"J&K Bank Q4 FY22 Earnings Conference Call"

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MODERATOR: MR. RENISH BHUVA – ICICI SECURITIES LIMITED.

Moderator: Ladies and gentlemen, good day, and welcome to J&K Bank Q4 FY22 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 telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Renish Bhuva from ICICI Securities. Thank you, and over to you, sir.

Renish Bhuva: Hi. Thanks, Inba. Hello, and good evening to everyone. Welcome to the J&K Bank Q4 FY22 Earnings Conference Call.

I would like to thank the management team for giving us the opportunity to host the Q4 FY22 Earnings Call. From the management team we have with us today, Mr. Baldev Prakash – MD and CEO, and his entire top management team.

We'll start the call with brief opening remarks on FY22 and Q4 FY22 numbers. And then new MD and CEO will lay down his strategy. And then we'll open the floor for Q&A.

I will now hand over the call to Mr. Baldev sir for the opening remarks. Over to you, sir.

Baldev Prakash: Thank you, Renish. And a very good afternoon and warm welcome to all the participants for the investor brief of the J&K Bank for March 2022. Along with me, my CFO – Rajni Saraf; Ashutosh Sarin – Credit Head; and Mr. Altaf Kira – Head of Risk are there.

As this is my first interaction with you after having assumed the role and responsibility as Managing Director and CEO of the J&K Bank, I would like to briefly introduce myself at the outset.

My name is Baldev Prakash. I'm a career Banker with over 3 decades of service in the largest public sector Bank that is State Bank of India, where after joining as a Probationary Officer in 1991, I have had the experience of working in various roles including the Branch Head, Regional Head, and the Module Head in GM Network. And before joining my duties here in J&K Bank, I was discharging my duties as Chief General Manager of Digital and Transaction Banking at SBI corporate office, Mumbai.

Now moving over to my current assignment as MD and CEO of J&K Bank that I assumed on 30th December '21, I would like to share with you my preliminary understanding of the institution, its unique characteristics, strengths, opportunities, and challenges. As I have to present the findings of the diagnostics carried out by me since my joining the institution, my vision and strategic plan to further capitalize on the strength, reinforce the financial soundness while addressing the concerns, this presentation may take a little extra time, which may curtail the time for question-and-answer session. I would request you're a patient listening from you please. Backed by a rich legacy of over 8 decades, the Bank has carved out a special position for itself in the financial landscape of J&K and Ladakh. The brand recognition and the recall of the Bank in this geography is unparalleled, and is truly a household name, convincingly maintaining the market leadership tag with over 65% of the market share. UT government ownership further enhances the brand value and credibility of the Bank. J&K Bank has assumed strategic and systemic importance for the UTs of J&K and Ladakh as the major provider of finance, especially to agriculture and allied activities, and MSME to keep the wheels of economy turning and helping entrepreneurs to realize their economic pursuits.

The Bank enjoys captive clientele of government employees and pensioners, who in addition to maintaining their salary accounts with the Bank also significantly contribute to lucrative and healthy personal finance segment as borrowers. Owing to the extensive outreach of the Bank over the length and breadth of the twin UTs, it has been able to build an unmatched liability franchise which continues to grow with every passing day, a CASA share ranking among the best in industry and extremely stable retail deposit component confers a cost edge to the Bank, which has all along been reflected in comparatively better NIMs, which could be further leveraged in the competitive pricing of loans.

Designation as agency Bank for government Banking transactions of J&K and Ladakh and lead Bank responsibilities in 12 of of the 20 districts of J&K also provides additional armory to the Bank for maneuvering the tide to its advantage. The average household debt in J&K compares favorably with the neighboring states being significantly lower than Himachal and Haryana or national average thus offering ample opportunities for further financial deepening, especially in the agriculture, high density farming, allied agriculture activities like dairy, sheep farming, fisheries and apiculture, housing, tourism, infra, mini hydro and unconventional power projects, etc. With low penetration of financial services, the area offers significant opportunities for other financial services like insurance, assets & wealth management, depository services, broking, etc.

The Bank has adequate infrastructure and footprint across the geography to capitalize on these opportunities. These growth avenues exist in the business-as-usual phenomenon in this geography. However, going forward, there is expected to be a big add on effect as an outcome of the ambitious initiatives of the J&K Government to attract sizeable domestic as well as foreign investment in the sectors like real estate, horticulture, tourism, healthcare, and other infrastructure.

