



“Kotak Mahindra Bank Q1 FY13 Earnings Conference Call”

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Moderator

Ladies and gentlemen, good day and welcome to the Kotak Mahindra Bank Q1 FY13 Earnings Conference Call. 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 the conference call, please signal an operator by pressing "*" followed by "0" on your touchtone phone. I would now like to hand over the conference to Mr. Uday Kotak. Thank you. And over to you sir.

Uday Kotak

Good Evening, Friends. This is with reference to our 1st Quarter. I will change the sequence for this call by first talking a little bit on the specifics of the firm and then going into big picture. On the specifics first, it has been a tough quarter for the bank both at standalone and consolidated. If we look at the bank standalone numbers, the story on the net interest income side is reasonably good with a 27% growth. There has been a challenge on the other income which has grown at only 5%. The main reason for that is last year we had significant income coming in from distressed asset division compared to this year in the 1st Quarter which makes a difference of about 45 crores on a YOY basis in terms of revenue last year versus this year on distressed asset recovery, so that is one. Second, there has been a significant increase in credit cost for this quarter and our credit related provisioning for this quarter is 52 crores versus 12.5 crores for the same period last year, so these two have been significant deltas in terms of the bank's standalone, which as you know has grown at 12% after these important differences.

In terms of the credit situation itself we have had one chunky account, which became an NPA towards the end of June. It is an account which is below 100 crores and that went into the NPA category, and we have made appropriate provisioning as well on this.

Just to give you a flavor on the NPA account side, we have only one account which is more than 50 crores which is the one I am mentioning but below 100 crores in the NPA category. There is no other account greater than 50 crores category in the NPA side.

On the overall credit cycle, in that connection with reference to our book we are seeing the consumer continuing to hold well, even on the corporate side with the exception of one or two accounts over on the corporate side is still holding up otherwise well. We are seeing softness in the Construction Equipment segment and the Commercial Vehicle segment in terms of the whole credit cycle. And it seems obvious if we think about it logically that if the Infrastructure sector is slowing down both Commercial Vehicles and Construction Equipment will see some pressure.

However, in terms of the overall pricing power we feel that we had the ability to get appropriate pricing for our loans and it is reflected in our net interest margins which continue to be at a healthy 4.7%. In terms of advances growth we have had a consolidated advances growth of 28% YOY for the year and we at this stage would like to give guidance at 20% plus for the year which is what we think is the kind of number we see through the rest of the year.

On the focus and issues in addition to these which I have laid down, we are examining significantly, particularly at the bank level the productivity and that includes how do we ensure that getting the productivity of our cost structure significantly better than where we have been so far. The other challenges which are there in the financial sector right now are related to Capital Markets, Life Insurance and Asset Management businesses, all of them are going through a trough and continue to go through challenges both externally and internally.

On a broader basis we do believe that this environment in the financial sector is both a challenge and an opportunity. Challenge because as we have mentioned, a slowing economy certainly increases credit cost. At the same time for us it is an opportunity to really get differentiated in terms of, number one, the quality of our book and also the quality of how we look at some of these credit costs. For example, we are very clear that even if we have to restructure an asset, our preference is to make it a non-performing asset rather than restructure it and let it sit as a standard asset. We have disclosed our numbers on total restructured standard loans, and that number is only Rs. 12 crores which is about 0.03%, probably the lowest in Indian Banking at this stage but that is how we stick to our philosophy on how we look at NPLs versus restructured, and we will continue with fundamentally that philosophy as we go into the future. Having said that we will drive our business based on what we think is right for our book and be less concerned about what the accounting implications may or may not be in the short run.

With that I will now hand it over to my colleague, Jaimin Bhatt and we will be very happy to thereafter at the end take questions, I we have got our full team here; both my colleagues Jayaram and Dipak are with me as also Mr. Manian and Gaurang Shah are here available for Q&A.

Jaimin Bhatt

While Uday has taken you through some of the highlights, I will just take you through some of the specifics. At the bank's standalone level we closed this quarter with after tax profit of 282 crores which compares with 252 crores which was for this period last year. Loans in the bank's standalone have grown 31% year-on-year with closing the period at Rs. 42,300 crores. And as Uday mentioned, our restructured advances which are standard as of 30th June amounts to only about 12 crores, which is 0.03% of the overall advances at the bank. Net NPAs at 0.78 without the distressed asset and the gross number corresponding would be about 1.39. Our capital adequacy we continue to be pretty healthy without the current quarter profits at 16.6% overall and 15% Tier-1, if I add the current quarter profits those numbers would be 17.1 and 15.5. At CASA we have seen a 34% growth in CASA largely coming in from the Savings Accounts which have grown primarily in the last eight months of the year since the deregulation of the Savings Bank deposit.

On a consolidated basis, we closed the quarter at a profit after tax of 443 crores against 416 crores same period last year. Loans in the consolidated entity have grown by 28% with closing the period at 57,000 crores and we now have a net worth of 13,400 crores. NIMs have

held up pretty well at 4.7% for the quarter with RoA again on a consolidated basis at 1.9%. Book value on this basis would be at Rs. 180.9 per share.

Overall advances, if you look at the breakup of 57,000 crores, Corporate bank contributes about 14,000 crores, Commercial bank about 19,900 crores and the Consumer bank about 22,000 crores. This quarter we have seen growth in Corporate bank are following from a flattish quarter in Q4 last year. We have also done one small change whereby Business Banking which is now being shown separately is clubbed with the Commercial Banking and which was earlier a part of the Corporate bank and therefore, the previous numbers have got adjusted to that extent.

