"YES Bank Limited Q1 FY17 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to YES Bank Limited Q1 FY17 Earnings Conference Call. We have with us on the call today Mr. Rajat Monga – Senior Group President, Financial Markets and CFO; Mr. Ashish Agarwal – Senior Group President & Chief Risk Officer; Mr. Jaideep Iyer – Group President, Financial Management. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Rajat Monga – Senior Group President, Financial Markets and CFO, YES Bank. Thank you, and over to you, sir.

Rajat Monga: Aman, thank you very much. And I welcome all on this call, which will detail the results of the first quarter of the fiscal year 2016-2017 for YES Bank. This is also marking the 13th year of the operations of YES Bank since it was founded in 2004. And we will detail on our results, but we are pleased to report that the Bank has posted another satisfactory quarter of financial results in terms of various financial parameters, including growth, profitability, as well as asset quality.

While the stress in the banking system continues to exist in terms of distortions and asset quality consequences, however, we believe that the economy in the backdrop is progressively improving and is also offering progressively more opportunities for new growth, as well as making the risks in the environment pretty apparent for progressive banking opportunities to be identified and benefited from.

Broadly, on the economic front, it's been a while since India has had moderation in both current account deficit and fiscal deficit and they continue to be at their lowest level since the global financial crisis, which is a fairly encouraging backdrop for the macroeconomic structure of the country. There has been continuous accretion to foreign currency reserves of the country as well, despite varied backdrop across the world, especially in emerging markets and the foreign currency reserves of the country stand now in excess of $363 billion.

In this backdrop, the currency has also been pretty steady, range bound and has been able to navigate the volatility on account of Brexit pretty comfortably. So there will be some uncertainty which will remain on the Indian rupee on account of the redemption and/or rollover of FCNR deposits that is now lining up for the third quarter of this fiscal year.

We also believe that the Indian economy will improve on its GDP performance this year. We are expecting the Indian economy to deliver a 8.1% GDP growth for the current fiscal year, as opposed to 7.5% that it has had delivered in the last couple of years or so.

The themes on domestic growth continue to be led by urban consumption, as well rural consumption, which should also see benefits coming from what looks like a normal or better than normal monsoon season which is currently underway. We are also seeing a fair amount of public expenditure on the CapEx side, and we continue to see a low key outcome on the CapEx side from the private sector.

Globally, on the other hand we continue to see a low growth and a low inflation sort of an environment. We are seeing more easing coming from certain Central Banks, except the US Central Bank, which possibly can still look to tighten maybe later this year. In this backdrop, we continue to believe that there is room for India to achieve moderately higher growth as well as look at a monetary comfort from what should be now a lower inflation due to better monsoon and food prices as they begin to consolidate, possibly by the month of August, naturally being helped by a somewhat subdued pricing power in the economy and the continuing softness in the global commodities. There is, we believe, also room for more monetary easing that can happen in the country and we do expect 25 basis points to 50 basis points rate cuts that we should be able to realize in the current fiscal year itself. However, we are also due to see some leadership changes at the Central Bank level in the country and possibly would wait to hear from the new leadership in terms of their thought processes around inflation and monetary policy management.

I will move on in this backdrop to detailing out the results of the Bank for the quarter gone by. The Bank has reported a net profit after tax of Rs.7.3 billion, this represents a little less than 33% growth on a year-on-year basis. The total profit was well supported by a 38% growth in income, and the growth in income was about 24% from net interest income and a healthy 60% from non-interest income. The Bank is reporting slightly improved margins when compared to the first quarter of last financial year, we are reporting a net interest margin at 3.4%. This is, however, a marginal improvement of the margins that we reported in the first quarter of previous year, but it is flat as compared to margins of the sequential previous quarter.

On productivity and profitability, the return on assets stand at 1.7% and the Bank is reporting a return on equity of 20.7%, both these numbers are annualized as far as the current quarter is concerned. The book value of the share stands at Rs.345.2 as on June 30th. The NII growth particularly was well supported by balance sheet growth, so the interest bearing assets of the Bank grew about 24%. Loans in turn did better, the loan book has grown at the rate of 33% and the deposits have grown at the rate of 28%. Within deposits, we have seen a fairly good growth in CASA book as well. The CASA book has increased at the rate of 63% on a year-on-year basis, resulting in the CASA ratio improving to a number of 29.6%, and this is a good improvement from 23.4% position on CASA June 30th last year.

The total capital adequacy of the Bank stands at 15.5%, and within that, the Tier-I capital adequacy stands at 10.3%. The total capital funds are about Rs.223 billion, that is about Rs. 22,400 crores of capital funds that the Bank has as at June 30th, 2016.

The next few data points will be on the asset quality side. I think the Bank has had an in-line quarter as far as asset quality is concerned. The Bank is reporting a credit cost of 15 basis points for this quarter. The gross NPA position as at June 30th is 79 basis points, and the net NPA position is 29 basis points. This in turn represents a 64.2% provisioning coverage as far as NPAs is concerned.

The restructured advances book of the Bank has been constant in nominal terms, however, it has reduced in proportionate terms on account of the growth in the base loan book. The Bank now has the restructured advances book which represents 49 basis points of the total loan book, it is down from 71 basis points that it was same time last year. The Bank has not undertaken any additional restructuring in the quarter gone by.