The area which would require special focus is the NPA management where all the avenues for effecting recovery shall have to be vigorously pursued to ensure worthwhile recovery and unlocking of valuable capital.

The Bank has been recording abnormal SMA figures though the slippages from the portfolio has been restricted. This area of concern also needs to be addressed directly through concerted campaigns sensitizing the borrowers to maintain financial discipline and a better repayment record, which would entail benefits like better rating and pricing, easy access to enhanced financing or add-on and complementary facilities, etc, while also putting in place the deterrents for delinquencies.

Growing business in the rest of India geography and evolving strategies for making the outside of J&K branches to adequately contribute to the bottom line of the Bank is on the top of our agenda. We can replicate our success stories in agri lending and personal finance in J&K in select markets in the rest of India and complement the business volumes by taking exposure to small and mid-corporate good rated borrowers and public sector units.

Increasing share of non-fund business and augmenting our non-interest revenue streams is being strategized and duly incorporated in our business plans, supplementing the revenue streams with adequate tabs on the controllable expenditure shall result in improving efficiency of the resources and finally, moderation of the cost to income ratio to the desired level. Here I would like to state that the cost to income ratio of the Bank in J&K and Ladakh is in the lower 40s while the drag is coming from the rest of India business which needs to be specifically addressed.

Capital adequacy is another area that we need to focus on. We are figuring at the lower end of the spectrum when it comes to CRAR, especially common equity Tier 1. The Bank augmented its capital by Rs. 1,100 crore during the financial year ‘22 by way of preferential allotment of Rs. 500 crore to the promoters, Rs. 150 crore raised via ESPS, Rs. 93 crore via QIP and Rs. 360 crore as Tier 2 bonds. The response to the QIP was below the expected level, owing to the geopolitical strife which dampened the market sentiment.

Now, I would like to briefly take you through the initiatives that have either been rolled out during the quarter 4 of financial year ‘22 and the ones on the anvil for launch. The Board of Directors has been reconstituted with induction of more independent directors having expertise in finance, accountancy, information technology. Compliance with all the regulatory prescriptions with regard to Board and Committees thereof is ensured including the chairing of the Board meeting by an Independent Director, thus splitting off post of Chairman and Managing Director has been achieved. Delegation of powers has been reviewed and the committee approach for taking material decisions has been adopted in line with industry best practices. Succession planning of the top management level is currently underway to ensure desired focused attention and oversight of all the verticals and business lines for achievement of the corporate objectives in each and every segment while avoiding any conflict of interest. We have also placed President level functionaries to oversee and drive credit and business operations while maintaining proximity with the operating levels at regional levels for rest of India and Jammu region. We have also operationalized 3 clusters offices in rest of India in Lucknow, Mohali, and Bangalore for driving business growth at these centers.

We also conducted a strategic conclave to identify the potential future leader and to evolve strategies through collective thinking for addressing the areas of concern. The annual business plan for financial year ’22 - ‘23 was formulated well before the start of the financial year and promptly communicated to the operating levels to ensure a head start. We have reviewed the business model in the rest of India and have put in a plan seeking to leverage the network efficiently while aiming to gain traction in business growth, more sweating for increased productivity with improved profitability. While the majority of the branches in rest of India shall focus on Retail, MSME and FOREX business while some designated corporate business units would focus on increasing volumes through good rated small and mid-size corporates and PSUs. The strategy has already started yielding results as for the first time after a number of consecutive quarters of degrowth, the rest of India credit portfolio has grown by over 6% on a Q-on-Q basis during Q4 of financial year ’22. A process of monthly business and recovery reviews has been institutionalized to ensure that the growth momentum is consistently maintained every day, every week, every month, and every quarter. We have rolled out 2 special OTS schemes targeting NPA accounts of up to Rs. 15 lakh and 15 lakh to 5 crore, respectively. The response so far has been very good and we are expecting to resolve NPAs amounting to over Rs. 200 crore under these schemes during the current quarter. In addition, we have redoubled our efforts to pursue recovery of NPAs vigorously. By employing all available avenues, we are targeting to bring down gross NPA of the Bank to around 6% level by the end of the year.