Contributions of the different entities in the group to the overall profits, 282 crores coming from the bank, Kotak Prime at 94 crores, the insurance entity at 32 crores, Kotak Securities at 23 crores which are the larger contributors to the overall profits of 443 crores for the quarter.

As Uday mentioned, our overall asset side now of the consolidated balance sheet is at about 97,000 crores and effectively in this quarter we continue to see the financing business contribute large amounts, the financing entity is now contributing 85% plus of the overall profits.

At the financing business level itself, the net interest income is just short of 900 crores for this quarter, which is about 20% rise from same period last year. NPAs of the consolidated entity at 0.6% at the net level. The NPAs at the bank as we said 1.4% gross and 0.78% at the overall levels.

As far as the bank profit and loss account goes we have seen an increase in the net interest income on a year-on-year basis by about 27%. The other income has not grown as much, which Uday explained as a result of the stressed asset piece which was there last year not contributing this year. Expenditure has been at Rs. 514 crores resulting in an operating profit of Rs. 448 crores. We have taken hits on account of provisions, Rs. 52 crores this quarter as against Rs. 13 crores in the same period last year as well as just Rs. 12 crores in the immediately preceding quarter, helped to an extent by write-back on provisions from investments our overall positions are at Rs. 34 crores for the quarter resulting in a pre-tax profit of Rs. 414 crores.

At the segment level, the Rs. 414 crores contributed; the largest contributor being the Wholesale Bank at Rs. 238 crores, Retail Bank at Rs. 133 crores with Treasury contributing 42 crores of the profits. The Corporate Bank numbers there would include bulk of the amounts which have been contributed by the stressed asset division. The classification of Corporate Bank here would mean the RBI classification which in any advance or any loan which is over 5 crores will get clubbed in Corporate Bank. And to that extent even some of the commercial advances which are of 5 crores plus will be classified as Corporate Bank. Bank advances overall growth at 31%, as I said this quarter contributed by Corporate Bank as also some of the

commercial segments, largely Agri continued to grow on a year-on-year basis pretty significantly.

At the bank balance sheet level, we end the period with a net worth of about Rs. 8200 crores. The overall CASA, as I said, grew 34% largely held by the savings account growth. We closed this period at 5500 crores of saving deposits which is about 68% growth over the same period last year. In addition there are Sweep TDs which contribute close to 8% of our overall deposits, whereas we have also increased the overall balance sheet size of the bank standalone to about Rs. 68,000 crores.

The Consumer Bank on the liability side we have increased our branch presence today. We ended June with 366 branches with an 858 ATMs across the country. Added about 1.4 lakh customer accounts on the liability side this quarter.

Consumer assets grew about 26% this period with mortgages contributing the larger part of the consumer assets along with cars. Commercial financing on a year-on-year basis has seen a 28% growth, largely coming from the Commercial Vehicle, Construction Equipment and the Agri segment. We have continued to meet all our priority sector requirement and Agri actually shows a pretty healthy growth on the overall numbers. Wholesale Bank has shown 29% growth year-on-year with deepening of our presence in the Corporate sector and the new opening of the government business further opportunities which we certainly hope to benefit from.

Kotak Prime as I said ended the quarter with Rs. 94 crores profit with about 75% of the advances continuing to be coming from the Car business. Net NPAs of the Car business at a pretty low number of 0.1%.

The Life Insurance Company clocked Rs. 32 crores of post-tax profit for this quarter. Solvency continued to remain pretty healthy at 2.97 times and premiums for this quarter at 457 crores as against Rs. 2900 crores for the whole of last year.

Kotak Securities, you are well aware about the dip in the market volumes this quarter was not particularly good and we have actually seen cash volumes of the market slip again. Our market share overall cash plus futures plus derivatives at 2.5% and the securities company ended up contributing Rs. 23 crores to the overall profits.

The Investment Bank was involved with Specialty Restaurant IPO, certain private equity transactions and equity placements. We have also handed open offers and buy back transactions. Some of these will actually get booked when the transaction closes, which all of these have not really come in, in the 1st Quarter. The Investment Bank ended up with a profit of Rs. 6 crores for this quarter.

Our overall assets under management at the group level for this period at about Rs. 51,000 crores, about the same level as the previous period. The asset management company actually having seen a drop in the AUM on a year-on-year basis has seen the profits at Rs. 4 crores for this quarter whereas the alternate asset piece which currently manages about Rs. 5000 crores of assets across private equity and realty funds has seen a profit of Rs. 8 crores for this quarter. Our Infrastructure Fund, we expect to close that any time this quarter.

That is broadly the overall highlights for this quarter. Open to questions from anybody.

Moderator We will now begin the question-and-answer session. We have the first question from the line of Manish Oswal from KR Choksey. Please go ahead.

Manish Oswal My question on Kotak Mahindra Prime number, because during the quarter what we saw loan book grew by 5.4% and total income increased by 8.5% and net NPA actually down by 1 crore on a quarter-on-quarters, whereas PBT went down 2.8%. So is there any operating expenses, other expenses increased during the quarter drastically in this?

Uday Kotak I will ask my colleague Mr. Manian who oversees that subsidiary.

K. V. S. Manian There are two parts to that. One is the primary car business itself had challenges around compression in its margins, and therefore, the net margins there were under pressure. And the second is on some of the other businesses which we run out of that entity which is the commercial real estate and all that had challenges around growth in profits because their books could not grow during this period. So, it was a combination of the two.

Manish Oswal Secondly, I want a small clarification on your brokerage income and sub-brokerage expenses because in Kotak Securities total income is down by 9% whereas your brokerage expenses that is basically sub-brokerage expenses went down 10.9%, so how would you explain that? In your consolidate number there is a breakup of other expenditure. If I go that....

