



“Kotak Mahindra Bank Limited’s Q2 FY-14 Earnings Conference Call”

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MANAGEMENT:

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Moderator: Ladies and gentlemen, good day and welcome to the Kotak Mahindra Bank's Q2 FY-14 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call you may signal for an operator by pressing '*' and then '0' on your touchtone telephone. Please note this conference is being recorded. I now hand the conference over to Mr. Uday Kotak – M.D. and Executive Vice Chairman, Kotak Mahindra Bank. Thank you. And over to your Sir.

Uday Kotak: Hi, good evening friends, and welcome to an update on Kotak Mahindra Bank at the end of half year, September 30, 2013. As a part of today's update, what I would like to do is first start today's update by focusing on the balance sheet of the bank and the group and give you an update on the key items of the balance sheet before I hand over to my colleague Jaimin Bhatt who will thereafter take you through the specific updates on the earnings for the quarter.

I genuinely believe that for leverage financial institutions the balance sheet is a very significant and important financial statement and in many ways I think the earnings of most financial institutions come as a derivative of the status of the balance sheet. I would like to focus on four important items on the balance sheet, which is Capital, Investments, Loans, and Deposits as the four key items on the assets and the liabilities side of the balance sheet.

Starting with 'Capital,' on that, Kotak Mahindra Bank as of end of September including the profits for the half year is at core equity, unadulterated at 18.1% both at the bank and the consolidated level, and this is not capital adequacy, this is pure core equity. We believe that the bank is extremely well positioned particularly with the advent of Basel III and has significant capacity to both take from a point of view of cushion as well as for growing the balance sheet on any appropriate risk metrics. So, that is first on capital.

Second, and this is a very important aspect particularly this quarter which is 'Investments.' I would like to first make three important points with reference to our bank on 'Investments.' No. 1, we have made no transfers to HTM during the quarter July-September. No 2, our total HTM book is 11% against the statutory SLR holding of 23%, and 24.5% permitted by the RBI. Therefore, our overall book in the HTM is probably amongst the lowest in the Banking industry. No 3, the duration of our Investment book is about 2.1 years.

Now, I would like to actually go into the black box of Bank's Investment portfolio in a little more detail on this call. If you look at our balance sheet as of 30th September, our total investments are about 22,000 crores. This includes both SLR, non SLR, and money market instruments in totality, and for the moment all the investments into equities of the subsidiaries and others, I am keeping out from these calculations. The breakup of 22,000 crores which sits on our balance sheet as investments, 8,000 crores approximately is in hold-to-maturity category. About 5,000 crores is money market instruments primarily treasury bills, and 9,500 crores are what we call as mark-to-market category which includes both SLR and non-SLR

instruments. So, roughly the breakup of 22,000 crores is 8,000 crores government securities into HTM, about 5,000 crores of money market securities, which as per RBI are amortized over the shorter period during the life at carrying cost. And third is what is mark-to-market securities, which is about 9,500 crores. For these 9,500 crores keeping in mind our duration overall is around 2.1 years and this may be in the range of around 2.3 to 2.4 years. On this 9,500 crores, the total mark-to-market on these 9,500 crores is securities as of 30th September was 264 crores. Out of these 264 crores, we have decided to amortize it in three parts. Therefore, we have taken a hit into the P&L for the September quarter of 88 crores. This leaves as of 30th September the unamortized amount at 176 crores which is proposed to be amortized over the next six months.

I am happy to inform you that since the overall duration of our investment book is at the lower end of around 2 years, thanks to the RBI policy dropping the MSF rate even further in October to 9%, there has been a significant gain in the investment book including on the MTM portion and this unamortized portion of 176 crores as of 30th September is down as of today to amount of 90 crores which means there is a gain of approximately, mark-to-market gain in the last 22 days on this portfolio of about 86-87 crores. Therefore, over the next two quarters at the valuation as of today the unamortized portion over the next two quarters is about 90 crores pretax. We believe that in many ways this gives us the ability to continue with our core philosophy of managing a clean, transparent and fully available for scrutiny investment book obviously for ourselves as management, but for analysts and investors on the market. Therefore, to sum up in totality, on investments we run 2.1 year duration, our HTM is 11%, which is roughly about 50% of the total SLR book. Our mark-to-market unamortized as of 30th September 176 crores, value today, and the unamortized portion on a pretax basis now down to about 90 crores. Duration as I mentioned earlier about 2.1 years of the total investment book. So this gives you a clear picture on the exact status and the nature of our investment book.

Moving to the third item on the balance sheet is 'Loans – Here, I would just like to step back and give a little bit of perspective on the macro picture. We believe that India is right now like two Indias -- there is a good India and there is a challenging India. We are focused on building our loan book in the good India and being cautious on the challenging India. In that context, something which we have discussed and shared with you in our earlier calls, we have been bearish on two segments of our business, which is Construction Equipment and Commercial Vehicles, and in these two segments we have had a year-on-year degrowth, that is negative growth in the book of 17%. If we took out these two, our Loan growth which overall in the average is 11% comes to about 18% loan growth excluding CE and CV. More importantly, the segments which we really like, which are Consumer and Agri, we have grown at an average rate of about 24% year-on-year in the two segments which we really like. Therefore, our focus on the balance sheet is we will lend where we see opportunities and we are ready to grow at a faster rate and where we are concerned and we have conviction that we should cut our positions, we are ready to take a call of even having negative growth. Therefore, overall picture, Agri and Consumer grown at 24%, the total book excluding CV and CE grown at 18%, CE and CV grown at (-17%) and therefore bringing down the average to about 11%

year-on-year. So this is the picture on the Loan book. We continue to be extremely cautious in addition to Construction Equipment and Commercial Vehicles, in three sectors where we have relatively low exposures and almost minimal exposures, and in some cases even zero, and the three sectors we are very cautious about are Leveraged Infrastructure and Project Finance business, Airlines and Diamonds. These are the sectors we are fortunate that on a relatively basis, we have been able to keep ourselves away from.

