“Kotak Mahindra Bank FY14 Earnings Conference Call”

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Kotak Mahindra Bank FY14 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Uday Kotak – Executive Vice Chairman and Managing Director, Kotak Mahindra Bank. Thank you. And over to you, sir.

Uday Kotak: Good evening, friends. Delighted to be with you once again as we close the year 2013-14 and look at a very interesting year ahead. I will first talk about the year behind us and then about how we see the situation ahead of us. First of all, I look at the year 2013-14 as a year of high volatility in the financial industry, particularly in India, especially around the period – June, July, August – and then over the next five to six months significant action taken by policy to a more stable situation by the end of the year 2014. I therefore look at from the bank's point of view the year 2013-14 as a year of consolidation and capacity building. We took some significant calls and took the knock on the chin during the year; one of which was a change in the government securities yield post July 15, 2013 and we did not succumb to the pressure of moving any securities post July 15, 2013 into the HTM category and decided to take it through the P&L. On a broad basis if I look at a year-on-year delta we have taken Rs.200 crores P&L charge through our profit & loss account for the year 2013-14 with the objective of the fact that it enables us to recognize reality as it is, as also we begin the next year with a fair value of these securities including a higher current yields on the securities. Simultaneously, we started in early 2013, we took a call on a few sectors and increased our caution on that, which was mainly in the area of Infrastructure, Construction Equipment and Commercial Vehicles. What it meant was we saw a significant degrowth in the Loan book on those sectors by choice and design and that actually also we believe enabled us to have a much more robust Loan book on our balance sheet. We believe as we stand today that the stress in our balance sheet has bottomed out, something which I mentioned in the January call with significant more conviction. We see from here our overall GNPA numbers and net NPA numbers improve, and more importantly, we go into the year April 2014 with a squeaky clean balance sheet.

I would here to like to share with you something which we have so far not done, but this is with reference to the distress loan we buy from other banks, and other financial institutions. Our rough estimate of this is the total gross collectible amount of loans which we have on our book would be roughly in the region of Rs.1800-2000 crores, we carry these loans in our books at less than Rs.250 crores. We see this as a significant longer-term potential for our business as we get into the future – and I will talk about it shortly as we go forward.

In terms of building the capacity in our ability to look at growth into the future, we grew our Savings Deposits book at 39% in the last one year. Our average cost of Savings Deposits is around 5.5%. We pay 6% on Deposits above Rs.1 lakh; 5.5% on Deposits below 1 Rs.lakh and 4% on NR Deposits, and the weighted average pool for us comes to about 5.5%. The other area which we have focused on is building capacity in our liability side and stability as well. And our Term Deposits below Rs.1 crore grew last year at 35%. Combined this has also helped us in addition to stability bring down our CD ratio to below 90%. Going forward, we believe in the year '14-15 we will grow our Savings book at (+35%) and Term Deposits below Rs.1 crores at (+30%).

Moving on to Loan growth for the last year – We grew our non-CV/CE Loan book at 17% in the bank, and we think that from here we do not see any further degrowth in the CV/CE book based on our assumption on the economy. We assume for the next year GDP growth to be in the region of 5-5.5%. And based on these assumptions, our Loan growth assumptions for 2014-15 are 15-20% Loan growth.

Coming back to the subject of 'Stress Assets,' we are very hungry to buy stress assets; however, as per the current rules banks who are selling stress assets are more motivated to sell them to ARCs on the 95/5% SR route rather than selling them in cash, because the valuation available on the 95/5% formula is significantly superior. This postpones the cash resolution of these assets by 12-18 months, but we do believe that opportunity will come and we will be seriously looking at taking significant share of that opportunity.

Moving beyond the pure 'Financing' and the 'Banking' business – we are seeing some uptick in the Capital Markets businesses. If I look at our average volumes and revenues in the Capital Markets businesses, particularly, Brokerage business for the whole of last year, and compare that with the volume in the month of March, March alone is about 25-30% higher in terms of revenues compared to the average for the 12 months as a whole. So, if this traction in Capital Market remains, the operating leverage in those businesses is pretty significant and we think we are well-positioned to get advantage of that. This is of course in addition to the fact that we are seeing increased traction in the Advisory business as well.

On to the Life Insurance and the Asset Management business – I am happy to share with you the fact that we are making significant progress in the Alternate Assets business. In these difficult times for raising Alternate Assets, we have got mandates from two sovereign wealth funds in the real estate space for us to be managing about close to $400 million with promise for more. We think this is a very significant break-through for us in our future endeavors in this space and I would believe that from a level of around 1.2-1.4 billion this business has the ability to multiply.

And lastly, on the Life Insurance business I mentioned briefly in the last call as well, we see our ability now to have a delta growth compared to the industry increasing. We are making significant progress on improving the depth and quality of our distribution, both in Alternate as well as the tied space, and I will be happy from time-to-time to report to you the progress we are making in a differentiated distribution in the Life Insurance business which will start giving us more traction over the next one or two years.

With that I will now request my colleague, Jaimin Bhatt to take you through the Earnings Update and Specific on the Financials before we get back to Q&A. Over to you, Bhatt.

