Kotak Mahindra Bank Q3 FY 2017 Earnings Conference Call

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MANAGEMENT:	**MR. UDAY KOTAK -- EXECUTIVE VICE-CHAIRMAN AND MANAGING DIRECTOR** **MR. DIPAK GUPTA – JOINT MANAGING DIRECTOR** **MR. JAIMIN BHATT – PRESIDENT & GROUP CHIEF FINANCIAL OFFICER** **MS. SHANTI EKAMBARAM – PRESIDENT – CONSUMER BANKING** **MR. NARAYAN S. A. – PRESIDENT – COMMERCIAL BANKING & CAPITAL MARKETS** **MR. K. V. S. MANIAN – PRESIDENT – CORPORATE, INSTITUTIONAL & INVESTMENT BANKING**

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Moderator: Good day, ladies and gentlemen, and a very warm welcome to the Kotak Mahindra Bank Q3FY17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I am now glad to hand the conference over to Mr. Uday Kotak. Thank you and over to you, sir!

Uday Kotak: Good evening, friends. Welcome to our first call of calendar 2017 and I wish all of you a Happy New Year. This is with reference to the quarter which just got over which is October to December, I think it is truly a historic quarter for any bank and financial institution in India. As you know we had the unique event of demonetization where we basically, had 86% of the currency demonetized within a period of 50 days. And therefore, it was a very challenging and interesting time for the banking industry including Kotak Mahindra Bank.

First, with reference to the whole impact of demonetization, I think, as of today I see normalization begin to happen in most of the segments going forward from here. But for the quarter ended December, we saw some challenges in our agricultural finance, some of the rural sectors and our SME or business banking segment which had some pressure particularly on the side of loan growth.

We were however fortunate to see some shift which is already beginning to happen from the informal sector to the formal sector which is reflecting in higher corporate banking growth in the loan book, , coming at in due course as we look at it on tighter pricing.

Overall, on the asset side of the balance sheet some slow down on SME, agricultural and rural sectors. Consumer sector also did slow down but the wholesale banking sector actually continued to pick momentum.

Also, keep in mind, for us the demonetization happened fortunately at a point of time when most of our integration issues were behind us. To refresh you, we did a full technology and people merger sometime in May, June. We had guided that we should be done more or less by September, October. By the time demonetization happened we were a fully integrated bank. The integration fortunately happened before that.

Also, the liability side of the business saw a significant boost which has led to an improvement in our liability ratios which is in all the 3 areas CA, SA, and also a significant growth in our sweep deposit base. We feel very good about the stability of our liability franchise and it is continuing to gain momentum as we look at the future.

Overall, from the point of view of the bank's core philosophy which is adding risk commensurate or at times probably less proportionate to the levels of returns we make, which is the core of our philosophy it continues to hold us in good stead through volatile and challenging times.

Essentially, the business model which we are building is focused on returns for the level of risk we take and see that the risk does not disproportionately go higher than the level of return the risk produces.

Going forward, I do believe that in some of the sectors normalization will happen within January to March quarter and April to June quarter. October to December loan growth was slower than what we would have liked. We are not too worried because we see us getting back to normal momentum in the next couple of quarters. However, we will continue with our core discipline that we must get the returns for the level of risks we take and we are ready to sacrifice returns if it means significantly lower risks.

One other point, I must also mention is that we are now beginning to see the benefits of the merger kick-in. It's still early but we see momentum on returns coming out of the merger now looking much more real than they did six months ago,. Of course, that does not mean we reduce our guard or do anything of that sort. But broadly from the point of view of Kotak Mahindra Bank we do feel that we are in a place where the formal sector is gaining and our liability franchise is in good shape. On the credit side our discipline is broadly working, i.e. for the levels of risk we have taken we are getting commensurate returns and going forward as normalcy restores in the economy we will see traction in growth on the loan side.

So, all in all, reasonably positive with a caveat that we need to watch each segment of the market place for one or two quarters before jumping in more aggressively in some of the segments. And at the same time, I do believe that in this period and this is more for the banking system and something which we are very watchful at our place, we do not want to take our eyes off some of the stress which is there in the system including some of the stress which we may be carrying out of our history and focus on recovery because there is a need for much higher focus on recovery which is certainly getting tougher than before.

With that, I will hand it over to my colleague Jaimin Bhatt to take you through the details of our specific performance for this quarter.

Jaimin Bhatt: Thanks, Uday. Let me take the standalone numbers first. We close this quarter with a profit after-tax of Rs. 880 crore compared to Rs. 635 crore which we did the same quarter last year. Our total loan book now at Rs. 1,29,000 crore.

