



“Yes Bank Q1-FY13 Earnings Conference Call”

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Moderator

Ladies and gentlemen, good day and welcome to the Yes Bank conference call hosted by Morgan Stanley India Company Limited. As a reminder for the duration of this conference, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. 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 a lot Marin. Good evening everybody and thanks for joining the post- results conference call with Yes Bank. As you know they have reported very strong setup numbers earlier today. It gives me great pleasure to welcome Mr. Rana Kapoor-Founder Managing Director and CEO of the bank to discuss the earnings and the outlook for the business. He also has senior members of management team along with him for the call. We have Mr. Rajat Monga-Group President-Financial markets and the CFO, Mr. Jaideep Iyer-Senior President of financial management, Mr. Aparajit Bhandarkar-Executive VP and Head of the Finance and other members of the team. Mr. Rana will give opening remarks for the first 15 odd minutes and then we will open it for Q&A.

Rana Kapoor

Anil thanks very much for hosting this investors call. Basically let me start by giving a few comments on our quarterly numbers. As you would have noticed that we have recorded a profit after tax of 290 crores which represent the increase of 34.3% compared to the corresponding quarter last year. Net interest income has increased by 33.3%, noninterest income by 74.3% and total net income by 46.4%. The overall ratio noninterest income to total income is 37.9% fairly consistent with the previous quarter and cost to income ratio is around 39.5% so still well below 40% and net interest margin has been quite stable at 2.8% with some of the new CASA numbers helping us to preserve margins in and otherwise fairly tight scenario. Balance sheet advances grew by 16.4% including credit substitutes the growth was 32.4% and deposit growth crossed 50,000 crores, the first time we have crossed overall balance of 50,000 crores and it was about 15.2 compared to year-on-year numbers. The yield on advances was around 12.4 which is improved from 11.6% in June 2011, cost of fund has gone up to 9% from 8.5% about a year ago and the highlight of this quarter as in the last two quarters has been the increment in CASA, quarter-on-quarter it has grown quite significantly by 71.5% and sequentially it has increase by 1.3% to an overall CASA level of 16.3% which basically is a 5.3% overall increase year-on-year in our CASA balance sheet.

The other part I wanted to mention is that our retail deposits as well as FD deposits plus CASA has improved to 37.3% compared to about 27.2% so retail contribution in the overall make-up of our deposit base has stepped up by 10% from 27% to 37% now. Gross NPAs continues to be at a fairly manageable level of only 0.28% and net NPAs are at 0.06%. The 0.28% gross NPAs translate into an absolute level of 109.5 crores and net NPAs are at an

absolute level of 23.7 crores. The other related numbers in on restructurings which have remained stable at 0.51% with the absolute amount being approximately 196 crores.

Our overall specific coverage is at a fairly comfortable level of around 78.3% and overall loan loss coverage is now at 295%. Our capital funds have improved to approximately 10,000 crores, just short of 10,000 crores 9,995 crores so just short of 9,500. Capital adequacy is at 16.5 with core Tier-1 one at 9.2 and when added back for the profit for June is at a level of 9.7%. ROAs quite similar to the last 15-16 quarters at 1.5% and ROE has improved further to a level of 24% which is being above 20% or around 20% for the last tune of 4 years 16 quarters now. Book value has crossed 140 and 140.7 with the EPS for this quarter at Rs. 8.2. We added 25 branches in this quarter taking the overall number of branches to 381. Overall HR headcount has improved to 6183 people so we are accreting about approximately give or take 100 people every month as it represents an increase of 41% compared to June 2011. So as you will see based on these highlights that despite the extenuating circumstances, domestic and offshore that overall the bank's performance is been satisfactory with P&L growth of 34.3% and this is a result of productivity and efficiency gains accruing from some of our businesses as well as the improving contribution of retail, particularly on the liability side and we are also seeing steady growth in absolute terms in our retail assets as well as in our SME asset book as well. Overall SME and retail is now at a level of around 15.4%, commercial banking which is our mid-market business constitutes about 20.4% and corporate and institutional banking a slightly more than 60%. So overall I would say that given these circumstances and the fact that the bank is following a fairly cautious growth strategy as reflected in fairly modest loan growth at only 16.4% and then of course credit substitutes have grown quite well during this period. We believe that P&L outcome is particularly good with a fair amount of diversity in our noninterest income as well with trade finance transaction banking contributing about 24%, treasury fairly well distributed across a FX, fixed income and distribution of debt capital markets contributing about 33% approximately, advisory both corporate finance as well as I-banking at a level of around 35.6% and retail banking while growing in absolute term is still fairly modest at the overall contribution of only 7.5%. Besides that there has been a fair number of recognitions the bank has got during this quarter and to highlight one of our prestigious awards is being given to the bank for the third time by the Financial Times IFC Washington for our sustainability practice as the No. 1 Sustainable Bank in Asia Pacific region two years in a row and the third time is been given to our bank and the only Indian bank for several years now. By and large these are the key financial highlights.

One other thing I want to quickly mention, savings accounts balances have grown by over 350% in the last 12 months and CASA as you know not of questions in this meeting particularly so come up on CASA and CASA has improved by 71.5% year-on-year. As you also know we have given the dividend of 40% which is 60% better than the previous year. so as far as I mentioned both risk management and granular liability generation continue to be the predominant objectives at Yes Bank, most certainly for the last four to five quarters and increasingly the traction on this particular front is getting reflected in our CASA growth and

we have quite sure that we will be able to maintain the momentum also in the year and in remaining three quarters of this year.

