



## **“YES BANK Q3FY13 Earnings Conference Call”**

**January 16, 2013**



Morgan Stanley



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YES BANK  
January 16, 2013

**Moderator**

Ladies and gentlemen, good evening and welcome to Q3FY13 Earnings Conference Call of YES BANK, hosted by Morgan Stanley India Company Private Limited. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference, please signal an operator by pressing '\*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Anil Agarwal from Morgan Stanley. Thank you. And over to you, sir.

**Anil Agarwal:**

Thanks, Inba. Hi, this is Anil Agarwal from Morgan Stanley. Thanks a lot for joining this YES BANK third quarter results call. It gives me great pleasure to welcome the senior management team from the bank. We have with us Mr. Rana Kapoor –the Founder, Managing Director and CEO of the bank; along with him, we have Mr. Rajat Monga – Senior Group President, Financial Markets and CFO; Mr. Pralay Mondal who is the Senior Group President, Branch and Retail Banking; Mr. Jaideep Iyer – Senior President, Financial Management; and Mr. Aparajit Bhandarkar -- EVP and Head of Financial and Investor Strategy Team. Mr. Kapoor will basically give brief remarks and then Rajat will talk about the results then we will open it up for Q&A. Mr. Kapoor?

**Rana Kapoor:**

Yes, Anil, thanks and good afternoon to everyone. I understand we have a number of participants today. In a nutshell we have had a fairly good third quarter December 2012 against the backdrop of heightened economic risk with all sort of credit issues in the marketplace, uneven liquidity at a time most of the last year for that matter. And by and large YES BANK's performance in this quarter has been fairly satisfactory and very much in tandem with our version 2.0 objectives.

Mainly first I will talk about our P&L achievements. As you would have noticed if you have a copy of the report, our profit has gone up by about 34.7% compared to the corresponding quarter to a level of 342.3 crores. This has been significantly contributed by an improvement in net interest income which showed an increase of 36.7% compared to the corresponding period reached overall NII of 584.3 crores. Non-interest income was fairly significant number this quarter at 48.1% and I will talk about this in a few moments as well. So stood at 313.2 crores compared to about 211 crores in the corresponding quarter last year. Total net income was up by overall 40.5% to a level of 897.5 crores compared to 639 crores in the corresponding period last year. Operating profit was up by 41.3% to a level of 563.4 crores compared to approximately 399 crores last year. And non-interest income as a percentage of total net income was at a level of almost 34.9% which is a number which we believe we can achieve on a more sustainable basis.

A couple of other important numbers. Cost-to-income despite ongoing investment in people, branches, ATMs, improved quite significantly compared to September 2012 quarter by almost 2 percentage points to a level of 37.2% very much in tandem with our overall cost-to-income

ratio in the previous year '11-12. Overall yield on advances was at 12.3%, cost of funds at 8.5%, net interest margins improved by a further 10 basis points sequentially. As you may have observed that both September quarter and December quarter have registered 10 basis points improvement respectively adding to 20 basis points over the last two quarters from 2.8% we have moved to 3% without reflecting any repo reductions at this stage. So we are hopeful that if there are further improvements in money market rates and improved liquidity is going to help our net interest margins further as is our growing CASA. ROA improved to a level of 1.6, 10 basis points compared to previous quarter. And as you know that almost now 17 quarters YES BANK's ROA through various cycles have been at 1.5% or better the last four years and almost six months. Similarly, return on equity on annualized basis is almost touching 25% at 24.9% amongst the highest in the private bank and public sector banking industry in India. And it is something that we are really proud of considering the fact that we have been at 20% or better also for the last 17 quarters through the cycles of 2008-09 and also the cycles between '11-12 and '12-13. So a fair amount of resilience in ROE as you would see from this particular number.

Moving to some of the balance sheet highlights, our overall customer assets, so both advances and credit substitutes went up to a level of 55,750 crores representing an overall growth of 27.4% and advances on a standalone basis increased by 22.3% to a level of 43,860-odd crores.

Deposits improved to over 56,400 crores by an overall 20.2% and fairly in tandem with our loan growth. CASA which is our continuous highlight for over the last four to five quarters crossed 10,000 crores for the first time touching 10,340-odd crores reflecting an overall CASA ratio of 18.3, so which has been graduating almost 1 to 1.25% sequentially for the best part of the last five quarters and overall CASA has increased by 74.9% correspondingly with SA alone having increased by over 307% compared to December 2011.

The other number I want to highlight is that our retail granular liabilities as in like consumer liabilities, small FDs plus CASA which truly represents branch banking liabilities have increased to overall contribution of 37.8% compared to 30.7% one year ago, reflecting an increase of almost 7% in one year and we believe that we are on track to take this number to 55 to 60% over the next two-odd years.

Balance sheet has crossed 87,000 crores reflecting an increase of 22.4% compared to the corresponding period. Overall capital adequacy was quite firm at 18% with the Tier-I at 9.02%, the balance being hybrid capital. If we add the profit of December quarter Tier-I goes up to 9.52% and overall cap add goes up to 18.52%. Book value per share I mentioned already is 158.8. Our total headcount over the last one year has gone up by 1519 people, an increase of 30% in the last 12 months to a level of 6,532, representing our single biggest investment with predominantly most of these new hiring going towards our retail branches, so over 80%-odd is going into retail branches and this is our single biggest investment. The number of branches have grown to 412, ATMs have grown to 723. So as you can see that there is ongoing investment even in branch infrastructure to roll out our retail branches much faster.

A few highlights on asset quality. As we all know asset quality has been a major factor in the banking markets in India. Once again in the December quarter we were able to preserve overall asset quality with gross NPAs at a level of 0.17% and net NPAs at a level of only 0.4%.

In terms of absolute amounts the NPA of 0.17% actually is only 76 crores and net NPA at 0.04 is about 15.5 crores and both numbers in terms of absolute amounts have improved over the September 2012 quarter and overall specific provisioning coverage is at 79.6%.

Just moving on in terms of our overall asset composition. Corporate banking now is at a level of around 65.9%, our commercial banking which is mid-size corporate where we are uniquely positioned as a life cycle banking organization contributes now about 20.6% and retail and SME including micro SME which is truly branch banking consumer and micro SME assets are now at a level of around 13.5%.