As Uday mentioned, we recorded just over 12% growth in our loan book on a Y-o-Y basis.

Our net interest margin for the quarter stood at 4.49% and the net NPA at 1.07%. Our capital adequacy continuous to be pretty healthy with overall number of 17.6% with Tier I at 16.5%.

Total balance sheet size now over Rs. 2 lakh crore. CASA at the end of the period now at 42% and this is independent of the Sweep deposits which is another 7.3% of the overall deposit base.

On the P&L, the net interest income for the current quarter at Rs. 2,050 crore, a 16% rise over the previous year. This quarter to some extent was impacted by higher cash which was very little including the higher CRR requirement for a period.

The other income of Rs. 910 crore include Rs. 725 crore of fees and Rs. 185 crore on other activities including treasury. Fees helped by increase in syndication fees, exchange transactions, and also the fact that the office in the Gift City which we set up is now kicking in pretty well.

Other income, also includes sale of some priority sector certificates and the income we earned is sitting in the other income.

On the employee cost, the small increase which you see over the year is primarily coming from increased numbers on retiral and pension benefits, thanks to interest rates going down.

Other operating expenses include some amount on demonetization as well as purchase of priority sector certificates. On a net number we would have paid a little over what we had earned. Provision for this quarter at Rs. 192 crore including on investments which is largely on account of security receipts.

So, at the end of the quarter we end with pre-tax profit of Rs. 1,336 crore and a post-tax profit of Rs. 880 crore. On a segmental basis which is the classification as per RBI norms profit before tax for corporate bank Rs. 712 crores Retail at Rs. 322 crore, and Treasury & BMU at Rs. 302 crore for the quarter.

On the advances front, as I mentioned on a year-on-year basis 12%growth largely coming out of the corporate bank. Commercial vehicle & construction equipment and the home loans continue to show some growth. The segmental advances classified on the basis of RBI, out of the Rs. 1,29,000 crore, Rs. 77,000 crore out of that coming from the corporate segments.

On the overall deposit side, as I mentioned, the CASA stood at 42% and Sweep deposits at 7.3%. On a period end basis we have seen the savings balances as of December being 45% higher than the previous year on an average basis for the quarter 40% higher than the previous year.

Our current account averages also have grown 25%. We talked earlier about the fact that we would be relocating and rationalizing branches, about 100 of them. We have done 24 in the current period, over nine-month period. CASA and term deposits which are below Rs. 5 crore now constitute a healthy 76% of our total deposit base. Savings cost at 5.52%.

Our overall balance sheet as I said over Rs. 2 lakh crore. Overall deposits grew by 14%. During the period, we have reduced dependence on the higher cost deposits as well as borrowings.

In terms of number of Branches, we are now spread pretty well in the North, South, and the Western parts of the country and apart from the 1,348 branches there were 2,051 ATMs as of December 2016.

I would request Shanti to take the digital slides before I come to consolidation.

Shanti Ekambaram: Thanks, Jaimin. The demonetization period particularly November, December, as expected saw a significant increase in the throughput in digital channel. Our mobile banking, first time logins showed about a 108% increase from October to December; Net Banking about 52% increase and the Debit card Customers saw an 86% jump. Across all channels, we saw both transactions and value growth, key being Debit Card and Mobile Banking which saw a significant increase. So, on one hand, while we saw significant throughputs through the digital channel, we also saw request for cheque books go up about 3x during the same period.

Now, in terms of our contribution from mobile, our mobile banking app continuous to be still rated highest amongst all banks for best in class experience. From a value perspective Y-o-Y, we have seen 119% jump and a volume growth of 161%.

In terms of transactions, more than 55% of our recurring deposit and more than 60% of our term deposits come through the digital channels. 15% of our personal loans now come through digital channel.

Out of our active customer base 50% are digitally active. Our mobile banking is more than 3x of our total net.

We have enabled many payment transactions and payment possibilities through our app. For our customers there are two key things. One is the mobile store where we brought in PVR; we have Mobile Pay where you could pay for 600 odd restaurants just by using your mobile. We got UPI through our Kay Pay app. And if you look at our transactions in the mobile channel, it crossed Rs. 4,800 crore for the month of December.

We have seen significant increase in transactions through our payment gateway transactions as well as payment gateway transactions through mobile. Customers can now transact on BHIM and USSD. Kotak Bank customers can get on BHIM and USSD for their transactions. So, like I said significant increase in digital throughput and footprint on the demonetization side.

In addition to the bank, our subsidiaries both securities as well as life insurance saw a significant increase on digital front. Kotak Securities mobile app contributes to about 17.61% of the total online business and to about 10% of the total Kotak Securities business.

