



“Kotak Mahindra Bank Limited Results Conference Call”

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Moderator

Ladies and gentlemen, good day, and welcome to the Q1 FY12 Results Conference Call of Kotak Mahindra Bank. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Uday Kotak. Thank you, and over to you, sir.

Uday Kotak

Good evening, friends, and I believe lot more people on the call today than probably we have ever had in our earlier calls and its good time for me to start with the format which we have done which is I will start by giving a few general comments and thereafter my colleague Jaimin Bhatt will take you through the results in greater detail.

The more general thing, I think the banking sector continues to be in pretty good shape as we can see in our bank. We have seen a reasonable current credit growth on year-on-year basis is 35%. Though I would like to believe that broadly we would be looking at about a 30% kind of credit growth for the full year as things look today. We continue to therefore see a significant growth particularly in what I define as Bharat. The slow down on credit is a little more evident in things like home loans and others, but the broader tractor, rural lending, commodity financing part of the story continues to be pretty robust. Therefore what we have focused on is to build the story around borrow from India and lend to Bharat. That does not mean we are not focused on other assets. We continue to grow the broader asset **book** including cars and also the wholesale banking side. But in the wholesale banking side, at this point of time, we are focused on making sure that we do not have disproportionate concentration to any sector or industry and we have tried to be a little more conservative on that across sectors like telecom or airlines or any other major infrastructure sectors, where we tend to be a little more cautious and we, as a firm, have historically disliked concentrated exposure. Therefore, the pure banking story and the financing story continues to be moving ahead.

Yes, there has been some pressure on margins and that really comes out of the fact that if you go back to April, May 2010, just for comparison, one year deposit rate was 6.5, 6.75%. From that you are now having one year deposit rates at around 9.5% to 9.75%. Therefore lot of the deposits which were there with banks including with us have over the year got repriced and some of that impact has been in the margin compression. So there are NIMs are more like 5% than what they were earlier. So I would like to believe 30% advances growth. We see NIMs of around the 5% mark is something which is reasonably sustainable and the banking story looks to be broadly robust and with continuing growth at a very, very good situation at this stage even on the NPA side. We are seeing that positive NPA story and the credit story continue, and so far no signs of any stress on our portfolio, of course, our portfolios are **far** less concentrated as I mentioned to you as we look forward.

Non-financing businesses particularly the capital markets, namely brokerage and investment banking have had a very rough time and I see this as a **segment** which will continue for a while because industry is going through, as we have discussed, a significant fragmentation and margin pressure and excess capacity, and that has to correct itself either through mortality or consolidation. And we see that is not happening for the next 12 to 18 months. Beyond that hopefully things will correct. Maybe mortality can happen earlier. But this is a broad picture on the capital markets side. This reflects in a way in the mix of our earnings which is getting significantly skewed in favor of the banking and financing business. On the broader macro side our view is, we have probably around 50 basis away from the peak of the monetary tightening cycle subject to of course the commodities not going out of control from here. We think that cycle peaks out sometime around September, October, remains flat for a while. Not declining in a hurry. But we think the big opportunity in market will come in the second half of the current year, probably around November, December time when we would see revival activity in some of the markets, businesses and of course the interest rate cycle as it sort of peaks off will start making banks significantly more comfortable on NIMs and growth as well. And if it plays out this way, the key thing is, the credit cycle holds. And our view is pretty comfortable on the broader credit cycle other than select companies and sectors of the wholesale side, which are exposed to execution risks or political and investigative risks, some of which we are all aware of.

With that I will hand it over to Jaimin Bhatt to take it forward and we will all join again for Q&A.

Jaimin Bhatt

Thanks, Uday. The quarter April-June 2011, we ended the consolidated numbers with a profit after tax of 415 crores which is 27% rise from 328 crores which we have declared for the same quarter last year. Loans, the advances growth has been 36% at the consolidated level with the end of the period advances being close to 45,000 crores. If we take the growth for this quarter, on an annualized basis we would be at about **34%**. The NPA improvement continues and we end this period with a net NPA of 0.41%. Net interest margins at 5%, which is as Uday explained a compression from the same period last year than we were at 5.4%. Capital adequacy at the consolidated level at 18.4% with Tier-1 itself standing at 16.9%. Assets Under Management across the group have grown during the quarter by about 4000 crore largely in the debt mutual fund, the domestic mutual fund activity and we close the period with 51,600 crores of Assets Under Management. At CASA, we end the period with a 27% CASA and overall number of 8,254 crores, which is roughly about 25% jump from the same period last year.

Our revenues coming in largely from the financing activities that contribute 1445 crores of the revenues, about over 50% of the revenues of the group companies from the financing activities. Fee income at 324 crores for the quarter. As regards to advances, as I said 44600 crores at the end of the period. Large growth coming in on year-on-year basis from commercial vehicles, construction equipment which has shown almost 54% growth. The mortgage segment which showed a 34% growth year-on-year though it had slowed down during the last quarter. Corporate bank on year-on-year basis showing a 35% growth and a substantial jump during the quarter. Auto loans at about 27% on a year-on-year basis

If you take the contribution of the different entities in the group to these bottom-line for quarter, the bank continue to be the largest contributor, 252 crores out of the 416 crores was contributed by the bank and we will take in that some detail as we go forward. Kotak Prime, the car finance subsidiary has brought in 94 crores of tax profit for the quarter, which is a jump from 76 crores same period last year. Insurance has been the other large contributor at the entity level 46 crores profit for the quarter as against negative 7 crores same period last year. We own 74% of this entity and therefore part of it has knocked off from the minority interest. Of the balance the capital market subsidiaries as Uday explained **were** subdued in their contribution and together that's contributed 24 crores of the bottom-line. We have had a scenario where typically we have seen rising profit as we go quarter-on-quarter and this quarter at 416 is somewhat lower than 491, which was the **last** quarter profit for the last financial year.