- Moderator** Thank you sir. Participants we will now begin the question and answer session. Those who wish to ask a question may press “*” and “1” on their touchtone telephone. If you wish to remove yourself from the question queue you may press “*” and “2”. Participants are requested to use only handsets while asking a question. Anyone who has a question may press “*” and “1” at this time. We have the first question from the line of Vishal Goyal from UBS Securities. Please go ahead.
- Vishal Goyal** I have two questions, what is the number of savings accounts we added basically in last quarter average?
- Rajat Monga** We are adding about 1000 a day.
- Vishal Goyal** So this number remains the same from last quarter also, last quarter we were also doing 30,000 per month?
- Rajat Monga** The number is similar just like March was particularly better so we have not yet fully able to conclude it that was seasonal but there looks like a seasonality element in March.
- Vishal Goyal** Second question actually some color on your investment book which is the credit substitute, what would be the duration of your non-SLR book?
- Rajat Monga** It is between two and three years, modified duration.
- Vishal Goyal** Any sense on the rating profile of this book?
- Rajat Monga** pretty good
- Vishal Goyal** It is externally rated?
- Rajat Monga** Yeah 100%, that is a regulation.
- Vishal Goyal** Any Sort of Breakup You Have?
- Rajat Monga** You can say it will predominantly be AAA, AA+.
- Moderator** The next question is from the line of Rajatdeep Anand from ICICI Prudential Life. Please go ahead.
- Rajatdeep Anand** My questions, I have three of them. First one being on investments growth, if we continue to grow like this I think we will have more investments than advances in a few quarters so just

like to understand what the thought process behind that is. Secondly cost of deposits for us seems to have stabilized at 9% whereas for most banks they have increase quarter-on-quarter. Is 9% the peak of the cost of deposits and lastly on the fee I think all of us are pleasantly surprised and this traction. It seems to have come in from financial market but what part of financial market?

Rajat Monga

The investment book is meant predominantly for distribution. So it is not a take and hold strategy that we are following with respect to the investment book. But there is the warehousing element of that comes into that business which does result in this showing up on balance sheet for some time before we are able to distribute it to the rightful holders. We are also targeting a lot of distribution to wealth management clients, to Provident funds, to pension funds, most of who have a monthly inflow in their own system that result in us being able to distribute our paper over a period so it's not a hold strategy at all. It is just that we have become more relevant for our clients, more so in the last two years. There have been lots of issuances by very good names in this space. We have also been trying harder to start business with the various houses like the Tata's, the Birla's, the Mahindra's so we have worked with all of these houses in the last 12 to 18 months. So it is a bit of both that it seems to have exaggerated its expression on our balance sheet but that is not the core part of the strategy. The core part is distribution which is ongoing.

Rajatdeep Anand

Whatever gain you make on distribution if that booked under financial market so is there element of that in this quarter?

Rajat Monga

They would be definitely and there are some elements of that every quarter. This quarter was I would say fairly decent in respect to the other quarters.

Rajatdeep Anand

So this is the main uptake in this quarter?

Rajat Monga

No, the main uptake in this quarter the financial markets year-on-year actually will be government paper. So we are reporting about 95 crores under this category, about 30 to 40 of that will be on account of G-sec.

Rajatdeep Anand

Understood.

Rajat Monga

On your question on the cost of deposit, as far as our view is that would have peaked in this I think for our cost of deposits computation number that we're showing this quarter are flat as compared to March. We have had a benefit of increasing CASA which also is adjusting this number little lower relative to the others so the most banks are actually reporting lower CASA. So we have had also the benefit of the fact that if there was a little bit of March heaviness in CASA that benefit will be fully well felt in the June quarter as compared to the last quarter. The assumption that cost of deposits may have peaked for unless there are unknowns that we are dealing with is it fair.

- Rajatdeep Anand** Just on the SA bit there seems to have been some amount of, the momentum has declined slightly so has the low hanging fruit being picked and this is a new normal of growth on SA that we should be looking at?
- Rajat Monga** Maybe we will not be able to give you very conclusive answer here. We are ourselves trying to understand if there is a seasonality in the business because at least I do know that the SA balances fell in April before they picked up again and there was about 150 crores maybe between 150-200 crores for correction in the SA number before it picked up back all over again. So March therefore is a little bit of a difficult benchmark yet adjusting for this seasonality also the Q4 look a little bit better than the Q1 bit. So we are still giving it a benefit of seasonality because the underlying momentum is not particularly worse off. The account opening and the money in money out momentum indicators of savings accounts are all upwards.
- Moderator** The next question is from the line of Umesh Matkar from Major Trend Capital. Please go ahead.
- Umesh Matkar** My question was your other income has grown by 74% Y-o-Y, I just wanted to understand what has led to such a high growth and do you see the same run rate going forward?
- Rajat Monga** Y-o-Y I think most of our lines have grown. We disclose our noninterest income under four lines which are financial markets, financial advisory, transaction banking and retail these are the four lines. So most lines have grown in line with balance sheet except that the financial market line has grown sharply and I was describing in my answer to the earlier question, it is also partly driven by the fact that we have been able to realize some gains on our SLR portfolio given that we have seen some corrections in yields, on bonds in the last two quarters particularly. We have been able to convert that into P&L so to speak. So we have seen a 24% year-on-year increase in financial advisory, 2.5 times increase in financial markets which is enclosed by the fact that we had the ability to realize gains on SLR book in 1st Quarter this year that opportunity did not exist in the same quarter last year. we have 65% increase in income from transaction banking, is largely relating to trade finance, LCs, guarantees, cash management, Escrows and some other capital markets solutions which could be like dividend payments, interest payments, bankers to issue. So all of these solutions have put together helped us grow our income by about 65% and the retail income has grown by 40%.
- Umesh Matkar** So going forward are you seeing a similar other income contribution to be equal as this quarter or will it be otherwise?
- Rajat Monga** You can expect that we should be generating about third to two fifth of our income from other than interest. I must also mention that there is always cyclicity in other income but very transactional in terms of its drivers. If imports and exports from our country increased it typically happens in times when economy is strong even we will get more transactional