Friends, our treasury operations which had been shifted to Srinagar on experimentation basis has been relocated at the commercial hub, Mumbai to reinstall market connect, vibrancy and profit center orientation.

The fresh capital infusion during the financial year supplemented by ploughing back of the profit has resulted in capital buffers improving to 180 basis points over the regulatory minimum. However, we are looking forward to further augment the capital base during the current financial year maybe after putting in a couple of good quarterly results which shall improve the pricing and attractiveness of the Bank stock. The J&K UT government has earmarked Rs. 200 crore in the annual 2023 budget for infusion of further capital in the Bank. However, instead of increasing the promoter stake, we would like to increase the public holding.

On the IT and digital front, we are on the cusp of completing rollover to advanced core Banking solution, Finacle 10, total centralization and automation of account opening and loan processing, loan appraisal for all personal loans, full automation of EWS framework while we have already migrated to an advanced version of mPAY, which is our mobile payment app. Automatic auditing, upgrading of MIS with real time dashboards as part of a decision support system and improved internal control to name a few. We are targeting to achieve a digital to total transaction ratio of 85% to 90% by the year end, thereby gaining higher operational excellence, reducing costs to serve, and releasing more resources for marketing assignments.

We also took some tough calls during the last quarter to reduce the stress in the balance sheet and also on the profit and loss to pave way for a better and sustained performance going forward. For classification of NPAs, we recognized even the non-financial infirmities like pending stock statement submission, audited financials that cause delay in renewal of such loans, though not being 90 days past to on financial obligations. Earlier during the financial year, the Board of the

Bank had approved creating a corpus aggregating to Rs. 319.36 crore on voluntary basis for pension liabilities on account of medical allowance and variable pay though this was not mandated under AS15. The board had approved funding this corpus over a period of 5 years starting from financial year 21-22. The Bank had made contributions of Rs. 48 crore toward this fund during the first 3 quarters of financial year ‘22. We took a call to fully fund the corpus during this year itself, thus providing the remainder of Rs. 271 crore fully during the quarter 4 so that we are not precluded from declaration of dividends in the financial year ‘23 and beyond, when we are envisaging better results and resumption of dividend payments to our shareholders.

Coinciding with the reformative business processes initiated within the Bank, we are witnessing some positive changes in the overall business environment. The pandemic is ebbing. Economic activity is gaining traction. J&K UT is receiving a huge number of tourists and a good season seems to be in offing - overall a promising start for the financial year 2023.

My focus during the first few months at the helm of this Bank was on revamping the structure, the business model, growth strategies and firmly put in place a framework that can lead this institution to truly realizing its potential by capitalizing on its unique attributes and core competencies.

I will now briefly run through the financial numbers of the Bank in Q4 and financial year ended March 22:

The Bank has clocked a YoY growth of 6% in deposits and 5% in advances. The growth in Q4 has been promising with deposits growing at 5% Q on Q and advances 3% Q on Q. The demand deposits have grown at an impressive rate of 14% during the quarter 4, but the highlight is the 6% Q on Q growth in the loan book and rest of India after witnessing countless consecutive quarters of degrowth.

Our CASA at 56.56% is among the best in the industry, which lends us a cost edge as our cost of deposit is 3.65% for the year. Despite providing for some exceptional items, as I mentioned earlier, we have been able to register Rs. 500 crore plus profit figures for the financial year delivering a 16% YoY growth after 7 years of muted profitability. Our NIM remained stable and at a healthy level of 3.5%.

On the asset quality, we have improved our gross NPA to 8.67% that is 100 basis points down from the previous year. Likewise, there has been improvement in net NPA from 2.95% in ‘21 to 2.49% as on March 22, and the provision coverage ratio from 81.97% to the current level at 84.26%. And capital adequacy has also improved by 103 basis points over last year to 13.23% providing a headroom for the growth.

Anticipating improvement in the operating environment, our guidance for the year ‘22- ‘23 will be deposit growth of about 12% to 15%, advances growth of about 15% with J&K UT growing at about 20%. Net recovery is in the range of Rs. 1,000 crore, credit cost of below 1%.

We acknowledge your support and trust and we expect it to continue in the coming days. I'm looking forward to more interactions with the analysts and investors in the days to come. We are also contemplating to host an investor and analyst meet during the second or third quarter wherein we would like you to personally feel and observe the business environment in our home turf to gauge the systemic relevance of the Bank for the twin UTs of J&K and Ladakh which in turn confers on it a value proposition which needs to be acknowledged and unlocked.