The mix currently of more than 80% of our profits have come from the financing business which is largely from the bank and Kotak Prime. On a consolidated basis deposits, we end the period with 29,397 crores with borrowings at 24,000 crores. Deposits have grown from 22,000 crores last year and overall, we have a balance sheet size of 78,000 crores. Our net worth at the end of the period is 11,400 crores compared to last year, the rise is also coming from the **issuance** of 1360 crores which we have done in August last year which is a placement to SMBC.

At the consolidated levels on an annualized basis return on average assets would be at 2.2 and we end the period with a book value at 154.6. Net interest margin at 5%, this compares to 5.4% in the previous year of the same period. I will just take a minute to explain small change, which we have done there. Till the last period processing charges which we were collecting from retail customers was being treated as interest income as that was factored in, when we calculated the IRR where this amount was being lent out. We have changed that to showing it as other income from the current period and that's contributing about anywhere between 25 to 30 basis points . On a comparable basis NIM for the whole year last year was 5.2 and for the first quarter last year was 5.4, which is now down to 5% for this period. Capital adequacy is at 18.4% at the group level. NPAs have shown substantial improvements at the gross level, we are down to 1.1% without the acquired stressed assets into account. And during this quarter, has been a small addition of about 10 crores to the gross NPAs.

As regards different businesses, financing, advances we have done 36% growth with net interest income showing a decent rise during this period. Financing contributing a pretty large portion of the after tax profits with the benefit also coming from lower NPAs. The consumer bank, which comprises the liability collection side, we ended the period with 323 branches and 725 ATMs.. We continue to maintain the fact that we would want to be at about 500 branches during the calendar year 2013. Continued focus on the affluent segment here and we are showing a lot of cross-sell, especially in the consumer-related products coming in from the branches, which largely consists of mortgages, passenger cars, personal loans and the like.

Look at the consumer financing piece that contributes about 17,800 crores out of the overall 45,000 crores of the advances. The growth of this segment on a YoY basis has been at 28% with

a larger growth coming from the mortgages which has somewhat slowed down during this quarter. The segment continues to focus on the self-employed non-professional category. Unsecured piece which we had actually brought down our book substantially over the last few years, we have seen a small growth in the currency rate.

Commercial financing, which is now contributing about 14,000 crores of the overall advances book has actually been the fastest growing piece among the three buckets, contributing to a growth of 48% on a year-on-year basis.

Faster growth coming from the commercial vehicle, construction equipment segments which has grown 54% and the agri piece which has grown almost 50% on a year-on-year basis on absolute term. We have continuously met all our priority targets, thanks for contribution coming in from this space.

Our exposure to the MFI segment continues to be very low; it's now down to less than 0.1% of our advances. The wholesale piece which is largely catering to the corporate segments ends the period with advances book of 12,600 crores, on a quarter-on-quarter basis it has the fastest growth, up from the end of period number of 10,900 crores.

The focus here is to leverage on our group relationship including that from our investment bank and continuing to focus on the trade finance and transaction banking activities. We also continue to have a strong presence in the debt capital market segment.

At the bank's standalone entity level for the quarter we ended with NII of 568 crores which compares with 483 crores, same period last year, with other income contributing 229 crores compared to 162 crores. Our operating profits for the quarter at 386 crores, we had a small provision this period of 22 crores, which includes NPAs and MTM provisions. After that we have a PBT of **364** crores with the tax provision we end the period with PAT of 252 crores compared to 187 crores same period last year.

On a segmental basis the wholesale bank contributed the largest amount to the PBT of the bank with 238 crores, Retail bank contributed 138 crores. Treasury had a small negative this period. Thanks to MTM Losses which came in at the end of the period.

The bank's standalone ends with the balance sheet size of 55,000 crores, deposits at the end of the period at 31,000 crores, showing about 30% rise from last year's June number. We continue to have resorting to **refinancing** from NABARD, ADB and the like as well as foreign exchange borrowings. That figure has grown to 13,800 crores from 11,000 last year.

At the bank's standalone level, our capital adequacy at 18.2% with Tier-1 itself at **16.1%** And the NPA improvement story continues there.

With Prime, the growth continues to be showing in that segment which is for the financing buckets and PAT for the entity at 93 crores for the quarter compared to 76 crores same period last year. The overall advance booked in Kotak Prime at the end of the period is about 11,500 crores with cars contributing just short of 9000 crores. The NPA from the car segment is very small amount of 26 crores. Capital adequacy of this entity is 16%.