Many new launches have been done. A new version of the mobile app which really gives the customers a lot of new facilities and a Trade Smart terminal has been launched recently.

In terms of insurance, 60% of the business in terms of listing comes through Genie for the Banca channel which is the bank channel. 50% of the switch requests and 14% of the renewal premium come through online channel so, subsidiaries have equal footprint as far as digital is concerned.

Jaimin, back to you.

Jaimin Bhatt: Yeah. On a consolidated basis, we clocked a post-tax profit of Rs. 1,267 crore for the quarter compared to Rs. 945 crore same period last year. Loan book for the consolidated entity stood at Rs. 157,000 crore again, a 12% rise on a year-on-year basis, a healthy capital adequacy ratio of 18% at overall level and 17.2% as Tier 1. The total asset book now close to Rs. 260,000 crore.

The net NPA number at consolidated level stood at 0.92% and we end with a book value of Rs. 201 per share. Of the non-bank advances, we have seen the auto segment growing by about 7%, the rest being largely in the areas of capital market which has about grown almost 20% on a year-on-year basis.

Other than the bank for the quarter, the profit came from Kotak Mahindra Prime which was Rs. 133 crore. The securities company clocked Rs. 85 crore post-tax profit for the quarter; the insurance entity at Rs. 68 crore; Kotak Mahindra Investments at Rs. 48 crore; the mutual fund and the trustee company at Rs. 16 crore and the international subsidiaries at Rs. 22 crore.

We end this quarter with an overall net worth at Rs. 37,000 odd crores with the bank at Rs. 26,500 crore. Kotak Prime, about 75% of the loan book continues to be cars with Rs.17,310 crore., a pretty healthy Capital Adequacy ratio at 18.2%. The net NPA at just 0.28% and a healthy ROA at 2.3%.

Kotak Investments has seen loan book jump 25% on a year-on-year basis with a NPA level on a net basis at 0.09%. Capital adequacy of 18.2% with a ROA of 3.4% and has clocked a profit of Rs. 48 crore for this quarter. The insurance entity shows a premium of Rs. 567 crore for the quarter including Rs. 240 crore coming from individual premiums; the sum assured has grown by 20% on a year-on-year basis; claims settlement at 98.5%; and the post-tax profit of Rs. 68 crore at shareholder level for the quarter.

Kotak Securities for the quarter shows average daily volume of Rs. 432,000 crore, income of Rs. 287 crore and post-tax profit of Rs. 85 crore.

The investment bank continues to be active both in the IPO and the advisory segments and has been involved with a number of transactions during the period. The overall assets under management at the group level now at Rs. 133,000 crore up from Rs. 95,000 crore a year ago. Large jump coming in the domestic mutual fund at overall level as well as equity assets under management have seen over 20% growth on a year-on-year basis.

Those are broadly the highlights for the quarter. We should be open for questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the Question-and-Answer Session. We will take the first question from the line of Avinash Singh from Jefferies India. Please go ahead.

Avinash Singh: Just one small question, on your very strong CV/CE loan book growth. I mean, it seems that you are gaining market share. Can you provide some color on that CV/CE growth? Thank you.

Uday Kotak: Yeah, I will ask my colleague Narayan to give you a perspective. But keep in mind, we were starting from a smaller base where post 2011 we went a little slow. So, we saw the change happen a few years ago, about 18 months ago, and we rebooted at that stage. So, you are seeing the growth of a smaller base. Over to you, Narayan.

Narayan S. A.: Yeah, that is right, Uday. But having said that, over the last 12 months we have gained market share continuously and we have also grown our distribution so that we offer this product in more places than what we were offering earlier. All this has added up to our market share and we hope to gain further market share in next one year.

Avinash Singh: Any changes in your short-term outlook on that product particularly after demonetization and some visible stress in some of the sectors?

Narayan S. A.: Actually, we did not see any pressure in that segment in November and December as far as collections are concerned. Of course, disbursement did come down. We feel the maximum pressure in that segment was in the small operators and our exposure to that segment is now relatively small, so we will watch January, February and March collections. As of now, we do not see an issue as far as collections are concerned. And in fact, we are a little bit bullish on January to March quarter because of certain issues like the BS-IV and some demand for LPG carrier going up. So, I think January, February and March, the market should see a 7% to 8% growth and we hope can get our market share at least current market share, better.

Avinash Singh: And one more if you may allow, please. Can you please provide us some color on 30 DPD at October, November and December end particularly in SME segment?

Narayan S. A.: Jaimin?