opportunities and therefore more revenue and if the economy slows and so do imports and exports we will have opportunity to open less LCs, translate less currency relatively speaking unless we fight harder for our wallet share also happens. So there is cyclical in this business and we do also benefit from that once in a cycle interest-rate outcome because we naturally sit on fixed income portfolio through SLR. When the economy slows down it interest rate come down which they are in the process of we are able to make gains on our SLR book which we realized so we also have a countercyclical income which comes in our reporting. It is cyclical only in the down cycle it comes so that is not something which we can say, we can replicate every quarter. So there is an element in this non-interest income which occurred in March quarter of last fiscal, it occurred in June quarter this fiscal still have some momentum because rates are falling, will not occur when rates are rising.

Umesh Matkar

Just wanted to know what will be your strategy for this year, going forward will you be concentrating more on CASA growth or it would be trying to push for more of advances means growing above the industry?

Rajat Monga

The priority which the management has outlined for itself at the top has predominantly two of them, the others are also priority but the number two priorities are liabilities and risk management current year as it was for the last year. So we continue with those number one priorities. When we say liabilities it means more CASA, also means more granularity of liabilities, it also means more transactional embedment and therefore stickiness for liabilities. Risk management is about handling the consequences of the cycle as well as the economy. So we want to consolidate, we want to de-bulk, we want to de-risk wherever we believe there is a challenge in terms of navigating the down cycle and will be the highest priority along with the liabilities. Loan growth is not the number-one, number two priority. As you can see also we are growing at about system rates at this point.

Umesh Matkar

The amount of credit substitutes for this quarter would be and for the last year?

Rajat Monga

Same time last year and this year?

Umesh Matkar

Yeah.

Rajat Monga

11,000 crores is the credit substitute numbers, last year would be about 4000-5000 crores same time last year. we will confirm the number on the call.

Moderator

The next question is from the line of Nilesh Parikh from Edelweiss. Please go ahead.

Nilesh Parikh

Just wanted to get a sense on the average cost of borrowing books and what is the quantum today in terms of the stock of borrowing?

Rajat Monga

Stock of borrowing I am not carrying the number but my sense would be about 8.5%.

Nilesh Parikh

So we ended FY12 with about 16000 crores odd so we would have seen some increase in that in terms of the borrowing?

Rajat Monga

The cost should be coming off because some of the borrowings if it is, let us say, is Tier 2 type of borrowing which is about 4000 crores of the total block that will not change because it is fixed and for a long-term. There is an element of short-term money market borrowing which would have re-priced down because RBI has cut rates, liquidity has also inched up. We have refinancing borrowings where we take eligible portfolios which are available for refinancing from EXIM or NABARD or SIDBI. Those borrowings are typically one-year in their contract, may not have re-priced down because days would be December to March contracts in the last lot. That should be another 2000 to 3000 crores there, another 2000-3000 crores should be from foreign currency sources. I think that cost would have gone up because same time last years the hedging cost was much lower than it is now. So overall sequentially I won't sense a whole lot of change, maybe marginally lower and Y-o-Y it will be higher because we have seen a lot of increase in interest rates Y-o-Y.

Nilesh Parikh

What I was referring to was one is obviously the cost which you mentioned but the second is our strategy going forward as a proportion of balance sheet. How does one kind of practice here because we seen deposit growth being obviously slower than overall balance sheet growth and borrowing as a number is picking up. so where does it settle in terms of the overall contribution and in that context I wanted to understand the cost because today it is basically substituting for deposits?

Rajat Monga

Purely because it is cheaper and that will change when the interest rate environment falls . The predominant reason why borrowings have been increasing because they have been cheaper than deposits to be contracted. Now I can get into specifics of the reasons of they being cheaper except Tier 2 because Tier 2 is more a lifecycle management borrowing. I mentioned foreign currency borrowings in the first half of last year till October were cheap. You would contract a one year borrowing in dollars, swop that into rupees for a landed rupee price of 6 to 7% and that's when the cost of deposits was already in 9-9.5% so we ventured into some of that. The refinancing that you will take from, I mentioned the refinancing situation, the SLR, CRR exempt because it is defined as a take out. So that borrowing on adjusted first CRR and SLR is about 1% cheaper than deposits, adjusted first CRR, SLR so we also relied on that source of borrowing. The yield curve was also very steep, most through the last six to eight months. There has been a little bit of increase in overnight borrowings as well because you could take overnight borrowing 8.5% call was reasonably 8.5-8.6% and without too much worry on the upside so we could lock some of our funding plans into borrowings so it's predominantly a function other than life-cycle function of the fact that the borrowing was cheaper and as that color changes so we'll our mix.

Nilesh Parikh

On a blended basis the cost was about 8.5% on this borrowing and so obviously its cheaper that what you are raising on the term side but when you look at the CASA if I kind of club the

two borrowings and deposits put together and the share of low-cost deposits not seen meaningful improvement that is what you would just probably looking at the deposit base. So from our balance sheet perspective the improvement in terms of low-cost deposits is not that meaningful, isn't that the metrics would track.