Jaimin Bhatt When you are talking about brokerage which is part of the consolidated table, it includes brokerage paid by various entities which will include on the loan sourcing and what not. All the retail advances which are sourced through brokers are brokerage is paid.

Manish Oswal Lastly, your non-funded exposure increased by 34% YOY and 11.1% QOQ whereas your fee income, I am referring the consolidated number the commission/exchange fee breakup and that is down by 3.9% YOY. So despite a strong growth in non-fund exposure why it has not been translated into fee income growth?

Jaimin Bhatt Two things there, one is the other income would also include the stressed asset piece which as I explained has been down from a YOY. The other big contributor to the other income would

be brokerage income both in the domestic stock broking company, asset management and what not, so that has come down, so some of the gains of what you talked about coming in from the non-fund asset growth would have gone out, and larger part of the drop would be on account of stressed assets. Also remember that the non-fund growth when the asset grows the fees are effectively amortized over the period of the LC or the guarantee.

Manish Oswal

Lastly, on corporate loan book I understand you removed your business banking from your wholesale book but historically Kotak Mahindra Bank has seen strong growth in corporate loan book in the first half and de-bulking of corporate loan book in the second half of fiscal year but this time we have seen muted trade growth in corporate loan book despite adding back the business banking to the wholesale and you have derived the growth number. So what is going on there and what is your outlook going forward?

Jaimin Bhatt

Actually we have always grown corporate banking sharply in the 1st Quarter. So if you look at corporate bank this time around has grown, at the end of the quarter was 12,300 it has grown to 14,300, so we have added 2,000 crores which is about 16-17% during the quarter itself. But you do not expect that into four as an annualized growth.

Moderator

The next question is from the line of Mr. Kunal Shah from Edelweiss. Please go ahead.

Kunal Shah

On this current account, if we look at it the current account it has come off quite significantly. So firstly just wanted to know the reason for that and also wanted to know how the average quarterly balances would have been in Q4 and Q1 because if we look at it almost like 2,000 crores coming off in the current accounts but we are not seeing that impact in the funding cost while the deposit growth still continues to be quite strong. So if you look at it the CDs have gone up in equal proportion similar to that of the decline in current account, so that should have an impact of almost like 35-40 crores on funding cost, so almost like 20-25 bps impact from the funding cost and cost of funds are pretty much flat. So just wanted some sense on that.

Uday Kotak

First, on the current account end of period versus end of period, I would want you to keep in mind that end of period the current account grows because a lot of companies move money end of March into the bank from the point of view of Section 14A from investments because that is considered as valid from the point of view of investments for the full year. Therefore, you would see a significant spike end of March coming into the current account which is not the base or say the number if you look at on a quarter-on-quarter basis are much more normalized. The average CA for Quarter 1 is higher than average CA for Quarter 4. Secondly, on the whole current account situation with reference to the overall current account growth being more muted compared to savings account, there are really two reasons for that. One reason is that as the economy slows down the velocity of transactions begin to reduce and that has an impact on overall current account balances system. Number two, we see at that stage in the cycle companies and others also as the interest rates remain high and as the profitability and actions come under pressure, start becoming much more focused on not leaving current account

balances idle. Number three, in our case we also offer sweep both on savings account as well as current account, and therefore lot of customers do take advantage of the sweep product in our case which is why if you look at our sweep product actually it has shown a pretty decent growth and, of course, the sweep product on current account is more expensive to the bank compared to zero interest, it is still lower than the full TD cost for us on that basis and our sweep number therefore if you see is close to 7.8% compared to 7%-odd last year. But there is a clear slowdown in the system on current account balances and we are not an exception to this.

Kunal Shah Definitely, Q4 would be an aberration, but if I look at Q2 and Q3, there also the balances were much higher as compared to that of Q1. So, in Q2 of FY12 it was 5,800, Q3 it was 6,200 and now it is 5,000. So the average balances maybe would be like more a quarter-end phenomena wherein the current account in Q1 would have gone down since you are saying that the average in Q1 would have been higher than Q4?

Uday Kotak: The average in Q1 is higher, yes, that is correct.

Kunal Shah Secondly, apart from this chunky account, was there any other stress in any of the retail segment? Are we seeing any early warning signals in any of the segments?

Uday Kotak: Yes, as I mentioned in my initial comments, besides this chunky account the segments where we are seeing spottiness are Construction Equipment and Commercial Vehicles segment. Again, just to highlight that to you in both these segments we are seeing a clear slowdown within the Commercial Vehicles segment it is higher in higher and medium vehicles. At this stage the LCV demand is continuing to be strong without any significant stress there, but our experience says that these are all ripple impacts. Therefore, we have to be careful about within the overall Commercial Vehicles segment, what looks like a good segment today which is LCVs, sooner or later we will also begin to see some pressure come into that. And so far surprisingly and interestingly, the household segment is not seeing any pressure. So it really depends on how the economy goes, how the overall situation continues and my sense is it is possible if the broader economic growth does not go below 6% and we see the economic growth for the year actually remain at 6% plus. But if the economy slows down further the spottiness can run risk of spreading and we need to have a close watch on that from time-to-time.

Kunal Shah That has been the reason maybe in CVs and CEs the growth has been 25% while the other leading players are still showing like 50%-odd growth, so maybe the cautiousness in this segment has led to relatively lower growth as compared to the ...

Uday Kotak: And again maybe this is an opportunity for me to share with you something which we have been following for a long time, is our policy on accounting for NPAs across the board. Therefore, if we get a customer paying us money on the 30th of June by a cheque, and if that cheque which is deposited obviously next day or the following day all over the country, if that

cheque bounces anytime in the first 15 days or first 10 days, we consider that as a non-receipt and make the account an NPA if it is meeting the NPA stipulation as per RBI guidelines, as of 30th of June. We have seen situations where some of that has also added to our NPAs but it is back to our philosophy of calling a spade a spade. A cheque on 30th June which bounces in the 1st week of July is no payment.