Jaimin Bhatt: I do not have DPD on hand. But yes, the RBI did give some relief with respect to recognition and yes, the benefit of that is there.

Moderator: Thank you. We will take the next question from the line of Karthik V from Investec. Please go ahead.

Karthik V: Most of the results so far including ours seem to have reflected all the benefits from demonetization. While some of the negative aspects have not yet reflected. Is that a fair judgment or you feel that the results that we have reported is what the ground reality is at this stage?

Uday Kotak: Let me first say that there are elements of cost which are embedded in our October to December numbers which have come out of demonetization and essentially, these costs are in three parts. Number one, there was incremental CRR for a period of about a little more than two weeks on which we lost some money as we had to provide for the same. Number two, as a bank, when we collected the demonetized notes or SBNs as they were called, we were running significantly higher cash at branches on which we were effectively paying depositors interest other than on current account. And when I am saying significantly higher cash, they were like a multiple of a few thousands of crore over and above our normal cash because it was cash at the branches and the offloads were difficult, we were earning no interest. Third, there was a reasonable increase in operational costs for vans, for movement of cash, for refilling of ATMs, for acting on various instructions, which came to us from government and RBI, which did increase our operational costs for the quarter ended December. Therefore, all those costs are reflected in our operating expenditure which are there. Number two, on the cost side as Jaimin mentioned, as the interest rates dropped there is a pension cost which is taken in our employee cost for the quarter ended December as well. Therefore, we actually believe that there is a reasonable amount of cost which we took in this quarter which hopefully gets better as we get into the future. On the asset side, twe were fortunate that our SME book on a merged basis de-grew during April 2015 till September 2016, due to the merger and integration pangs we went through during that period. Some of the pains which would have otherwise hit in the post demonetization era in the informal sector did not hit us for reason of pure coincidence since we had not grown our SME book because of the merger pangs. And it also took us time to settle down the teams between the two banks which is complete as I mentioned to you in September, October. Therefore, with the book not having grown for 18 plus months or now 21 months we now actually feel that we are in much better position on our SME side, we were feeling in fact that we were missing out on the whole SME growth in this period of 18 to 24 months post-merger because it took us time to settle down on integration. In hindsight and for may be pure coincidence, this has not happened and actually gives us a better base to build on with reflecting the effects of demonetization. Third, a significant part of our NPA pain came post-merger out of the erstwhile ING Vysya book which we have been consistently providing for the last 18 months to 21 months. And we are seeing this come to an end and therefore, a lot of our risk issues which were there post-merger are actually coming on a winding down basis. And as I mentioned, at the beginning, we are seeing normalization happen faster than what most people would have anticipated and we actually see if we can manage the risk well, the formal sector and some of us as banks actually gaining market share, particularly when we believe that some other banks may actually be more cautious on risk including the state-owned banks.

Karthik V: Thank you, sir. In that context, any view on what the system credit growth could be for next year? And you also sort of hinted that, you would take some lower return if the risk is disproportionately lower. Is that an indication towards higher corporate growth?

Uday Kotak: I think our corporate bank is kicking very well and I must say that it has been one of the heartening features of the October to December quarter. And keep in mind, our wholesale bank integrated 9 to 12 months before the retail bank and therefore, was in good shape on a merged basis when we hit into demonetization. The retail bank got integrated and merged in May 2016. So hopefully, they too will get their act together as we go forward.

Karthik V: Thanks. Any sense on the credit system credit growth for next year, sir?

Uday Kotak: I wish I knew. I mean, you are asking me that it is raining, suddenly it stops raining, now it is cloudy, now it is sunny, this is English weather, how do you expect me to give you a projection for 15 months?

Moderator: Thank you. We will take the next question from the line of Bharat Shah from Quest Investment Advisors. Please go ahead.

Bharat Shah: Sir, we have been listening to you, I mean, very often disruptive technology keeps you awake and now, we are at this doorstep of the digital movement. So, in that scenario, what are the emerging trends, can you elaborate more?