The other point I wanted to mention is that we have a fair amount of granularity in our non-funded fees which as you know has gone up quite significantly this quarter by over 48.1%. The big contributors to this is really our financial advisory business which is predominantly corporate finance, structured finance type of business with some contribution of our investment banking business as well. So this is the single biggest contributor in this particular quarter. It constituted about 51.9% of the total non-funded fees.

The second big contributor which used to be a low single digit number till about two years ago but it is part of annuity stream is a transaction banking income which this particular quarter contributed 80.5 crores compared to about 63.9 crores in the corresponding quarter representing a contribution of 25.7% in the total non-interest funded income.

The third number which was a little soft this particular quarter was financial markets which was slightly low number of 39.2 crores, contributing 12.5% of non-funded fees and retail banking fees while just tad below 10% and 9.9% has in absolute terms almost doubled from 18.7 crores to 31.1 crores and this is one particular aspect of our non-funded fees, a significant part of which is non-loan fees which we believe will keep on rising and possibly in the next two years or so become a single biggest contributor towards our fee income.

That is pretty much the commentary on the quantitative as such. I do want to mention and use this opportunity with valued stakeholder in this particular call that we have continued to maintain a fair amount of portfolio diversity. So other than Agri business which is somewhat more than 10%, almost every other segment is well below between 5% or lower in terms of our overall portfolio mix.

The bank has also sustained its efforts in knowledge banking, increasingly we are partnering with trade associations, chambers of commerce, state governments to really position the bank as a thought leader and I do want to mention this that some of these qualitative objectives of the bank are resonating very well in the Indian marketplace and they add at least we would like to believe a fair amount of value to the bank's brand equity, the bank's presence and goodwill

and most of all customer access in the process. So, as we get a chance to go through the analyst commentary please do find some time to go through some of our knowledge and sustainability initiatives.

The bank raised in this quarter 904 crores and cumulatively for the year we crossed 2000 crores of upper Tier-II, lower Tier-II and perpetual capital, as a consequence of which we have been able to maintain very healthy cap add at around 18%.

Also, our other product related businesses like debt capital markets which is embedded in our treasury business is growing very steadily and YES BANK has evolved in the Bloomberg league Tables, this is a third year in a row where we are in the top five rupee bond arrangers in the domestic market and this has become a fairly recurring and stable source of income with significant upside to our corporate bond book which today constitutes almost 17, 18% of our total credit book as such. The second area where we have built a certain product competitive advantage is in being a fairly significant rupee loan syndicator and there too YES BANK has evolved in the top five loan arrangers in our country even though the volumes in both the bond market and in the loan market has shrunk but YES BANK's market share and rankings have improved to Rank 5 in both these particular product offerings.

A couple of more points, As in the past, and with more formidable competition, YES BANK once again was ranked as the "Best Medium Size Rank 1 Bank" in the Business Today-KPMG Annual Rankings for the fiscal year ended March 31, 2012 and also by "Business World" and "PricewaterhouseCoopers" in their annual survey. Internationally, we got two important recognitions. "The Asian Banker," a leading magazine "Singapore Asia" ranked us as the "Strongest Bank from Overall Strength and Quality Standpoint as the No. 1 Bank across Private and Public Sector in India." And we were also recognized on certain other product features which are part of the commentary that we would be sharing with you.

With this I would like to open the discussion for any questions. Rajat, Jaideep and the others will respond to your questions. I will be part of the call for the next few minutes as well. Thank you very much.

<b>Moderator</b>	Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from Alpesh Mehta of Motilal Oswal Securities. Please go ahead.
<b>Alpesh Mehta:</b>	Just two or three data points. What would be our outstanding borrowings as of 3Q?
<b>Rajat Monga:</b>	The number will be above 20,000 crores.
<b>Alpesh Mehta:</b>	And the SLR securities in the balance sheet?
<b>Rajat Monga:</b>	19,400 crores will be the SLR number.

- Alpesh Mehta:** And if we book any trading gains during the quarter where do we report it? Is it under the financial markets or some other line items or non-SLR securities?
- Rajat Monga:** What we gained in last quarter are not significant.
- Alpesh Mehta:** But if at all there would be any gains it would be under financial markets, right, non-SLR securities?
- Rajat Monga:** Wherever they are significant we will also kind of disclose those details.
- Alpesh Mehta:** And what would be our average yield on the credit substitutes right now?
- Rajat Monga:** Should be close to 10%, 10.25.
- Alpesh Mehta:** And the last data point provisions breakup for the quarter?
- Rajat Monga:** There is no specific provisioning; it is general or contingent provisioning. So out of total of 55 crores of provisioning, it is predominantly firstly credit related, about 20 crores is general provisioning, the rest is contingent provisioning.
- Alpesh Mehta:** Any view on that specific lumpy media exposure, how it has been treated, has it been recognized as NPA?
- Rajat Monga:** No, it has been provided. So we are (+80%) provided for as at the end of December exposure. So the contingent provisioning is predominantly on account of that single account. So during the quarter we have actually added no NPA practically. I mean there are very small numbers there and there has been no restructuring. So we just stepped up on our contingency provisioning on that one account. As at December 31<sup>st</sup> it technically continues to be a performing account because there continues to be recovery through monetization of the receivables which are exclusively charged to us. Technically, it is not a NPA and we need to be very clear technically for further action and legal recourse in this account. But on the provisioning side we have been proactive. So we are (+80%) as I was mentioning covered. So in our judgment this should be more than sufficient provisioning, factoring short-term recovery, possibility which should be a good 10, 15% of the exposure and another 20, 25% recovery over the course of next three, four quarters I guess. Again that depends on how the legal system also takes its course.
- Alpesh Mehta:** Just wanted to check, what would be the outstanding principal exposure on that account now?
- Rana Kapoor:** As Rajat just said that between September and December quarter we have made a provision of over 80% equivalent to exactly 90 crores. For the balance amount, we have enough hard assets which we will enforce and these are prime assets in prime cities like Hyderabad, Chennai, Bengaluru, and Delhi which are enforceable. So for 20% we do not anticipate any further provisioning requirement. On the contrary, if all goes smoothly we will probably have 10 or

15% recovery of the 80% provisioning that we have made in this account in two quarters itself without in anyway impairing the profit & loss of the bank.