Kunal Shah Okay, How are we seeing any delay or deferment in terms of payments, say moving from 30 DPD to 60 DPD, are we seeing that movement happening in CV space?

Uday Kotak: That is what we are saying, we are seeing some delays in that space so which is what we are watching very closely.

Kunal Shah One last question in terms of the growth guidance, we have lowered it from 25 to 30% to almost say 20% plus. So this is also mainly on account of the retail side wherein as you mentioned if the economy continues to be below 6%....

Uday Kotak: We have kept ourselves open. We have said 20% plus. We are watching the economy very closely. So rather than giving you more definitively 25 to 30% we are saying 20% up but we will watch.

Moderator The next question is from the line of Vikesh Gandhi from Bank of America. Please go ahead.

Vikesh Gandhi I just missed on the opening remarks. So if you could just tell me what led to this NPA uptake sequentially rather?

Uday Kotak We give a breakup of our accounts. First of all there is no NPA on any account which is greater than 100 crores. We have had one chunky NPA of an account between 50 and closer to 100 crores but below 100 crores and other than that there is no NPA account which is greater than 50 crores.

Vikesh Gandhi That is from a corporate account?

Uday Kotak It is a corporate account.

Vikesh Gandhi So what sector would that be?

Uday Kotak Here it is inappropriate for us to disclose that because we have only one account. If we had a whole roast of accounts we could have told you which sector its.

Vikesh Gandhi I was looking at your Annual Report and on your Prime business, apparently the loan against securities piece which was fairly big, has this been not there now in FY12? So has it been clubbed with something else?

- Jaimin Bhatt** On the overall number we have not grown the book, but it is pretty much there, overall advances on the capital market would still be of the order of between 1600 to 1800 crores for the group as a whole.
- Vikesh Gandhi** And that number was around 10-11 billion in the Prime business, so would that be...
- Uday Kotak** 1100 crores.
- Jaimin Bhatt** It has been flat for a reasonable period. It has not grown at all. If I look at a broad number year-on-year growth it will be about 3%.
- Vikesh Gandhi** Any light on your fee income been weaker than probably expectations in terms of...?
- Uday Kotak** I think again you have missed it. The answer on that is in two parts, first is at the bank standalone entity other income growth is muted because in the last year 1st Quarter we had a distress asset income which was higher than this year which is at delta of 45 crores in terms of the two accounts, so the other income number in the bank standalone has this differential of 45 crores, which was there in last year's 1st Quarter and not in this year. In terms of overall commission fees and exchange, the bank's side is chugging along well. We have also seen a growth in our non-fund business. What is dropping the fee income is brokerage and asset management, so that is where the pressure is coming from.
- Vikesh Gandhi** Finally, what would be your share of wholesale deposits in total?
- Uday Kotak** If you look at our number and I think we can give you that information, I do not know whether we are ready with it or not but year-on-year there is a significant change in our mix and we define retail deposit as 1 crore and below and our number on 1 crore and below, the mix has pretty significantly changed and improved in favor of below 1 crore and in below 5 crores category overall if I take 0 to 5 crores, more than 50% of our term deposits are now below 5 crores.
- Moderator** The next question is from the line of Aditya Narayan from Citi. Please go ahead.
- Aditya Narayan** I really had two questions, one was in terms of the slightly lowered loan growth level that you are looking at, is it running along with any change in the kind of loan mix you are targeting at this point in time either in size of individual assets or sectors or between consumer and corporate and other distribution, so one is that. The second question is you talked about there being both risks and opportunities in the market and internally. Generally, where would the balance lie, towards the greater risks or towards greater opportunities? And likewise if it is played that there are risks on one part of the business and opportunities on another, if you could throw some light on some of the thinking there?

- Uday Kotak** I remember you had asked me a similar question in the January of 2009, I do not know whether you remember it.
- Aditya Narayan** I do, but I ask you in the context that there was a point in time when you had slowed down and you later came back with that thing that maybe you had got too cautious then, you stand on that, not in the same place but somewhere there along the line?
- Uday Kotak** Let me just sit back and give my perspective on this. First, where do we see the economy growing? I think at this stage assuming we had no significant policy action; our view is that the economy in that case grows below 6%. However, if we see quick policy action and the window for that is not very big. There is a chance for getting the average economy growing for this year at, at least 6%. So really we think the next 20 to 30 days are critical for us to be able to take a clear call on what we feel will happen with reference to the overall economic growth. In the absence of policy action we certainly see below 6%, with some policy action which gives some win, some momentum and, of course, global headwinds we assume are not going to see a European blow up and it is going to be a European muddle, we could see around 6% GDP in that case. So, our estimate on where we grow is linked to that. We see nominal GDP growing between 13% and 14% depending on where we take inflation which we do not see below 7%. A nominal GDP growth of 13% to 14% is the base of what we are seeing. Then we need to temper our growth accordingly. We are clearly seeing significant worries in the Infrastructure sector. We are also concerned about the related sectors which have serious top-line pressures which we are very watchful of. So those are our negative list of sectors and we have quite a bit of that at this point of time so that is out of our radar for growth. We are happy fundamentally if we believe that we have a collateralized ability to loan and the collateral is recoverable. In those situations where we are convinced that we can recover the money through the collateral we are continuing to be more comfortable, therefore, we will take some of those calls even if there could be short-term cash flow pressures on those loans, and in that case even if they run the risk as you have seen some increase in our NPL numbers because a lot of those loans also happened to be collateralized. We are ready to take that call as long as we know finally our risk adjusted money and returns come back. Therefore, at this stage my balance is frankly not to shut shop in terms of new lending but give or take around 20% mark with some clarity coming in the next 20 to 30 days. If that clarity is poor then it will be more 20ish, if that clarity is better we could take a bolder call, but we are certainly at this stage not going into red signal, we are somewhere between amber and green.
- Moderator** The next question is from the line of Anand Vasudevan from Franklin Templeton. Please go ahead.
- Anand Vasudevan** In your opening remarks you had talked about some cost efficiency and productivity measures that you are looking at. What are the areas where you think you can squeeze more out of what you have now?