Rajat Monga

I think there are lots of ways we can track, the issue is we want to take high cost deposits... so the way we have to look at is that when we look at the deposits book there is always a core deposit book which is recurrent, which is transactional, where there is engagement with customer, where there is also other transactional relationships, cash management etc. And there is also a purchase deposit book which is one of contracts, lots of government deposits come just like if you are the best price available. So we would want to track the core deposit book differently from the quantity deposit book so this year particularly the core deposit book has done very well, whether it is Casa, whether it is retail deposits, granular liabilities whatever name we want to give them. And most of the underperformance of the deposit book on the balance sheet has come from the high cost deposits. So our concentration of deposits has come down, we have been saying no to very large depositors beyond a threshold of quantity. The quality is much improved in the inside of deposits but the quantity is not expressing a great outcome.

Nilesh Parikh

Within our SME or retail any specific, how much is retail within that?

Rajat Monga

Retail will be overall couple of percentage points or 2 to 3% depends on how you define retail but consumer retail will be about 2% of the total book. It will be other retail also which is difficult to draw line between SMEs or retail or not, whether a small transport operator is retail or SME I don't know. We will combine the two and give that total number.

Moderator

A kind request participants to limit to one question at a time. You may come back in the queue for more questions. The next question is from the line of Suresh Ganapathi from Macquarie. Please go ahead.

Suresh Ganapathi

Just two question, one is on the margin outlook of course not for the next quarter, I want to understand over the longer term how do you see your margins panning out because we have seen such a good improvement in your liabilities franchise but margins are stuck up because of various reasons and now once retail also starts picking up what do you think would be a normalized state of margins with your target under 30-35% CASA assumption and the second question is have you received any intimation from RBI on the promoters stake or you are allowed to maintain above 20% stake for quite some time, anything on the promoters stake clarity?

Rajat Monga

Let me answer the last one first, no we are not operating on any deadline. There is correspondence which happens between the bank and RBI on promoter ownership. We naturally have had I would say a continuous correction in our promoter holding. If I can take

back to eight years ago, we started the bank with the promoter ownership of 72%, now at 26% so we have had a very strong track record on that part. Our promoter ownership is split between two entities which are independent. There is Rana Kapoor and family, there is Ashok Kapur and family and there is Rabo-Bank who would be in the promoter category. So while there is correspondence between the bank and by RBI but there is no such December deadline.

On your former part of your question which was on margins, yes we are also little bit disappointed by the fact that the margins had been flat despite core improvement in the mixes. Unfortunately we have had the challenge of funding becoming very tight in March and we are still overcoming that cost burden that we acquired like other banks did. Relatively speaking we have been noticing most banks have been reporting falling margins sequentially so we are actually reporting constant margins. I feel reasonably confident in the short-term though your question does not refer to the short-term but I would want to even give the short-term feel on margins that is reasonably positive because we have acquired a 12-14 basis points of margins just in Q1 on account of improvement in CASA, expressed itself because we had to take some downside on account of non-CASA cost push. But the non-CASA cost push is also easing as rates have settled little lower, liquidity in the banking sector is far better than it was four months ago. The outlook for liquidity is yet better for at least the next month or two. Over the long-term I think if we do size up on margins for a 30-35% CASA we are looking at 3.3-3.5% margin I would say outcome in that backdrop. So we are hoping that we should be adding 10-15 basis points on margin almost every year on our CASA development.

Suresh Ganapathi

Asset quality, this sharp increase QOQ on NPA I know there is a low base effect but any large account of any particular sector or concentration there?

Rajat Monga

QOQ sequentially there should not be a sharp increase unless the number is reported net because you had a 20-30 crores total NPA addition for the last 3-4 quarters. This is before adjusting for recoveries or any upgradations. So the addition to NPAs has been in that kinds of quantity range for the last 3-4 quarters.

Moderator

The next question is from the line of Anand Vasudevan from Franklin Templeton. Please go ahead.

Anand Vasudevan

The credit substitutes of about Rs.108 billion that you are carrying. Does this include stuff that your warehousing would be offloading pretty shortly?

Rajat Monga

Yes this is the total headline.

Anand Vasudevan

Rs 108 billion of credit substitutes.

Rajat Monga

Absolutely this will include CPs, this includes any transient deals also that had happened and are possibly going to move out a matter of days. This also includes some of the positions

which our warehouse meant for distribution. This will also include some true credit substitutes which we are likely to hold to maturity as well.

Anand Vasudevan Has the underlined true credit substitutes as you call it as a proportion of advances, has that for any reason increased overtime, is that trending up and is there any reason behind that?

Rajat Monga I think short-term trend must be up because the loan trend is particularly weaker. I don't seem to have a great reason to say why the investment book is relatively trending higher. One probable reason is that there is definitely preference for borrowers who generally believe that the pricing is better in a bond than a loan so the issuers who have access to capital markets who can issue paper have rating which is also distributable in some sense do tend to have a preference for bonds. For example, the two significant deal that we handled over Hindalco and Tata Steel in the last quarter which are still under distribution as far as so they are still under warehouse situation. But these are not the ones that we want to hold for maturity, these will be distributed to the rightful holders.

Anand Vasudevan The other question is on capital, what is your core equity Tier 1 capital currently if we include profits for the quarter?

Rajat Monga It should be 8.6 to 8.7%.

Anand Vasudevan Now that is at the lower end of what the other private-sector banks are maintaining, so what are your thoughts on capital requirement and capital raising cycle?

Rajat Monga We have a prima facie approval from shareholders that we have taken earlier this month to issue up to \$500 million of equity. There is no short-term plan that we are working on. We are still working with the assumption that we have about 20 to 25% ROE performance that we are budgeting, factoring for some dividend and therefore believing that we will be able to handle a 20-25% growth without needing capital. There is the element of capital consumption which is also gone towards the credit substitute books which is in the scope of management, we can release capital as well through sales of those investment position. So there is I would say yes while we are possibly expressing a lower end of the range number but there is about 50-50 basis points which is short-term management handle is available on locking that kind of capital if need be. So we are not budgeting for a very serious loan growth in this year. It should be industry levels may be slightly better so we are not looking like we will be reporting worst capital number than this in any case.