Our life insurance with the change in the regulations which came in September last year, we have seen a drop in the premiums in first quarter compared to the same period last year. In quarter one this year we end up with the overall premium collection of 511 crores. We continue to have a pretty good capital efficiency and our solvency ratio is at 2.85. Assets under management in the insurance segment continue to grow and we are just short of 9000 crores there. As I said, the profit after tax for the insurance entity for the quarter at 46 crores and during the last one year we have brought down certain number of branches. We come down from 234 branches as of June last year to 202 branches as of now.

Kotak Securities, as we have maintained last quarter, the market has seen increase in overall volumes but all the increase in the volumes coming in from the option segment, whereas the cash segment and the future segment actually showing dips in volumes and that's what contributes to the revenue of growth in entity. The impact of that has been that income for the entity has dropped and we end up with a profit after tax of 23 crores in the segment.

The investment bank continues to be involved with several issuances during this period with Muthoot Finance and Future Ventures. We have also been involved with some placements as well some of the M&A transactions which have happened during this period including the takeover of Camlin and the open offer of Kemrock, the restructuring of Jubilant. Some of these transactions are still not closed and to that extent revenue from that has not yet got accounted. The investment bank ends up with profit of a crore for this period.

The asset management business – overall at the assets under management at 51,600 crores with more than half of them coming in from the domestic mutual funds. The domestic mutual fund contributing 34,000 crores of the assets under management, which has grown from 30,000 in March of this year. Almost all the growth coming-in in the debt segment of the funds under management there. The domestic mutual funds are continuing to have 84 branches and has contributed 9 crores to the bottom-line in this period.

Alternate assets which is done through Kotak Investment Advisors, today has, as of June actually we had realty funds under management of 2,000 crores and private equity of 2,900 crores. As of July we have just closed another realty fund which has brought in another 450 crores of assets under management.

International subsidiaries, thanks to some **MTMs** ended up with a small negative for this period. With that we will open to take questions.

- Moderator** Thank you very much. We will now begin the question and answer session. Anyone who wishes to ask a question may press '*' and then '1' on their touchtone telephone. Participants are requested to use only handsets while asking a question. Anyone who has a question at this time may press '*' and then '1.' The first question is from Kunal Shah from Edelweiss. Please go ahead.
- Kunal Shah** Sir, the question is particularly on asset quality. Considering this kind of interested environment, definitely in terms of gross NPAs which continue on the declining trend and credit cost is also much lower. Have you seen any signs in any of the segments and suppose if you are expecting another 25, 50 basis points hike from hereon, what is your outlook on asset quality?
- Uday Kotak** I think Kunal what is happening is, so far we have not seen any significant deterioration of asset quality. Keep in mind the nature of our exposures as well. As I said, number one, we don't have any big concentrated large ticket exposures to some of the most sensitive sectors or companies, so that is one. Second is, most of our lending is collateralized. If there is any big lesson which you once learned from 2008, 2009 is that collateralized lending actually is, in general, less susceptible and so far we have not seen any significant signal of credit stress. Second point is you are also in a highly inflationary environment. If you lend against cars, trucks, construction equipment, where even with the slow down, the prices of the underlying assets have not gone down significantly. In fact, they have gone up because of the input cost of some of the manufacturers. So that helps us to take in the underlying collateral value as well. So keeping these factors in mind, so far we haven't seen and in many ways it also depends on psychology. If the psychology is a few 100 basis point increase from here, I think we would have trouble, but if we are seeing 25, 50, 75 basis points maximum increase from here, maybe we are more likely to see a soft landing on the credit side, particularly, where you are decently collateralized and not concentrated with exposures to sensitive sectors.
- Kunal Shah** Okay and on the retail side on mortgages and everything, as you mentioned, collateralized but there is no, say, the hikes which we have seen, we are not seeing any impact as such
- Uday Kotak** Not yet. One has to watch the situation of developers more closely and what kind of liquidity pressure they will see, but compared to the 2008-2009 cycle, this time in totality one gets a sense that the levels of leverage maybe a little less than what we saw in 2008, 2009, though yes, finally we all know that on the real estate side in terms of actual sales there is clearly a slowdown in the front end.
- Kunal Shah** Okay and just two, three data points; firstly on this retail processing fee which would have been adjusted, can we get the number of NIMs for Q4 so how much would the NIMs have declined sequentially?
- Jaimin Bhatt** If you look at what we have declared this period, Kunal is 5.0 on a consolidated basis, on a comparable basis if I rework the previous period it will be 5.3, so, technically 5.3 of Q4 has gone down to 5.0 for Q1 this year.