Uday Kotak

It is a very important point for us and the key issue for us is are we getting enough bank for our buck and we internally believe that our challenges are very significant number of internal verticals which we have created. We need to get our integration including merger of some of the verticals better. Number two, on the front-end consumer bank engine, we need to ensure that our ratio between the front-line staff and the non-front-line staff gets better than what it is. We have actually taken some steps as of April 1 and Jaimin mentioned about this. We had a business banking group sitting in the wholesale bank which was called BBG and there was another effectively similar group which was there in our commercial bank. . We had two independent verticals, two operational sets of people, two credit recovery and all that. We effectively on April 1 merged these two into one division and with a common back office and credit process being put in place. So, we are looking at a number of areas within the internal system where there is a significant drive not to lose the growth momentum particularly on the liability side which we will continue to drive. But how do we squeeze the juice which is relatively low hanging and in the growth phase which we have not done enough. It is showing in a way, if you look at our 1st Quarter our top-line growth is 21%, operating expenditure growth is 25%. So we have pretty significant scope to get better. On the top-line growth, of course, we have got to adjust it for one-time stressed asset income. So even if you adjusted it we must finally get this equation much better, but that in no way will slow us down from doing the rights things on the liability growth side where we need to get our liability focus even further, so we will not use expenditure or productivity increase in anyway to reduce our muscle for the future. But how do we get more efficient? As a group we are 22,000 employees. A 5% increase in our efficiency is 150 to 200 crores a year.

Anand Vasudevan

In terms of tangible numbers that we can see, your cost/income ratio is still around 53%, so what sort of targets and in what sort of timeframe would we start seeing....

Uday Kotak

If we are talking to you one year from now we would like to see our cost to income ratio having the first digit 4.

Anand Vasudevan

If you are talking about some of the different verticals being integrated there are also some pockets of capital inefficiencies within the group. Is that also going to be addressed as a part of this restructuring?

Uday Kotak

That is an ongoing process and something which we are very focused on. We have made reasonable use of some of our surplus capital, for example, Kotak Securities is a 49% shareholder in Kotak Prime and a lot of the Prime's growth now has been coming based on surplus capital from the group and less from the bank. So wherever we have ability of getting surplus capital use we are working on that. The two main engines where surplus capital is currently used is the Bank and Kotak Prime. And we have Kotak Securities with 1800 crores net worth, Kotak Capital with 500 crores net worth, so various pockets are sitting on significant surpluses which have been created in those businesses over the years and Kotak Life is sitting on significantly surplus solvency. On the capital side you are absolutely right but the engines where capital is currently required are two; Bank and KMP. Bank itself has got

surplus capital and KMP as of end of June is 16% capital adequacy. So despite the fact that we have grown advances at 28% to 30% year-on-year we have and depend on how you want to look at it at this stage of the cycle, the luxury and the burden of surplus capital.

Anand Vasudevan The other comment you made was that there are some external and internal challenges in the Capital Markets businesses, the external challenges are quite easy to understand, what do you mean by internal challenges?

Uday Kotak Internal challenges is that how do we serve institutional customers even better, how do we use this period to get so much more productive internally to get our market share up, how do we focus on saying that franchise improvement is significantly enhanced and not just bothered about revenue at this stage of the cycle, and there is a significant amount of internal meeting up which is happening for us to get better on asset management, every one of our Capital Markets, Life Insurance and Asset Management businesses, while I think we have got our costs reasonably under control in a lot of those businesses and continuing to get better, we need to get our franchise significantly better from where it is today on a continuing focus base. So that is what I mean by internal challenges. If through this period two years from now assuming the markets remain sluggish which is not impossible, how are we getting our share gain and franchise gain in the eyes of customers both perceived and real and that is what I mean by internal challenges. External environment in terms of market volumes is less in our control.

Anand Vasudevan From what you are saying, am I correct in concluding that there is not much more that you can do on the cost base in these businesses?

Uday Kotak Obviously you can keep on tinkering away on the margins, but I think the big cost if you look at out of our total costs are sitting in the bank. So getting the productivity on the cost side, yes, on the other businesses we can do a little bit of tinkering but the big cost in terms of sizeable cost, what I mean by is that relatively low hanging fruit on the cost side is still the bank.

Anand Vasudevan Moving on to Savings Account competition in the market are there competitors offering much higher rates for high value Savings Account deposits and are you also getting into this game?

Uday Kotak I think it is a very important question. What is the Savings Account? Is it a core individual's transaction account or is it a money market account? Our view is that it is an individual's transaction account. We do not want to make it into a money market wholesale account. We do not offer for any amount above 6%, therefore, none of our savings are coming in for any amount even if it is 100 crores, at above 6%.

Anand Vasudevan And what is the market practice?

Uday Kotak We understand that some of our competition is going up to 8% and 9% also. But we want these savings proposition to be a core operating, transacting account, we know our overall average savings cost is about 5.5% which is 1.5% higher than most of the major banks. We think that is

a price worth paying to grow the savings proposition but we do not think it is a money market account as a strategy.