We can take some questions regarding the strategic plan as I have will presented.

For any queries regarding the numbers, you can always contact our investor relation department, and we shall be glad to respond to it. We always look forward to your guidance and advice for improving our working. Thank you so much.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. We'll take the first question from the line of Renish Bhuva from ICICI Securities. Please go ahead.

Renish Bhuva: So, there's just a couple of things, okay. So, one is that we all are aware about our full liability franchise in J&K. But when it comes to the asset side, we have our own learning curve on the asset side. So, briefly, if you can throw some light, let's say, on the asset side which product will be your focus product going ahead and which geographies you will target to grow that product, sir?

Baldev Prakash: Good question. Renish, actually, all the segments like agriculture, retail as well as MSME will be on our focus and the stages we have decided that already we have with Phone Pe Loan which is a digital loan for the employees of department only of J&K government. So, now, the Phone Pe Loan facility that a digital loan has been rolled out to all the government departments and going forward in a month or so, we will be rolling out to all corporates of the J&K government. So, that is one and then going forward, we will be approaching the Ladakh UT also so that the employees of that UT also are covered under this scheme. And the effort is that all the retail loans are done through digital mode only. And we are going forward, we are now very aggressively working for the AMTs, advances monitoring team because as of now, as you know, that the assets in the MSMEs are basically spread out and the credit risk is spread out across geographies. So, from 1st of June, all the teams will be specialized teams will be headed by the relationship manager and the team will be owning a number of accounts of 30 to 35, and it will be supported by the Credit Support Officer. So, these teams will be exclusively responsible for maintenance, growth, and audit related issues of the MSME, which will give us definitely edge and it will further improve the quality of our portfolio.

Renish Bhuva: And sir, any growth numbers would you like to guide for.

Baldev Prakash: As I've already told, we are looking for around 12% to 15% growth as far as the deposits is concerned, and we are looking for around 15% of growth in advances during the current year and in the J&K UT, we are expecting a growth of 20% in advances.

Renish Bhuva: And just the last question from my side on the margin. So, we already entered the rising interest cycle. So, looking at your asset mix and your deposit profile, how should the margin trajectory going ahead, I mean do you foresee a margin expansion or, let's say, margin will remain static at around current level, sir.

Baldev Prakash: So, Renish, what we are thinking is that our NIM should be in this range only because our CASA portfolio is quite strong and we are confident that this will be maintained at around 56%, 57% level, and the credit growth which is expected mainly in the retail segment and agriculture segment. So, we are confident that it will be maintained in the similar range.

Renish Bhuva: So, our SA rate is linked to the benchmark rate or how is it sir?

Baldev Prakash: It is both, it’s external also as well as MCLR also. I think around 40% is external and 60% is MCLR.

Renish Bhuva: So, I’m saying SA rate, not the asset book.

Baldev Prakash: Pardon. Renish, you have to repeat.

Renish Bhuva: So, this saving rates are linked to the repo rate or it is the fixed rate pool.

Baldev Prakash: The saving rate as of now is fixed, and then with respect to RLR, that’s linked to the repo rate, repo linked lending rate, that’s the external benchmark rate. Our Risk Head is responding to this question, Renish.

Altaf Kira: So, if we look at it with respect to the margins, I think the margins are settling as sir rightly said, because due to the hardening of the interest rates there, because of our rate sensitive assets are at higher end. So, it will give some benefit of that and going forward, the margins will be higher than this.

Moderator: We'll take our next question from the line of Gaurav from Bowhead India. Please go ahead.

Gaurav: I think it's a long time that we have had a stable CEO at the helm. So, I’m sure that with your presence we achieve the numbers which we had all been waiting for the last 5, 6 years. Sir, with that, what about your capital raising plan, if you can highlight, so since we are already low on the CET1, what are our plans on the equity?

Baldev Prakash: As I have covered in my opening remarks, so last year it is around Rs. 1,100 crore, Rs. 1,103 crore of the capital, and the same effort will continue this year also. Government of J&K is expected to provide around Rs. 200 crore which they have already budgeted and once after a quarter or so, we are confident that our rating will be improving with the growth in the profitability as well as in the business. So, we will be again reaching and going to the market for raising capital in Tier 1 as well as in Tier 2.