This brings me to the fourth point, and I think that is an extremely important point. We believe that this is a very big opportunity for us to grow a sustainable institution and that is going to be building low cost and sustainable deposit franchise which is a big focus for us. As you will see in this particular quarter we have added 57 branches in this one quarter and we are upping our target of branch network which we will reach by March to 600 from the current 502 branches as of September. We are also taking a position that in less than three years, we will double our branch network from 500 to 1000 and this is with a view to building a stronger and a stable, and a sustainable deposit franchise, we are also focused on customer segmentation with a high focus on mass affluent and above as well as non-urban customers, and the digital customers. We are also seeing improvement in our credit-deposit ratio at the bank level, is in the range of around 95%. We propose to bring it down steadily through a growth on the deposit franchise within the next 12 months into the 80%, and we actually feel that with a strong capital, a sound asset book, both on Loans and Investments, and a focus on building a sustainable and a stable low cost deposit franchise, we are extremely well positioned to take advantage of a tough macro to building a differentiated micro.

With that I will now hand over to my colleague, Jaimin Bhatt, to take you through the earnings aspect of the quarterly and half yearly update. Over to you, Jaimin.

Jaimin Bhatt:

Sure, thank you. Let me take you through the earnings update which we have mailed earlier today. The consolidated numbers, we end this quarter with a consolidated profit post-tax of 583 crores, 16% up over the same period last year. At the consolidated level ROA of 2% annualized, and NIM at the consol level at 4.9%. At that level the Loans for the year grew at 11%, we ended the year with 68,000 crores. As Uday mentioned, if we take out the Commercial Vehicle, Construction Equipment from the consolidated numbers, the Loan growth is close to 16%. Asset book now at 1,14,000 crores and at the consol level the net NPAs at 0.8%. At the bank's standalone level we saw the quarter profit of 353 crores, which is 26% higher than the same period last year. Loan growth in the bank again overall 11% without the CV/CE growth clocking at 18% largely coming from Consumer and the Agri segments. Capital adequacy at BASEL III number including the current half year profits, overall 19.4% with Tier-I itself at 18.1%. CASA has seen 25% growth year-on-year, and CASA percentage stands at 29, this is not including sweep deposits which would be another 7.5% of our overall number. Restructured advances considered standard still remaining at 0.09% of our advances with the aggregate number at 45 crores.

If you look at the P&L, the Net Interest Income has grown year-on-year 22% and for the quarter giving a number of 924 crores with total income at 21% growth. Expenses have grown 17% year-on-year with operating profit at 26%. For this quarter we have taken an overall provision of 72 crores which takes your pretax profit to 534 crores, post tax, 353 crores for this quarter. The other income comprising of Fees and Services which gave 212 crores for this quarter, Treasury giving 70 crores, the ARD division which had a relatively quarter giving 13 crores. The MTM accounting is what Uday has explained, in this quarter we have taken overall hit of 88 crores for this period.

As regards segmental at the bank level, the Wholesale Bank giving 307 crores profit for the quarter, Retail 180 crores and Treasury 47 crores. And if one looks at the overall split of Retail and Wholesale Advances as per the classification required by RBI which is 5 crores over and under, the advances number is 24,000 crores of Retail and about 25,000 crores of Corporate Book. Advances as we discussed, overall Consumer Bank growing by about 26%, large growth coming in terms of larger books of mortgages growing 17%, Small Businesses and Personal Loans lower based, growing at 59% whereas the Agri division grew 23%. The CV/CE (-17%) growth bringing the overall number to 11%.

As regards balance sheet of the bank, overall Deposits growth 16% year-on-year with CASA growing at 25%, Savings Account itself has shown a 42% on a growth year-on-year basis with overall balance sheet now at 82,000 crores as of September. During this period the Investment book has been brought down, we ended this period with investment book of 22,500 crores, which was down by over 5,000 crores from the position just a quarter ago. At the bank levels, NPAs gross number at 1.97 with a net number of 0.96. Restructured as I mentioned that considered standard at 45 crores, and we continue the fact that we do not have any CDR participation, no transfers of stressed asset to ARCs and no conversion of balance sheet items.

During this quarter we also crossed the 500 number as regards bank branches and 1,000 ATMs. As Uday mentioned we expect to end the current financial year with over 600 branches, and plan to double the number of branches within three years. We have added 1.7 lakh customer accounts during this quarter. And if I look at my CASA plus Term Deposits which are less than 5 crores, they constitute 63% now of the overall deposit base. The Consumer Banking assets, a large amount being contributed by Mortgage Loans, this segment continues to show profitable growth and pretty low delinquencies. So, mortgages, we are growing in select territories, and the focus of the Consumer Bank asset side continuing to be on the self-employed non-professional category and cross-selling to the bank branch customers. The Commercial Banking assets while CE and CVs has had a negative growth, the Agri division showing a growth of 23% on year-on-year, and the focus on lending in the Bharat area continues. We are also rolling out rural branches in these segments. The Wholesale Bank for this quarter ended the book with an overall number of just below 15,000 crores in the bank standalone, which focus being largely medium term finance and working capital. We are seeing a lot of traction in the Transaction Banking services, and we continue to deepen franchise across customer segments where we operate in. At the consolidated level, if you look

at entities and their contribution to the quarter profits, apart from the bank, Kotak Prime contributed 125 crores, with Kotak Securities clocking a post-tax number of 40 crores and Insurance entity is 44 crores. We have also seen the Mutual Fund contribute 17 crores for this quarter.

Overall, if I look at the net worth of the different entities in the group, all the entities are pretty well capitalized and while the bank has a net worth of 11,500 crores and overall net worth of 17,800, the NBFC Prime has a net worth of 2,500 crores with the securities company at 2,000 crores. Total assets as I mentioned was 114,000 crores. If you look at the overall Advances at the bank level, 68,000 crores, 17,000 and odd coming from the Corporate book, about 22,000 from the Commercial book and 28,000 from the Consumer book.

As regards Advances at the overall consolidated levels, apart from what we saw in the bank, the Auto Loans have grown by 11% on a year-on-year basis which is done in Kotak Prime, and the other segments which has shown actually a negative growth for the year is the Capital Markets Lending segment which is under the others segment there.