Jaimin Bhatt: Thanks, Uday. Let me take you through the Earnings Update which has been mailed to you earlier today.

For the full year FY14, consolidated level end with the post-tax profit of Rs.2,465 crores Vs against Rs.2,188 crores for the previous year. ROA at the consolidated level at 2.1%. Overall Loan book at the consolidated level is Rs.71,693 crores, about 8% jump from the previous year and as Uday mentioned, if I take out the degrowth in Commercial Vehicles and Construction Equipment, the overall growth is about 17%. The NPA numbers at consolidated level at 0.88% at a net level and the book value after dividend which we declared is Rs.247.6 per share. At the standalone bank, we closed this year with profit after tax of Rs.1503 crores which is after taking the pains on treasury which Uday explained earlier. At the bank level, an ROA of 1.8% and overall Loan and Advances book of Rs. 53,000 crores.

NIM at the bank level again at 4.9%. For the year apart from the bank Kotak Prime contributed Rs.491 crores to the overall bottom line, up from Rs.431 crores previous year. Kotak Securities delivered Rs.160 crores of post-tax profit. The Insurance Company at the entity level had a post-tax profit of Rs.239 crores. With this, we have an overall net worth of over Rs.19,000 crores, where the bank has been in excess of Rs.12,000 crores, Prime is just short of Rs.3,000 crores and Securities company at Rs.2,000 crores, the Insurance company now having a net worth of Rs. 1,000 crores plus.

If we look at the overall Advances book of Rs.71,693 crores roughly about 25% of that is coming from the Corporate sector, about one-third from the Commercial segment and 42% is coming from the Consumer segment.

Looking at sector wise growth, on a year-on-year basis the Corporate Bank grew about Rs.14,500 crores last year March to Rs.17,000 crores and as we have done in previous year the last quarter actually had a negative growth in the Corporate Bank. The Agri division grew 25% year-on-year from Rs.8,356 crores to over Rs.10,000 crores. Home Loan and the LAP segments again grew 17% to over Rs.12,000 crores at the end of the year. Commercial Vehicles/Construction Equipment segment now having a 30% degrowth for the year and having a book size now of Rs.5,500 crores.

At the bank level, the Net Interest Income for the year at Rs.3720 crores, the Other Income partly taking a hit from the treasury numbers were down to Rs.1400 crores, still up from last year but a big knock on the treasury front. On the cost side, the employee cost just about 10% higher than last year and operating profit level the overall number is Rs.2,577 crores for the year. This quarter particularly we made a provision number which was negative, coming largely from recovery on Advances, which we had provided earlier, largely coming from acquired stressed assets which we recovered in this quarter. And the investment provision we have taken the amortized MTM hit which we had talked about in the previous quarters, at this stage now written off all of the MTM losses on that count. End of the period therefore for the quarter we have ended the bank at Rs.407 crores with Rs.1503 crores for the year. And the MTM on investments which we talked about the overall same for the year has been Rs.175 crores and in fact if we had chosen to take the benefit of the RBI circular and taken the permissible amount into the HTM category, the profit before tax for the year would have been higher by Rs.163 crores.

At the bank segment level, the Corporate and Wholesale bank contributing Rs.1301 crores of profit compared to Rs.1211 crores last year. Retail Bank had Rs. 793 crores, the Treasury Rs.176 crores, somewhat also helped by the fact that we raised capital at the beginning of the year. Bank advances we talked about the fact that it has been a 9% growth overall, but without Commercial Vehicles/Construction Equipment negative growth, standing at 17% on a year-on-year basis, big growth again coming from the Agri division and Home Loan segment. Small business segment on a smaller base growing 18% year-on-year.

Bank balance sheet Uday touched upon of the numbers on the Deposits side, we have seen an overall deposit growth of 16% for the year, the Current Account itself has grown 14% on a year-on-year basis, while the Savings Account at 39% with an overall Savings Account cost at 5.5%. At the end of the period the CASA ratio at 32% compared to 29% previous year and Sweep Deposits making up for another 7.2% of the overall Deposits. Actually, during this period reduced our dependence on large certificates of deposits which is down 30% on a year-on-year basis and the other point which Uday touched upon is Deposits which are less than Rs.1 crore actually grown 35% on a year-on-year basis. At the bank level, we have crossed the Savings number of Rs.10,000 crores in the month of March and our overall restructured number as of March end is all of Rs. 10 crores which is 0.02% of our Advances book and the fact that we have no CDR participation, no sale of our loan-to-ARCs as well as no conversion of our on-balance sheet items to off-balance sheet items.

At the Consumer Bank, we have grown our branch network; we ended the year with 605 branches which is up from 438 which was a number at the beginning of the year and we are talking about the fact that we would be 1,000 branches by Calendar 2016 and we hope to cross 750 branches in the current financial year. Our CASA plus Term Deposits below Rs.5 crores continues to be at a healthy number of 63% on the overall deposit base. This quarter we added 1.63 lakh customers to the growth pool. At the Consumer Lending space, that has shown an overall growth of 16% on a year-on-year basis, focus continuing to be on the self-employed non-professional category as well as we cross-sell. Delinquencies in this segment continuing to be very low.