The security receipts book stands at 19 basis points, again a prorated reduction on account of increase in the loan book, and there have been no additional sales to ARCs in the current quarter either.

The Bank has undertaken a single small SDR in the current quarter, that would be amounting to about Rs.34 crores, representing 3 basis points of the loan book, and this is the first SDR that the Bank has had to undertake. And there was no account that had to be taken up for 5/25 refinancing in the quarter gone by.

On the slippage front, the Bank has taken a slippage in the current quarter of almost Rs.3 billion and has also seen a fair amount of recovery and upgrades from the earlier NPAs stacking up to Rs.1.9 billion in this current quarter. As a result, the Bank has taken about Rs.206 crores or Rs.2.06 billion of provisioning. Out of the Rs.2.06 billion, Rs.0.95 billion is on account of NPAs, so it is increased provisioning for NPAs. About Rs.0.7 billion is on account of the counter-cyclical provisioning that the Bank has added in this current quarter, and about the remaining Rs.0.4 billion is on account of standard or general loan loss provisioning on account of the increase in loan book.

Within the loan book, which grew at a pretty healthy rate of 33%, the Bank is reporting a corporate mix of 67.5% and a retail & business banking combined mix of 32.5%. This is a seasonal correction that typically Bank experiences, so you would note that the corporate banking book has increased in proportion over the last reported number as at March, given the seasonality and adjustments for the priority sector portfolios also that take place between the fourth quarter and the first quarter. We witness a similar correction in the June quarter of last year as well and we are assuming that the proportions will again move in favor of retail & business banking through the year, possibly peaking out again at the end of the fourth quarter of the current financial year.

The sectoral distribution of the Bank's portfolio has seen small shifts, maybe in favor of telecom and power, and away from iron and steel, away from petroleum, and away from EPC, which is Engineering Procurement and Construction. The telecom exposure is largely on account of Rs.15 billion underwriting bond issuance by a telecom company, it's a AAA-rated bond investment which was made towards the end of the quarter and therefore somewhat corresponding increase in the telecom sector exposure.

In the power sector, I think barring one significant exposure that we have taken on captive power plant, most of the other growth is distributed across the different sub-segments, maybe some reduction in the bond holdings because of ongoing distribution and more increase in working capital funding of the operating power projects in general.

The rating profile of the Bank is more or less stable as compared to the previous disclosure as at March and we continue to hold about 75% of our corporate exposures continue to be rated A or better, which is more or less in line with what we have been observing over the last few quarters.

The risk weighted assets of the Bank stood at Rs.1.44 trillion, so that's Rs.144,000 crores, and as a proportion of total assets that represents a ratio of 81.4% as compared to 81.0% proportion this corresponding quarter last year. So it is a pretty similar, let's say, presentation of the risk characteristics of the book on an overall basis.

The Bank continues to also be comfortable on internal and external ratings. The profile in the detailed note you will see is reasonably steady, as well as on the external ratings the Bank has been reaffirmed the rating with Moody's on the International segment at Baa3, which is at the sovereign country rating. As well as the domestic rating agencies continue to maintain their AA+ ratings at a stable level.

The Bank has also seen gradual improvements in the liquidity coverage ratio which stands at 83%. This is despite some tightening of regulation that was introduced by the Reserve Bank of India at the beginning of this quarter. However, the LCR continues to be comfortably above the regulatory minimum. And some more dispensation has also been added by the regulator just last week.

And the Bank is moving somewhat sharply and somewhat generally forward on the digital front as well. It runs a reasonably successful domestic remittance program, which is called YES Money. We have serviced over 5.1 million customers on that platform with a cumulative transaction throughput of about $2 billion, that is Rs.13,000 crores. The Bank has also in a very short period become the largest virtual prepaid card platform on MasterCard. The Bank has been in different tie-ups with the various e-commerce and fintech companies and players, where some of the wallets that the e-commerce players have been holding are being attached by a virtual prepaid debit card, which can empower the wallet to be used as a card as well. And we have added about 2.4 million such virtual prepaid cards in just in the last seven months since the program got launched in January 2016.

The Bank is also powering the wallet which is run by FreeCharge, which is again a wallet company in the Snapdeal Group. Since the launch in September of last year, so about 10 months back, the Bank has expanded this program to 34 million wallets, that is 3.4 crores wallets that are being serviced by the Bank's payment platform in a joint arrangement with FreeCharge. And we have also very recently introduced a QR Code based proximity payments, this is in collaboration with a company called Click & Pay. Essentially, authorization can be exchanged using a QR Code.

Some few more statistics on the expansion and the plans of the Bank:

The people strength of the Bank now has moved up to 16,400 employees. This is about a 1,421 employee increase in the current quarter and about a 5,000 employee increase since last year. So the hiring continues to be strong to support the underlying expansion of the Bank's, particularly the Bank's retail businesses. The branch network now stands at 900 branches. We have added 40 more branches in the current quarter. The ATM network strength is short of 1,700, and about a third of them are now either bunch note acceptors or cash recyclers, that has also being added to make ATM both a cash accepting and a cash dispensing machine.

The Bank has also received certain regulatory approvals in the quarter gone by. Among others, the Bank is now eligible to be owned by foreign investors, to the extent of 74% through the FII category. So the Bank was the first bank to be approved under the liberalized Foreign Ownership Guidelines introduced by the government.