Kotak Prime for this quarter showing a profit after tax of 125 crores with net interest income at 220 crores. Car Finance continues to be about 77-78% of the overall Advances of Kotak Prime. Prime having a net NPA number at 51 crores with a percentage of 0.3. Capital adequacy is pretty healthy in Kotak Prime at 16.4%.

The Insurance entity continuing to have a healthy solvency ratio overall. Agency Business has been growing 48% for the first half, and Kotak Bank continuing to be at about 25% contributor to the new business premium which we are getting there. The Securities Company showing us marginal rise in the average daily volumes, though of course the volumes coming largely from the Derivative segment. Market share overall at 2.4% with income for the quarter at 152 crores and post tax profit of 40 crores.

The Investment Bank has seen participation in a number of issuances. We were involved with the rights issues of Godrej Properties and Camlin as well as the offer-for-sale of Bajaj Corp., Hindustan Copper and Oberoi, as well, we have also had two announced deals which are still continuing, which is the divestment by Vijai Electricals of a part of their business to Toshiba and the buy back by Great Eastern.

Overall, assets under management of the group at about 60,000 crores. This year has seen a rise in the overall number in the Domestic Mutual Funds particular in the Debt segment. In fact if one looks at the year-on-year assets under management in the Domestic Mutual Fund, while the industry has grown by 8%, Kotak Mutual Fund has shown average assets under management growth in this period by 14%. As I said, largely coming in from the Debt segment there but profit for this quarter in the Mutual Funds business at Rs.17 crores. The Alternate Asset which is done in Kotak Investment Advisors comprising realty, private equity and the infra fund, overall assets under management now at about 6,000 crores, and this entity showed

a profit of 4 crores for this quarter. So, that is broadly where we ended this quarter with. We will be open to take any questions.

Moderator: Thank you very much Sir. Participants, we will begin the question-and-answer session. We have our first question from the line of Mr. Jaiprakash Toshniwal from India First Life Insurance. Please go ahead.

Jaiprakash Toshniwal: You touched upon the Commercial Vehicle Loan book degrowth, can you just give more light of how you feel at this point of time and what is the portfolio going forward?

Uday Kotak : Let me first specifically talk about the portfolio going forward. I think both in Commercial Vehicles and Construction Equipment, because we took a conscious decision about 18 months ago to slow down, I think on our existing portfolio we have taken most of the pain, there may be some residual pain, but we think we are now coming to a level where the pain which had to be taken in most of the accounts have been taken, and from here we do not see any increase in stress on our existing portfolio which we continue to carry because we think that is a residual good solid portfolio. In terms of Lending, we are continuing to lend for existing healthy customers in these segments, which we are comfortable with, but it is not that we have shut shop, but we are doing it primarily for customers known to us, and where we see comfort in terms of their existing leverage, the business segments which they are serving. The bulk of the pain in CV and CE which you are seeing is coming from Commercial Vehicle operators who are serving Mining segments and Infrastructure Project segments. So, wherever these truck operators are dependent on these two segments we have seen significant slowdown in their load carry. I think we are probably close to a bottom, but early days yet to say whether the turnaround is happening. Therefore, we would watch and take a call when we feel that we really see that there is a firm bottom behind us. But at this stage we are probably close to a bottom, but not out of the woods with respect to these two sectors yet. Obviously, we do believe that if good agricultural crop and significant political spending in the next six months may lead to some revival of the overall economy. So, that is far as these two sectors are concerned, and I hope it answers your question.

Jaiprakash Toshniwal: Second question is on the branch expansion. As you said, we have 500-600 branches and will go for 1,000 branches, how many cities we cover at this point of time and how would we cover when we cover 1,000 branches?

KVS Manian: We cover close to about 190 cities today, including all the small towns that we cover. But, more pertinent is among the top 100 deposit centers as defined by RBI, we cover close to about 93 of them. Going forward, obviously half of these branches will come up at smaller locations. So if we add another 500 from here, 250 new centers will get added obviously because each of them will be in a small location, but rest of the 250 probably will be more concentrated in the top 20 cities rather than the rest of the 100.

- Moderator:** Thank you very much. Our next question is from the line of Mr. Rajiv Verma from Bank of America, please go ahead.
- Rajiv Verma:** Actually I just wanted some clarification I know you have on your loan book from the call the others which has grown like 75% obviously coming off a lower base, so I want to have an idea what is your sense on that? And secondly, I know you do not have exposure to the whole Infra space, but just wanting your perspective on how do you see things moving forward in that space especially in case you are looking at any exposure there?
- Jaimin Bhatt:** I think first one, on that 75% of course comes from a very low base, but this will include a mix of various things, it includes for example my stressed asset, acquired asset there, it includes loans against shares done at Retail levels, it includes loans against fixed deposits or small overdraft accounts done at the bank branches or what not. A variety of things, which are there, some of which started from a very base last year and to that extent while percentages are looking big, overall for the year that number has grown by about 600 crores.
- Uday Kotak:** I think also two other segments which we have added, one is Gold Loan, we will see it from a zero base about a year ago, so we are doing a bit on the gold loans, therefore absolute percentages are high, and the second one is, which we have just started is Rural Housing.
- Rajiv Verma:** And one other part is the Credit Cards?
- Uday Kotak:** And credit cards.
- KVS Manian:** Which also has grown during this period.
- Uday Kotak:** And on your second question, which is infrastructure, which is much more a fundamental question. Frankly, we have just floated an Infrastructure Fund and collected some money, and in addition to that we are looking at opportunities even further on this space. Our view is the bigger opportunity is not lending Rs.100 for Rs.100 rupees loss. The opportunity is distress infrastructure, and therefore we think the first part of the fund will be not lending at par, but buying at reasonable discount to par as some of these loans will get available in the next 12-24 months, because the moment you buy it at below the original loan value, you start increasing your cushion and your yields. So, we see that opportunity coming in the next 12-18 months and therefore our way of thinking of playing this infrastructure game is on a risk adjusted return basis, solving some of these problematic infrastructure businesses by taking exposures through the distressed route maybe a better return and in exceptional situations if there is something more interesting, we are always open to looking at it, and even within infrastructure, whatever little we do, we really go with the top end companies with highest AAA quality, therefore we do not like to go deep down in terms of buying at face value. If we are buying at distress, it is a different matter.
- Rajiv Verma:** Actually just one follow up. In this quarter have you bought any stressed assets?