At the Commercial Bank, while the overall growth is 1% comes as a mix of the CV/CE segment having a negative growth whereas Agri business has 25% growth on a year-on-year basis.

At the Wholesale at the Bank standalone level, overall loan book has grown to Rs.14,500 crores end of the year with non-fund base is north of Rs. 11,000 crores.

Kotak Prime Rs. 491 crores post-tax profit for the year, coming from an Advances book of Rs.17,000 crores. Our Car Advances is continued to be a dominant part of what Prime does; Rs.13,200 crores of the overall Advances comprising Passenger Cars. Net NPA number at Prime is 0.3% with capital adequacy of 17.7%.

The Insurance entity showing a small growth in the individual regular premiums when the industry has actually shown a negative number. The Group business has grown 26% on a year-on-year basis. At the overall entity we had a post-tax profit of Rs.239 crores this year compared to Rs.190 crores in the previous year.

Kotak Securities – Uday talked about the fact that March has seen a rise in volumes. We finished the year with Rs.160 crores post-tax profit**.**

The Investment Bank ended the year with a Rs.14 crores post tax profit.

Across the Group, our Assets Under Management are at Rs. 56,000 crores spreading across the domestic mutual fund, the alternate asset piece, the Insurance business as well as the offshore funds. Domestic Asset Management business the AMC and Trustee Company put together this year clocked profit after tax of Rs.41 crores compared to Rs.12 in the previous year.

On the Investment Advisory piece as Uday talked about the fact that we have just had a closing in the Realty fund in the month of April, and the overall funds which we have collected in the Realty segment has now crossed a billion dollar, in April '14. This year the KIAL which is Alternate Asset entity clocking of post-tax profit of Rs.18 crores. We are open to taking the questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Amit Ganatra from Religare Invesco. Please go ahead.

Amit Ganatra: This question is to Mr. Uday Kotak. You mentioned about 15% to 20% kind of loan growth outlook based on the current assumptions on GDP growth. Now, this loan growth outlook, is it subject to change during the course of the year or you think this is the outlook right now based on whatever the GDP?

Uday Kotak: I think you are linking it to GDP growth, therefore the outlook on GDP growth changes for the better or the worse, we will modulate it, but at this point of time, at a 5-5.5% GDP growth we believe the Banking industry is going to have a challenge on capacity – whether it happens on the next three months, six months, one year, we can debate that. And therefore we do believe that we would be now focused on getting share of the risk from the system and growing reasonably faster than the system, and we think 15-20% growth rate on a 5-5.5% GDP is a good number, and keep in mind the significant part of the degrowth which we saw particularly in the last year which came from our conscious decision on Infra, Construction Equipment and Commercial Vehicles has now made that base extremely small for us to be able to grow faster in totality from where we are. We therefore see reasonable comfort that 15-20% is something which we are comfortable with, and should we find traction we will not be averse to growing faster if there is an opportunity.

Moderator: Thank you. The next question is from the line of Manish Karwa from Deutsche Bank. Please go ahead.

Manish Karwa: Especially on the Commercial Vehicle and Construction Equipment, which has de-grown so sharply this year, how difficult do you think it will be for you once the market revives to get back into this business, probably because competition would have taken away some share and…?

Uday Kotak: I will give some comments and then ask my colleague, Narayan. In general, we have not cut capacity on the people side. So that is point #1. Point #2, we have already started seeing the bottoming out in February-March. So, it is not that we have waited till October to really start thinking about life beyond bottoming out. And we feel confident that we can do it; however, more specifically on Heavy Commercial Vehicles, Light Commercial Vehicles space Narayan, why do you not address this question of Manish?

Narayan S.A.: Manish, yes, we did substantially pull back, but what we did not do was we did not move from any area where we are present. We continue to be present and which did not reduce strength in those areas substantially, especially the key guys there. While the fleet on street were cut, but not the key guys. And we have been in this business pretty long and we have maintained our relationship and continue to give money to those clients which we are comfortable with. What we did not do was we did not go and acquire new to bank clients where we did not have the comfort. Having said that we have started building the portfolio gradually in the last 2-3 months and the traction has been reasonably okay to the extent our appetite as of today. What I mean by that is while we are not ready today to jump the portfolio 2-3 times, but if we get the comfort as the market improves, especially at the economy level, I do not think we will have problem in pressing the accelerator and taking it to the next level and going back to where we were in the next 6-7 months on a disbursement month-on-month basis.

Manish Karwa: Currently your repayments are still running ahead of your disbursements?

Narayan S.A.: That is right, they are running ahead of our disbursements.

Uday Kotak: But we feel bottoming out happening, Manish. We are building traction, but this is a marathon run, so, we just want to time it well.

Manish Karwa: Just a related question on this. Such a sharp decline in Commercial Vehicle, does it impact your priority sector commitments?

Uday Kotak: No, we have actually done better on priority sector compared to last year, because our Agriculture business has shown a 25% growth.

Jaimin Bhatt: If we look at the Agri Advances have grown 25% and it includes Tractors which has grown even faster than that 25%.

Manish Karwa: Uday, you mentioned one thing about the recoverability of stressed assets. This is a recoverable amount or this an amount which value of assets that probably you hold?