Anand Vasudevan I have one last question. The recent dictat by the Finance Ministry to PSU banks to go easy on bulk deposits, does that in anyway open up opportunities for private sector banks?

Uday Kotak I think it does. As I mentioned to you our below 5 crores deposit is about little over 50% which means plus 5 crores is just below 50% and if we can save money there we will save money.

Anand Vasudevan Which means that you could increase your bulk deposit?

Uday Kotak At the same time we are clear that low-cost and stable liabilities is heart of what we are building. So we will not compromise on that philosophy in terms of building a long-term franchise.

Moderator The next question is from the line of Alpesh Mehta from Motilal Oswal Investments. Please go ahead.

Alpesh Mehta Just wanted to check what is the outstanding stress loans standing on the balance sheet right now?

Jaimin Bhatt: Overall stress loans as of now we would be net of provisions about 350-400 crores including the SRs.

Alpesh Mehta Only SR component would be?

Jaimin Bhatt About half of that.

Alpesh Mehta And would you be having the exact number of the gross NPA including stress loans?

Jaimin Bhatt What I mentioned 1.39 is 1.6.

Alpesh Mehta But the absolute number?

Jaimin Bhatt 685 would be the overall number.

Alpesh Mehta Secondly, as we have already mentioned regarding some slowdown into the CV and the CE component but if I look at on a sequential basis your growth is still quite strong at around 9%, so what explains this?

Uday Kotak I think within the CV segment we have seen the LCV segment continue to hold, so that segment we have continued to grow and on Construction Equipment we have moved to the higher end quality and done some working capital lending but we have moved very much up the curve.

- Alpesh Mehta** What would be your outlook on the car loans considering there is some compression in the margins on that product and some slowdown even at the ground level now?
- Uday Kotak** I think in car loans our focus is to get into new markets and new segments and the current book we are writing is of pretty good margins. Some of the loss in margin we had is because of the loan we wrote two years ago which had very good margins which ran down and that has sort of given the mix but we think we get back on the car loan margin in the next few quarters.
- K. V. S. Manian** Like Uday said, I think current margins are okay, our placement margins are fine and therefore, we are not worried on that front. And we have very low delinquencies right now and our belief is that with CIBIL and all in place I think there is a new normal in terms of delinquencies that one is seeing and with low delinquencies and I would say relatively expanding margins I think we are comfortable continuing to grow that business.
- Uday Kotak:** I think we will gain share there.
- K.V.S. Manian** And we are gaining share already and like Uday mentioned we are also expanding to newer geographies which actually help us expand the spreads a bit more than in the most competitive markets.
- Alpesh Mehta** Just wanted to know your view about the CV market as we are seeing most of the private sector banks are right now growing their CV portfolio quite aggressively. Is it to do with that people are thinking in second half there would be a decent amount of slowdown and we should build up the priority sector loans right now?
- Uday Kotak** I do not think priority sector loans drive us. We think we will get there in any case. What drives us is the quality of the risk and the credit.
- Alpesh Mehta** What would be your outlook on the competition right now in this product?
- Uday Kotak** Of course, there is competition, but again I think the mix of the competition is changing. What used to be more NBFC like competition maybe there is a little bit of slowdown there but we are continuing to see some more banks getting aggressive there.
- Alpesh Mehta** Jaimin, just a last question regarding the same chunkiness about the recoveries that you had for the last year 1st Quarter. So, was that the thing in any of the quarters last year?
- Jaimin Bhatt** You are talking about stressed assets?
- Alpesh Mehta** Stressed assets, the 45 crores recovery.
- Jaimin Bhatt** As Uday mentioned we had about 65 crores last year and this is lower amount this quarter.

- Alpesh Mehta** This time it is around 20 crores and last year full year we did around 130 crores or so, so was there any chunkiness in the second, third, or fourth quarter or it was quite evenly distributed?
- Jaimin Bhatt** Reasonably even thereafter.
- Moderator** Thank you. We take the next question from the line of Manish Karwa from Deutsche Bank. Please go ahead.
- Manish Karwa** I just wanted to check on one thing, on your margin outlook of 4.7, given the fact that you seemingly are becoming a little bit conservative on risk, would that stand a chance that margins actually start coming off from current levels?
- Uday Kotak** At this stage I will give the guidance which I gave at the 1st Quarter call which is, we see margins sustaining at 4.5% plus, so that should give you some indication even if the mix changes and actually there is reasonable pricing power for banks today.
- Manish Karwa** Secondly, I wanted to check on insurance. While we understand the trends have been weak but now we are actually also seeing profitability numbers coming in fairly lower than what we were seeing last year. Now would it be fair to assume that given the fact that trends remain slow, profitability numbers will continue to remain at a lower level compared to what we have seen over the last two years now?
- Gaurang Shah** Last year and this year we should be more or less aligned with 10-15% difference and I think a 1.25 profitability in particularly 1st Quarter got impacted big times in terms of our new business volume which is due to the change in the minimum sum assured requirement for getting the tax benefit more at the time of investment and as a maturity benefit is required all the product changes and other things. And if the operating environment there is a new product guideline which is on the way, if we do not get major changes in that then that is the only risk as we see for this year in terms of both the new business volume as well as margin.
- Uday Kotak** But saying that it does the variation which is significant and even if it is in the range of 10% to 15% versus last year.
- Moderator** We will take the next question from the line of Venkatesh Sanjeevi from ICICI Prudential. Please go ahead.
- Venkatesh Sanjeevi** This is on the branch addition. I think last call you had spoken about 15-20 branches per quarter. Now we are talking about a slightly lower loan growth expectations. Was there any change on the branch targets?
- Uday Kotak** No, we continue with the same focus on branches and we stick to our guidance which is 500 branches no later than December 2013.