Anand Vasudevan I haven't seen the savings account balance, what is your savings deposit balance by the end of the quarter?

Rajat Monga June end position is about 3010 crores.

Anand Vasudevan How much of your deposits would be above 7%, is that a material part of the savings account balance?

Rajat Monga No, it will be very high number, close to 98-99% will be 7% or below.

Anand Vasudevan What is the number of savings accounts?

Rajat Monga Total outstanding?

Anand Vasudevan Yeah.

Rajat Monga 450,000.

Anand Vasudevan As compared to around 300,000 at the beginning of the quarter, is that correct?

Rajat Monga We would have added about 80,000 accounts this quarter. I don't have the final number so if you can allow some approximation we can work with 80,000 increments for the quarter and the final number should be between 4 and 4.5, I don't know if we gave a number last time.

Anand Vasudevan I think I have got 300,000 in my notes.

Rajat Monga So it was more than 300,000 as at the March end and it is less than 450,000.

Moderator The next question is from the line of Rajeev Varma from Merrill Lynch. Please go ahead.

Rajeev Varma Can you probably throw some color on your retail strategy for sales per se you have taken _____ **44.51** to expand that so what are you looking at both short-term I guess over the next 12 to 18 months?

Rajat Monga We are obviously putting our forces behind the retail business. We have seen breakout moments on retail liabilities in the last 12 months so we want to leverage and consolidate on those positions. We are definitely looking at retail strategy where liabilities are going to precede assets. So the management has been supplemented, complemented through external hire, internal re-allocations and retail is in our opinion now reasonably well invested as far as top management is concerned. We have added about 175 branches in the last 15 months which takes our branch network now to about 380. So that a serious 60-70% addition to branches on the ground. We have also added about 50% to our headcount in the last 15-18 months concurrently which is predominantly gone towards populating the branches as well as the support functions which will support the retail business. So all the investments are in play, ATM networks etc also have more than doubled in the same period, management has been added, and products have been launched. We are there though the outcomes are still very small, not very measurable exactly. But all retail lending products also have been rolled out, including new car loans, mortgages, education loans, auto loans, commercial vehicle loans,

construction equipment loans. They are in different stages of their setup or evolution. While the overall numbers are not yet expressing greatly on the balance sheet but the internal works are well underway. We have raised our branch targets for the Version 2 plan from 750 to even 900 by March 2015. So strategies are all basically, people, process, technology, infra and distribution so we are working on all of these fronts and you should see results sooner than later.

- Rajeev Varma** I am not holding you to number but let us assume you have to put a number on fiscal 14, what do you think could be the share of retail loans in the next two years?
- Rajat Monga** I will borrow one more year from you so fiscal 15 is where we have a 30% share from SME and retail that is our Version 2 target we are working with. We are currently at 15.
- Rajeev Varma** We would still have higher share of SME versus retail?
- Rajat Monga** I found that line always very difficult to draw but there would be a fair amount of overlap as well. So classical SME and classical retail and the hybrids should be equal.
- Moderator** The next question is from the line of Manish Shukla from Deutsche Bank. Please go ahead.
- Manish Shukla** If I see the loan book sequentially, the commercial banking on branch banking fees seems to have shrunk quarter-on-quarter, is that assessment correct?
- Rajat Monga** Yes.
- Manish Shukla** What would that lead to because the way I see it, commercial banking return 5% quarter-on-quarter and branch banking return almost 12% quarter-on-quarter in my numbers?
- Rajat Monga** There would be a PSL rundown factor in both the segments and I don't have a very precise explanation right away. But you can assume that if there would have been a bought-out transaction we would have done in between December and March, we should have had a rundown effect in the 1st Quarter. If we bought a gold pool for example that would have run down completely.
- Manish Shukla** Within that the number seems to high for it to be just appear on that front. Secondly wanted to check how do you define the retail term deposit? Is it defined as a class of investor or is it the size of the deposit?
- Rajat Monga** We define retail deposit predominantly by sourcing of the deposit. So we work every client is mapped to a relationship in the bank. We have several relationship segments starting with Corporate Banking, Corporate Financing, Commercial Banking, Business Banking, MNC, International Banking, Indian Financial Institutional Banking, Business Banking and Branch

Banking. So Branch Banking is what we typically defined as Retail Banking where the deposits are sourced and serviced by the branch local.

Manish Shukla

So it is not a function of the size of the deposit?

Rajat Monga

There is a size, sometimes you have rich people also in retail so we don't want to limit ourselves by size, and it is more limited by channels. There could be an individual who has a 5 crores deposit as well.

Manish Shukla

In the new priority sector norms there has been some alteration as a modification in some fine print, what are the implications of that and how do you plan to counter it, for example lending to HSCs will not be PSL so how do you counter all those channels?

Rajat Monga

Lending to HSC was a 100 crores position in our compliance of PSL fiscal 11-12 so that should not be a great deal. In fact we have already done more business this year than 100 crores. So at least this year and we don't seem to be worse off but we will have to work out of this was proportion beginning fiscal '13-14 that one. The next biggest fine print loss is the lending to mid-to-large segment of supply chain which was eligible for a 1/3rd – 2/3rd classifications between direct Agri and indirect Agri. So that part is missing. So that's a 300 to 400 crores loss on direct Agri. That will have to be rework in some other sourcing arrangement.