- Kunal Shah** Okay and how much would be the quantum maybe in first quarter if I look at it comes to 23 crores or so of last year and if I look at Q4 maybe the change in other income which is what you have reported last time and what is there in there, the difference is almost 57, 58 crores so, is this quantum correct, maybe --?
- Jaimin** That's not true. On an annual basis you would find the number for the last year would be anywhere between 100, 110 crore.
- Kunal Shah** Okay but was it more skewed towards the last quarter because --?
- Jaimin** Not necessarily, it's reasonably even; these are more retail advances which are not really pushed towards the end..
- Kunal Shah** Okay, and how much would be MTM during the quarter, maybe in the provisioning you mentioned its like MTM plus NPL?
- Jaimin** Yeah, the 22 Crores which we have provided includes fair share of both advances and MTM.
- Kunal Shah** Yeah and if MTM would be significant maybe credit cost would be much lower than the 10 basis points or so?
- Jaimin** Yeah so, it is fairly even split between the advances and MTN.
- Kunal Shah** Okay, and this international subsidiary reporting loss of 3 crores so, you mentioned from MTM, if you can just explain what is this in particular?
- Uday Kotak** These are primary holdings which we have both on FCCBs, thanks to the interest rate environment take a hit on the MTM basis there.
- Kunal Shah** Okay mainly on FCCB basis?
- Uday Kotak** Yeah.
- Kunal Shah** Okay sir, thanks a lot, yeah.
- Moderator** Thank you. The next question is from Murali Gopal from Brics Securities. Please go ahead.
- Murali Gopal** Yeah, thank you, good evening. A couple of quick questions; on the CECV segment that seems to be growing very robust. My question is I would have thought that segment will be a little bit more interest rate sensitive than what seems to be happening, how is it playing out versus your expectations, and also in the 30% loan growth that you guided to, what kind of mix in loan growth are you generally assuming?

UdayKotak

See, let me first of all try and broaden it a little, if you look at the both commercial financial business that includes commercial vehicles, construction equipment, tractors, commodity financing, agri loans, the fact of the matter is Bharat is less leveraged on a relative basis, and last year's high crop prices, high agricultural produce return have created a much better position for semi-urban and rural India, and we actually feel that, that segment is holding up much better and yes, commercial vehicles obviously year-on-year growth may slow down a bit, but the broader commercial financing business is showing significant opportunity for deeper penetration, and this actually goes back to a very fundamental modern thing, which we keep in mind that our history that of an NBFC part pre-2003 and therefore a lot of our businesses continue to run as specialized commercial financing verticals, which we nurtured and grew through this period, and those continue to be the growth engine. There maybe pockets within that like commercial, like construction equipment and all commercial vehicles in some pockets, may show some pressure. But in totality that piece is still significantly underpenetrated and it is a difficult market to penetrate easily. And we think therefore in a way and if I had to make a more general point you have seen this space actually being something which some of the NBFCs have done very well because that's the historical mindset of NBFC which has worked in this space. Everything that continues because it is more verticalized, more difficult to sort of get deeper, and we are continuing to see growth in that in totality, within that commercial vehicles maybe pockets of commercial vehicles maybe a little slower than what they were a year ago, but overall agri customer or the rural and semi-urban customer is more confident and continuing to feel comfortable taking more money.

Murali Gopal

Okay and also, Jaimin, if I may ask, the employee cost of the bank seems to have declined sequentially and also the other operating expenses but other operating I guess probably partly you had the 25th year related expenses last year, can you throw some color on what maybe driving the lower expenses sequentially?

Jaimin Bhatt

Okay, two things there; one is the employee cost, Q4 also we paid out to employees incentives which included some part of paying for the 25 years and what not which was possibly somewhat one-time but that's kind of we have seen about the 12 crores dip with the employee costs if you look at sequentially Q4 and Q1. The other expenses which have gone down, the largest contributor actually **is advertising and publicity** because Q4 had the World Cup going and we had advertiser on that time, which Q1 has been very slow, there is hardly any advertisement cost which has happened in Q1.

Murali Gopal

Okay and lastly, again Uday, if may I ask, you are carrying a lot of excess capital and recently, I did see an interview where you seem to be a little bit more positive, I know you have always said you have been open to doing acquisitions, but you sounded a little bit more positive maybe I am reading little too much into it, but my question is how comfortable would you be if say, carrying this level of capital, if you think you don't come across the right opportunity for say the next couple of years or do you see at some point there is going to be too much pressure that you have to do something with all the excess capital?

- Uday Kotak** Let me assure you one thing. We will not do it because we have to do anything, okay? So, that's a first philosophy I will share with you. Having said that I just feel that in some of these things it is no point talking, if and when we see something appropriate as I have said in those public interviews, our preference for acquisitions is in this order, banking broking asset management and we will see how it goes and we also understand that we have significant capital, we will use it well and we obviously need to be open minded, which is what we are, and we think there will come a time where the right opportunity will come for a value which will help create significant value for our shareholders and we are watching.
- Murali Gopal** Okay, and just a quick follow-up on that last point, when I look at your Kotak Mahindra Bank and most private banks are probably in the Tier-2, Tier-3 cities, you have been more an urban-centric bank, as and when you do a deal, I mean culturally do you think its something that can be easily dealt with or in a combination with another bank or is that something that you perceive as a reasonable risk?
- Jaimin Bhatt** When I started I just mentioned one statement, a very significant part of our business model was post-NBFC and therefore the core of our branch banking model was liability, and therefore, our core of our model was- we were lending to India as well, but very significant rules by a model now if you see is to borrow from India and lend to Bharat so, we are comfortable with Bharat but we think at this stage Bharat is more **existing** on the asset side and on the cost to serve basis tougher on the liability side, and we continue to believe that is the reality, therefore we don't want to be sort of running away from the reality that the asset side of Bharat is what is attracting us right now, on the liability side urban India is where more of the money is and in rural India or semi urban India where there is money, the issue on the liability side is cost to serve, and we are conscious about that, but if we get an appropriate inorganic opportunity just because it has got more branches in Bharat, we would not be worried about it, we will make sure that we get a right mix of assets and liabilities from such locations, and even today the way we are building our model going forward including new branches is to see that rural branches and semi-urban branches will be more focused on the asset side, because that's where the bank for the buck is better for the costs we put in and liability will be more selective and more measured keeping in mind the cost to serve.
- Murali Gopal** Okay great, thanks a lot.
- Moderator** Thank you. The next question is from Suresh Ganpati from Macquarie. Please go ahead.
- Suresh Ganpati** Yeah, Uday, just two quick questions; one is on your CASA, I mean for the past three, four years CASA has not gone anywhere, it's just been stuck up at 27% to 30%, so the performance on that front has been a bit disappointing. So, can you just guide as to what is your strategy to improve this in the future, what is the problem that you are faced for the past three years that this number has been stagnating around 27% to 30% level? And the second question is on securities and investment banking. I know you have been pretty bearish in these businesses,