Gaurav: Sir, in terms of your operating profit, do you have any targets for FY23? Like for FY22, you generated Rs. 1,369 crore of operating profit. Do you have any target for FY23?

Baldev Prakash: So, this year actually Gaurav, our operating profit has been impacted because of this provision which was amortize for 5 years, but we have covered it in this year itself. So, that is amount of around Rs. 270 crore.

Gaurav: Sir, that is anyways part of the exceptional items, right? It is not the operating profit. The operating profit which I am referring to Rs. 1,370 crore odd, that is excluding the exceptional item of Rs. 270 crore.

Baldev Prakash: That has affected this quarter's operating profit. So, going forward, we are confident of achieving appropriate profit of – so we are expecting Gaurav a 25% growth excluding this one-time item from this year.

Gaurav: And sir, you mentioned 1% for FY23. Sir, can you hint at the absolute number since there is some confusion, some Banks leave it on assets, some Banks leave it on advances. What does, sir 1% translate to in terms of absolute number?

Baldev Prakash: I'm sorry, Gaurav, please. Can you repeat? I'm not able to hear correctly.

Gaurav: Sir, in your credit cost, you gave a guidance that for 1% credit cost for FY23. I wanted to check the absolute number here, that 1% translates to what kind of absolute number for credit cost with the provision line item in your P&L.

Management: Actually, Gaurav, the ageing requirement for the year '23, it is below Rs. 500 crore. Usually, we have made additional provisions for a number of accounts for the current year also. So, their liability will be less than Rs. 500 crore. So, actually the credit cost will be below 1%. Though we have given a conservative figure of 1%, it will be much below that figure.

Gaurav: So, 1% wouldn't mean what, Rs. 500 crore.

Management: Less than Rs. 500 crore.

Gaurav: And sir, in terms of your employee cost, on a full year basis, that has gone by % around 18%. So, for FY23, how do you see that line item?

Baldev Prakash: Actually, Gaurav, that is a matter of concern for us actually because we are among the high cost to income ratio, mainly contributed by employee costs. So, one is that that that productivity of the employees, as we have covered that marketing teams will be now strengthened and rolled out in all the zones of the Bank. And the productivity and profitability of the employees will be in focus, number one. Number two, the areas which I think need more focus is the increase of income, non-interest income as well as other income of the Bank, that will also improve the cost to income ratio. And plus wherever that income leakages are there in the form of commitment charges or processing charges, etc, that will be blocked proactively.

Gaurav: And sir, lastly, what's the modified duration for our investment book?

Baldev Prakash: Just a moment. I'll let my -- Risk Head will be responding this. Just a moment please.

Altaf Kira: Our AFS portfolio is very small as on date, most of the securities in AFS are short dated, that is the CDs mostly and the T bills. So, actually, those won't have much of an impact there. The maturity over there is less than 1 year. And definitely the modified duration is far below 1. So, those won't actually have the impact of this hardening of interest rate with much effect there, because actually, these discounted papers and very short-term papers. In fact, AFS group is purely consisting of these securities as on date. We were actually anticipating there will be some north way movement of the interest rates, the interest rates were actually bottoming out. So, we were not taking any positions. We were not building our HTM book over the last 1 or 2 years actually. That is why the yields from our investment group were also a bit low, because we were actually going with the short term investments only, and Treps lending and other lending. So, as you see, we were actually anticipating the rates to go up and then there would have been erosion of value. Now, we have started building this HTM book also with high coupon securities with better yield. So, over this period the yields will also improve. We had a lot of surplus, and the surplus now being deployed, at better rates, we'll see a better return and the interest income will definitely improve over this year.

Moderator: Thank you. I would now like to hand the conference back to the management of J&K Bank for closing comments. Over to you, sir.

Baldev Prakash: Thank you, ma'am. And as I have stated already in my opening remarks, the Bank is on the growth trajectory now. And whatever the stress was there in the loan book has already been booked and we are well capitalized also as compared to the last year. Of course, that effort will continue. And the provision coverage ratio is quite healthy. And so that Bank is bound to achieve new heights during this year. So, I request all support from all our stakeholders. Thank you very much.

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