- Uday Kotak:** Very nominal, a little bit here or there, but nothing significant. The problem Rajiv is, for us to be able to buy stress assets, other banks have to write them down and sell them. They will not sell them till they have written them down.
- Moderator:** Thank you. Our next question is from the line of Mr. Anand Vasudevan from Franklin Templeton. Please go ahead.
- Anand Vasudevan:** A question on the promoter stake. Currently, promoter stake is 43.7%. What I would like to understand is, is there any timeline by which you need to show RBI some further progress in reducing the stake?
- Uday Kotak:** Let me put it this way, in terms of a hard timeline it is 2018, the rest is indicative and therefore not a hard commitment. Therefore, in terms of hard timeline between now and 2018, we have got to come down to 20%.
- Anand Vasudevan:** But in terms of managing that any sort of indications that you can give?
- Uday Kotak:** Anand, always happy to share ideas with you.
- Anand Vasudevan:** The other question is on your numbers. If I look at the quarterly accretion to the Savings Account balance, past three quarters you have been adding about Rs.7-8 billion per quarter, this quarter it is down to Rs.3.3 billion. I understand from the presentation that the customer acquisition pace seems to have continued. So just like to understand why the number is lower this quarter?
- Uday Kotak:** I will ask my colleague, Manian.
- K.V.S. Manian:** No particular reason itself. There are some large outflows that do happen during the September quarter due to Advance Tax and things like that. So, they do have some impact on the overall book, but we do not see it as a trend of having gone down. The acquisition trends remain same, the new value that we acquire, we track that separately, and that remains as strong as it was in the previous quarters.
- Uday Kotak:** Anand, just one other point, which I need to clarify which I have done in the earlier calls. When we say 6% for Wholesale savings accounts we do not give money market rates of 7 and 8, it is 6% and that is where it remains, it is a simple transaction savings account and below 1 lakh it is 5.5, full stop.
- K.V.S. Manian:** In fact, if you go back a few quarters and look at last year's September quarter end also, you would have noticed a dip in the quarter. I would tend to believe that this is largely because of Advance Tax flows that happen in the month of September.
- Anand Vasudevan:** And one more question, Uday, you mentioned this time as well as in the previous call that you have not had any conversion of balance sheet exposures to off balance sheet items. Just like to

get a sense of how prevalent is this practice in the market and also I would like to get an idea of how banks actually achieve this?

Uday Kotak:

There are all sorts of stories in the marketplace, some of them may be facts, some of them may be rumors, and it would be inappropriate for me to mention the rightness and the wrongness of practices of others, what I can comment on is what we do not do. It is something which we have been consistent with that what we think is acceptable and it is back to a very deep philosophy we have. And when we talk about balance sheet we talk about non-fund and fund, **thats what** our balance sheet as far as risk is concerned. And for us we genuinely believe that for leveraged institutions like bank, the balance sheet is a far more important factor than the P&L. That does not mean we should not be focused on producing the right P&L. But the balance sheet needs to be squeaky clean. And whatever is there needs to be known and disclosed.

Moderator:

Thank you. The next question is from the line of Anish Tawakley from Barclays. Please go ahead.

Anish Tawakley:

Firstly, you mentioned that you are still disbursing in the CV/CE book. I mean given the rate of shrinkage on a quarter-on-quarter basis, it does not look like the disbursements are very strong at all. So I guess my question is what is sort of the state of early stage delinquencies, check bounces, etc. in that?

Uday Kotak:

I can tell you one thing, in terms of incremental NPA we have bottomed up in both these, and quarter-on-quarter it is now not looking likely it is getting worse. And keep in mind that all these loans are EMI loans, so they run down every month. Therefore if you are disbursing at a slower pace, your EMI loans from the existing book are running down every month. Specifically, since this is a thing which is on your mind, let me tell you one thing, the area where we are finding in the CV/CE segment the most pressure is Andhra Pradesh, and we actually find the areas in and around Andhra having pretty significant stress, I am sure that is true for Infrastructure sector but it is also true for Construction Equipment and CV segment. Some of those places we have got very cautious in terms of where we put money, but in general we have not stopped lending but lending slowly in these segments.

Anish Tawakley:

One further question I had which is a different topic is that just trying to understand the P&L. There are three items that stand out as Insurance items; one is the profit on sale of investments in the Insurance business, the premium on insurance business, and the third is policyholders' reserve, surrender, etc., right? If I sum those up for this quarter and I sum up sequentially the previous quarter, the net seems to have declined quite sharply almost by Rs. 200 crores.

Uday Kotak:

No, that profit has not declined by so much.

Anish Tawakley:

Exactly. So the Insurance profit has not, but I am trying to figure out where there is another corresponding sort of saving on the Insurance side.