- Alpesh Mehta:** Just the last question from my side. When we have reported 9.52 Tier-I ratio including profits, is it include 3Q profits or including 9M profits?
- Rajat Monga:** Both.
- Alpesh Mehta:** For the first nine months including profits, right?
- Rajat Monga:** Yes.
- Rana Kapoor:** As you probably know, we had a full statutory audit...
- Alpesh Mehta:** Half yearly audit, I just wanted to clarify.
- Rana Kapoor:** So at 9.52 includes the December quarter, excluding that is 9.02; overall it is 18.02 cap add. If we add December quarter it goes up to 18.52.
- Moderator** Thank you. The next question is from Anand Vasudevan of Franklin Templeton. Please go ahead.
- Anand Vasudevan:** Can you give us the numbers of savings account customers that you added during this quarter and how does that compare with Q2?
- Rajat Monga:** We have not begun to disclose these numbers for competitive reasons of confidentiality but the savings account numbers are number to number will be about 5 to 10% higher sequentially. I am sorry, I cannot give you the exact details, and we want to keep that little close to us.
- Anand Vasudevan:** And out of the total balance of Rs. 49 billion of SA that you have, how much of that would be more than 7%?
- Rajat Monga:** It will be predominantly 7% in terms of weight because the bigger the balance the more material it becomes at 7%. So our average accruals will be just about (-7).
- Anand Vasudevan:** Sorry, I do not understand that.
- Rajat Monga:** The portfolio will be costing us about (-7)...
- Anand Vasudevan:** How is it (-7) when the minimum that you pay is 7%?
- Rajat Monga:** Minimum we pay is 6%. So below 1 lakh rupees of daily balance we pay 6%, above 1 lakh rupees of balance we pay 7%.

- Anand Vasudevan:** The balances over 7% compared to the previous quarter. Has that increased?
- Rajat Monga:** Proportions are the same. I am just looking at a basic indicator which is weighted average cost of savings account deposits.
- Rana Kapoor:** To add to this, basically I think as Rajat is saying, when you take the blended average of the two main retail rates we have below 1 lakh which is 6% and above 1 lakh balance which is 7% and there maybe a couple of strategic trust accounts which do not add up to more than 6, 7% of the total SA balances, the blended average cost on that is less than 7%. So it is not 6.5%, it is somewhere between 6.5% and 7% and (-6) to (-7%). So it is very granular to answer your question there is significant granularity which is core to the SA acquisition strategy.
- Moderator** Thank you. The next question is from the line of Rajatdeep Anand of ICICI Prudential Life. Please go ahead.
- Rajatdeep Anand:** Just two questions. First one on loan growth. I think it seems to have picked up quite a bit but your investment book is also growing quite robustly. So I just want to understand when does loan growth begin to converge with your credit substitute growth or investment growth because even now investment growth is much higher than our growth. And secondly, your branch additions which are quite strong for the last three, four quarters. I think this quarter you have added only 10, 11 branches. I just notice that. So if you can ....
- Rana Kapoor:** I will answer the easier part of the question. Basically, you are right, we added only 12 branches in the December quarter taking the tally to 412 branches and subsequently we have added a few more but we will talk about that later. And the main reason is that we were waiting for the new set of bank branches to be licensed from RBI. While we did not share this in the earlier meeting but I am very pleased to share with you that we have received the higher number of metro license and urban license Tier-I licenses since the inception of the bank from the Reserve Bank of India, 146 new licenses is what we have received from RBI as recently two weeks ago. And just to give you a reflection, last year we got an approval for only 56 metro and urban in the Tier-I category. And as you know Tier-II to VI frankly we have also built a fair number in advance to justify the high number of increased metro and urban branches at this level of 146. So significant part of our focus is going to be to take advantage of this dispensation by a regulator and really deepen our metro and urban presence because as you know the deposit density is maximum in the top five cities followed by the next 22 cities aggregating to 27 cities in the country. So, our license capacity today has been enhanced significantly to invest in these particular deposit centric cities. I think the second part of your question on the corporate book which I am sure Rajat will give you a better answer that if you see in December quarter that while our overall loan and credit substitute growth is 27.4% within that the advances growth is 22.3%. As both Rajat and I and maybe even Jaideep has mentioned in the past meetings the focus in '11-12 and for the best part of '12-13 and possibly till even March this new quarter has been really to get improved P&L stretch and with greater efficiency and productivity while ensuring that we continue to invest in retail, particularly



people and branches and ATMs. So if you see the P&L has shown a growth of 34.7% and if you look at YTD till December 2012 our PAT growth is 33.1% relative to YTD loan and credit substitute growth of 27.4%. So the emphasis of the bank strategically at a time when the risk were higher is to get more P&L stretch, more P&L elasticity out of the balance sheet by ensuring that we are syndicating more, we are distributing more, we are selling down more rather than just growing loan assets for the sake of it. And I think the other point here is on the corporate book, I think we have built a very good corporate investment book at a time when interest rates were at a recent peak, we were a very good quality book AAA, AA+, AA-, that level of a book which is fairly liquid, marketable and I am sure at the yields prevailing now that we will see some significant gains on this book as and when we crystallize and monetize part of this book going forward. And as the markets improve it is only natural that we will put the accelerator on advances growth and monetize the investment book and that I think is going to be an opportunity which we will tap over the next fiscal year starting with this quarter itself.

**Rajatdeep Anand:** Of this, 11,000 crores of your credit substitute book, bulk of it is AAA and AA?

**Rajat Monga:** Predominantly yes.

**Rajatdeep Anand:** Predominantly would mean more than 80%?

**Rajat Monga:** Yes.

**Moderator** Thank you. The next question is from Jiten Doshi of Enam Asset Management. Please go ahead.

**Jiten Doshi:** Just was enquiring on the fund raising. What would be our size and when do you think we will be out to raise QIP?