The Bank has also received in-principle approval from the Securities Exchange Board of India for setting up an Asset Management Company. The Bank had earlier received an approval from the Reserve Bank as well, so both the critical approvals are in place and the Bank should be looking to target the launch of an AMC business now starting of the next fiscal year.

The Bank has also taken some steps to continue to invest in CSR initiatives and has taken up livelihood and water security additionally in this year and has announced a commitment of as much as Rs.2.5 billion, about Rs.250 crores to focus on these two particular important segments for the society.

There have been some additional recognitions that the Bank has received in the quarter gone by. Bank was also adjudged Asia's Best Bank for CSR at the Euromoney Excellence Awards for 2016, these awards were held in Hong Kong. The Bank also won two awards at the AAA Asia Infrastructure Awards that are hosted by the Asset Magazine and the Bank was awarded the Best Renewable Energy Deal that was a solar transaction. And also the best Green Bond Facility that the Bank had raised jointly with IFC, Washington, and this was for a Rs.315 crores Green Bond that the Bank had issued.

The Bank has also entered the Forbes Global 2000 List of the World's Top Companies, so we are very happy to be the youngest Indian company in that list, and also among the youngest banks in the world to be on the same list. The Bank was also recognized as the Best BFSI brand by the Economic Times. The Bank was also awarded the Best Trade Finance Bank in India by the Asian Banker. And also for the Best Corporate Payment Project for API Banking Implementation with Snapdeal. Again, these are the awards for the year 2016. And very recently as well, the Bank was also acknowledged by IDRBT, which is the technology arm of the Indian payments infrastructure, and the Bank got the recognition for being the best in cyber defense in the mid-sized bank category and got the award from the Governor of RBI himself.

I think with this I'll conclude my sort of detailing of the financial results and we will be happy to take questions.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Maru Adajania from IDFC. Please go ahead.

Marukh Adajania: Just wanted to understand the movement in your cost of funds during the quarter, because if we just work out balance sheet averages it appears to have gone up, so what went into the movement?

Rajat Monga: Mahrukh, cost of funds is flat between March and June. So the numbers we are publishing are with the basis on daily averages. Period end will always have its biases, cost of funds for the March quarter was 7.0% and cost of funds for June quarter is also 7.0%.

Marukh Adajania: That's because, I mean how would it differ from the quarterly average?

Rajat Monga: It is the quarterly average.

Marukh Adajania: No, what I'm trying to say is how would it differ from what we calculate from the balance sheet?

Rajat Monga: That will be a function of, let's say, if there is a rear ended growth or front ended sort of buildup of anything, so your quarter-end numbers will always, so there is the balance sheet growth and it does not always grow in the straight line. So this is the number that we are publishing, assumes give a daily average.

Marukh Adajania: And just in terms of retail consumer banking growth that's more of a second half story, is that the correct way to look at it?

Rajat Monga: No, there will be some seasonality in terms of the retail banking and there is also a little bit of priority sector influence wherever there is an overlap, because March 31 is usually the compliance date for priority sectors, so the business has to maximize and that time. And now this behavior will change this year because the priority sector compliance has also become now quarterly. So the seasonality will reduce going forward, but there still is seasonality.

Maru Adajania: And in terms of your margins, any outlook?

Rajat Monga: Yes, I mean the outlook continues to be favorable, in the sense that the CASA mix is moving up, the CASA price is moving down. We are also becoming more and more self reliant on buildup or compliance with priority sector, so we don't have to be buying or assuming originations of others any more, progressively so, if I may say. There is also going to be higher share of retail loans in course of time. So all of this will have a contribution towards margins going up. And we, on paper, have visibility of margins, which look in excess of 4%, but you have to give us three, four years to get there.

Maru Adajania: But this year you would see progressive movement in every quarter?

Rajat Monga: Well, so firstly, there is also a pressure on growth. So you also have to factor what can pull margins lower. So growth without, let's say growth higher than ROE will always be burden on margins, because we are not getting enough equity sort of mix in the funding structure and therefore the margins will mathematically fall. However, there could also be capital raising in the course of this year, and therefore that could also add to margins. So you have to look at margins a little bit over a longer period, if you ask me, and one year later the margin should clearly be 10 basis points to 15 basis points higher.

Maru Adajania: And just one last question, the exposure that you gave in your press release, the breakdowns like steel, steel is 1.9%, electricity. What will be the denominator, the base amount that is rupees, billion or whatever?

Rajat Monga: It will be close to Rs.1.5 trillion.

Moderator: Thank you. Our next question is from the line of Veekesh Gandhi from Bank of America. Please go ahead.

Veekesh Gandhi: Just had a quick question on consumer banking. So obviously I realize the difference between the March and the June numbers, but where do you see this going, let's say 18 months, 12 months from now, 9.4% that you have disclosed? And also if you can give some color of what is it made up of in 9.4%, some broad color.