- Venkatesh Sanjeevi** So this quarter I think you had about 10 or 11...and Second question on this commercial real estate exposure. Could you tell me what is the extent of exposure right now?
- Uday Kotak** We are pretty flat, there is no increase quarter-on-quarter.
- Venkatesh Sanjeevi** Can you give us some flavor of the new geographic spread of the exposure which place is this done?
- Uday Kotak** It is basically major metros, mainly Mumbai, Delhi, Chennai, Bengaluru, Ahmedabad and Pune.
- Venkatesh Sanjeevi** In terms of stress levels in this particular segment over the last quarter or so?
- Uday Kotak** Nothing major, we have not seen anything major and we have been operating at very low LTVs in this segment.
- Moderator** The next question is from the line of Seshadri Sen from JP Morgan. Please go ahead.
- Seshadri Sen** Just a quick question on the ownership guidelines that the RBI has put out, in terms of do you have a roadmap on how you intend to get there and some sort of plan?
- Uday Kotak** Obviously, we have put out the release as soon as we receive that communication from the RBI. The current requirement of RBI is that the promoter ownership from the current level of about 45% has to come down in about a six-year time which is March 2018 to 20%, and thereafter RBI will obviously take a view based on new banks, how much lower or higher than 20% depending on what they allow new banks. If they allow new banks 15 which is what the draft guidelines say, we suppose that is what will be applicable. To us, if they allow 20 we should get 20, and if they allow 26 which is the voting rights in the Parliament and then hopefully we would be allowed to hold 26, so it all depends on how this plays out over next few weeks, months or years. In terms of our game plan, honestly, we have said that preference is a combination of inorganic or if and when the bank needs new capital, that is clearly our preference. There is some small dilution which happens every year through ESOPs and our not-so-preferred option is secondary. But, if pushed into shove we will have to look at a combination of all.
- Seshadri Sen** A quick follow up is that in terms of timelines has RBI communicated that you need to start showing movement in this direction?
- Uday Kotak** Let me assure you that at this stage we do not envisage raising any new capital in the next one year.
- Moderator** The next question is from the line of Rahul Jain from Goldman Sachs. Please go ahead.

- Rahul Jain** My first question is with respect to our operating expense which seasonally we see coming down in every 1st Quarter of the fiscal, but this quarter we have seen it remaining stable versus the last quarter as in the 4th Quarter. So just wanted to understand, has there been any increase or addition in employee count this quarter or what explains this higher employee expenses this quarter?
- Jaimin Bhatt** Yes, there has been some increase in the employee count especially in the bank as we are growing branches. Also if you look at some of our payments which we make to the employees are also linked to stock price and that would have taken some amount of hit this quarter. The third one, of course, is what we call as compensated absences and provision on account of that the AS15 provisions have been higher this year than last year.
- Rahul Jain** Can I know the absolute number of employees as on date in standalone banks?
- Jaimin Bhatt** Across the group would be about 22,000 bank would be about 13,000. I am giving you a rounded number, I do not have exact numbers.
- Rahul Jain** My second question is with respect to our credit-to-deposit ratio which has been hovering around 100% plus. So how long do you think this is sustainable to maintain 100% plus kind of CD ratio? What is an internal roadmap for this credit-to-deposit ratio or how do we view it as a business?
- Uday Kotak** I think first, if you look at our credit-deposit ratio we hold significantly higher Tier-1 capital, so whether you take that number as 5%, 7%, 8% that is obviously clearly gives us greater comfort with reference to the absolute ratio, so that is point number one. Point number two is we have significant levels of refinance from institutions like NABARD and others, which are average total door-to-door, total maturity five years, repayable every six months, with no call option. So, we think those are very stable liabilities and match beautifully with some of our fixed rate financing. So that obviously does not come in the CD ratio, but it is stable funding. And third is we have used the foreign currency limit of borrowing which RBI allows us pretty significantly fully hedged, of course, into rupees as long as the cost of that is rupee adjusted, fully reserves adjusted cost of that is lower than the deposit cost and we have tried to replace wholesale deposits with that and we have made sure that the percentage of retail deposits in our total deposits, as I mentioned, more than 50% of our deposits are now below Rs. 5 crores. So we are changing the deposit mix. We will gradually improve the CD ratio and we are conscious about stability of the liability side, therefore, we get the mix on re-finance from re-finance institutions as well as foreign currency deposits fully hedged as a part of the liability mix.
- Rahul Jain** If I can extend this argument a bit further so this borrowing the re-financing, I understand typically comes at about 100-125 basis points higher than the retail deposit card rate and given that in select product segments we are seeing some sort of increased competition. Do you see that it will sort of impact our margins going forward?