**Rana Kapoor:** As you know that cap add effectively 18.5% fairly comfortable supported by a ROE of 24.9% even adjusted for dividends we still have give or take enough accumulation, enough retention from our profits to sell to grow at between 20 to 22% even if we do not leverage hybrid capital in the future. So in a nutshell, 20 to 22% growth comes from in-house retention of corporate. So that I wanted to really reinforce to you and the valued stakeholders. I think to answer your main question, if we see market atmospherics for Indian banks particularly private banks looking better. At some point sooner than later this year we will tap the window even though we are adequately capitalized, but we will tap the window. What is the deal size? I cannot predict. You probably know better than I as a market maker, as a leader but I cannot tell you what would be a deal size, all I can tell you is safely is that we will maintain a minimum ROE of 20%. As we have done on the back of the last capital raise in January 2010 when we raised \$225 million and diluted about 11.5% and yet maintained ROEs in excess of 20%. So from that experience the next capital raise with ROE now at 25% we have reason to believe \$300, 400 million deal will ensure that we do not dilute more than 9, 10% which will ensure that ROEs do not drop below 20% and that is very key to our performance metrics. As you have noticed quite well, almost every metric in this quarter, every metric without fail has improved

whether it is asset quality, P&L metrics, productivity and efficiency ratios to improve cost-to-income by 2% in this quarter has been a very important part despite brand spend, branch spend, most of our people spend, top management spend, we have been making unabated investments. So I think it will be a good time in 2013 to raise \$300, 400 million, on a good day it could be even more.

**Jiten Doshi:**

And you said that you could easily meet 20 to 22% growth without diluting but I think the Version 2 etc. was aspirationally a much higher number. Are you on course to achieve those aspirations which you had initially mentioned two years back, the goal that you had set for yourself by 2015-16?

**Rana Kapoor:**

I think we are very much on track because some of the magic numbers for Version 2 really are the investments in people. So, as I mentioned 1500 people have been acquired and we are at 6500 people, branches very much in track to get to 750 minimum, best case 900, ATMs 2000 on track. On the overall PAT growth if you see in YTD we are over 33% PAT growth which is very much in sync with our Version 2 where we had made assurances, let us say, aspirations to grow our P&L by a CAGR of 35% in this period coinciding with the 35% growth. So, yes, '12-13 maybe slower on growth in terms of balance sheet but there is no compromise on P&L growth as you can see from the numbers and definitely all three quarters of this year we have been able to demonstrate growth in the mid-30s. So, give or take 5% or so variation margin I see no reason why in rupee terms we will not get to Version 2 objectives. We are very much in track. And most of all we are on track on CASA.

**Jiten Doshi:**

One last question, what do you think will spoil the party? Anything that comes to you mind that worries you in the environment today?

**Rana Kapoor:**

I think the party was nearly spoiled 18 months ago but I cannot say the party has started all over again but at least the green shoots are there in the system and as you know the green shoots start basically impacting the bank's first foremost. So if we see what we have seen over the last month sustain and with the monetary cycle reversal if that happens within this quarter and most definitely in the next fiscal year is going to augur very well for our bank if not for the entire banking sector. So I am not seeing any significant impairment as such, only a better and improving climate for Indian industry and therefore Indian banking.

**Moderator**

Thank you. The next question is from Amit Mehta of PIMCO. Please go ahead.

**Amit Mehta:**

Just really a bit of a follow on from that last question. Just wanted to understand your appetite for loan growth because you had been a bit more cautious late last year or early last year. Just trying to understand what things are coming to the table and what your appetite is for credit growth going forward just in the context of what you said your self-funding at 20 to 22%?

**Rana Kapoor:**

Basically, we see growth opportunities in some of the sunrise sectors. We continue to like Agri business, Healthcare including Life Sciences. I think there are select opportunities in renewable energy. Selectively, like the education sector, there are selective mid-market,

hospitality opportunities for small business hotels which also facilitate tourism. So I think YES BANK as in the past will continue to follow a very segmentive strategy as far as our small, medium and large corporate businesses are concerned. But the real opportunity we are seeing with the savings intervention roughly about 15-odd months ago is to really build granular liabilities, because we have seen liabilities becoming a very meaningful reservoir of granular funding but equally contributing to P&L by improvements in NIM, lower cost of funds, so there is a lot of emphasis on granular liabilities at this stage. We are also seeing improvement and traction in our retail and consumer assets for new product introductions. We had a good month in December; we had a good quarter October to December in terms of consumer asset growth and that will continue to be an area of emphasis. At the same time, we are also being cognizant of the risk we are going to preserve risk quality, we are not going to go ballistic, we will stay on course next three months till there is a perceptible improvement in the risk climate in the country and so preservation of risk quality is very important for us and we are seeing literally a lot more income growth non-funded growth accruing in the bank in trade, in retail, part of which I spoke about briefly, we see improving conditions for treasury activity, more FX inflows from small medium customers. So I think to really put it in perspective we are at a sweet spot, at least we like to believe at inflection point that we probably saw HDFC hit in the year 2003-04 and we are larger bank, we have more branches and I think we want to learn and go through the same experience. So it is a very crucial stage for people who know our bank and who want to look at our bank an in-depth sense because today we have critical mass of branches, we have critical leadership in place, we have most of all over almost 4500 people in retail, sales, service and operations out of a head count of 6500 people. So it is a inflection phase in our life cycle. And the next two years is going to be very critical for defining our retail strategy, not only on liabilities, but on steady roll out of consumer asset products as well...

**Amit Mehta:** I just want to follow that up, your name has been associated with possibly buying RBS banking asset. I was just wondering if you can comment on how you maybe see as leapfrogging you into that region or do you think you can do organically if you need to do any bolt on? That was one question and then I will follow up with the second question after that.

**Rana Kapoor:** If you segment RBS business assuming that a deal is there on the table and also assuming that we win a deal it is a very good signal for a strategic message for our Retail Banking business, assuming that there is a deal and we conclude the deal. Having said so, if you actually see the size of the business it is the sort of business that today given current momentum we can literally build in six months or less. So it is not like it is going to be transformational in our life cycle except that it is a good message to the marketplace as well as to our internal stakeholder. So good to have it but it is not like a big deal if we lose it or we do not get it.