Uday Kotak: I think the key challenge for banking and this is much more of a philosophic point for the banking industry as a whole and particularly in India, the cost to serve per customer and the operating expense ratios of banks are disproportionately high for the new world and I think those have to significantly come down as we go into the future. Now, digital is an extremely important part of that journey because in a way the whole physical world by its very nature and a high cash world is a very inefficient and an expensive world. Therefore, we are sitting at a network of say around 1,350- 1,400 branches. When I think about our future, I do not think our future at this stage requires us to add or set up new branches which takes us to 4,000 or 5,000 branches by setting up those many branches as some of our competition has. We believe that we can do it far more efficiently on the customer acquisition side through the digital route with a less dense branch network than what we would have envisaged even two years ago,. The second part of the whole digital journey has to be significantly lower cost of acquisition and a good ability to increase the usage of digital channels before you really think about monetization. And my view about digital is that there are really three parts in financial services which are linked to digital, it is transactions, it is risk, and it is skill. I think the transaction piece is where we are going to see the highest competition and challenges to margins and where volumes will go higher than margins. The risk piece continues to be the most crucial piece particularly in banking and banks which can get the risk piece right will have a sustainable competitive advantage. And the third piece, which I think is crucial, is the area of skill in financial services. Therefore, whether it is asset management, wealth management, advice, structuring, the whole skill piece on financial services will also continue to be a relatively higher margin business provided there is value add. Therefore, I think the future of financial services will see significant competition in digital with highest impact on the transaction piece but on the risk and the skill piece you will continue to see significant differentiation continue even in the future.

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

Gaurang Ved: Sir, in 2014, RBI through its notification has asked promoters to bring their shareholding down to 30% by December 2016 and up to 20% by March 2018. So, does that earlier notification still holds any color on that will very much appreciated, sir.

Uday Kotak: We are in communication with RBI and that is where it exactly is and the status on that is we are discussing and in communication with RBI.

Moderator: Thank you. We will take the next question from the line of Manish Ostwal from Nirmal Bang Securities. Please go ahead.

Manish Ostwal: Yes sir, first question on this demonetization impact on overall consumer side of the business basically, the disbursement run rate of two wheelers or car loans, how the things are improving? Where we are in terms of the current status and going forward?

Uday Kotak: Yeah. First of all, we are not in the two-wheeler financing business. So, we will not be able to give you a color on that. But on the consumer side, I will have Shanti and on the car and commercial side, I will have Narayan.

Shanti Ekambaram: So, if you see the individual products, October was an all-time high in terms of disbursements. But you saw products like credit cards and personal loans continue to grow even through the demonetization period and in fact the months of November and December had no impact on credit cards and personal loans and we saw our best growth actually in the month of December. If you look at home loans and loan against property from October which was an all-time high, we saw November come off may be about 25%, 30%, but in December, we were back to almost 90% of the volume. So, I think, you are beginning to see the turnaround or the volume come back into the market. Like I said, for individual products like credit cards and personal loans, no impact. For the other products, we more or less came back to about 90% of the volumes that we saw in the September, October. Narayan?

Narayan S. A.: On the car loan side, November of course was a problem month, the disbursement substantially went down. But in December, we saw it coming back and the only difference was if you look at the market, the sales were not on the top-end cars but in the small-to-medium cars. This is where Maruti and Hyundai gained share whereas in the top-end cars the volumes were low. Our volumes for December were far higher than normal. In fact, I can say it was almost like normal. January, we hope things are normal. But generally January sales are low because December most of the discount and the sales happen.

Manish Ostwal: Secondly, just to add one point here. When I look at the other bank's retail loan portfolio, performance during this quarter especially, personal loan and credit card portfolio grew significantly whereas in our case it is at quarter-to-quarter decline. So, I mean, difficult because demonetization will have higher alternate transactions especially on credit card side and the personal loan portfolio; is there de-growth in personal loan portfolio, small business loan significantly during the quarter?

Shanti Ekambaram: No, actually there are three businesses included in that. There are credit cards, personal loans, and the business banking small segment. If you heard Uday earlier, he talked about the fact that the working capital at the small segment actually saw a de-growth because during the demonetization period people actually (A) came back and reduced their utilization of overdraft and cash credits by putting money into their accounts and the utilization was lower. So, the dip that you see is because of the working capital business at a small end which is a sizable portfolio while the credit card and the personal loans actually grew significantly. That is why since it is combined, you are seeing that figure.

Manish Ostwal: Okay. And last question digital strategy and branch expansion plan. Since, we are now looking at relatively lower branch expansion given the digital strategy, in the overall business mix what do we have currently? How do you see the cost-to-income ratio panning out at in the next 12 to 18 months'?

Uday Kotak: If you recollect, at the beginning of this year, when we merged with ING Vysya, ING Vysya Bank was operating at a cost-to-income ratio of 58%. So, on a post-merger basis, we were above 50% on a combined basis. I had mentioned that our cost-to-income for 2016 - 2017 would be below 50% which is if you look at the first nine months we are on track and looks like we will be reasonably below 50% for the year. We see cost-to-income ratio clearly declining as we look at our future and keeping in mind that cost-to-income needs to have higher income and more controlled costs.