Uday Kotak: Let me just again clarity that. We hold in our books after writing down significantly over the years, assets at a value of just over Rs.200 crores. We think we will be able to recover Rs.1800-2000 crores on this.

Manish Karwa: In your view over what time period?

Uday Kotak: It is certainly not five years, it is probably less than three years in totality.

Manish Karwa: And the asset backing this would be higher than Rs.1,800 crores, right?

Uday Kotak: Of course, otherwise, how will we get our settlements and resolution?

Moderator: Thank you. The next question is from the line of Kunal Mehra from Visium. Please go ahead.

Kunal Mehra: Two questions; one, on the capacity constraint that you outline that the system would confront in the next 12 months, would love to get your thoughts on it, because instinctively given everyone's LDRs where they sit right now as well is the traction in the Savings Accounts growth, I would have not imagined the capacity constraint would be something will be heating up again in the next 12 months, what is prompting you to say that and why are you confident of it?

Uday Kotak: I think the capacity constraint in the system I see as three parts: First, is ability to assess risk and take risk, appropriately for risk adjusted returns. One of the things which has always bothered me is banks in general, and I am not saying any bank in particular, significant issues on mispricing, therefore, capacity to assess risk and take risk and therefore a mindset which is significantly a combination of deep sector knowledge, kind of ability to understand what the true risk of asset is and how do you price it. So, the first capacity constraint in the Indian banking system is ability to assess and price risk. The second and this is a bigger one in terms of real terms is capacity constraint coming out of capital, and something which I have discussed independently as well. If you look at the Indian banking sector capital, banking sector's capital base would be around Rs.6.5 lakh crores give or take, maybe Rs.7 lakh crores post-March numbers. So, even if you took Rs.7 lakh crores as the Indian entire banking capital, against that a loan book of about Rs.75 lakh crores. On a loan book of about Rs.75 lakh crores, disclosed NPAs that is GNPA plus restructured assets is more than 10%. What I think is not disclosed which maybe there on off-balance sheet or sitting on ARCs books as SRs that would be another 4-5%. Therefore, the banking system level total stress of about 15% which is in excess of about Rs.11 lakh crores if you take the number. Even if you take true loss which may be recognized over the next two or three years of 35-40%, we are still talking about a number which is Rs.3.5-4 lakh crores of capital requirement without loan growth with the banking system will need over the next three years. Therefore, on a Rs.6.5 lakh crores capital currently, if just replacement capital is Rs.3.5 lakh crores, that is a significant need which Indian banking will need over the next three years. Therefore, capacity one is risk assessment in taking, second is capacity in terms of capital, and third, is capacity to grow stable liability. When I use the word 'capacity, I am using the capacity point in the context of these three aspects and on that I do feel that if the real economy started growing faster, the financial sector will lag the real economy, and that is what I mean, Kunal.

Kunal Mehra: As we have invested in the bank over the years, you have always guided us to that one inflation in your strategy has allowed you to arguably stay ahead of the market and create the shareholder returns, upfront it was the diversification of way for capital markets, and give you arbitrages, third you talked about the granularization of your liability side, and you have been meeting all these targets, look at the next 12 to 18 months I am trying to noodle down to what is the one variable to focus on right now, possibly one or two, what would you guide us to look at? Obviously, it seems to have a growth theme but I fear that would be too simplistic way of looking at it, so I would love to get your thoughts on how we should be looking at it going up?

Uday Kotak: I think if I have to look at 18-24 months the two biggest opportunities will be organic loan growth for the system, therefore which are the banks, which have the capacity to manage risk, capital and take a loan growth of quality loan, Right now we are in muddy waters, how do you separate the mud from clean water? And that is going to be a very big challenge, but the banks who can do it, can actually grow significantly faster on loan growth than the industry, because you can then take significant share because an industry which is going to be under pressure because of history, therefore our view is drive the car, looking at the windshield. And I believe the sector is going to have a lot of headwinds out of rearview mirror and that I think is a tipping point as we see going into the future. And along with this, if there is such a huge pool of distressed loans out there which are currently either on bank's balance sheets or as loans or maybe moving from bank's balance sheets to security receipts or SRs on balance sheets of ARCs or restructured assets, will finally need resolution. And if the industry number is as I said Rs.10 lakh crores of this size, I am saying what stops the bank from picking and choosing Rs.5,000-10,000 crores loans and making money on that. I think that is going to be a significant opportunity in the next 12-24 months which is quality loans as capacity of the financial sector is behind the real economy and stress loan which is more opportunistic but an opportunity which we think is over the next 3-5 years, and ability to look at it not just from debt, but also restructuring equity and structured finance opportunities which will come in in the Indian banking sector and the financial sector for the next 3 years.

Kunal Mehra: Just a clarification on that last point I am assuming the catalyst will have to be some incremental reform or policy pronouncement purely because right now all the PSU banks happy to take 5/95 because of the way it allows them for instant revenue recognition with postponement of loss recognition?

Uday Kotak: Finally, ARCs have to mark these assets at the end of one year at fair value, and you have a more focus regulator and a system pressure which will over time ensure that there is fair evaluation of SRs. Having said that you have basically postponed the resolution opportunity by 9-12 months, that is all, but opportunity still sits.