Rajat Monga: So, I think on the first part of your question, the destination number for this book, if you give it maybe three, four, five years, is about 20% of the loan mix, somewhere between 20% and 25% of the loan mix is the destination number that we are currently working on and we will take it from there on once we get there. And as far as the component of this, let's say the 9.4% is concerned, it is split between seven loan products largely. And these loan products would include, I will just name them, commercial vehicles, car loans, construction equipment loans, inventory loans, healthcare loans, housing loans, loan against property and personal loans, I think they are eight of them. And each of these products are, let's say between 0.5% to 1.5% within the 9.4% breakout that you are referring to. Fee and LAP are higher, let's say, PL and healthcare financing is lower on the spectrum, basically between 0.5% of the loan book to 1.5% of the loan book.

Veekesh Gandhi: And I am assuming this would be all to the internal customers only as of now, whichever way it comes?

Rajat Monga: There could be some legacy holdings from the past, but incrementally you can set almost 100% incrementally, yes.

Veekesh Gandhi: Sorry, so when you say legacy, as in which sense?

Rajat Monga: Let's say we are still holding one commercial vehicle pool, which is running down, which we bought three, four years ago, but that's about it.

Moderator: Thank you. Our next question is from the line of Anurag Bansi from Jefferies.

Anurag Bansi: First question regarding your loan growth, what would be the guidance for the full year, if there is any impact of FCNR, and if you could help me with the credit substitute figure?

Rajat Monga: Yes. So just to get some of the factors out, so we did not take FCNR deposits when they were in more in demand, that was three years ago. So we do not have the corresponding redemptions that we are currently worrying about. In fact, we might look at participating in the rollovers of FCNRs if they do roll over, if the pricing conditions become more conducive. So we might look at adding to FCNR in this period, effectively. So, no real pull back or no real worry on account of FCNR as far as our growth is concerned. I will also quickly add the credit substitute statistic and the credit substitute book will be Rs.11,000 crores.

And on your first part of your question about growth expectations, I think we continue to be working with the assumption of mid to high 20s as far as the book growth is concerned, that should include loans, deposits. And within that, we are assuming that the CASA growth will be higher. And we are assuming that the retail loan growth will be higher from the average point of mid to high 20s that I mentioned.

Anurag Bansi: And secondly regarding the provisioning for the quarter. So currently after the additional contingency provisioning, what would be the outstanding number? And basically has there been any utilization at all?

Rajat Monga: No, there has only been a net addition to the contingent provisioning number. However, the proportion of contingent to loans has not changed, because the addition only could make up for the increase in the loan book. So our proportions of contingent to total loans continues to be at 30 basis points.

Anurag Bansi: And would you have any outlook or any guidance for the PCR, you have raised that by couple of percentage points this quarter.

Rajat Monga: Well, let's say the intent is to keep it above 60 and it is a little bit of a function of the underlying individual loans as well, because we are already, as you look into IFRS coming in or IndAS coming in, we have to be making provisioning which is in reference to LGDs going forward. So it is easy for me to say that I will make it 65, but it is not easy for me to argue sometimes that it should be 100 or 20. So it will become more and more, or I should say less and less discretionary. I mean, it will be a function of how we are arguing our case for loss given default. But as it looks, I think, we are sufficiently provided. So because there has been a little bit of a discussion in keeping higher specific provisioning cover, so we have more than enough cover. I mean, if everything else is constant, this book will give us provisions back, the NPA book, rather than take more provisions.

Anurag Bansi: And lastly on the, SDR exposure. First of all, if you could just help me understand if this was a consortium lending account and what would be the entire banking sector exposure to the account? And secondly is there any pipeline for SDR or 5/25 that you envisage?

Rajat Monga: So this was a consortium exposure and therefore it was more a consortium decision and our decision to tag along. And this would be a multiple hundred crores account for the banking sector. As far as pipeline is concerned, again, to that extent that we cannot predict which consortium will decide to go for CDR, it is hard for me to tell, and whether or not we will be in that proposal, be happy to tag along etc is still contingent. But from the current information point of view, I do not think we have any imminence of another SDR. I am not aware that the SDR is happening or likely to happen. Like I said, we can always be given information by the consortium, sometimes a little late in the day. But it is not looking like there is anything happening in a hurry.

Anurag Bansi: What would be the sector for this account?

Rajat Monga: It's a construction business company, EPC.

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

Manish Karva: Sir, just on your SA deposits, they have actually been growing fast for some quarters, but the growth seems to have been picking up even on a higher base. Two things, one, is there any one-offs which is there on SA or this is all granular and what is actually driving this? And while we understand the growth has to be stronger, has been strong, but this growth is getting even better on a higher base.

Rajat Monga: Yes. So, I think we are also wanting to, let's say, consolidate on this growth. I mean, we are not taking the growth for granted just because it's happened we are happy that it is growing and well. Just to quickly also address the one-off issues etc, there is a, like we have been indicating that we think 80% to 90% of this book is what branch banking potentially should regularly normally be generating and the range continues to be 80% to 90, and the range has although worsened in this quarter. I will not be able to say that this is a one-off, but I can say that the increase also has contributed by some accounts which are possibly higher than average in terms of their balances.

Manish Karva: You mean these will be some corporate accounts which probably…?