Moderator: Thank you. We will take the next question from the line of Adarsh P from Nomura. Please go ahead.

Adarsh P.: Just a question on your fee income. Wanted to just check what the drivers were in this quarter individually certain parts because after integration, this is the first quarter where there has been a strong momentum.

Uday Kotak: I think there are three parts. First, a lot of the integration pangs are behind us. Therefore, various lines of fee income which were affected because of the integration piece are now coming into place. Therefore whether it is customer foreign exchange (as distinct from proprietary), at retail, commercial, and corporate level. Second, we are now seeing a significant progress on the syndication side. And the third, within the fee income as Jaimin mentioned, there were these priority sector certificates that are now allowed to be traded. Now, if a bank is surplus in one category and short in another category, the bank can sell from the surplus category and buy in the category it is short. The way Jaimin and his team would want the accounting to be done is that if there is an income coming in on the side of priority sector certificates which we have sold, it come in as fee income and priority sector certificates bought come in as the cost. On a net basis, we are net cost. Therefore, fee income to the extent of about Rs. 20 crore has come in because of priority sector certificates which we have sold. And on the cost side, there is Rs. 30 crore cost for priority sector certificates that we have bought. So the net is we have been net buyers. Rs. 31 crore is the cost. Therefore, on a net basis, we have spent about Rs. 11- 12 crore on these certificates. But the way it appears is Rs. 20 crore as a part of fee income and Rs. 30 odd crore as a part of costs. But there is also growth in various other items, Gift City has also helped us because we have been able to do some syndication out of Gift City. And we think that broadly, we should see most of the traction on this line continue as we go into the future. In fact, the last quarter as you know was also much better on incomes like the insurance income which were relatively subdued in the third quarter because we were cautious on the terms the basis on which we were selling insurance and not do anything which would be questionable later.

Adarsh P.: Just in continuation of the syndication fees that you mentioned, I want to understand again, more relative as well, some of your competitors have been building this fee income over time?

Uday Kotak: Let me assure you it is nowhere near as dramatic as what some of our competitors are doing. It is marginal by comparison.

Adarsh P.: If you can just throw some light or color on what kind of deals would this be without taking names and…

Uday Kotak: Say for example, if there is an off-shore financing which we are participating in underwriting, there would be a certain amount of fee income, Manian, you want to talk about this?

K. V. S. Manian: Yeah. So the syndication fee has three kinds of transactions that we undertake. One is the debt market deals where we make some fee or capital profits that we might make by taking an interest rate position. Second is domestic loan syndication, in which is we take on a loan which is larger than what we would like to keep in our books and over a period of three to six months typically we sell those loans. So we make fee on that and the third is the Gift City kind of transactions. These are again foreign exchange loans that we do out of our Gift City. Earlier, we did not have the ability to do these transactions because we did not have a foreign exchange balance sheet. Now that we have Gift City, we have participated in some foreign exchange transactions where subsidiaries or group companies of domestic companies operating in foreign territory seek financing and we finance that and a large part of that again we sell down. Some part of it, of course, we keep in the Gift City balance sheet.

Uday Kotak: And let me just add that all these are high quality credits. These are not weak credits.

K. V. S. Manian: So, we typically do not undertake a syndication transaction unless we think it is good for our books. So most of these transactions we would keep in our books and if we are happy keeping that credit that is the kind of credit we source to sell down in the market. So, it is good quality credit.

Adarsh P.: Perfect. The other question again on the cost side was, you mentioned that there is a Rs. 30 crore cost also coming from this PSL buyouts. If you exclude that, your cost-to-income starts kind of looking little better. So just wanted to understand, from a two- to three years' perspective not getting into cost-to-income but from a cost growth perspective, how should one kind of look at it?

Uday Kotak: You got to keep in mind that the benefits of a merger including branch relocation, rationalization, all have just begun to flow in and I think Jaimin mentioned that out of the 100 branches which we work towards rationalization, relocation we have completed only 24. So essentially, what this means is we combine branches which are close to each other and then move to a new branch which is like additional capacity. But the number of branches does not increase in totality. So we get additional capacity without necessarily having additional costs out of a branch rationalization exercise, so some of those benefits of integration are just beginning to kick in. If you ask me, if I look back at the merger, we probably took may be six to eight months more to recognize and realize the flow of benefits of the merger which are now beginning to kick in and I think it is still early days.

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

Amit Premchandani: This quarter had seen a large growth in the corporate loan book and you alluded that this quarter also you started the Gift City operation. So, if you can give us a break-up of what percentage of the growth was driven by Gift City? And what is the foreign exchange corporate loan?