- Uday Kotak:** I will ask Gaurang to answer that question.
- Gaurang Shah:** I think the accounting of insurance is all done on the basis of policyholder accounting and they do not segregate between ULIP and non-ULIP. Now, in ULIP when the market does well, the ULIP Fund goes up, so on the one side you will see as a gain and the other side the reserve goes up. And the same way when the market comes down or from a particular level then if you have not gained or if you have lost money the reserve reduces and here the amount reduces. So I think that number you should never try to, because they are two different numbers. Unless you get all the details very difficult for you to...
- Anish Tawakley:** But I guess my question is on your consolidated P&L, where else would it show up?
- Gaurang Shah:** It will show up in Insurance, take for example, in the September '13 quarter the number is 165 crores and in September '12 quarter it is 900 crores. Now, in these two cases the equivalent reserve which I owe as a Insurance company liability to my ULIP policyholder, the reserve would have gone up by exactly the same amount because ULIP is like a collective investment scheme and is a pass-through. The same way this year September '13 it would have gone up by 165 crores, so the other entries in the reserves of insurance. It is a neutral entry, it has no such bearing, but one side is disclosed, the other side never comes up.
- Anish Tawakley:** And just one final question, the CA growth was not very strong, last quarter where you had very strong year-on-year CA growth...
- Uday Kotak:** I think the Current Account growth on the industry is under pressure and same applies to us. It is a slow economy, slower GDP leads to lower velocity and that is showing in the level of CA growth. It is area of great focus for us but there is a clear slow down in the economy which is reflecting in lower CA growth.
- Moderator:** Thank you. The next question is from the line of Manish Karwa from Deutsche Bank. Please go ahead.
- Manish Karwa:** Just wanted to take your outlook on the cost savings that you have been doing, and this quarter, the staff costs have been pretty low compared to historic quarters, any one-off there? And how do you see the trend moving forward on cost-to-income or cost-to-assets?
- Uday Kotak:** Cost-to-income obviously has gone up, that is because last quarter we had treasury profits which if you recollect on this call I had mentioned that cost-to-income of 43% is lower than what our operating norm is and this year maybe it is higher than what our operating norm is because treasury at more pressure than normal. On a cost-to-income late 40s is where we think we are at sustainably currently. And specifically on employee cost I will ask Jaimin to give you the reasons for where we are on the current quarter.

- Jaimin Bhatt:** A couple of points which come in there; one is of course, this quarter if you compare with the previous quarter the treasury had not performed well as much so there is an incentive provision which is lower; second, a part of our deferred payments are linked to stock prices. So to that extent that has come down; and thirdly, very interestingly your retirement benefit which is your compensated absences, your gratuity, all of that is present valued from your retirement age. And as interest rates have gone up in September versus June you get a present value benefit. So the hit for this quarter is actually much lower than what was there in the previous quarter. So these are kind of some of these things which are contributing to the lower employee costs this quarter Vs previous quarter.
- Manish Karwa:** And does it mean then going forward it should revert back to the normal levels or normal run rate or...-?
- Jaimin Bhatt:** Some of it, yes, and the one as I said it would depend on the interest rate which happens and as per the accounting standard we will have to take it at the end of the period. So what happens in December will determine my present valuing of the future cost on that. And of course, some of the others may come back.
- Uday Kotak:** Having said that overall at this stage we are essentially adding people primarily for branches and distribution. For all the other businesses there is no significant addition, but branches and distribution related people we are continuing to add.
- Manish Karwa:** And in terms of growth, what is the overall growth outlook would you see on the Loan front this year and probably next year given the fact that a couple of segments may be slowing down, but few of the segments which you like are growing at a reasonably good pace?
- Uday Kotak:** I would continue with our guidance of around 15% for the year average. Now, obviously, if we see a little pick up it may go little higher but annualized or around maybe 15, 16% kind of a number is where we think this year looks like, assuming of course that GDP is at least (+4%).
- Manish Karwa:** And just a broader strategy question. Kotak Bank is one of the best capitalized banks. While it is good to be greatly capitalized, but it seems that you have pretty overcapitalized today and there is not enough growth opportunities, which will obviously hamper return on equity for a reasonable period of time, and given the fact that a couple of segments are not growing and probably will take time to grow, it clearly seems that we will lag others in terms of growth. How do you address this because ultimately it will impact ROEs for probably this year and next year as well?
- Uday Kotak:** I think it is a very good question and we will continue to explore opportunities which can give us the growth we need for the capital we have, and we are focused on seeing how we can get growth. If we can get growth in segments which we like we would continue to do that. If there are other ways of speeding up our growth in a sensible manner we will do that. And even on inorganic we are open to growing but we have to keep in mind two or three major changes

which have happened. Number one, branch licensing is freed up and we will certainly grow faster in terms of our branch network and therefore to that extent we can now go ahead with our distribution within the formula which RBI has given much faster organically and when we think about inorganic opportunities we need to keep in mind the fact that branch licensing opening up is a significant organic advantage versus inorganic opportunities. So we will evaluate that more seriously. And on Loan growth, frankly, our view is if we find the risk acceptable we will grow. If we find the risk unacceptable just because we have excess capital we will not necessarily use it or misuse it because putting Loan growth in segments like we have seen over the last two or three years. Putting loan growth in the wrong segments actually creates negative equity return rather than accretive returns. But as you saw both in Consumer and Agri we have grown at close to 25% year-on-year and if we like the segments we will go for it.

Moderator: Thank you. The next question is from the line of Radhika Merwin from The Hindu Business Line. Please go ahead.

Radhika Merwin: A couple of questions, most of my questions have been answered. One, I just wanted to understand on your margin front the sequential improvement that you have seen marginally, has it come predominantly by lower cost of funds or have you seen some uptick in yields as well because of a retail exposure?

Jaimin Bhatt: A couple of reasons there. One of course is the fact that remember we raised capital in the middle of the last quarter. So since we are talking sequentially in Q1 we got the benefit of that only for half the quarter whereas for this period we got that benefit for the whole period, so that is one. Second, we have had some recoveries in this period from items which we had fully provided for. So effectively you had no assets there and which got me interest income, so that pushed up the NIIs a bit. The third one is the contributor to the numerator of the NII calculation comes from both Advances and Investments, and typically the Advances contribution is higher in terms of percentage, whereas in this quarter we have reduced our Investment book. So the proportion of Investment book to the overall number which is contributing there has gone down and to that extent that has pushed up the NIM.

Radhika Merwin: Just one question on the part where you have not transferred, you have not made use of the window that RBI has given to transfer the securities marked as of July 15th. Any particular reason why we have not done that because losses would have come down significantly?

Uday Kotak This is one of the important points which we had a fundamental view of doing something which is back dated and we did not like that.

Jaimin Bhatt: And since you mentioned that just add one point which we possibly did not cover earlier is had I actually taken the benefit of the RBI circular and transferred securities to HTM which we were permitted and we had enough head room that 263 crores which you saw would have been down to just 46 crores and which also we could have amortized.