Rahul: This is Rahul from Goldman Sachs. Basically I have got three questions. First, in terms of NIMs, will you be able to give me some color as to what really broken into this quarter versus last quarter, because in my calculated numbers, I am getting NIM expansion of about 10 basis points QoQ. So, just trying to figure out what is the reason?

Uday Kotak: Two or three things are beginning to happen. #1, for our side we have got reasonable FCNR(b) deposits in the month of October-November. Second is we are seeing pretty significant traction in our SA as also our Sweep deposits growth. So, our cost of funds actually has improved by about 11 basis points in this quarter and in addition to that obviously, on the investment side by us marking to market our investment rather than carrying at low value on HTM basis, we will start getting higher yield on our investment portfolio as well. If I am holding a 7.5% security which if I have moved into HTM, I would have still earned only 7.5%, but by doing the mark-to-market pain on myself, I am now holding it at 9%. So my carry yield boost to 9%.

Jaimin Bhatt: One of the other points, Rahul, is proportion of Corporate book this quarter would be lower than what it was in the previous quarter; corporate book is typically lower spread than the other book.

Rahul: In terms of guidance, you are seeing NIM is sustainable going forward?

Uday Kotak: We are seeing a continuing improvement in our CASA and Sweep combined. We have also mentioned that stability of the liability side is getting better. Our cost of funds we hope therefore as we depend less and less on wholesale, our cost of funds continues to improve. On the other hand, yes, as we start growing our Loan book faster, we will be ready to do business, if on a risk adjusted basis, we feel lower yields are justifiable, but at least we do not see any visibility of a significant drop in NIM and I continue to make the same statement I have been making for the last few years…we see sustainability of NIM above 4.5% for some while; above 4.5% whether it is in the range of 4.6% to 4.9%, I cannot predict, but sustainable NIMs above 4.5% is something we are comfortable in terms of how we see our loan book.

Rahul: Second question was on liability profile, while we have over the last couple of quarters brought down your credit-deposit ratio but historically given the fact that we always carried some of the portfolio like CD and other Agriculture portfolio which was eligible for refinance. Now that we have started building that portfolio again, would you look to utilize that window again of refinancing and take the CD ratio up to whatever 92-93% or you would maintain CD ratio at 90% odd going forward?

Uday Kotak: Even now if you see, we are carrying Rs.5,000 crores of Wholesale Deposits, if we find instead of Wholesale Deposits, Refinance is cheaper, we will take it.

Dipak Gupta: But there is no relationship as such between the two. CD is a very different market, what we are talking of really is the refinance market.

Uday Kotak: But having said that over the last few years we believe that the heart of our strategy has to be stable and low cost liability, and we have got conviction, that something which we will continue to build through thick and thin, and therefore, the Current Account is linked to the economy, and obviously, we will work harder to improve the Current Account but Savings we think is more predictable, we believe a sustainable savings at 5.5%, we are not paying higher rates, so it is 5.5% Savings Deposit cost, (+35%) growth is what we are aiming at, and on a Term Deposits below Rs.1 crores, we have done 35% last year, we are going with a guidance of (+30%).

Rahul: Last data point in your Life Insurance business have you disclosed your NBAP margins?

Uday Kotak: No, we have not.

Moderator: Thank you. The next question is from the line of Sampath Kumar from IIFL. Please go ahead.

Sampath Kumar: When you are talking about taking market share growing faster, what would be the growth rates for different segments that you are present in? And second thing is are you implying from your statements that there will be improvement in pricing based on risk going forward for the sector as a whole?

Uday Kotak: Answer on pricing is something which is risk adjusted. So, if we feel the risks are lower, we will price appropriately. If we believe the risks are higher, we will price appropriately. So, giving you exact sense on how pricing goes, we think it is linked to the risk we take, and we also believe that reasonable ability to hold pricing is coming from the point I made earlier, which is capacity of the system. Therefore, we think there is some ability for us to ensure fair margins for the risk we are taking. In terms of segments, there is a variety of segments, and to a certain extent, there is a lot of internal thinking and planning going on about that, but on a broad contour which I can share with you, we think SME and mid-market corporate space and when i say SME, it also means part of it is in the Consumer Bank, part of it is in Commercial Bank, part of it is in the Corporate Bank, so across the chain, whole, small medium and mid-market space we think is a huge opportunity especially as a lot of these customers currently sit with the state owned banks.

Moderator: Thank you. The next question is from the line of Saikiran P from Espirito Santo. Please go ahead.

Saikiran P: Just a quick question. Going into the next cycle on the CV side, do you see any reason to change your strategy from earlier cycle both in terms of customer mix and product mix?

Narayan S.A.: When you say, customer mix and product mix, what do you mean by that?

Saikiran P: Maybe large fleet operators versus single truck operators or maybe heavy vehicles to the medium vehicles or any kind of, what are your thoughts over there?