but do you think you can go to the extent of making significant losses in these two businesses, say, in the next 12 to 24 months if the situation remains where it is currently?

Uday Kotak

On CASA, I think, first of all, you must keep in mind and this is a long time ago, eight years ago we started with zero, now also in recent times particularly the last two or three years you have seen our asset growth has been pretty aggressive and we have grown, say for example, last year at close to 40% on the asset side. So, for us to be maintaining a percentage, it means a minimum growth equal to the asset growth. If we are growing an asset at 40% to be the same percentage we need to grow CASA at 40%, so, that is point number one. Point number two, keep in mind in addition to that, the other issue which you need to keep in mind is that in addition to CA, we have gone on a pretty aggressive strategy of wanting SA customers, and at the end of eight years as a bank, one experience which is coming out pretty clearly is to build a retail bank through SA customers in particular is a much tougher climb than at least we bargained for, because the acquisition costs hit you upfront, SA customer grows gradually and if you go forward, things like corporate salary, the upfront costs are very significant for getting those customers, again, on a very detailed and minute measurement, there is significant ATM costs because they can use third-party ATMs, as outsourced costs, therefore one of the most important points I believe is that for the banking business and the retail banking business, which is in addition to current accounts, corporate banking all those are the quick hits, but pure consumers favor household, a retail bank I think will find it very tough to start making money before 10 years of its life. And other important point is because we wanted to attract these customers, we also aggressively started a product which is known as the "Sweep Product" therefore we have in a way sort of eaten into our own CASA by giving the sweep product aggressively to our customers and even today sweep for us is 7.5% of our deposits. Now that's the total cost of sweep is higher than SA, but significantly lower than a term deposit for us effectively, because there is premature withdrawal and things like that, sweep is broken often. Therefore, look at our low-cost liability in three buckets; CASA, sweep and term deposits and sweep is a number which adds another 7% to 8% of our total deposit base.

Suresh Ganpati

What would be the cost differential between sweep and SA?

Uday Kotak

The cost differential between sweep and SA would be about 100 basis points higher.

Suresh Ganpati

And why not explore what's wrong with going for CA --?

Uday Kotak

Let me explain, SA is 4% now, sweep would be around 5%, because prematurely sweep gets broken quite often. And the other point you asked was about capital market. Again I want to first say that we think capital markets are going through a phase which is going to be low for the next 6 to 9 months unless you see a sharp revival, but even if you see a sharp revival I don't see margins improving and going away in a hurry. We think this is a time to build. In fact, we are continuing to build between now and end of the year; we will probably have more people than we have today. We would like to see building in a manner which gives us growth and cash and the future space, we don't want to change the option space because the margins are

too low, it's mainly a crop activity. Therefore, this opportunity actually is something we want to work on both capital markets and investment banking. We do not foresee either of these businesses having any losses.

- Suresh Ganpati** Thanks so much.
- Moderator** Thank you. The next question is from Amit Ganatra from Religare AMC. Please go ahead.
- Amit Ganatra** I just wanted a clarification in one of the previous questions, something was mentioned about retail processing fees, the accounting seems to have been changed, what has been done?
- Uday Kotak** I think Jaimin has explained, but in simple language assuming earlier a retail customer came to us for a loan, the way our vertical businesses would calculate is they would consider a fee and interest and when they work the IRR, they considered both together, as a result of which the fee was also considered as part of interest, because that fee was coming only because a loan was given, it was linked to the loan. Starting April 1, we are now classifying that fee as fee and not as interest.
- Amit Ganatra** So what has been impact this quarter?
- Uday Kotak** About 25 to 30 basis points.
- Jaimin Bhatt** On the P&L there is no impact, this will be on impact on NIM. The impact on the NIM would be about 25 to 30 basis points.
- Amit Ganatra** So it was not done previous quarter, right, so quarter on quarter comparison of NII is actually -
- Jaimin Bhatt** No, all the numbers which are there in the current presentation are on adjusted basis, so when we say 5 this time --
- Amit Ganatra** I am asking for the 4th Quarter, so 4th Quarter number if I'm comparing the NII as compared to this first quarter number --?
- Jaimin Bhatt** If you look at the current presentation, the fourth quarter numbers have been adjusted.
- Uday Kotak** What is the fourth quarter number earlier we have given?
- Jaimin Bhatt** That will show a difference of about 35 crores on discount.
- Uday Kotak** Basis point?
- Jaimin Bhatt** About 30 basis points here.