Manish Shukla

Any other component which impact?

Rajat Monga

Not at least to our interpretation at this point in time. These are two components which we seem to have given up clearly.

Moderator

The next question is from the line of Amit Ganatra from Religare Asset Management. Please go ahead.

Amit Ganatra

Is it possible to get total gross addition to NPAs this quarter?

Rajat Monga

30 crores if you allow us 1-2 crores of error.

Amit Ganatra

And is it similar to what was last quarter as well?

Rajat Monga

The range is give or take 5-7 crores is been the same number.

Amit Ganatra

You don't have the total quantum of borrowing?

Rajat Monga

It will be about 17,000 crores.

Amit Ganatra

So this includes Tier 2 as well, right?

- Rajat Monga** Yes.
- Amit Ganatra** This is a very large number and it is important from our calculation from a cost of funds perspective. So if you can just include this in your future presentation.
- Rajat Monga** You mean the cost of borrowing?
- Amit Ganatra** No, the borrowing number as a percentage of overall funds, it's a large number. So just from a calculation of overall cost of funds for the bank which will include the total cost.
- Rajat Monga** We will give a breakdown of these because this number also deserve the breakdown in terms of the different categories because we get repeated question so we will include this as additional disclosure.
- Amit Ganatra** That's the only request.
- Moderator** The next question is from the line of M. B. Mahesh from Kotak Securities. Please go ahead.
- M.B. Mahesh** First question is on your financial advisory which has been again very strong quarter in terms of income. Could you just give a little bit more color on the kind of fees that you are generating in this business?
- Rajat Monga** There are predominantly 3 or 4 products and businesses which are driving the fees. These would be corporate finance which could be one, there would be investment-banking which could be second and there would be loan syndication which would be third. The basic revenue model here is fees so the services that we provide to clients are could be in the lines of that we are helping them raise loans, we are helping them buy businesses, we are helping them raise equity, we are finding structured solutions for their financing requirements which could be domestic, overseas, in subsidiaries, in the companies so all of this is where I would say is the element of skill based approach to clients where you may combine your origination, structuring and distribution capabilities.
- M.B. Mahesh** If you were to do syndication deal, there are chances that you will get about 20 to 30 basis points on every book.
- Rajat Monga** No we can get more.
- M.B. Mahesh** How is that because if I understand the deal that you have done on Hindalco or Tata Steel.
- Rajat Monga** The Hindalco will appear in financial markets. We report our debt capital market as a financial market, this will be loan syndication. So if we approach L&T in one of their road companies and we tell them that we will re-syndicate your road project and lower your cost of fund by 1% and if we do more than that we will want to share your upside. So we will re-syndicate the

financing done for a road project in this particular case 800 to 900 crores in terms of size and get new banks on board, re-package the cost to them, maybe also into some foreign currency funding part to that. So it's a part of that loan syndication one such episode will be progressing like what I described. Typically you have an instance of fee upfront which could be 0.25%, it could be even 1% in depending upon what the situation is. We also have the element of sharing of upside in our transaction. If we agree with the client that we will get this money to you at level 75 for 8 years and we ultimately raise it at 11.50, we also work with them to sharing that 25 basis points with us and that 25 basis points is for eight years. So that converts itself into element of fees. Investment banking is classical advisory. I must also add that we are little bit more clear in terms of classification of income into financial market, transaction banking and retail so even some of the residual categories come into advisory. So it also takes up a little bit of residuary role in terms of classification because we are reporting only four headers.

M.B. Mahesh

On the transaction banking, it's been about six quarter we have been moving in the range of about 60 to 65 crores. This quarter strong income has come from also from Q1-FY12 was very weak quarter, just wanted to understand where we heading in terms of numbers? So we seem to be improving our deepening or relationship with corporates, shouldn't this number already be on the above 100% range?

Rajat Monga

We have to analyze the number in terms of transaction banking. The largest contributor of fee transaction banking will be trade finance. So that is actually a little bit of cyclical number in the sense that it is a function of also country importing and exporting. This number is purely on the basis of incremental business. It is not on as and when basis, if more imports happen more business will happen.

M.B. Mahesh

But is that pertinent to the size at which we are because as a bank we are still a very small player to where the opportunity is.

Rajat Monga

I would agree, yes there are some markets which we shut ourselves out from, let us say oil. We are just about an incumbent player in the oil import market because a typical LC size for a full shipment for oil is \$100 million. So a single LC \$100 million I think this is the first year, six months that we have begun to put most kind of size LCs for oil importing customers. So yes there is an element of us getting more optimal which is there but there is also an element of both risk and cycle which is also weighing us down a bit. Some of these are actually risk embedded products. When we are typically opening this LC, the LC also has a supporting working capital facility to the customer. If our risk appetite is lower so we will be our appetite to open LCs. I must mention except the upside we keep on SLR during down-cycles other than that all fee is cyclical. We will see the element of slow down in the economy also show up on non-interest income.