- Radhika Merwin:** Just one point on the CV/CE segment when we are talking about the stress, did we mention that we have bottomed out as far as delinquencies go within that segment?
- Uday Kotak:** We think so, on our book. Bottomed out meaning we do not see incremental hit higher than where we are.
- Moderator:** Thank you. The next question is from the line of Mr. Sampath Kumar from India Infoline. Please go ahead.
- Sampath Kumar:** Just one question, you have ambitious plan in terms of branch expansion. How do you see this impacting cost growth particularly given the current context of macroeconomic condition?
- Uday Kotak:** We now have a base which enables us to add about 25-30% without putting pressure on us. Therefore, if we started say around 500 branches currently, around 150 branches a year is something which is par for the course, and the incremental above that is we do not think that material, and we think the faster growth which we would like to see on our deposit franchise would make up for this cost over time and we do not see at this stage our cost-to-income going sustainably above 50%.
- Moderator:** Thank you. The next question is from the line of Mr. Kunal Shah from Edelweiss. Please go ahead.
- Kunal Shah:** Firstly, on the credit cost, so definitely on the CV and CE we highlighted like say we are very close to bottoming out. But how otherwise would have been the slippages in this quarter in the qualitative term as compared to that of last, because as Jaimin also highlighted, there was some recovery. So was this recovery in the gross NPL or it was from the written off accounts?
- Uday Kotak:** Some accounts were fully provided for and written off.
- Kunal Shah:** So this does not get reflected in terms of the slippages and upgrades because I see the provisioning write-back of --?
- Uday Kotak:** Actually a full write off account which we got the principal back on that account and some others but overall it is mainly from the write off accounts.
- Kunal Shah:** And how has been the behavior of the slippages? And if you can just touch upon the outlook on the credit cost in the other segments as maybe in a quarter, I think in terms of a macro not much has changed, so what is the outlook for that?
- Uday Kotak:** For us the very good thing is the mix of the book which we have by design chosen is giving us a lot of comfort and we think the mix we have got is right, and yeah, there is always some accounts which will be under pressure which is what we call as the 'Watch List Accounts' but currently we seem reasonably comfortable with the mix of our book and we do not see any major blowouts in the near future of any big accounts.

- Kunal Shah:** And considering the stress on the CV side almost over, so should we expect a better trend in terms of the overall...?
- Uday Kotak** I am not saying CV industry stress is over.
- Kunal Shah:** Yeah, maybe in terms of the incremental stress which is....
- Uday Kotak** Which is with reference to our book. Therefore, we have shrunk our books. It is like distillation of the book towards better quality accounts. So I am not saying external sectors CV or CE has bottomed out. I am just saying the distillation of our book is now at a level where incremental hits and slippages do not look to be significant from here.
- Kunal Shah:** what is your view in terms of the overall unsecured portfolio? I think the growth out there is also quite significant. So how are you seeing, any change in the behavior?
- Uday Kotak** It is of a very small base. I think I will ask Manian who handles a lot on the Small Business Loans segment out of the Consumer Bank. What are you seeing there?
- K V S Manian** If you see the unsecured portfolio, part of the growth there is because we acquired a portfolio from Barclay, so that is showing a growth there. Having said that in our own portfolio also we still see fairly steady performance of that portfolio, we are not seeing any undue stress. Of course, it is about the kind of segment we have chosen to operate in. I think most of our unsecured loans are more focused towards the services side of the economy rather than the manufacturing side of the economy. So that probably is one reason that is a guess I have, why our portfolio still is not seeing any stress. So we will continue to grow it steadily the way we are doing as of now.
- Kunal Shah:** What has been the reason for upping this overall the branch expansion guidance? It is more to do with the branch licensing being freed up in the Tier-1 and Tier-2, and whatever inch up is there in terms of the guidance, that is mainly coming from the increase which we are expecting or say the growth in the top-20 cities?
- Uday Kotak** Branch licensing being freed up by RBI is a big factor in our decision to grow faster because otherwise it takes some time and some discretion at RBI is to decide the mix of the licensing of branches. We now know what we can do, what we cannot do, what are the terms, how do we need to tweak our strategy and we feel very good about this freeing of a branch licensing from the point of view of our future and it is straightforward.
- Kunal Shah:** One last question on Kotak Mahindra Prime. So actually if you look at the Auto Advances growth which has been holding steady at say 20% odd or say 17% odd, that has moderated this quarter to 11%. So one is to do with the overall underlying sales, but is it like some kind of say even like pushing back in terms of the Auto Advances as well? And what is the overall earnings

growth outlook because there is some inch up in the NPLs, and I think the margin pressure would also be there in this segment?

Dipak Gupta: Kunal, the industry itself has slowed down. I think there is no change in delinquency profile in that business. The margins are still comfortable and good. The industry itself is slowing down. And automatically what you disburse out for the type of quality of assets which you require automatically slows down. There is no other issue.

Kunal Shah: And on this RBI circular with respect to subvention, how do you think would it impact our business?

Dipak Gupta: We have curtailed it but not necessarily all NBFCs have curtailed it. The circular is essentially applicable for banks but we have decided to go ahead with it the same way.

Kunal Shah: So overall maybe this 10%-15% is the kind of growth which we can expect in the Kotak Mahindra Prime as well overall Auto Advances?

Dipak Gupta: It depends on how the industry grows. Industry also has been behaving erratically on the Auto side. You see 15 days of good growth and then 30 days of very low growth. So I guess it will keep on getting modulated as the overall industry grows.

Uday Kotak: Broadly, Kunal, we will continue with our guidance of 15% Loan growth overall.

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

Alpesh Mehta: Just two accounting related questions; first is if I look at your standalone numbers, the treasury gains for FY13 was 225 crores, annual report number is roughly 155 crores. So what is the difference in accounting over here? Secondly, during this quarter our standalone treasury gains is roughly 70 crores and the group consolidated numbers which have been reported. The capital gains from the other business is (-5) crore. So again there is some disconnect over there.