Rajat Monga: Government possibly, but the accounts also, let's say, there is churn in the account. So, let's say you are running a scheme account and there are sometimes monthly disbursements in those schemes, so the accounts get funded and then the disbursements are made for the month. And as the new month sets in the next month's funding comes in. So these are operating accounts, but sometimes let's say, you might get a Rs.100 crores funding to start with. And then the funding will get utilized during the month. And then the next month you might get another Rs.120 crores funding, depending upon what the scheme allocations are and how they are performing in that particular period etc. So we do not control the in and out, but what we have to be deriving benefit from is that the ins and outs are ongoing. So, it is not that it is in and idle, it is basically moving on both sides and the averages continue to be not volatile.

Manish Karva: And if I have to see savings account on an average, how much would it have grown?

Rajat Monga: Well, let me maybe answer it differently. So because savings account growth happens at month ends and then it preserves, not all, some of that will get used up. Then the next month end again growth happens, because all salaries get paid out, for example, in month ends. So the average trend of SA will not be far away from the quarter end trend of SA, will not be. I cannot say that for CA, CA usually has a little bit more quarter end bias. While SA has a month end bias, but that bias is by design, in the sense that because, actually there is a designing CA as well, but the CA cannot sustain, SA sustains. So there is lots of, let's say commercial flow settlement in the current account during the month end, that will not stay. But the settlements into a SA account stay longer and they stay longer than the next month end and more comes in at that time. So let's say if you see a SA book is Rs.25,000 crores as at June 30th, the averages for the month of July will be close to Rs.25,000 crores only. But not necessarily for June, because June we will get a month end flow that will increase the start for July and the averages for July. Then July end will yet be higher.

Manish Karva: And what would be the average SA cost for us?

Rajat Monga: It's pretty much similar, 6.5%. However, we are possibly also due to take some price correction, i.e. have to navigate the RBI policy which is early August and we could possibly look at our pricing steps also after that. It is also a part of the consolidation I was referring to earlier on the question.

Manish Karva: And the second question is on your employee additions. So last one year you have almost added like 5,000 employees, this is largely to do with retail operation launch which you are doing across all products?

Rajat Monga: Yes, predominantly, and branches.

Manish Karva: Front end,right?

Rajat Monga: It is 95% retail you can assume, but it will also include the employees because we have also had a good branch growth last year.

Manish Karva: But have we done enough, or this trend of strong growth can continue, because this is also reflecting into very strong employee cost as well, overall.

Rajat Monga: So Manish, this is more like I would say a little bit of a calibration number. I mean we have to take a two, three-year visibility of our business and have to hire with that sort of a design. So if I am suggesting that we should be growing in the mid to high 20s, I think the cost also will keep pace, because it has to come with more branches, with more retail sort of distribution on top of that and the new hiring also takes a bit to get productive, maybe 12 months, 18 months, though we are assuming that the hiring for retail assets will get productive sooner, because it is not a fixed cost structure. It is more incentive based, or origination and therefore earning based compensation structure, unlike branches where you have to put a cost first up and then hope that business will ultimately come. So, the cost model also will be more productive the more we look at retail assets.

Manish Karva: And lastly on fees, again, this quarter has been a very strong quarter for corporate banking fees. Any one-offs or these are basically pure activity related or transaction related fees?

Rajat Monga: So, both. So there continue to be one-offs, but I mean I have been saying that there have been one-offs for the last three, four quarters already. So, there are one-offs, I think there will be two, three transactions which are, let's say, in excess of $3 million - $4 million each in terms of fees. So that is there, I mean I don't know if I can call them one-offs, but there is couple of items where fee is significant, that is right.

Manish Karva: And the treasury income would be how much as a…?

Rajat Monga: So, this quarter has a little bias of monetization of fixed income holdings. So about, let's say Rs.100 crores to Rs.120 crores can be attributed to the fact that we were monetizing our fixed income holdings, that includes government bonds as well. So, I mean, if you look at the trend over the last three, four quarters, we were reporting anywhere between Rs.30 crores and Rs.50 crores of such realizations. This quarter has been higher. And that's also therefore enabled us to keep the provisioning run rate correspondingly higher.

Manish Karva: And just the last one, would you have some outlook on this, because look, rates have only come down post June as well. And in that case, you may be sitting on reasonable gains as well and can we assume that this sort of numbers can continue, assuming that the interest rate scenario is what it is today?

Rajat Monga: Maybe not in the same intensity as Q1, but maybe the intensity will be higher than it was last year.

Moderator: Thank you. Our next question is from the line of Nitin Agarwal from Antique. Please go ahead.

Nitin Agarwal: My question is like, how do we manage our asset liability mismatch? Like with this rising dependence on SA deposits which is growing at over 80% now aided by higher savings deposit rate. But this is an unseasoned funding base with obviously no limitations to withdraw the balance. So in that context, how do we manage the ALM?