- M.B. Mahesh** Sir just to clarify how much the LC be contributing to your overall fees in transaction banking or LCBGs?
- Rajat Monga** So it will be predominantly LCBG, Trade Finance, Banking Credit, Post-Shipment Financing, LUT that will be 70-80% of the Transaction Banking.
- M.B. Mahesh** Just wanted to check this regulatory arbitrage which we have been getting on the investment book both on the PSL side and also on the base rate side?
- Rajat Monga** Wrong adjective there is no regulatory arbitrage.
- M.B. Mahesh** It is an opportunity which the entire banking sector has, it is not restricted to one bank just wanted to check RBI is looking into this by any chance?
- Rajat Monga** I have no clue you should ask RBI that question actually.
- Moderator** The next question is from the line of Mr. Anish Tawakley from Barclays. Please go ahead.
- Nikhil** I had couple of questions. One what is OPEX growth we are estimating for the year and the second is that can we sustain the other income given the **comps 1.2.2** will be getting tougher because we had a strong quarter in Q2 and Q3, so these are my two questions?
- Rajat Monga** Yes 75% growth is not sustainable; there would be some contextual situations in the running quarter as well as in the base quarter. So it is not something which we can very simply generalize and say 74% growth is there for taking. The core growth should be in line with balance sheet plus-minus. I think that is what we will want to budget for there is a countercyclical expression like we have described in answering some of the earlier questions, that there is an element of the interest rate cycle which is expressing itself in these numbers. If the cycle base has to low interest rate that expression will continue. The certainty of that happening every quarter is everybody's guess, so we are not planning for that, it just if that happens we use that for additional provisioning buffers in our P&L as and when that happens. So that actually a welcome let us say overshooting of the non-interest income trend as and when that happens, it is not necessarily jacking up the bottom-line because we also want to increase provisioning in that backdrop. So you should be for let us say ball parking the other income I think it should be in line with the overall franchise balance sheet growth, when the balance sheet growth is slow it will be little bit higher, when the balance sheet growth is brisk, it will be a bit lower because the non-interest income is a lagged product, we generate income through LCs, BGs, FX, etc., there is a little bit of lag in terms of developing balance sheet relationship with borrowers. So there is I would say that I don't know if I have answered your question but that's a sense I would leave behind on non-interest income. OPEX growth we are looking at about 35% in terms of current, let us say acquired costs and also some let us say pending costs, that we are dealing with in the last 3-4% function, of how the income is also

running. If the income run rate continues to be satisfactory we will keep the cost on rate also anchored at about 35%.

- Moderator** Thank you. The next question is from the line of Jaymin Trivedi from ICICI Direct. Please go ahead.
- Kajal** Sir wanted to know about this income from investments which is coming from credit substitutes, can we get the breakup of normal income from investment and what is coming from credit substitutes?
- Rajat Monga** We do not have that split but I can give you a little bit of a very quick let us say guidance, where we should be able to backward the numbers. The current substitute the total investment book, so we have in interest income investments of for the quarter is 630 crores. The total investment book is 30,000 crores, out of the 30,000, 19 is SLR, 11 is non-SLR, SLR yield will be 8.2. We can work the math back so that it fits up which we can do, but you should get an answer of about 10.5 and 11 the yield on non-SLR investment.
- Kajal** Also if you can share the provision breakup?
- Rajat Monga** Provision breakup out of the 30 crores we have about 21 crores provision on account of NPAs net provisional, and we have about another 10-15 crores of general provisioning.
- Kajal** One last question on capital raising plans, if you can throw the light on that?
- Rajat Monga** We have enabling resolution which we have with the shareholders have approved about 10 days ago in an AGM. So we are empowered by the shareholders to raise up to \$500 billion and this mandate is available to us for the next 12 months. I think there are two criteria that we are keenly looking at to raise capital. First criteria is that the markets have to be conducive and kind enough for an issue is to happen, mainly there should be visibility of growth, that we are also able to put that capital to use with some certainty. I think what we are looking for is an upturn in the cycle in this economic cycle which is where we should be able to put our capital raising plans through.
- Kajal** But this \$500 billion what we are talking on capital is only equity what we are talking?
- Rajat Monga** Exactly yes.
- Moderator** The next question is from the line of Jyoti Khatri from Systematix Shares. Please go ahead.
- Jyoti Khatri** Can we have the average balances of current account and savings deposits for the quarter and if you can have the same number for the last quarter as well, average balances?

Rajat Monga

I am not carrying the numbers but we are giving quarter-end numbers. The saving account numbers are pretty linear so you can simply interpolate.

Jyoti Khatri

Secondly on if I look for the credit growth number for the current quarter it was it was around 16.5% levels, extent growth looks on a higher side partly due to the low base effect and can you throw some light when you will be comfortable growing at around slightly above than industry average you did mention on that but currently if I look at the balance sheet structure it is routed more through investments and on the liability side more of borrowing and I think we are running of spread is around 100-150 bps there how the margins have been maintained at around due 2.8% levels, if you can share something on that side and plus on the balance sheet front?

Rajat Monga

On an year-on-year basis the biggest margin increment has come from increasing mix of CASA, so our CASA has improved by 5% that on the standalone basis should have added about 25-30 bps of margins, but that margins have not been expressed in the numbers have been disclosing various reasons. One reason is that the share of investments like you have mentioned has gone up and investments do not get us the best yields or spreads, so some of that benefit has been lost to investments. The share of borrowing has increased as I was mentioning earlier in the call in answer to other question these typically found borrowings cheaper than deposits especially 6 months of the last financial year when the deposits were really expensive, so that should have also added about 5-8 bps to overall margin consequences in the give-and-take of between mix presence on the balance sheet in their impact on margins. Finally, we have not been able to express any net increase in margins given the mixed changes, but what we have also been seeing is that if we do not look at margins for a bit but if you look at loans spread as we would call them. So yield on loans minus cost of deposits or cost of funds, so whatever we take both the numbers have been growing except in the June quarter over March quarter. So in the last 12 to 15 months the spread numbers have been accreting. So the core books has actually been adding let us say value to itself, while on a total book basis it has been lost to some low margin business that has also been put on the balance sheet.