Jaimin Bhatt: 70 crores first one is not the treasury gain. We are talking about other income. Even treasury has a negative, in fact that 88 crores of provision which we talked about is going to sit entirely in treasury. So what we are talking about as details of other income in the consolidated results is showing a (-5) which is correct and the Treasury segment has shown a profit of 47 crores; Treasury segment has income other than what is coming only from the sale of investments. So a lot of the other revenue streams of treasury goes into contributing the profit including on the surplus capital which have been allocated there. So on profit on sale of investments on the treasury book in the bank standalone we will also see a negative number which will actually be higher than the consolidated number.

- Alpesh Mehta:** Jaimin, I was referring to the non-interest income breakup that you gave in the presentation, the treasury income in the standalone numbers, that number is roughly 70 crores, I am not talking about the....
- Jaimin Bhatt:** That is the non-interest income is 70 crores but that will also be offset against the treasury sale of investment which is a negative number. So actually if you look at the Treasury segment the profit is 47 crores. The 47 crores comes from the non-interest income of 70 crores and the loss on sale of investment and the (-5) crores which you are seeing in a consolidated number is just a profit on sale of investments.
- Alpesh Mehta:** Sure, I will take care of it. And secondly, our yield on investments if I look at on the consolidated basis, that number comes to roughly 9%-9.5%. This is on a calculated basis and almost 80% of our book is towards the GSec where the average was roughly 8%. So just trying to understand and this number seems to be almost 100-150 basis points higher than the peers in the segment.
- Uday Kotak:** These are standalone, no?
- Alpesh Mehta:** No, I am talking about the consolidated yield on investments because we also report the Investment book on the consolidated basis.
- Uday Kotak:** That may be considered as Insurance as well. Keep insurance out of this. But on the bank standalone the yield on investment is 8.09%.
- Alpesh Mehta:** And just a last question related to the recoveries from return of accounts, Jaimin, you mentioned earlier that the recoveries were relatively higher in this quarter as compared to previous quarter. But when I look at our standalone numbers, the recoveries from written of accounts were at around 62 crores in 1Q whereas that number...?
- Jaimin Bhatt:** That is ARD. If you take the standalone table which we have given out, and if you look at the provision number of 72 crores we have given the break up of that 72 crores which includes about 70 crores towards investment, about 22 crores coming from advances and then there is a number of others which is 20.16 crores, that is where the recovery has come from.
- Alpesh Mehta:** So these are on books recovery from return of account?
- Jaimin Bhatt:** That is correct.
- Alpesh Mehta:** The earlier quarter would have been the stresses and recovery.
- Jaimin Bhatt:** That is correct.
- Moderator:** Thank you. The next question is from the line of Manish Chaudhary from IDFC Securities. Please go ahead.

- Manish Chaudhary:** Just wanted a couple of things; one in terms of the fee income, there is continuing to be strong growth of almost 25% in the Banking space. Just wanted to check which particular segments come in that growth? And secondly in terms of your restructured loans, I think there is some increase of about 40 crores this quarter. Is there a fresh restructuring there or ...?
- Uday Kotak** I think the fee income we have seen some growth also in our foreign exchange trade and FX flows which have picked up and which is looking better. And on the restructured standard loans there is only one account of about 30-odd crores which has been added to that number which is why it is at 45 crores, and we felt that was a genuine case where if we did not do it we ran the risk of the client saying if you declare me as an NPA that is something which it was not acceptable to him and we really wanted to make sure we could collect money.
- Manish Chaudhary:** In which sector or segment would that account be in?
- Uday Kotak** I can tell you the state, it is Andhra.
- Moderator:** Thank you. The next question is from the line of Mr. Sai Kiran from Espirito Santo. Please go ahead.
- Saikiran:** Hi, this is Saikiran. Just quickly a question on the Business Banking piece. We have seen a reasonably good growth. Just wanted to check how do you see in this current downturn in the economy, what are your experiences in growing this book and then the asset quality behavior?
- Uday Kotak** I think as I said right at the beginning in terms of my comments this time in this cycle unlike earlier cycle of 2008-09 we are really seeing two Indias. The good India and the challenging India and the business at banking piece, small businesses piece is actually in the good India piece and we are actually quite happy with the way that is going and at this stage we do not see any serious stress so far in that segment.
- Saikiran:** If you can just explain the nature of this book in terms of ticket sizes and then the underlying business of that would be useful?
- KVS Manian:** Like I earlier mentioned, this portfolio is somewhat in the services side, somewhat on the large traders, some exporters, then there will be education sector. So these are the kind of sectors that our Business Banking book would be. So this broadly gives you some sense of which sector this book lies.
- Uday Kotak** And we think in this segment some benefit by a weaker rupee is actually benefitting some of these players and they are not large leveraged financed foreign exchange exposed players, it was the rupee in many cases is now giving them protection vis-à-vis imports.
- KVS Manian:** Actually, the segments will be fairly wide. I can give you examples of people who have three or four textile shops in a city. These guys do very good business. So it is the medium size business kind of guys who really are not that affected by all this slow down, for a medical pathology

labOr a marriage contractor or a caterer. So segments like this, these are really small every day kind of businessmen who are not as impacted by all this slow down.

Saikiran: What will be average ticket size in this segment approximately?

KVS Manian: So we operate in two segments there; one, we call the small business; one we call emerging business. In emerging business our average ticket size will be close to about 10 crores and in the small business the average ticket size will be actually a crore.

Saikiran: And sir, the other question earlier Mr. Kotak has mentioned that you might find some opportunities in terms of stressed acquisitions in Infrastructure space in the next 12-18 months. Can you just help us understanding what are the signposts which you are looking at and why do you feel that in the next 12-18 months might be an opportunity which might kick in?

Uday Kotak One is in the next 12-18 months we will have greater clarity of the politics of the country; number two is we think banks at some point of time will start recognizing and providing against some of these accounts or finding resolution towards some of these accounts and we think that is the time the opportunity will come.