Narayan S.A.: Let me explain like this; first, we have to split the entire market geographically because there may be certain geography where we may be able to do all three well, because for example, in the LCV segment, it is more related to that particular town and city how it is doing well or not. And some of the places where Agri dependence is good and LCV use for that purpose also, so you may start doing more of LCVs there because we find the repayment experience is good. As far as the large operator is concerned, obviously, yes, that is one which all of us would like to focus on because the comfort there is much higher, and I personally believe that some of the good large operators are also being careful in how they grew their business and how they do their overall asset book. But, obviously, the margins in that space is going to be lower than normal, because of the competition, and as Uday said, the quality of the risk there is much lower than what is in the lower end segment of the market. As far as the lowest end of the segment which is the second hand vehicles, etc., is concerned, we are not large players yet there, but yes, that is a segment which we will consider later as we see the cycle progressing.

Saikiran P: Just a couple of more question. There is a very high growth on the fee income and even when I look at it on a year-on-year basis or a quarter-on-quarter basis, any one-offs over here or what has driven such high growth?

Jaimin Bhatt: The regular fee income growth both from the Retail segment and Wholesale segment, it is not very high; it is pretty reasonable actually.

Uday Kotak: In fact the biggest crib within, when we look at our own business compared to the banks on the street, is we ask ourselves why is it that our fee income is so much more low or sort of low compared to the street, and if you look at our overall fee income,..

Jaimin Bhatt: If you look at other income to overall income, it would be at 27%, which actually we need to do some catching up there.

Uday Kotak: In the other income to total income, we are the lowest among the peer banks, and including the larger banks.

Saikiran P: So going into maybe next couple of years, what are the kind of opportunities you would find to include this?

Uday Kotak: Clearly, we benchmark against the industry, and we feel there is opportunity to grow the client fees on variety of products, including FX and trade, and also we are quite amazed that the debt capital market fees which the other banking peers are generating and on a relative basis our fees are pretty small. So, if our benchmark shows that our other income to total income is lowest amongst the peer 5 or 6 private sector banks, and if at all we need to get that number higher.

Moderator: Thank you. The next question is from the line of Nikhil Poddar from ICICI Securities. Please go ahead.

Nikhil Poddar: My question is on the Agri Loan side; the growth has been pretty strong and it now forms 15% of the book. So, could you please share some color on that? I understand Tractor is one of the major product out there of all the other. And also, geography wise, is it concentrated into any particular geography?

Narayan S.A.: As you rightly said, Tractor constitutes a good part of that, other than that, it is not concentrated in a few geographies per se, we are spread across the country and we will have across various segments for example, we have a reasonable presence in the cotton ginning market or we have a reasonable presence in the North side, we have presence in a lot of mandis, so spread across.

Nikhil Poddar: What is the proportion of Tractor as a percent of total Agri?

Narayan: One-third-33%.

Uday Kotak: There is something we have told a few years ago to all the analysts community and investors for us Agri is not a necessity any longer, it is an opportunity which we have continued to grow.

Nikhil Poddar: What is the total outstanding of NR Deposits?

Uday Kotak: I think we will have to check it and come back to you offline I will have Jaimin and Devang, give it to you.

Moderator: Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: In the auto loan book are we seeing significant pricing pressure, because the growth has been almost flat while some of the other peer banks are reporting very high growth, are we saying like there is some market share focus of course in some of the peers and you are kind of moving out of that?

Uday Kotak: First, let me tell you one thing. We have gained share, we have not lost share in Car Loans, but when you have a de-growth in the market, you are fighting a headwind which is absolutely lower sales in the marketplace, and therefore, if you also have to look at the base no, therefore, we have grown our share but the growth is muted, because the Car industry is having negative growth.

Amit Premchandani: But, if you look at especially the larger peers, they are reporting (+20%) growth in the same market. So, that is why the question was that has competition increased in some of the larger peers?

Uday Kotak: Competition can increase, but we are gaining share no, we are not losing share.

Moderator: Thank you. The next question is from the line of Pranav Tendulkar from Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: So, this business of sovereign wealth funds giving you $400 million to manage So, how is the arrangement – is it fee income based or is it risk sharing also in the profit that you generate out of those management assets? And how is the scalability there? What business exactly is that – will it be a debt financing to real estate projects which have problem? That is one. And second is when you say that you take stressed assets in the banking sector loan book and it is a good opportunity to take that business. How that business is different from ARC or why would somebody selling to Kotak and ARC?

C. Jayaram: The sovereign wealth fund have given us managed account in the context of investing into residential real estate in India, and typically, the way these managed accounts work are, they are at slightly lower levels than the normal 2 and 20 sort of thing, but these are typically that is the structure, but obviously it is not the 2 and 20 which you would have in blindfold of funds, but it will be slightly lower than that, but it is working off a hurdle and with a carry involved in that as well. The belief is that if we do a good job on the first fund with a couple of these large sovereigns they are quite happy to sort of increase the exposure over longer periods of time.

Pranav Tendulkar: It will be debt financing to real estate project?

C. Jayaram: No, it is a clear combination of different types of exposures in the two differential real estate, not necessarily only debt.