Uday Kotak: Gift City is not a few hundred million dollars, it is small.

K. V. S. Manian: No, the large part of the growth is domestic not driven by Gift City, some syndication transaction we did through Gift City but that has not added too much to the balance sheet as of December end.

Amit Premchandani: Any sectorial composition of the corporate book?

Uday Kotak: I can give you sectorial concentration by saying that we have been very focused on higher quality credit for wholesale growth and more careful on anything which we felt was not great. So, moving towards the better quality credits.

Management: Off the cuff I do not have all the numbers, but all I can tell you is we do not have large exposures on the generally sensitive and riskier sectors in corporate.

Amit Premchandani: And sir, in terms of disclosure, you give a break-up of retail and corporate in the bank side. What all is included in corporate?

Jaimin Bhatt: This is the RBI definition, so technically anything which is over Rs. 5 crore.

Uday Kotak: Yeah. Therefore, the segment in which Jaimin talked about those numbers, be careful about considering that as a management business. The wholesale there is anything more than Rs. 5 crore. So for example, if it is SME loan from the commercial bank above Rs. 5 crore it may get classified there. Therefore, that is not wholesale bank as the wholesale bank from a management point of view. That is a break-up as per RBI classification, which is standard across the industry. Therefore, even a home loan above Rs. 5 crore will fit there.

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

Nilanjan: Two, three questions actually. First on the fee, could you throw some color, what percentage of the fee at least this quarter vis-à-vis sequentially previous quarter was coming from third-party distribution and further from credit card receivables?

Uday Kotak: Broadly let me tell you, insurance, and mutual fund fees, both year-on-year and quarter-on-quarter do not show a significant move. So, it is the other, line items and we think that mutual fund and insurance actually have room to grow. On the other hand, we have seen good growths in credit card, Shanti did mention about it. So on the credit card side, we have pretty good growth. I would say roughly in excess of 30 to 40%.

Nilanjan: Right. Secondly, could you just elaborate on this digital one? How does Airtel Payment Banks fit into this whole equation? What kind of outcomes are we expecting out of it? If you can touch upon what could be the revenue potential and the cost sharing?

Uday Kotak: I will ask Mr. Dipak Gupta, one of the main architects of that to speak on this.

Dipak Gupta: Well, Airtel Payment Bank is just about launched. And in the beginning, we are seeing a lot of customer acquisition happening and hopefully as the digital piece picks-up, we should expect a lot more customer acquisition happening out of that. As far as revenues and others are concerned, I think we really have to wait and watch and see what revenue pools really generate over a period of time.

Uday Kotak: And if I add to what Dipak is saying, keep in mind, our percentage ownership is 19.9%. We have one director on the board and we are learning with what they are doing. But we continue to have our own digital journey which is independent of how that works.

Nilanjan: Okay. And finally, a small data question. How many employees are there in the bank for the December quarter ended and the sequential?

Uday Kotak: 32,000.

Nilanjan: And the previous quarter, September quarter?

Uday Kotak: Close, similar.

Dipak Gupta: About 1,000 added, I think.

Uday Kotak: We were 31,500, we are 32,400.

Moderator: Thank you. We will take the next question from the line of Sushmit Patodia from Motilal Oswal Securities. Please go ahead.

Sushmit Patodia: Couple of questions, one, the cost of savings as you mentioned in PPT is at 5.5% and that is almost the same as your 90 day FD. So, how do you think about this going forward? And secondly, any comments on your MCLR rate and the fact the cut was lower than the industry average?

Uday Kotak: See, on the savings deposit, we have to balance between the potential upside to our P&L versus the customer franchise. So we have significant room there in terms of P&L upside as we think about our future. But we want to balance that with our objectives of building a strong customer franchise. We look at our competition in the banking space as not just the big banks who are well-established but also the newer players. And we want to make sure that we have a future whether the existing bigger players are disrupted or otherwise and therefore, our positioning has to be done keeping in mind the entire development of the sector and not just what the bigger players are doing and we are very focused on making sure that we do not in the desire to get some quick short-term profits have a longer-term issue on customer franchise. But we are watching the space very closely, we are making our moves very carefully in that area and we will continue to get that balance keeping in mind the customer franchise as objective number one and if we feel that there is a P&L opportunity without affecting the customer franchise we will do that.

Sushmit Patodia: I mean, just to understand. Have you thought about the CASA ratio is at 40, 50? I mean, is there an approximate number that you have in your mind where you will start exploiting this from a P&L perspective?