**Amit Mehta:** Just a last quick question, on provisioning, there is a lot of comparison of your group versus others in terms of whether you are building provisions sufficiently for rainy day, I mean, I appreciate you have very low NPAs but in terms of actual provision spend you seem to be

tracking much lower than your peer group. I just want to kind of clarify why you think you are superior on your asset policy trends.

**Rana Kapoor:**

Most of all if you do history check, last four years, 16-17-18 quarters, because one thing that we have consistently demonstrated through fairly fierce exogenous and domestic cycles and two big hits for the banking industry is really preservation of asset quality. We have not had shocks even big one that we spoke about briefly we alluded to, I think everybody knows which name we are talking about, the fact is that in two quarters we have been able to literally provide more than adequately for that particular setback. And two, as I mentioned that if you see our provisioning coverage has been consistently at around 80% or so. But when you see the general coverage it has been hovering between 300 to 400% overall. The other thing I want to mention that as part of our risk culture and our rating system in the bank we have a rating system of 1 to 10. So while 10A is substandard, 10B is doubtful, 10C is loss, but the provisioning dynamically as per board approved policies commences when a company hits a rating of 8 or a 9 rating and we generally provide on average 7.5 to 10% on a 8 rated account steadily, not one shot, but steadily and certainly much within one year and effectively over 15 to 20% on a 9 rated account. So this dynamic provisioning policy that with board intervention, the management recommended and adopted in 2008-09 actually was a further intensified as recently as six months ago in the April 2012 board meeting. So, even in contrarian and countercyclical markets we are actually providing buffers for any setbacks and that strategy in good times will definitely continue and in bad times we will continue to build buffers. This is something which has stood the test of time last 4.5 years. So I think we are in really safe territory. Force majeure conditions **aside in 44:55.**

**Moderator**

Thank you. The next question is from Mahrukh Adajania of Standard Chartered. Please go ahead.

**Mahrukh Adajania:**

Just wanted to check you are selling down your corporate debt. Then will it be booked in advisory or in markets?

**Rajat Monga:**

It will be booked in financial markets, it will be gain on sale.

**Rana Kapoor:**

Debt market sales as Rajat is pointing out, debt bonds and all will be definitely financial markets but we also **(Inaudible) 45:35** in the past, we also do secondary syndication, not just primary syndication, we are constantly looking at bulky assets that we want to either debulk for creating more velocity in our book, creating more churn or sometimes we want to derisk by making sure that we are not carrying lumpy assets and that part of the skim goes to the corporate financial advisory board. So there are two ways of sweating some of the assets, both financial markets and corporate finance, but obviously, the distinction being the product, the product in financial markets is corporate bonds and loan syndications and corporate advisory.

**Moderator**

Thank you. The next question is from Manish Oswal of KR Choksey. Please go ahead.

- Manish Oswal:** My question on this ratio of retail asset mix continuously declining for the last four, five quarters. So any significant development in terms of building that book over a period of time? And secondly, in the market retail assets are growing fairly very strong pace. So, we have introduced most of the retail products of where we are in terms of growth perspective, where we are missing to generate the book?
- Rajat Monga:** We traditionally had more an inorganic source of the consumer books because we would be purchasing portfolios of loans from other originators, particularly NBFCs. And bulk of that would also be towards priority sector fulfillment. So there are several constraining and driving variables of this particular share of the book that we are talking about. What is beginning to materialize on the ground and change of late is that our organic share of this business is falling in place and quite well. Like we have been mentioning in answers to questions earlier we are not in a hurry, we want to build the organic part well, we have to make money in that business and not lose money. We have witnessed to plenty of accidents in rushed business in consumer lending, so we are not going to be falling for that outcome. I think the idea is to be slow and steady. We know the market opportunity is sizeable and growing very well. We know the Indian demographics are going to lead us to even more sizeable opportunities over the next 5-10 years. So we want to be a meaningful player in the consumer lending space in any case, but that is a five year plan that we have begun to execute. So you will see that this number will do not hold us on the mix every quarter because there are noises from the other parts of the business also, but we will take this number gradually to 30% over the next three years, if not three years, four years.
- Manish Oswal:** And that will be purely the consumer related loans or some small trading loans that is the biggest contributor because what other banks are doing and what other market is doing is a significant growth in the Automobile Loans or other Retail Loans and where this growth will happen to become 30% retail loan, I mean what are the key driver for this growth?
- Rajat Monga:** The biggest driver is there is a large market. So far we have not sought that market share. Let's say if we have a balance sheet share of 1% in the industry today, banking industry we have 1% balance sheet share. We do not have a 1% balance sheet share for consumer assets. Once we get our fair share, we will also get to about the fair mix, I mean, if you ask the mix of retail, SME in the industry is 30% plus, which we will go in that direction progressively. I mean we cannot do that all in one year that is where we will make mistakes. So you should watch us for a progressive improvement, if not quarter-on-quarter, but in six months we should show you improvement.
- Manish Oswal:** And lastly, this non-interest income any one-off in the financial advisory, any large chunky deal where you got the large chunky deal during the quarter, any one-off?
- Rajat Monga:** There would be one-off, but these are one-offs, which are not like there are one-offs every quarter, but there could be deals which have let's say 5-10 crore opportunity also on revenue. So it will be there.