Dipak Gupta: To answer the first one on stress asset, I think the opportunity which Uday mentioned about was first of all, on the stock side, that is the stock which we really carry at this point of time. Going forward, when you look at the comparison between ARCs and what the bank offers really the types of businesses are sort of different, yes, what we really would go after is a lot of debt aggregation, let us say we have two or three assets already from two to three different banks, which we would have acquired over a period of time, we try and aggregate those assets, try and get them from other institution and other banks would also be in trouble, plus a lot of opportunities also, continuous space is arising out of retail stressed assets across various banks and financial institutions. Some of these are very different really, and the big difference of course between an ARC and a bank there is as a bank you can offer cash down. So it is straightaway in the system, particularly for an institution which has already accounted for some of these, or provided for some of these losses, it is pretty easy to sell it at their value without too much of a loss, plus the new guidelines which now are out from RBI, allow them to, if they are taking a write-down, allow them to write-off that write-down over a 2-year period now. So all of those are opportunities.

Uday Kotak: I must also highlight that we as a bank own a sponsor stake of 49% in Phoenix ARC which is also active in the distressed business and it of course right now shows in our associates category, but we see that business in the ARC space also showing significant growth into 2014-15.

Pranav Tendulkar: So, basically whatever dispensation RBI allows for ARC companies will also be applicable to the asset that you buy from bank?

Uday Kotak: Correct.

Jaimin Bhatt: One data point which Nikhil had asked earlier the total NR Deposits between NRO, NRE, FCNR put together was Rs. 7,500 crores

Moderator: The next question is from the line of Nilanjan Karfa from Jefferies. Please go ahead.

Nilanjan Karfa: A couple of questions. Number one, very interesting to note on your capacity constraint, and I am particularly interested in finding out which segments are you seeing there is a substantial pricing gap today in terms of the assessment of vis-à-vis the actual lending rates?

Uday Kotak: Yes, we obviously need to grow our Loan book faster if we are comfortable with the risk, but keep in mind that compared to the industry, we have come in with obviously historically higher cost of funds, but we will still manage to produce decent NIMs. So, we obviously are very focused on where we can make money and that is what we will try our best for you and your clients.

Nilanjan Karfa: Second question on this distressed loan. If you can sort of talk about what are the specific sort of clients, the client profile or the segment or a sector profile that is currently available in the market as well as which is sitting in your book? And if you can add how the performance has been, for example, what the IRR has been for you for the loans that you have currently on the book?

Dipak Gupta: One would not like to share profile in the sector, but you see these are all across, what all cases go to CDR, what sectors go to CDRs, what sectors are NPAs. So this is a reasonably similar type of profile except that we have tried to go a lot more for assets which are reasonably well collateralized and we have got it over a period of time at reasonably good prices really, but there is no sector-specific consideration in your piece.

Uday Kotak: Actually, on a more general point, we are on the other side of the trade, the industry is on the sell side, we are on the buy side.

Nilanjan Karfa: The question is trying to figure out, would you have a particular ticket size in mind – would you be open to taking let us say an asset which is Rs.100 crores rather than Rs.500 crores?

Dipak Gupta: We generally are in the SME space at least size wise, big market SME space really, plus of course Retail.

Uday Kotak: Retail we are quite active.

Dipak Gupta: Pretty large and active in Retail. We are not in the Large Corporate segment yet.

Nilanjan Karfa: Given that what your current take on the GDP or general environment is, would you have the risk appetite currently to go into that market?

Uday Kotak: On the large space, we would probably be playing as we go through this year in special situations alternate asset situation. So we will try and have ability to play the whole distressed asset game across three important vehicles; first, of course is the bank itself; second is our ARC, which as I mentioned to you, we own 49%, which of course can also issue SR, so it is quite an active ARC under the name Phoenix ARC; the third is on the alternate asset space, it is something which we are looking at in terms of special situations and maybe even larger ticket, because there is significant appetite for institutional investors to be looking at doing things with us in the alternate asset special situations space.

Nilanjan Karfa: Would you assess the situation, given that you just talked about we are in muddy waters, do you think special situation is the area that will grow first rather than direct lending?

Uday Kotak: Why should I predict? Wherever I feel the opportunity I will take it.

Dipak Gupta: It will be on both sides, as the GDP grows, the opportunity will be on fresh lending, and there will be a lot more willingness to sell the special stress assets by banks and financial institutions.

Nilanjan Karfa: If you just can talk about the fees this quarter, it looks a little soft, what exactly happened and probably guidance on that?

Uday Kotak: Yes, I think on fees, it is absolutely the right question, we have got to get a lot better on that side. If there is one internal mandate we have for all of us in management is, what is it that we are missing, and we may not necessarily agree with all the Fee-pools which may be available to banks in general, but there are Fee-pools out there, which historically we have not focused enough on, and if there is one internal mandate for 2014-15, is to get significantly better on those pools compared to where we are and actually that has been something which we are very focused on and aware of that we can do a lot better.

Moderator: Thank you. The next question is from the line of Jatin Mamtani from Barclays. Please go ahead.

Jatin Mamtani: I have a question on the SA Deposit base. Just wanted to understand is there any portion of the SA Deposit, which is above 6% and what percent would it be of the total SA base?

Uday Kotak: We do not pay anything more than 6% to anybody in SA, whether it is Rs.1 lakh or Rs.100 crores, no one gets paid more than 6%, which is why our average cost is 5.5%.