Jyoti Khatri

Okay and Sir the cost-to-income ratio are the ratio has actually in the last five quarters increased from around 35% odd levels around 40 now, you said that you will be looking at a OPEX of around 35% odd level but then what is the call that you would be taking on this cost-to-income ratio side and the near term and consumer side you will be holding the retail liabilities I mean your balance sheet will be more of retails heavy I mean which definitely add to your cost, any sense that this number could inch up first?

Rajat Monga

I see this number is at 40 in the backdrop of over this increase in our cost-to-income during last 18 months particularly we have increased our headcount by 60% and our branches by about 70-80%, so we actually have seen a fairly sharp investment phase in the bank's lifecycle in the last 18 months particularly, that is also been in the backdrop of the fact that we were reasonably confident about business, so we could be able to deliver both top-line and of course

higher costs, that continues to be our thought process still. I have to mention that there are basis the last two years of investments there are also productivity gains that we are hoping to unleash. Lots of investments in retail liabilities particularly are very fixed cost light, so it is an investment which is fixed but your output increases every year. So that is the productivity I am referring to. These investments are fixed with some inflation cost of course but the productivity opportunity and upsides are still quite sharp. So we are overall hoping that our cost-to-income is not going to shoot much higher from where we are, very difficult to predict the number for every quarter, but yes there has been a like you have pointed out the increasing trend for the last 5-6 quarters particularly on the back of the investment that we have been making and these are investments which will give us top line over next many years. So we are not particularly worried about the cost-to-income ratio in the short-term but we have to calibrate that to opportunity. We have to calibrate that to affordability. So like we mentioned that while we expect OPEX growth of 35% but that can be calibrated to also where the revenue grows. No guidance on that number but we are not particularly let us say worrying too much even if it is 1-2% higher from here.

Moderator

Thank you. The next question is from the line of Sachin Sheth from HSBC. Please go ahead.

Sachin Sheth

Just a quick question on credit costs, while it seems to be very much in control if I look at the loan split the increase in loans sequentially seems to have come from mainly two sectors one is metals and the other is financial services, I just wanted to get a sense of metals is not exactly something which just covers in this environment, so what kind of loans have you made out here?

Rajat Monga

I think these I see we have given the split of our customer asset book, so it includes loans and credit substitutes and that two dominant let us say additions in particularly the metals has been Hindalco and Tata Steel. These are being two very large mandates that we have run in the debt capital market place. Hindalco was 1500 crores and Tata Steel was 750 crores. These are two let us say standout kind of commissions that we have in terms of exposures. I do not think we are very worried about these names. Thought they express themselves in the metal space.

Sachin Sheth

The other part is to do with as your retail proportion increases the inherent riskiness of that book also tends to rise. When you said that your medium term margins in response to an earlier question was in the range is may be 3.3 or 3.5%, you would also expect your credit cost to rise in the same way?

Rajat Monga

Right I am sure there will be a correspondent increase in credit costs as we get into more let us say retail like businesses which will have even statistical consequences and not just credit issues. So yes if we were to model we will model for higher price costs, but I do think we would be looking at a net, let us say loss to ROA level. Our base agenda would be to develop this business such that it is ROA incremental.

- Sachin Sheth** Absolutely, and then your term may be this year or next years you are still looking at in the range of about 25-30 bps in terms of credit cost?
- Rajat Monga** The trend has been I see even better than that in terms of what we have been experiencing. Again not easy to draw trend lines here because we have a sample set of 3-4 set of NPAs in a quarter. I think the only let us say the challenge may have to deal with this unbudgeted and unanticipated surprises on account of asset quality, but as we look at our portfolio I will cut it we do not anticipate any spurt in credit cost.
- Moderator** We will take our last question from the line of Adarsh P. from Prabhudas Lilladher. Please go ahead.
- Adarsh P.** I have just two questions on the credit substitutes part on that 108 billion I just wanted to know what part of it is so called distributable and what do you intent to hold to maturity, approximately?
- Rajat Monga** I think about I would say safe majority will be distributable.
- Adarsh P.** So could be in excess of 60-70% of that.
- Rajat Monga** We do not have a pure number because we will have to go name by name, deal by deal, provision by provision but my sense is that it should be of that order.
- Adarsh** And on that distributable part just wanted to understand are there rate implication either be positive or negative till it stands in your balance sheet and say market rates for AAA, AA, corporates move here and there, so are there rate implications probably in this environment may be positive but?
- Rajat Monga** While yes these are market risk bearing instruments so I mean one would look at it is that yes there are rate implications, if rates go higher there could be mark-to-market losses. The other way to look at is that we already have mark-to-market gains in this book, so there will be a cushion before we see the need to absorb those potential losses, and thankfully these are distributable so we may not have to fit through these _____ **1.20.20**, we will have the window for management action to be able to also let us say take the necessary actions to mitigate the consequences.
- Adarsh P.** And does that fee income or so-called income fee income that gets reported through this book includes some gains that is also booked?
- Rajat Monga** Gains can be booked only on sale.
- Adarsh P.** So when you would do to the eventual sale so all the even the market risk gain that you had or the MTM gains is also reported on that particular fee income lines?

- Rajat Monga** Only if it is realized. Loss can also be unrealized. So an unrealized loss and/or realized loss is reported, but only realized gain is reported, these are the RBI counting requirements.
- Moderator** I would like to hand over the floor over to Mr. Anil Aggarwal for closing comments.
- Anil Aggarwal** Thanks a lot Rana, Rajat and the entire team for taking time out from their schedule for this call. Thanks a lot and best of luck for the second quarter.
- Rajat Monga** Thank you all for sparing time in joining us for this call.
- Moderator** On behalf of Morgan Stanley India Company Ltd. that concludes this conference. Thank you for joining us, you may now disconnect your lines.