Amit Ganatra And that also explains the fee income jump?

Jaimin Bhatt That's correct.

Amit Ganatra Thanks.

Moderator Thank you. The next question is from Ashish Sharma from Enam Asset Management. Please go ahead.

Ashish Sharma Just coming back to the point on this change in the classification, I missed the amount which was there in the fee income for Q1 FY12?

Jaimin Bhatt Again, the same about 30 to 35 crores this quarter, and last year overall was about 110 crores.

Ashish Sharma The P&L which is in the stock exchange format even in that, we have restated the number?

Jaimin Bhatt That's correct.

Ashish Sharma Another question was from the branch expansion program we have, any impact with a change in policy, RBI has come out with the rule where 25% of the advances has to be under bank area, Tier 5 and Tier 6 cities, any impact of the new rule?

Uday Kotak Let me explain, what we have deferred got in our core focus is the semi-urban and rural branches are leveraging of our core strength, which is commercial finance lending, therefore our rural branches are continuing to be focused and will be focused as low-cost branches focused on more on the asset side of the balance sheet and urban branches are focused more on the liability side of the balance sheet. Therefore, in a way, some of our commercial financing businesses even before they were asking for more branches in rural India. What we think is this actually works to our strength because we will leverage of our asset capability which right now we had teams travel 100 and 200 Kms across the region, so we will open more branches closer to where the customers on the rural side are which basically is tractor financing and other commercial financing activities which are more suitable to rural India. And urban branches which will obviously get as a fair ratio of this, we will also do assets, but have a higher bias towards liability.

Ashish Sharma Any specific reason why we have opened only one branch in Q1?

Uday Kotak We have opened two branches this quarter and we had opened significant number of branches in the last quarter, and as we have said earlier we are on track for 500 branches by 2013, as we have planned.

Ashish Sharma Coming back with the CASA strategy, so currently the CASA is 28% and you mentioned the fee deposit is at 7.5%, the same mix has started any improvement, any target by March '13?

- Uday Kotak** We would love to see it higher and the only part is when interest rates go up people move money from CA to FD.. So that is the reality, it is a human psychology. So we have seen some movements on that, I think the SA growth is actually the bigger challenge over time and that is obviously subject to regulation and everything else. CA is always going to be little more volatile and we are focused on the transaction banking side, we are focused on the midmarket size. As we have said, right now we are at about 27%-28%; we would like to see it in the mid-30s over next two years.
- Ashish Sharma** And this last question on the capital market business, Kotak Securities per se. We have seen the volumes for the Kotak Securities going down, the decline in profitability is just a function of decline in volumes or the yields have even compressed further?
- Uday Kotak** No, I think decline in profitability is linked to volumes and while we are not disclosing it, we are watching the cash and futures more closely than the overall options volumes. And I can share this with you bulk of our drop in market share is in the option side, not in the cash and futures side.
- Ashish Sharma** So the drop in market share is more intensive, you don't want to chase those option volumes, there is no structural reason for such a sharp drop in the market share?
- Uday Kotak** Yes, that is correct, on a broad basis excluding option.
- Ashish Sharma** I really appreciated more disclosure; it would be appreciated if you can provide Kotak Securities income breakup also quarterly wise that would be really helpful.
- Uday Kotak** I appreciate that, we would love to, but we just want to make sure that we would like to be more investor-friendly and not more competitor-friendly.
- Ashish Sharma** Thank you and all the best for the next quarter.
- Moderator** Thank you. The next question is from Manish Oswal form KR Choksey. Please go ahead.
- Manish Oswal** What is the breakup of other income in banking fee, sir?
- Jaimin Bhatt** It comes from a variety of things, there is treasury income, there is fees which we collect on the regular banking and the other income. so it's a mix of all these three. We haven't disclosed the breakup of the three, but it's a reasonable mix of of all three.
- Manish Oswal** What is the key consideration for inorganic growth strategy for banking operation, whether the scale or market presence or product portfolio, what is your key consideration for that strategy?
- Uday Kotak** Our key consideration would be customer acquisition and distribution, and again, that we are going to balance with value. So customer acquisition and value will be the two drivers which we went down that par.