- Manish Oswal:** And lastly on the growth side, especially on the credit substitute side, what kind of sectors we are targeting and where this growth is coming in?
- Rajat Monga:** Credit substitute actually largely linked in with the ratings of the borrowers more than the sectors. We did business with Tata Steel, we did business with Hindalco, and we did business with L&T. So the sector gamut will be very wide, but what will be more generally common to these issuers will be that they will be better rated.
- Moderator:** Our next question is from Dhawal Gala of Birla Sun Life Mutual Fund. Please go ahead.
- Dhawal Gala:** A couple of questions. First question, if I could get your cost of funds for term deposits or deposits other than CASA deposits, a range?
- Rajat Monga:** You can use about I would say 8.90 as a reference.
- Dhawal Gala:** And how would have that improved over the last 12 months?
- Rajat Monga:** The pricing, again it depends, pricing in February of 2012 was quite off. It was quite wild. So we were paying anywhere between 10.5% and 11.5% for time deposits at that time. Today, the time deposit range has come down to between 8.25 and 9.25. From the peak and that peak did not last for more than two months, but we still had that peak about a year ago. So that is a wrong reference. Otherwise if you ask me the pricing of time deposits is about similar to what it was in let's say summer of '11, it has gone up and it has come back to basically in balance with the RBI kind of repo signaling. There what I am taking out is liquidity tightness. So what we do not have is the burden of illiquidity that came in the second half of last fiscal year.
- Dhawal Gala:** I was also asking this question was from the thought process that we have increased our CASA proportions by almost 6 percentage point in last four quarters and that is largely driven by Savings Account, which definitely significantly cheaper cost of funds compared to our other CASA borrowing resources. What would be the NIM expansion driven by improvement in SA and not just improvement in the wholesale rates?
- Rajat Monga:** The wholesale rates improvement is not going to be permanent. First, we will drop pricing on loans also. So you will notice that the pricing on loans also is beginning to come off. So that if at all is transient. So if you ask me about 15 to 18 basis points of NIM improvement can be attributed to SA. The change in SA between one year ago and now we can attribute about 15 to 20 basis points on NIM improvement that is at our current pricing. Suddenly tomorrow if we drop the pricing which we have no plans to but if we drop the pricing that has a further NIM unlocking opportunity. So this is also NIM warehouse of thoughts.
- Dhawal Gala:** Pricing on the deposits and not pricing on the loans?
- Rajat Monga:** Because let us say if we lower the savings account from 7 to 6, there is no plan, so I am putting a big disclaimer. We will be able to lower our cost of funds on that block of funding by 1%.

- Dhawal Gala:** Which would be about 7 basis points of improvement in NIM?
- Rajat Monga:** 7 basis. That is right.
- Manish Oswal:** To understand basically how sustainable the NIMs would look like means may be next 4-5 quarters, would it be about the current quarter number or it would be largely in the range of 2.8 to 3%?
- Rajat Monga:** I think as long as the competitive dynamic stay at what they are because the biggest risk factor is now competition. If tomorrow bank want to lend and nicely all over again I think we can expect some spread compression. But, if you ask me it does not look like that development is lining up for the next few quarters at least. If at all there will be modest improvement in the macroeconomic and therefore the operating environment in terms of the borrowing business is not going to be suddenly very, very hot. So, it does not look like that there is a great downside to NIM. I mean there could be regulatory shocks, none that we are anticipating, but if none of that happens NIM should be improving because the improvement on CASA is visible.
- Dhawal Gala:** And what would be your plans for the next say, medium-term to 1-3 years on net interest margins because this will be one of the key drivers for your -- because as the Version 2 unfolds your credit costs may not just remain at the place which they are right now as you increase retail also as you increase some other segments in the loan book and also I understand CASA will also increase. So what would be your medium term targets on net interest margins may be say more than one year and from three years point of view?
- Rajat Monga:** Three year hence you should assume that we will have 30% CASA. We will have 30% share of retail and SME lending and we will have 3.5% NIM.
- Dhawal Gala:** On the other part I wanted to ask you was on your capital adequacy ratio what would be the common equity Tier-I as per the Basel III? And also risk weighted assets, what would be the risk weighted assets for the credit substitutes which you book on your investment?
- Rajat Monga:** Basel III, I am not too sure we have not begun the micro computations with the Basel III is not yet effective. So, if at all after I know the number will be no different. There are some Basel III guidelines from RBI which are still under draft stage, so we do not know how they will be enforced. But as far as the Basel III implementation already being proposed to enforce by RBI affects only Tier-II, it does not affect Tier-I. What they will say is okay you should have a minimum Tier-I. That is all the Basel III guideline will say. So if that minimum Basel III Tier-I is more than what we have we will have to add. If that is lower than what we have then we are okay. So it is in that space, there is no real computational issue with Basel III. On the other part of the question, which is the risk weight, I think our total risk weight is the number that we have and that number is 65,000 crores. So you could easily put 60-70% risk weight cut for the credit substitute book. So the credit substitute book will take, one is the specific risk related risk weighting. So if it is a AA it will be 30% risk weight. But then there will be an add-on risk weight for market risk. We will have to add another 10% of risk weight for it being a market risk

sensitive position. So overall I think you can assume 40% risk weight to the total book that includes capital charge on account on market risk.

**Dhawal Gala:** And if I am allowed to ask one more question, any watch list companies either for the restructuring pipeline and any sectors you are still seeing there could be disproportionately more problems than the normal NPLs which come because of cash flow mismatches?

**Rajat Monga:** On the former part of your question with restructuring we have had only one restructuring request which we have rejected. It was in our judgment not needed. There is no other let us say inventory of restructuring that we are sitting on. I am giving you information which is current, I do not know if there will be anything different tomorrow, like none that we are anticipating that will change dramatically and that too overnight in any case. On the other part of the question, which is I cannot give the answer generically as such the situation of asset quality are not as generic as we may make them sound, they are still very specific, I think they are specific definitely to some sectors, which have had consequences in the past. MFI for example, is a sector which has across the board difficulty. I do not think there are many sectors outside MFI, Textiles where we can claim that there is across the board asset quality issue.

**Dhawal Gala:** I understood that there is no generic, but there would some sector or some accounts definitely in your pipeline on your watch list.

**Rajat Monga:** No, we will always have a watch list in terms of assets. I cannot give you names and sectors that will be a little unreasonable on my part, but I can tell you it is not growing. So that book is actually it was growing till about 12 months ago. So from two years ago to one year ago that book was growing. Plus we have acted on derisking steps have been taken, we have worked with some companies to expedite our recoveries and all of that. So put together the book is not growing any more.

**Moderator:** Thank you very much. We will take our next question from Vikesh Gandhi of Bank of America. Please go ahead.

**Vikesh Gandhi:** Just one small question I had is that we have seen your cost-to-income ratio coming down probably looking like lowest in last many quarters. So what is your take on that? I mean I would fairly assume that with the kind of branch expansion that you are looking at plus retail, which incurs lot of cost, but natural to assume it is going to be up like 200, 300 basis points from one year out, I am not talking about next quarter or something?