Rajat Monga: So, there are two parts of this. One is your interest rate risk and the other is the liquidity risk. I mean, this is not a new product that we are running, it is a pretty established product. When we look at the SA book as such, I think it is still dominated by retail customers. Yes, our averages will be higher than other banks, because we have not had the time, or the necessity to build the tail part of deposits, which is that we have not gone deep down into the interiors of the country and opened small ticket deposits as much as other banks have done, we haven't had the benefit of either distribution or time to support it. But I'm not particularly concerned from the standpoint that the money can outflow, many can outflow from the Bank even in fixed deposits. There are, I would say, 80% - 90% of our deposits are where customers can withdraw money tomorrow, it is only a question of economics, not the question of whether, it is only a question of what will one lose in terms of interest, and there is no loss to principal in any case. So the bank structure in our country is such that you cannot depend on necessarily the contract, you have to depend on the behavior. And that is where we think we will do pretty well, I mean because the customers and the SA balances or the CA balances that we are getting are pretty much because we service customers better. Customers come to us, is hardly the first account. When you say seasoning, we are rarely the first account that the customer is opening, except maybe in certain salary account cases. The customer is coming to us because we can service him better, and he already has an account with one of the established private banks or foreign banks. So it is a pretty, let's say, well earned business is what I am saying, it is coming for the right reasons. Pricing is not a reason customers' stay, if he is not getting service, there is no reason for him to be with you, pricing is there to get the customer over. And as we have already done over the last two years, we are continuously moderating pricing and you have not seen any consequence as such, I mean the book is still double from when we last took a pricing sort of lowering steps. And we are thinking of doing that again.

So, as the book is becoming bigger and increasing in proportion, we will continue to take pricing out of play, and when the book is more mature in terms of its stability on the Bank's, let's say, share, we have to grow CASA. We have to grow SA, we have to grow SA more in proportion than other banks need to, because they are already in a mature state, their CASA mixes are stable. Which means I need more acquiring tools than they need, they need more maintenance tools, so we will also move in that direction. So the price is more an acquiring tool, but maintenance tools are different. Price, people will not stay for price, if you do not get service, there is no reason why you will leave balances in your savings account with us, because you continue to benefit from some service or some structure and the story is same for current accounts, and harder actually. Current accounts, there is not even an interest compensation, we get current accounts only because we have a service overlay, because we are giving some more efficient servicing to customer, faster realization of their checks or cash or electronic payments or integrated payments and whole lot. And we get awards as well, that I was mentioning earlier on my commentary.

So ALM is actually close to a non issue as far as, I can't say it is not an issue, but it is close to a non-issue. In fact, what savings accounts is also giving us is that it is giving us a fixed cost liability and possibly a cost that I can lower, if necessary. It helps me build a consumer loan book on top of that, because I cannot lend a five-year structure of a car loan using time deposits, because time deposits in India are one year, you cannot do a five-year fixed rate loan on that, so CASA helps you do that. So CASA is a fixed rate liability structure. And the more CASA we are generating, the more our ability to make consumer loans. Actually it is becoming a compulsion, both from the distribution synergy standpoint, as well as from ALM that we have to get fixed rate loans. We do not get fixed rate loans in corporate, corporate are all floating. So, sorry I am not giving you a perfect answer, but the point I am making is that SA is earned, it is earned and we still give a slightly higher compensation than others are giving, but this compensation will go down.

Nitin Agarwal: And second, like what proportion of our loan book is on MCLR now?

Rajat Monga: So it is practically the new loan book. So I think it is some single-digit percentage number, maybe 6%, 7%.

Nitin Agarwal: So I see that we have cut MCLR rates, one year MCLR by say 15 basis points since the beginning of the MCLR, but the base rates have been unchanged. So as our composition of these MCLR linked loans increase, can this have a negative bearing on yields and therefore the margins?

Rajat Monga: No, base rate is due to be changed, so base rate will come down. I mean in base rate I have a little flexibility of timing, which I don't have in MCLR. But base rates are also due to be lowered, I cannot say when, but they are due to be lowered. And we have to wait for larger bank lead as far as base rate cut is concerned, if I have to put it simply.

Nitin Agarwal: But will it be fair to say that by the end of this year, the majority of the loans will be linked to MCLR?

Rajat Monga: No. New loans clearly will be linked to MCLR and then we have to see what loans come up for replenishment, in terms of either they're maturing and have to be rolled over, or there are facilities like working capital, which are being renewed. So according to me after one year, it will still be a minority, significant minority. It will take two, three years for it to be fully sort of moved on to the MCLR pricing structure.

Moderator: Thank you. Our next question is from the line of Saurabh Das from Franklin Templeton. Please go ahead.

Saurabh Das: A quick question on cost of funds, Rajat. So over the last three quarters we have seen significant traction on SA and the CA proportion is broadly stable. And I presume that there has been some benefits on the borrowing cost as well, because the liquidity is really good. We do not see that reflected in cost of funds, so can you just explain what I am missing there?

Rajat Monga: Yes, so we have seen the cost of fund change, I mean, Saurabh you will have to allow me a longer period. So year-on-year there is a 60 basis point drop in cost of funds.

Saurabh Das: I was referring to the last three quarters.

Rajat Monga: Last quarter was a little bit of, I would say a little bit of December going into March had benefits of, let's say escrow floats that were there with us. I mean those are essentially zero costing escrow floats and they lower your cost of funding, but they don't stay. So we may have, let's say, on trend basis might have a lower cost of funds in December and March than we ought have had.

Saurabh Das: So in terms of spreads, if I just take a yield and cost, do you expect that to expand in the next three quarters going forward, or there are some one-offs which will….

Rajat Monga: No, we are expecting that margins will expand is because the spreads will expand. And spreads will expand from the fact that cost of funds will come down more than the yield on loans will come down. But I must also hasten to add that the yield competition is also becoming a little bit more aggressive. Because of MCLR we have also opened up the range of a little bit of lower yielding opportunities to us. So, I think it will be a little bit of in and out as far as spreads and margins is concerned.