Moderator: Thank you. The next question is from the line of Alpesh Mehta from Motiwal Oswal Securities. Please go ahead.

Alpesh Mehta: Just wanted to know what is the portion of LAP in our overall loan book right now?

Jaimin Bhatt: Alpesh, if you look at my Home Loan, Mortgage is about Rs.12,000 odd crores. If I split that it will be more Home Loans than LAP, it would be roughly a mix of 60:40, about 5,000 is lap.

Alpesh Mehta: How do you see the scenario in that particular product the way the competition is shaping up right now? And how are the risk adjusted margins in that segment?

Shanti Ekambaram: I think so far the risk adjusted margins in this business has been reasonably good, yes, competition has stepped up. I think we have been able to find our space and keep to the margins that we have set for ourselves.

Uday Kotak: In LAP again you can play it smart, you can combine LAP with working capital, overdrafts, CPs, and really capture the client flows, because some of the competition in LAP is coming from NBFCs, and I think as a bank we have ways to counter that.

Alpesh Mehta: As far as the stress assets are concerned post-provision, the outstanding number is roughly Rs.200 crores, right?

Uday Kotak: Just over Rs.200 crores.

Alpesh Mehta: Whatever I remember, the gross number that we were carrying earlier were roughly Rs.500 crores.

Uday Kotak: But we have written down, no.

Alpesh Mehta: So, we would have provided with Rs.300 crores on that over there.

Uday Kotak: And again as I mentioned, we have given you our sense of what we think is recoverable in less than three years.

Moderator: Thank you. The next question is from the line of Prasanth Kumar of Credit Suisse. Please go ahead.

Prasanth Kumar: Just on OPEX side, as you continue to open branches, your gross income has actually moved up in past couple of quarters. And in current environment like with the growth has actually slowed down, would you kind of defer your expansion plan move towards 2016 or continue the current phase of around 170-180 odd branches?

Uday Kotak: We have actually guided that, we are just over 600 branches, we will be 750 plus by March 2015, so we will continue with a reasonably steady trot towards the 1000 and therefore no significant backending on that. We will go with that focus continuing, at the same time, we will strive towards cost-to-income ratio sub-50% in next year.

Prasanth Kumar: Would it be possible to share the number of employees for the bank standalone?

Uday Kotak: Bank standalone is 16,000, consolidated over 26,000.

Prasanth Kumar: One more data point, would it be possible to share the number of Term Deposits less than Rs.1 crore which was mentioned grew more than 30%?

Jaimin Bhatt: About 15,000 cr .

Moderator: Thank you. The next question is from the line of Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal: Do you think your equity capital is optimally utilized at this point of time? And if not, by what time you think you would be able to utilize it fully, and in what form, organically or inorganically?

Uday Kotak: I think we are at a Tier-I, I am not looking at capad, I am looking at core equity of about 18%, I would be very uncomfortable doing business with core equity in single digit. My view about comfortable levels of core equity would be in early double-digits, now whether that is 11% or 12%, we can debate, but that is where I think I would be comfortable in terms of core equity, in which case obviously we have significantly surplus equity and we obviously have great ability to sweat, which is back to the point I mentioned in the earlier call, capacity ahead of the opportunity. So we have got significant capacity created in terms of capital well ahead the opportunity, and whether it is a regular loan growth or loan growth in special situations in distressed assets, we think we have the ability to grow in both these spaces over the next one, two, three years, we do not foresee need for capital for quite some time, and our view is that if we look at equity at around early double-digits, on business we will look at including of course flows and fee incomes and all other streams of income we believe (+20%) ROE is possible on equity and we are aware that the current surplus equity is reducing our ROE, but we think that is the price for capacity building, and this capacity we think is now in the next few years is going to be of great use.

Pankaj Agarwal: But sir, do you not think you will have to grow your balance sheet more than 25%, 30% to utilize this capital and given that you have been growing lesser than the…?

Uday Kotak: Our firm approach to this is the size of the external opportunity and risks, if the external opportunity is there, we will grow it, but we have to be careful that just because we have additional capital, we do not waste it.

Moderator: Ladies and gentlemen, due to time constraints that was the last question. I would now like to hand over the floor back to Mr. Uday Kotak for his closing remarks. Over to you, Sir.

Uday Kotak: Thank you, friends. As we look at the year ahead, obviously, we are all waiting for the major event on 16th of May in terms of the political outcomes, and I look at a reasonably positively in terms of the future. We obviously see that if we get a decent stable outcome that is a significant opportunity to leverage capacity with the ability to manage risks if there is any downside. So we are positioned for whichever way the event risk, or event opportunity plays out. At the same time, we are also focused on the fact that if there is an economic growth trend change, which changes the trend of the trajectory of our economy over the next five years, we capture the trend changes well and do significantly to capture the present value of that trend change in terms of how we position our business. We are therefore reasonably excited about the road ahead and look forward to interactions with you from time-to-time. Thank you very much ladies and gentlemen.

Moderator: Thank you all. On behalf of Kotak Mahindra Bank, that concludes this conference. Thank you for joining us. You may now disconnect your lines.