**Rajat Monga:** Vikesh, I think the answer of cost-income is very hard to give. It is because it is a ratio between revenue line has its own cycles and trends and the cost line which is definitely more sticky than the revenue line is. What we know is that there is work to do on cost. So we are investing, we will be investing, there is a pipeline of branch network expansion, there is a pipeline of people to be hired so is there a pipeline for business development, balance sheet growth and revenue maximization. I think that is our management challenge that if the cost-income ratio is going much higher than 40 in a smaller scale we will have to calibrate that back



to cost control. Maybe we have invested too much too soon and that income is not coming through. So focus more on income, productivity improvements, encash your investments. So I think that is a little bit of management consequence we will be dealing on an ongoing basis. This quarter particularly actually you will see has revenue buoyancy. Margins are higher, non-interest income is higher, so therefore cost-income is lower. So whether we will maintain the revenue buoyancy, I would like to say, yes, to that question if I ask that to myself. However, investments will continue on the cost side. I mean our run rate has been about 35%, 40% year-on-year of late, maybe it might be not as aggressive as we have been seeing because the base also is growing. So we cannot grow at a bigger base at the same pace. Costs are also bandwidth constraints. I might say I will put 150 branches but it still comes with the constraints on the ground. So we might say that we want to hire 2000 more people even that is constraint because we have not designed for that rapid growth. So it is unlikely that our cost will grow more than low to mid 30s that is over the next year, therefore we have to guess that our revenue can grow in that proportion. As long as both grow proportionately, cost-income is steady.

**Vikesh Gandhi:** So basically from what I gather over here is that it will be consciously kept somewhere around 40, would not be allowed to just proportionately jump over that?

**Rajat Monga:** Without me saying so.

**Vikesh Gandhi:** And just one small data point. I do not know if you have answered this question. What is your actual consumer lending book at in terms of absolute number, Retail book? I mean, you break into that MSME and Retail.

**Rajat Monga:** One way to draw the line is between application for business and application for consumption which is that if I am buying a car it is actually for my own personal consumption, it is sort of a consumable. If I am buying a truck it is actually an earning asset even though it might be a Tata Ace for that matter. But both are Retail. I mean the difficulty is how do we draw the line? Even in the Retail space we are business oriented still. So we are not classical credit card kind of a portfolio.

**Vikesh Gandhi:** Let me ask you the other way. How much of your loans would have been given to Retail customers who would be coming to your branches, individuals if that helps? I am sure it might be a small number but just one.

**Rajat Monga:** We are not still giving loans to people who come to our branches.

**Vikesh Gandhi:** So if somebody walks in, I mean obviously you are not manufacturing home and all that but autos, personal loans.

**Rajat Monga:** Sure, walk-ins for lending have to be handled differently...

**Vikesh Gandhi:** No, if he has got a relationship with you as a customer from liability side?

- Rajat Monga:** For him we will do mortgage also. So if he is a liability customer we have all products, but we are not using these products as let us say strategies or new-to-bank customer acquisition methods. There would be a product. And finally mortgage is actually I mean if I have to over simplify it is just about writing a check. So it is not that one cannot do that. It is just that the process is a lot more cumbersome than what I just described. So if I have to force an answer how much is a book which is self-originated looks to retail if you allow me a little bit loose definition it will be about 1000 crores organic, self-originated, this does not include what we may have acquired pools and PSL assets from other originators.
- Moderator:** Thank you. Our next question is from Amit Premchandani of UTI Mutual Fund. Please go ahead.
- Amit Premchandani:** On the employee per branch metrics YES BANK has on an average around 16 employees, but if you look at other private banks it ranges from around 20 to around 28 for HDFC Bank. So, are you likely to move towards that range or 15 to 16 per branch is the metrics that you are looking at?
- Rajat Monga:** It will be a function of how much product intensity do we bring to a branch. We might be a very aggressive insurance distributor which we are not, but let us say if we are, there would be more headcount per branch. So it is a function of how much business we are designing and planning to do in a branch. I am saying that it is reasonable to assume that as we add more retail asset products we will add more sales energies on the ground. Some of these energies are not part of the branch, they might have their own management architecture. Some banks might be outsourcing, we are not. So it is difficult to compare across banks. I might have DSA Network which is working for me, those are off roles kind of feet on street. So it is not strictly comparable but it is reasonable to assume that the employee count per branch will grow. But I would rather you look at the employee count per at least one, two year vintage branch because new branches will not get maximum, especially in our case when our networks are growing sharply because I will not want 16 people in the branch on day one, but two years later the branch will have 16, since we are saying 16 on an average, maybe we will have 20 people.
- Amit Premchandani:** So this 30% share of retail and SME if you go with that say three years down the line your employee per branch may move to around 20, is it a fair assumption?
- Management:** In terms of employee per stable branch may already be (+20) is what I am saying. So the branches which are still shaping up, which are still kind of finding their feet will get more people. We do not need service staff in branches if there are no customers if you start with on day zero. So, over a period you will add more service staff as you get more customers to service. So there will be I would say a general uptick in this number unless we suddenly add disproportionately more new branches.
- Moderator:** Thank you. Our next question is from Pooja Kapoor of Citigroup. Please go ahead.

**Pooja Kapoor:** I just wanted to understand a bit more on the financial advisory fee. The number is obviously pretty large. Just wanted some granularity in terms of where it is coming from and also how sustainable this is?

**Rajat Monga:** Granularity in what terms? There are broadly three or four types of income that will come into this category. One is relating to investment banking, advisory work that we do with customers so that could be private equity, M&A type of work. So we have had four or five deal closures in the December quarter so there would be corresponding revenue. Deal closures have increased of late in that space, so there would be revenue on that count. There would be revenue on account of loan syndication which is where let us say we underwrite a couple of \$100 million size project and there is fees on that project for the role of underwriting that we provide. This loan will also be syndicated in the market and there will be a cost of syndication. So the net of the fees and syndication cost is what comes into this advisory income space. Rana was mentioning earlier on the call is that we have also picked up share in that business progressively we are now Top 5 in the Bloomberg Link Table of INR loan syndication. We have also listed deals that we have worked on in the four-five page notes that we would have had the opportunity to send across to you. If not it is there on our Investor Relation page on our website. So these are the deals where we have earnings. There will also be structural finance work that we do which is a little bit more credit sophisticated end of work. We can say that it is little bit lending related fees as well in some sense. So these are I would say the dominant three buckets of fees in this financial advisory space.

