of assets, sale of properties and deposits facility to our customers, we are expecting a recovery of 450 crore. Compromise and settlements which we will recover around 700 crore. Sir, sale to ARC is one component, and we are expecting around 800 crores from there. Then through NCLT route we are expecting a recovery of around 300 crores and upgradations of 1,700 crores.

Sonaal: Sir, just for the sake of clarity, because this number looks too large and the reduction looks too less compared to the numbers you are giving. What is the gross slippages you are expecting this year? And what is the net slippages you are expecting this year?

Management Next three quarters we are expecting gross slippage of 1,000 crores.

Sonaal: Gross slippage of 1,000 crores and the net slippage?

Management Net slippage will be 1,000 crores.

Sonaal: Net slippage will be 1,000 crore. And you said that you will be selling 800 crores worth of assets from your book?

Management Yes. We have already sold 190 crores in the first quarter, and the rest we are planning in the next three quarters.

- Sonaal:** So, that will get to a 1,000-crore reduction from your book.
- Management** Yes.
- Sonaal:** And does this guidance also include any major write-off you are planning to take when you say you are reducing?
- Management** No, the last year we had taken technical write-offs around 800 crores. That decision will be taken at the highest level by Board of Directors. So, this year we have not done anything on the technical write off so far.
- Sonaal:** Sir, in this financial year, would you have further need of equity capital and would the state government be willing to provide it? Sir, would you need equity capital, not the bonds, the equity capital this year, you know, this financial year?
- Baldev Prakash:** So, Sonaal, as I have discussed in my brief, 1,500 Cr we are trying to raise in tier 2 and 500 Cr in tier 1, CET1 through FPS.
- Sonaal:** But this 500 crore is through equity capital or through bonds?
- Baldev Prakash:** No, that will be through equity.
- Sonaal:** 500 crore equity. And would the state government be providing? Or you will use the market?
- Baldev Prakash:** No, I think, we have not approached state government as of now. We are first trying to reach the market.
- Sonaal:** And sir, what was the kind of technical glitch we saw? Was it new software implementation or some issue with the existing software?
- Baldev Prakash:** No, this was actually that Finacle 10 migration, the first closing post-migration was there. So, that's one time. We were not able to run various reports, the SLAC report which you file for NPA. The system was not able to run that report and that report was finally generated on the 1st of July instead of 28, 29, 30th June. So, that was finally they took care and then from the 3rd, Monday everything was normal. That's how this NPA as on 31st of July has come almost equal to the March level.
- Sonaal:** So, the numbers which you reported other numbers on 1st of July, is it what you are saying or 3rd of July?
- Baldev Prakash:** I will repeat it again. See on 31st March '22, the NPA of the Bank was 11,117 including tech write off. As on 30th June '22, it was 11,545, and on 31st July, it was 11,169.

Sonaal: So, I am trying to understand, you said the software didn't work on 30th June, so you could not compile the NPA. So, that is what you are saying?

Baldev Prakash: Yes. The compilation also because the system was not available to the operating unit. So, those customers who wanted to deposit money on their accounts on 28, 29, 30th, they were not able to deposit. So, because of that, that those accounts which were upgraded on 3rd.

Sonaal: But sir, why would any sensible customer try to do these deposits only on the last three days of before becoming NPA in spite of monitoring?

Management Sonaal, actually, you see when this interest application, especially in the government accounts, we have our running facility also that we have provided to them. It's just like an OD or CC account provided to the government employees. So, in that, what we do? We usually service the interest which is applied on every month end. So, they keep amount available in their operative accounts and they have given a standing instruction. The mandate is with the bank to debit those accounts and transfer the interest amount to the CC accounts of these employees. So, actually, what happens? There is a drop line limit. When they approach the superannuation – 5 years prior to that, the limit is actually brought down by 20% every year so that it gets adjusted by the end of service tenure of 60 years. So, till that time we only service the interest part.

The SMA is also actually a function of this thing that the interest actually may be served on the 1st, this thing may be run on the 1st. And on this day, the SIs didn't get executed, amount was available in their operative accounts. So, if you want the numbers also, we could give the numbers also how many accounts actually had the balance in the operative accounts. Only the SIMs, the standing instructions couldn't be executed. It's not that only cash coming on the last date. It's actually the system also there that we run these standing instructions. As per that the interest is applied. That standing instruction is executed so that the interest demand generated is satisfied.

Moderator: Thank you. We have no further questions, sir. I would like to hand it over back to the management for closing comments.

Baldev Prakash: Thank you very much all the stakeholders and participants. And thank you very much ICICI Securities for this call, and we wish you all the best.

Moderator: Thank you. On behalf of ICICI Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.