- Moderator** Thank you. The next question is from Ritu Gandhi from Antique Stock Broking. Please go ahead.
- Ritu Gandhi** Hi Uday, just one question on the infrastructure sector I had. Basically what is the lesson which we have learned of banks lending to the infrastructure sector, that was one? And the second question I had is just from a risk point of view when does it make sense for banks to actually fix rate loans as against taking equity in infrastructure project?
- Uday Kotak** I think you are asking some very fundamental questions. I think the big issue in infrastructure has not been execution., it is execution of the project and some of the challenges which are coming in infrastructure financing are coming out of that. The question is if you look at the last 2 or 3 years bulk of the pain of infrastructure execution challenges has been taken by the equity investors, especially in the public listed space. If you look at 2007 to 2011 the bulk of the pain has gone there, which are at 80% or 90% discount to peak and that is a real pain with the equity investors taken by financing infrastructure as an equity owner. So far the fixed income owner in infrastructure has not taken the pain, and some of the pain is also likely to get postponed by elongating the fixed income policy, lending period, restructuring, will happen in this space. Now, at the end of it, whether the equity owner alone loses the money or the fixed income owner loses the money, depends on the depth of the pain. At this stage I would say that probability of the fixed income owner or the debt owner taking losses is relatively low but not zero. The question in my mind is and one of the reasons why we have been cautious in that sector is if we are going to get lending kind of returns of spread which make our short-term P&L look very good. Has it got equity kind of risks but lending kind of return? And that is what has made us little more conservative in that space. We have missed some of the opportunities of better spread, fees and everything else which comes with infrastructure lending. But we feel more comfortable about our balance sheet.
- Ritu Gandhi** And just one additional question that do you think the RBI at some point in time will come in and actually ask banks to go easy on their infrastructure exposure, I know there are caps there but do you think that some feedback from the RBI on this front as in banks need to go little easy on infra lending?
- Uday Kotak** Not yet, RBI would be cautious in giving any formal signal like that because of the policy initiative needed for the country. So I would be surprised if RBI went out and give something like that but that does not change the fact that this execution on the ground is delayed, deferred or does not happen. Somebody has got to take the pain either the equity investors or the debt investor or both.
- Ritu Gandhi** And are you seeing a lot of private equity or project equity guys coming into infrastructure projects as of now, a lot of interest from them or not really?
- Uday Kotak** I would say there are two or three things in this, number one, there is an important signal that you have a FII debt limit of \$20 or \$25 billion for infrastructure financing and no money is come in that, virtually no money is come in that. On the other hand the regular debt limit is

very hot, it scares. That tells you something about how much the global investor is interested in putting his risk money into the sector in a hurry. So that is one part of it. But I do believe as we go down, we're going to see some opportunities coming out of stress in the sector and towards that we are just positioning ourselves, I would like Jayaram to talk about our new initiatives which is the infrastructure fund, which we hope to close by December or March.

- C. Jayaram** I think we are hoping to raise the infrastructure fund about 300 million and we are doing this along with two partners SMBC and Brookfield Asset Management from Canada. So we have just started the process of fund raising in terms of going and meeting with the investors and we believe that over the next 6 to 9 months we would be able to raise this fund.
- Ritu Gandhi** Thanks a lot.
- Moderator** Thank you. The next question is from Murali Gopal from Brics Securities. Please go ahead.
- Murali Gopal** I just had a quick follow-up on the retail processing fees, is this something that was relatively unique to what Kotak was doing versus the rest of the industry and also I presume this was the retail fees previously being accounted under NII, I presume that was only related to retail, in a sense the non-retail, you still have the fees going in the fee line.
- Jaimin Bhatt** What you said is right. That it was a retail fees and again it was something which the way this was being done primarily that was being treated as interest when you are evaluating the proposals that when needed the whole IRR calculation. Logically that has been done there for all this period.
- Murali Gopal** **Was Kotak doing innovative or** or it is the standard industry practice?
- Jaimin Bhatt** I am not sure that was unique or not but that was the way we were calculating the IRR and that's why we were accounting.
- Murali Gopal** Any particular reason for the in terms of why change now?
- Uday Kotak** We also look at what some of the other banks were doing, which they were showing as a fees and not under NII, and in order to make ourselves more benchmarked., we felt that we need to make this change once and the best time to make this change is the beginning of the new year.
- Murali Gopal** Thanks.
- Moderator** Thank you. The next question is from Kajal Gandhi from ICICI Direct. Please go ahead.
- Kajal Gandhi** I have just one question on, if we see FY11 the last year investments have grown very sharply from around 12,500 to 17,000 crores. So whether this is going to stay in the book because this is coming from others, I'm not sure what it contained also, so whether it is going to stay in the book in the current year?

- Uday Kotak** Bulk of these investments first of all are not equity, they are primarily short-term debt instrument. Therefore, reasonably short maturity and not long maturity. And if you look at our presentation we have given the bank balance sheet of this bank and if you look at it we have also given the broad breakup of those investments. 14,000 crores is government security, about 3000 odd crores is other securities.
- Kajal Gandhi** Also on this borrowing side we have seen in the last year a steep jump nearly doubling of the book so whether that is also going to see further sides to it, because this year most of the funding can happen from deposits, your advances and deposits almost at the same levels?
- Uday Kotak** On borrowings we wanted to highlight two sources of borrowing, which we have been focused on, number-one is refinance from NABARD, which is coming in without any CRR or SLR load and our fully cost-paid basis works out to be more attractive than deposits and second is we have been borrowing in foreign currency and hedging fully in the forward market but the fully hedged rupee cost of foreign currency borrowing is lower than the rupee cost of deposits and since both these are effectively economically efficient sources of net and borrowing, we have been using that and as long as we think that is giving us a positive value in our cost of borrowings we would continue to do it.
- Kajal Gandhi** And sir, one more question if we can get the last four quarters NIM on the adjusted basis.
- Jaimin Bhatt** I can give it to you, I have the whole year, I did not have quarter wise. Last year, if I do it on an adjusted basis would be 5.2 and first quarter last year was 5.3.
- Uday Kotak** On a like-on-like basis fourth-quarter of last year at 5.3 is 5% in the first quarter.
- Kajal Gandhi** Thank you.
- Moderator** Thank you. The next question is from Kunal Shah form Edelweiss. Please go ahead.
- Kunal Shah** Just a question on the life insurance, 46 crores of profitability if you could just explain how much of that is coming from surrender charges, how much is due to say bringing down the OpEx if you can just give some sense over there?
- Gaurang Shah** Last part is the difference between the 7 crores and the 45 crores plus is coming out of reduction in expenses, it has come down by almost 35 crores and other thing are also relating to the new business now as you shift to traditional you always have a upfront allowance little better. So as you see the total number which is coming out of the lapse or something on a incremental basis is quite insignificant in terms of overall contribution to this number.
- Kunal Shah** What is the outlook in terms of growth and on incremental basis how much would be the distribution between the ULIP and traditional as most of the guys are mentioning its 50-50. So wouldn't be similar for Kotak as well?