- Uday Kotak** I think this re-finance is not at such a big difference, number one. Number two, you have got to look at reserves adjusted cost because for every Rupee of term deposit there is an amount which goes into CRR and SLR. So when we look at the cost of these funds we adjust reserves adjusted cost for the deposit and then look at the comparison, and if it makes sense we take money from there or else we will not take it.
- Rahul Jain** Final question, on this Savings Account addition that you talked at about 1.5 lakhs in this quarter, how much of that would be on account of the salary accounts or the large proportion of that would be individual accounts?
- Uday Kotak** About 60% is non-salary accounts.
- Moderator** The next question is from the line of Adarsh P from Prabhudas Lilladher. Please go ahead.
- Adarsh P** A question on the credit cost overall. It has been about 6-7-8 quarters since credit costs have been holding up lower than probably expectations on the retail side. Just wanted to check, are there instances in the market where you are seeing that people have started to kind of pass this on to the consumer considering this being a little more structural than cyclical?
- K. V. S. Manian** Like we mentioned earlier in the call there are individual segments where the credit costs continue to remain low, and right now we are not seeing stress, but having said that we are not sure this is yet time to pass on the benefit of low credit cost in your pricing though we do suspect that it could be new-normal but given the situation just now we would not pass on the benefit in credit costs just now on pricing.
- Moderator** We will take the next question from the line of Sai Kiran from Espirito Santo. Please go ahead.
- Sai Kiran** If you can explain us the branch expansion strategy in terms of geographical locations, how do you intend to reach 500 branches in December 2013 and in conjunction with the asset branches as well.
- Uday Kotak** I think it is going to be a mix. As I said we are going to a number of 500 branches before end of calendar 2013. The mix is going to be continuing with our current strategy, which is primarily urban and metro-driven with select locations in rural and semi-urban where we think there is an asset growth, our rural and semi-urban branches will be focused more on making money from the asset side and the urban branches will be focused more on making money from both assets and liabilities and we do not want to change anything which is dramatic in our mix, and we will continue to focus on that broadly subject to regulatory requirements.
- Sai Kiran** Do you think the asset branch locations will be higher than the liability branch locations or the assets branch locations in the next couple of years?

- Uday Kotak** At this stage, early days. As we also want over time so-called asset branch locations to be doing more of liability. So we will gradually expand the liability base in the asset branch locations and in our liability branch locations also we are focusing on getting more assets throughput.
- Sai Kiran** Second question is in terms of the incremental retail disbursements, how do you see the mix changing between the rural, semi-urban versus the urban and metro markets?
- Dipak Gupta** At this stage we really do not expect to change very drastically though in some businesses where we are more comfortable and risk profile seems more acceptable like Mr. Manian explained in cars we are looking at expanding geographically deepening much more really in semi-urban centers, but otherwise apart from that not really significant expansion.
- Moderator** The next question from the line of Ashish Sharma from the Enam AMC. Please go ahead.
- Ashish Sharma** Just wanted a sense on this provisioning in the standalone bank on the NPA account. We provided around 52 crores for NPA. Was it largely for the NPA? And how do you see this account playing out in the ensuing quarters, do you expect it to turn into standard category or how do you see it?
- Uday Kotak** On NPA to standard category, seeing is believing. Therefore, I would say however much confidence my business team is giving me I am saying I will want to see it before I believe it. And overall, I do feel that it is back to us being pretty tough on ourselves in terms of recognition of NPAs as I mentioned including if a cheque bounces we will take it into NPA. We think that over a time with adequate security and follow-up and reasonable cash flows with the client we think that on a net basis the provisioning which we have done and, therefore, our net NPA as we carry it in our books are adequately recoverable. That is what our view is and if we felt otherwise we would have gone ahead and provided more.
- Ashish Sharma** But at this moment it is not that it is sort of a technical NPA, there are structural issues with account and with 100% confidence we can say that this can be recoverable?
- Uday Kotak** Let me be very clear that first of all whatever is in the NPA category is in a NPA category. Our total restructured standard loan as we have mentioned earlier is only 12 crores. So we are pretty clear. Therefore, if somebody does not pay for 90 days after the loan is due whether it is principal or interest, it is a NPA account and even if we had to do restructuring on that account I am happy to do it after it is in the NPA category and thereafter my focus is only on collecting my money.
- Ashish Sharma** And just two quick data points on the bank advances. In terms of split between CV and CE for the total book how is the split between CV and CE exactly?

Uday Kotak Commercial Vehicles is about two-thirds of the combined book. **Ashish Sharma** You seeing more pain in the CE side rather than CV?

Uday Kotak Select construction equipment has a proportionate higher pain because it is about contractors, some of them who happen to be having to receive money from State Governments or infrastructure companies.

Ashish Sharma In Agriculture Finance what will be the composition of tractor portfolio?

Uday Kotak Tractor portfolio is around 2000-odd crores. But at this stage we have not seen dramatic increase on a year-on-year basis on stress.

Moderator We have the last question from the line of Adesh Mehta from Ambit Capital. Please go ahead.

Adesh Mehta Just required some data points. What could be the gross and net NPAs the absolute amount excluding the stressed assets?

Jaimin Bhatt You are talking about bank standalone or

Adesh Mehta Both, standalone and consol.

Jaimin Bhatt If you look at gross at the consolidated level it will be of 770 with a net of 375 and at standalone level it will be 684 and 340.

Adesh Mehta What could be the provisioning on standard advances for this quarter?

Jaimin Bhatt It is a small amount; about 12 crores.

Adesh Mehta Any write-off this quarter?

Jaimin Bhatt There will be as a normal process we keep evaluating this.

Adesh Mehta Any amount to that?

Jaimin Bhatt That would be built into the positioning and result in numbers.

Moderator I would now like to hand over the floor back to Mr. Uday Kotak for his closing comments. Over to you, sir.

Uday Kotak As I said right at the beginning, the environment obviously is tougher than it looked six months ago. We think the next 30 to 60 days will determine whether the economy grows below 6% or around 6%. We are watching it very closely. And we are, therefore, of the view that this is a great opportunity to be able to navigate and see that we get our focus in terms of both credit quality and building low cost and stable liability. At this point of time we think



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20% plus loan growth, ability to maintain reasonable pricing power with select pockets getting softer particularly Construction Equipment and CV, and all-in-all watch but continue on a steady sustained path. Thank you very much, ladies and gentlemen.

Moderator

On behalf of Kotak Mahindra Bank that concludes this conference call. Thank you for joining us.