Uday Kotak: You know this is a moving piece. Frankly, we are fully aware of the fact that if we brought it down to the levels of what traditional banks are it is a Rs. 600 crore to Rs. 700 crore P&L for us. We are fully aware of that. Therefore, we do not like wasting money but we are also very clear we want to grow a very-very strong and stable liability franchise.

Sushmit Patodia: And any comments on the MCLR?

Uday Kotak: I think MCLR is moving down. We have moved it down in January. We think current direction is still lower and we will be moving in that direction.

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

Krishnan ASV: Just wanted to understand a little bit on the pricing environment on both sides of the balance sheet as the previous query indicated your cost of SA is 5.52%. When do you begin thinking about any headroom that is available to you? I mean, how one should think about the pricing environment for Kotak Mahindra Bank

Uday Kotak: I think, first, you must have observed, that we have already made that move in early January that for SA above Rs. 5 crores which is wholesale SA we have dropped the rate from 6% to 5.5% it is on the website, it is communicated widely. So that has already been done. It is a small step we have taken and it sort of effectively answers the question that if our wholesale deposit rate for the short end is 5.5% our SA for Rs. (+5) crore is also 5.5% already. But we just want to make sure that the core customer franchise is protected at all points of time as we move down the SA path. We think the two big levers for us in terms of our differentiated strategy are: number one – digital makes it possible for us to grow on our customer acquisition significantly faster with a less dense branch network than the traditional banks. So that is point number one and point number two is, we are very well-positioned in terms of where we are on SA. From there, we think there is potential both P&L upside at the same time a need to make sure that our customer franchise continues to grow. So, both these are we think as significant competitive advantages for us as we go forward.

Krishnan ASV: You mentioned recovery has been slow-moving, you have been saying this for a while now. Just wanted to understand where you see a lot of noise happening around asset resolution, deleveraging, etc., what kind of pace are you seeing closer to ground and could you just throw some light on that?

Uday Kotak: See the last quarter as you know and since you are familiar with the banking background, I think banks did not have much time on resolution. So, there was a disproportionate focus on a major event in the country which has taken some attention of from the whole resolution area for the banking industry. And I think, it is important that banks get their focus back on resolution quicker and sooner rather than later because what has gone into the ditch is not coming out in a hurry.

Moderator: Thank you. We will take the next question from the line of Sai Kiran from RW Advisors. Please go ahead.

Sai Kiran: Just a quick question, just to understand if you take a two years to three years perspective especially on the loan yields in last few years, we have seen some of the self-employed people where the organized or disclosed incomes are lower, the yields for the banking system have been higher. How do you see this panning out for the system as a whole and also may be any comments specific to Kotak Bank?

Uday Kotak: This is with reference to loan yields

Sai Kiran: Loan yields and margins, yeah.

Uday Kotak: No, I think you go back to the time when we did the merger. We came out with an indication on NIMs at about 4% to 4.25%. Yes, we have been able to do better than that for a variety of reasons, because of a very high focus on risk-adjusted returns. I would still continue to guide that we believe the steady normalized rate is around that and if we get anything more than that, it means we have taken a little more risk for which we are getting more returns.

Sai Kiran: Do you think this demonetization might have a structural impact on the margins for the system as well as for Kotak?

Uday Kotak: We have two important levers which keep us competitive into the future. Number one, with significantly higher acquisition on digital and relatively lower compared to the traditional banks physical network, we think we can get much higher acquisition with proportionately lower physical network. So, that improves our operating ratios over time on absolute cost especially as cash in the economy gets less. I do not think we are moving to a world where the brand does not matter, customer wants to see the brand. But the level of density of the network required for the future is less than what we have seen in the past. So, we think, that is a significant competitive cost advantage. Just to pick a number, say if we are at 1,500 branches with some other banks at cost levels of 5,000 branches and if we can significantly increase our digital acquisition it means we are operating at a more efficient basis as we go into the future. Second, we are sitting at a significantly higher SA cost than the traditional competitors. This positions us very well vis-à-vis the new players and also gives us significant room while we protect customer franchise for reducing our cost as we go into the future. So, the costs are at a higher level both in terms of operating expenditure and SA compared to most of our traditional competitors. So from there, we have a competitive leverage in the future rather than the other way around.

Moderator: Thank you very much. Ladies and gentlemen, due to time constraints that was the last question. I now hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak: Thank you very much friends. My view about a new year is that when a new year begins with very high expectations it turns out to be a more challenging year. This year has started for the world at relatively modest expectations. Let us hope the reality is better than the modest expectations the world is going through. And with that, once again, have a great year ahead. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, on behalf of Kotak Mahindra Bank, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.