**Pooja Kapoor:** Do you think that this is really?

**Rajat Monga:** There is a deal dependence in that business. It can't go to zero in the sense that the when there is sustainability it is not like we are going to stop doing this business. We are number 5 in loan syndication, number 1 is still 10 times our size. So as long as we have a product, there is a customer has a need, we have the hunger and the sales energies to convert it there will be business to be done. But it will have cycles.

**Pooja Kapoor:** And would it be fair to say that each of these three broad streams roughly are equal within the financial advisory or there is a skew?

**Rajat Monga:** No, see unfortunately there is a deal based revenue incidence here. So it may change quarter-on-quarter as well. These are success based revenue streams, partly. Investment banking is classically. So it will be visible every quarter. I can vouch for that but will it be in the same proportion all the time, no. There would be a dependence on closure of transactions. So, as customers close more transactions whether for funding or for financing or for purchase or issuance we will have more opportunities to book revenue. So it will be a little bit of a linked with the let's say the economic cycle.

**Moderator:** Thank you. Our next question is from Anish Tawakley of Barclays. Please go ahead.



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**Anish Tawakley:** I am also just trying to get my head around financial advisory side of things. So, three specific questions. One is, if we look at the fee it has grown by 800 million which is most, it is actually more than 60% the growth in the PBT over the past year. So my question really is 3 questions. One is, what is the cost-to-income ratio of flow of this business? So how much would it have contributed to the PBT growth? Second question would be what would be the average fee like related to the transactions you would have done? So is it 1% of the transactions, is it 2% of the transactions? And thirdly, I think at the beginning of the call it was mentioned that you have a competitive advantage in this business. If you could give me a qualitative sense of what competitive advantage in this business means that would be helpful.

**Rajat Monga:** Okay, I think the cost-income ratio will be like I would get close to 20% to 25%.

**Anish Tawakley:** Okay, it is as high as that is it?

**Rajat Monga:** On an average yes.

**Anish Tawakley:** So, the cost of doing this deal is and that is basically the team?

**Rajat Monga:** There will be some infrastructure required. It is not like that the, I mean like I said there is a decent amount of I would say corporate investment banking nature of the business. So our cost-income will be like that. Though I don't have a precise number I am just kind of just running quickly back of the envelope kind of numbers I am trying to arrive at some cost.

**Anish Tawakley:** This is good like financial advisory business would account for about half the PBT growth over the last year.

**Rajat Monga:** These guys also get good bonuses.

**Anish Tawakley:** And the bonuses would have been booked simultaneously?

**Rajat Monga:** Provision are made simultaneously, yes. They are not paid. So the provisions are there. He has not been paid. This is actually, I would say the people cost is the biggest cost.

**Anish Tawakley:** In terms of fee as a proportion of transaction volume?

**Rajat Monga:** Well, I think 1% is a good assumption.

**Anish Tawakley:** If I take 1%, it means that you did about 160 billion of deals in this quarter that is about \$3 billion.

**Rajat Monga:** We will have to carve out Aditya Sanghi investment banking will not, will even get to 3%. Because that is more high energy-low success type of a business. So, they will have even 4%-5% when the deals are small. So, it depends on the size of the deal else it is the same.



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**Anish Tawakley:** Because, I am just looking at the deals you had mentioned. The largest deal is about Rs. 10 billion. So that is about Rs. 10 billion would be about \$200 million.

**Rajat Monga:** The largest deal, I just took an example. It is a deal.

**Anish Tawakley:** It is mentioned there that it is about \$200-300 million. So, you have done about 30 to 40 deals or 20 to 30 deals?

**Rajat Monga:** Yes, I mean we would have done at least 15 to 20 deals. If you look the listing itself has names and numbers. The fee number is there.

**Anish Tawakley:** No, I am just trying to get a granular feel of. And what would be, the last question in terms of competitive advantage?

**Rajat Monga:** Competitive advantage in terms of the product is basically when we go in front of the customer not going by only our share of the loan. We are actually giving him the full package, the bundle. So he has the full underwriting. He has one bank to deal with. His project is closed out. We take on the burden to be able to sell down structure, sell down and go talk to several banks to be able to also finally give him the signed of loan documentation. So it is an end-to-end solution that we are bringing on to the table. It is not that there are no other banks, there are other banks but the list is very small. So we are fit to that list already. And the number one in that list is SBI. Not that we can replace SBI so easily they get all the Government business by default. But we are also acquiring a little bit and we have to do that proportionately. We can't do a billion dollars and then worry about it. So as we are acquiring size and substance in our own business our ability to do deals and the size of the deal is also increasing. The other part that I think we were mentioning is also on the flip side of this business is also debt capital market, which is where we offer similar solutions to customers but through the bond route. There also we have a distribution at the other end. So we structure price warehouse, underwrite and distribute. Their funding outcomes are certain. If somebody has a 300 million requirement otherwise he will have to go to 10 banks. We will do that for him in course of time.

**Anish Tawakley:** And if I may just ask one more thing, you had mentioned like the largest is SBI and that is about 10 time your size. If you were to talk about numbers like two, three, and four how would they be?

**Rajat Monga:** We will be a distant fifth.

**Anish Tawakley:** A distant fifth?

**Rajat Monga:** Yes see you will have ICICI, Axis and there will be one noisy name because some of this is not perfect. So the others are basically ICICI Bank and Axis Bank in terms of substantiality and IDBI Bank.



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**Moderator:** Thank you very much. Ladies and gentlemen due to time constraint that was the last question. I would now like to hand over the floor to Mr. Sumeet Kariwala of Morgan Stanley for closing comments.

**Sumeet Kariwala:** Thanks a lot Rana, Rajat and the entire team for this very useful call. Thanks and best of luck for the fourth quarter.

**Management:** Sumeet, thank you very much and I would also like to take the opportunity to thank everyone on the call for their patient listening.

**Moderator:** Thank you very much gentlemen of the management on behalf of Morgan Stanley India Company Private Limited. That concludes this conference call. Thank you for joining us and you may now disconnect your lines.