Moderator: Thank you. The next question is from the line of Veenu Batra from ICRA. Please go ahead.

Veenu Batra: Actually my question is on the branch expansion. We are talking about branch expansion, it will be primarily liability focused branches or you will do credit out of these branches too?

Uday Kotak I think it is both. It took us a very long time to integrate the loan and the liability piece out of our branches and I think we are finally getting that synergy now pretty well. Obviously, our primary focus is building a stronger stable and lower cost deposit base, that is the primary driver, but we have been also able to use the branch network now for integration on the asset side as well, which is one of the reasons why we have begun to see higher growth in the Consumer Bank lending side which is coming primarily out of these branches, and in the rural areas wherever we open branches we have a very significant Tractor Financing and an Agri Financing business that actually is more asset-led, urban is more liability-led.

Veenu Batra: So if we were to segment rural branches into liability-focused branches say whatever you would have opened in last one year, what percentage would be doing both and what percentage would be primarily...?

Uday Kotak All do both but urban branches are more liability-focused and asset-enabled, rural branches are more asset-focused and liability-enabled.

Veenu Batra: Would that change your asset quality going forward?

- Uday Kotak** No, I think asset quality in terms of control we have pretty strong standards across the branch network. A local branch manager has very limited powers on lending business. The powers of lending are much more parameterized and are centralized.
- Veenu Batra:** And considering that now flexibility is more on the branches which are in Tier-2 locations so that practically means 1 lakh and lower population although as per 2001 census I think. So at what level does a branch breakeven and how long typically does it take for the branches to breakeven?
- Uday Kotak** Our average time is around 3-4 years.
- Veenu Batra:** And at what asset base broadly do they breakeven?
- Uday Kotak** I do not think it is linked to asset base, because low cost deposit creates P&L for the bank. So we have a transfer pricing mechanism which we look at pretty surgically and it is about 3-4 year period within which each branch breaks even and starts getting profitable, and there is a significant distribution revenue in branches, we measure the number of products which we sell to customers through the network. So it is a pretty detailed focused exercise which we do.
- Moderator:** Thank you. The next question is from the line of Pankaj Agarwal from Ambit. Please go ahead.
- Pankaj Agarwal:** Any particular reason for a sharp decline in your Investment book during this quarter because historically around 30% of your asset side has been investment, so this quarter the decline is very, very sharp?
- Uday Kotak** I think it is pure and simple. If we were carrying treasury bills we let them run down, or if we are carrying money market instruments we let them run down.
- Pankaj Agarwal:** In terms of your cash and bank money, it used to be around 4% so it has gone up to around 7% during this quarter. So that is also to do with what happened during the quarter in terms of...?
- Uday Kotak** I think in the end of the month we got some foreign currency money which is lying in our account in nostro on the last day which is why it is showing in bank balance.
- Pankaj Agarwal:** In terms of loan growth even if I keep aside Commercial Vehicles and Construction Equipments, it seems even your Corporate Banking and Business Banking Loan book, the growth seems to be slowing down during this quarter. So it was one-off during this quarter or you intend to slow down your growth in these two segments as...?
- Uday Kotak** No, I think Corporate Bank, if we get acceptable credit and acceptable return we will do it, and therefore guiding for the year 15% despite the slowdown in CV and CE.
- Pankaj Agarwal:** Because in this quarter, I mean Corporate Banking Loan book grew only by 6% so...?

- Uday Kotak** That is possible because this quarter saw a lot of volatility in terms of cost of funds as well and particularly on the short end side. This is the same quarter in which you saw 91-day T-Bills at the beginning of the quarter having a yield of 7.5% and went to a peak of 12.5%. So you saw lot of volatility in this quarter, and that is the reason why we may have had slower growth in the Corporate Bank but Transaction Banking and working capital oriented we do not see any major issues at this stage.
- Moderator:** Thank you. The next question is from the line of Anand Laddha from HDFC Mutual Fund. Please go ahead.
- Anand Laddha:** Since you do a Tractor Loan, you do CV, just want to understand is there any refinance facility available from SIDBI, NABARD, to what quantum it is available, what sort of funding advantage it has over domestic deposit cost?
- Uday Kotak** On Agri Finance NABARD gives refinance. Whenever we find the refinance cost competitive Vs deposit rate we draw it. So it is an ongoing exercise about optimization of cost of funds and something we look at all the time.
- Anand Laddha:** If you can just guide in terms of what is the funding cost from NABARD and SIDBI and what proportion of the balance sheet will be funded from refinancing?
- Uday Kotak** Right now, the funding cost of NABARD is not cheaper than FCNR(B). So right now FCNR(B) is reserves-free, priority sector-free. Therefore that has been a reasonably good source especially in the recent weeks, but otherwise we do look at NABARD; NABARD is around 9.25-9.5%. Right now they are asking 9.75% I understand. So if it makes sense we will take it.
- Anand Laddha:** Even on NABARD refinancing, there is no CRR, SLR and priority sector?
- Uday Kotak** But FCNR(B) is cheaper, no.
- Mohan Sheno:** In terms of effective cost, FCNR(B) is cheaper and there is additional benefit of priority sector not being there on that.
- Anand Laddha:** You also mentioned on Rural Housing Finance, a new segment which you have started recently. If you can just share some in terms of when you mean rural financing, it is truly rural finance or it is semi-urban? What could be the ticket size you are looking in that target customer and how big is ...?
- Uday Kotak** It is other than cities, therefore it is semi-urban and rural and ticket sizes would be about 25-50 lakhs.
- Moderator:** Thank you. Participants that was the last question. I would now like to hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak

Thank you very much and appreciate the detailed questions. We overall do believe that this is the time to really focus on the good India for our growth on the Loan book. We are open to take risks provided it gives us the return we want and we are cautiously optimistic. At this stage we believe tough macro gives us an opportunity to be a differentiated micro. Thank you very much and wish you all a very happy Diwali and a New Year.

Moderator:

Thank you very much sir. On behalf of Kotak Mahindra Bank that concludes this conference. Thank you for joining us and you may now disconnect your lines.