Saurabh Das: I mean, that is why I was a little positive when you said that right now it is just 7% of loans and yet there are many customers who are okay to maintain at base rates, because I presume there would be other banks, would be competing for the same loan and offering it on MCLR, just like you would be probably looking to expand market share and go towards MCLR. So, is it like a very status quo in the market?

Rajat Monga: Actually I would have to put an additional context. See, in the base rate scenario we were always 50 basis points, 75 basis points higher on base rate as compared to other banks. So the argument I am making is that our book always had that problem, because if we are at base rate of 10.25%, there is someone at a base rate of 9.75% always.

Saurabh Das: And still you kind of held on to the…?

Rajat Monga: And he could have, maybe 0.5% is not good enough of an incentive for the person to take that kind of an effort. It also comes at a cost, it depends on your financing structure, you may have to create security again, there are administrative cost, there is uncertainty, etc. So I think, the point I am making is that there was always that risk and our book has seen that risk, I am not saying it has succeeded in managing all risks, so we have always had some losses on account of that. When a customer becomes good, I mean, his credit profile increases, I cannot always drop the rate, because base rate was always a hurdle. And he would go to, therefore, some of the other banks and we would possibly push him into a credit substitute design at that time. So that was our counter to base rate. However, you will see that this counter which used to come in credit substitute, actually will possibly fall back on loans. So the loan yields might seem to hurt correspondingly, but share of loans will increase on the book as compared to credit substitutes.

Saurabh Das: And still, I mean by the end of the year you mentioned it would be a small minority which would be MCLR linked.

Rajat Monga: No. End of the year, so let's say one year from now it will be a significant minority linked to MCLR. But it is not been at the full loan book as MCLR, it will take two to three years for it to be fully migrated to MCLR.

Saurabh Das: On the fees part, in the third quarter of last year, we saw a significant step up in the corporate banking fees. And at that point you had mentioned that it looks sustainable from those levels and it has kind of held on. So I presume that the loan syndication fee, structured finance, investment banking related fees has been strong. So if you can give us a sense of where do we stand in the league tables on either number of deals or volume of deals and how have we been progressing there?

Rajat Monga: So Saurabh, the bias actually is in favor of structured finance, has been so for the last 12, 18 months, it is because the syndication typically works better on a new loan, or let's say it is not that syndication is not happening, but new loans for new projects are certainly not happening. So, at least to that extent syndication is low, other than in renewable energy, and we are doing a fair bit of work in renewable energy. Let's say, two to three years ago syndications used to prevail over structured financing type of work, I think structured financing is doing better of late when compared to syndications. Investment banking is picking up, because of the M&A or asset sale, as well as PE and FDI activity which is generally are doing well. So investment banking is something that is doing better. I mean, though it is not the dominant fee item, but it could be as much as double of last year this year. But it's not a dominant item, but it continues to be in good stead.

Saurabh Das: And finally on microfinance, what is our size and what is the growth outlook, how has been the growth over the last year?

Rajat Monga: Well, microfinance is about 1.5%, maybe 2% of our loan book and the growth has been in line, maybe 30% growth broadly.

Saurabh Das: What is the outlook there?

Rajat Monga: Well, let's say I would not, in the short-term not painting a robust outlook, more let's say a consolidation type of an outlook here.

Saurabh Das: And just from a strategy perspective, is this more for PSL requirement or do you see substantial ROA contribution coming out of this business?

Rajat Monga: Well, we have to, Saurabh, approach business more from let's say all round banking perspective more than a standalone asset ROA type of a business. So I think that is among other the reasons that we have to set ourselves up better. So we are investing in a RIBB sort of, as we call it, it is a Rural and Inclusive Branch Banking, we do not have enough captive distribution in the rural and inclusive sort of opportunities. So we have to look at this as a comprehensive banking design and not as a standalone asset ROA led business, we can do that up to a point, to that extend that distribution can be outsourced and managed, but we are not happy to scale it up in that direction. So we have begun the rollout, management has also been identified some internally, some externally to sort of set up the RIBB business, which is little bit in early stages. So the thought process is to grow with more our own distribution than with the outsourced distribution and somewhere I think the tradeoff currently is moving away from outsourced distribution.

Saurabh Das: And in terms of the overall loan book, when you said 2%, does it include loans to MFI, NBFCs as well?

Rajat Monga: It doesn't, that will be another as much.

Moderator: Thank you. Our next question is from the line of Sachin Upadhya from ICICI Securities. Please go ahead.

Sachin Upadhya: A quick query in terms of retail proportion. I think the complete product suite is there now with our Bank, so is it being launched across all branches or how is it being launched? And what kind of growth over next three years can we look at?

Rajat Monga: See, I will also take Rajan's help, who is our colleague who runs the better part of that business. My understanding is that the products will be, so let's say if we have to do car loans versus commercial vehicles, they need not be all present in all branches. They will be on the basis of what is the branch sort of opportunity, and are we even close to the business, the relevant business, for example. Why don't you Rajan take up the question?

Rajan Pental: So basically what we have done in line with what Rajat said, we have identified some affinity branches across each product. So the branches where there is a potential or a scope for a particular product range, 100% of those branches, those products are available. So, as we talk today, 100% of the retail asset products are available, except the home loans where we are going very selective, because of the rate competition, so home loans is available to only our internal customers. So that is one product, which is available only for that segment. Rest, all the products are available for branch, as well as non-branch customers.