- Gaurang Shah** Yeah, currently, if you look at in this quarter between traditional and ULIP we are around 45% traditional and 55% ULIP, and I think we will also maintain the ratios of around 50 to 60 traditional and 40 to 50 ULIP. And I think outlook from sales perspective if you look at there is one more quarter where the base effect you will see, I think October onwards you will see the real growth in terms of, we expect around 15% to 20% growth once a base effect of last year growth.
- Uday Kotak** Kunal, I just wanted to highlight one important point on insurance. We are probably coming pretty close to wiping out all our carry forward losses, that means all the capital which the shareholders have put in is almost fully coming back and we move into positive territory in our pretty cost efficient basis.
- Kunal Shah** So how would be the OpEx to premium now?
- Gaurang Shah** OpEx to premium Q1 is always tricky one, it is around 21% but overall last year we ended up at around 17.1 but as you know that in the later part of the year you get more premium. So by year-end we should end up something better than what we ended with 17.1.
- Kunal Shah** In terms of our branches also we have seen some expansion in life insurance from 203 to 214.
- Uday Kotak** No, other way round, we have actually dropped to 202.
- Moderator** Thank you. The next question is from Ajinkya Dhawale from Bajaj Alliance. Please go ahead.
- Ajinkya Dhawale** I have two questions on banking business, one thing you are not giving the breakup of other income but can you tell us the growth on three line items, how much fees have grown, how much treasury profits have grown and how much is the income from the stressed asset recovery?
- Jaimin Bhatt** Basically if you look at this quarter my other income of 228 comprised it has the largest portion coming in from the traditional commission exchange, brokerage kind of thing. ARD, that has been pretty steady that hasn't grown whether you look at quarter-on-quarter or...
- Ajinkya Dhawale** What is the YoY growth in this core fee income?
- Jaimin Bhatt** YoY growth will be if you look at last year 162, if you are showing current year 228 has largely come from the traditional commission growth rate.
- Ajinkya Dhawale** It has grown about 40%.
- Jaimin Bhatt** It has grown at about 40% or actually more there. And if you look at YoY last year first quarter versus this year first quarter, first quarter in the bank will also include dividends if you get from subsidiaries. This year first quarter this dividend has been half of what we've done last year.

- Ajinkya Dhawale** So it is essentially core fees which have driven?
- Jaimin Bhatt** That's right. The dividend income from subsidiaries has been actually half on a YoY basis.
- Ajinkya Dhawale** And there is no large recovery from this?
- Jaimin Bhatt** ARD has been pretty steady both YoY and QoQ.
- Ajinkya Dhawale** And second question on a more two to three year perspective, on a return on asset basis we make very superior ROAs currently for bank maybe because of high margins currently. What is the target ROA for our kind of bank over the next 2 to 3 years?
- Jaimin Bhatt** We will continue to remain pretty healthy because we are looking at segments which we are operating and we will be there, so the currency dropped in this period at a bank level is 1.88 but 1.7-1.75 in this year; I do not think that should be an issue.
- Ajinkya Dhawale** Yeah, for the current year. But over a two, three year period?
- Jaimin Bhatt** It depends on how much it stands out, within three years maybe downward, but somewhere we certainly would be higher than what's going around.
- Ajinkya Dhawale** Thanks.
- Moderator** Ladies and gentlemen that was the last question. I would now like to hand over the floor back to Mr. Uday Kotak for closing comments.
- Uday Kotak** Thank you very much friends. As I see it if the game plays out, as it appears to right now being closer to the end of the interest-rate increase cycle maybe 50 basis points or around from there, I would say the banking story would continue to be looking pretty attractive and the credit cycle at least at this stage looks positive, and we think that is particularly true for us as a bank in view of our reasonably diversified exposure without any concentrated mix and without any significant exposures to the infrastructure sector which we have subject to execution risk. At the same time, at some point of time, we believe that capital markets will also once again for my sake and for the 200 people on this call for their sake come back and that point of time to be building our capital market businesses to be able to take advantage of those opportunities and options of P&L growth which will come out of those businesses at that stage. So ideal thing from our point of view would be a positive banking cycle and a positive non-banking cycle in the financial sector and I would say we are closer to coming there that what it looked like one or two quarters ago. Thank you ladies and gentlemen.
- Moderator** Thank you. On behalf of Kotak Mahindra Bank Ltd. that concludes this conference call. Thank you for joining us and you may now disconnect your lines.