So, just to take an example, like we have certain identified branches where we have a segment of customers which are looking for, say, just take an example of a Harley motorcycle. So, we have strengthened that and we are already in a market leadership position over there. So, whether in the catchment areas of commercial vehicle customers or secured business loan customers or a car loan customer, or a PL customer; so for all branches which are in the catchment area of IT hubs or large corporate offices, we have 100% of the branches the personal loan will be available. So that is on the coverage.

As regards the deep geo branches that we will go into the second phase as long as it does not get covered into the affinity branch.

Sachin Upadhyay: So, if I can ask it in different way, what will be the secured, unsecured mix, maybe one year down the line, or two-year down the line there is a thought process behind that?

Rajan Pental: So, we are looking at not a one or two-year strategy, we are looking at a slightly long-term strategy. So, we have to take a hard stop at 2020. As we will grow the business, initially the earning assets or the secured asset like commercial vehicle and secured business loans, we will start it faster. We have started it faster. Along with that, affordable home loan is getting launched. Like I said, all products are launched but if I have to talk from point of where we are pressing harder. But as we inch towards 2020, we will have a fair mix of 50-50 between secured and unsecured.

Sachin Upadhyay: And Rajat, just one quick query on MCLR related. So over three years, most of our book will be converted into loans into MCLR. Is there any compression in the spread that we would witness as the loans we had converted from base rate to MCLR, since there is a lead -- lagged impact on that right now?

Rajat Monga: So theoretically, no. Practically, I mean, it depends how you manage it. So let's say, we in the Bank already have a hurdle, let's say if the client is moving from base rate as a benchmark to MCLR as a benchmark and if the net pricing is coming down, it has to go through an exceptional approval process. So as long as the client is moving from one benchmark to the other and the net rate to the Bank or the net rate to the customer remains the same, then we are happy to auto sort of migrate that. So there is no reason for rates to come down on account of change of benchmark.

Sachin Upadhyay: And Rajat one last question from my side. Since that the loan growth which is coming right now, if you can give me a sense of what percentile will be from the current client and what will be the new acquisitions that we would be doing in terms of new corporates or maybe new retail?

Rajat Monga: Well, retail I am assuming will be a whole lot new, maybe some of the retail might be existing liability customers. So to that extent they will not be new to the Bank customers, but maybe new to asset customers. So that will be a fair bit of, I would say, new risk, maybe not as unseasoned because we know those customers from our liability experience. Or they are, let's say, salary account holders or a B2B, B2C design or dealer financing, which means there is supply chain sort of integrity also to the lending.

On the corporate side, I think we are definitely going to add a whole lot of the bigger customers, because having a lower MCLR as compared to our erstwhile base rate helps us sort of start talking to customers. I mean just I'll take a case in point where we did write, let's say a large underwriting for an acquisition that a customer in India was contemplating. So that was a Rs.2,000 crores facility and he is a new customer. So there would be, let's say a bank's desire to increase exposures to the top groups, which will include the Tata Group, MDIG Group, the Aditya Birla Group, so there would be new names and new adds that will progressively happen, and are already happening. And in those names we'll also want to deepen. We are also looking very seriously at multinational companies operating in India. We have a team which has been in place for the last four, five years. In fact, we have also been hiring even foreign nationals in that team, because it is easier for the communications between us locally and some of their head offices for facilitating banking business.

Government banking continues to be an increasing focus. We have had a team for government banking for eight to nine years now, so far focus has been more liabilities, I think it is going to become more national banking focus also progressively as we get more competitive on both pricing and service.

There is also a general deepening that will happen in the SME and the emerging corporate space, because the CRM there is vast. I mean when we ran a SME award program, we used to get some tens of thousands of applications for people sort of applying for these awards. So the CRMs are pretty large in some of the segments. So there is, I mean I am not sure if I am able to give a sense in terms of whether the growth will be whole lot from new customers, there will also be a deepening with existing customers. In the corporate side, it is hard for me to say that we are not there in many customers, we are there, but we may not have done fund based…

Sachin Upadhyay: I mean from sanction side, which is basically how the sanctions have behaved?

Rajat Monga: We may not have done fund based business, we may have done non-fund business, so we will also move to fund based business. We may have done outside consortium work. In the large corporates, the good corporates, we want to get into mainstream consortium or multiple banking arrangements. So that will mean that that will get added. So as I see it, you will see a whole lot more growth coming from, I think it will be fair to say there should be a good mix of growth coming from both existing customers and new customers.

Moderator: Thank you. Ladies and Gentlemen, due to time constraints we will take our last question that is from the line of Adarsh from Nomura. Please go ahead.

Adharsh P: Just a question on the yield on loans from a credit perspective. We have seen like a 150 bps fall in yields, some part of it is because of the overall rate movement. So just wanted to say, if you adjust for that what is the underlying, is the portfolio less risky in terms of just what the yield represents, or if you can kind of throw some light on that.

Rajat Monga: Yes, so portfolio is I would say, maybe it is fair to say that it is less risky than it was a couple of years ago, because some of the new growth has clearly been better. You also see that our proportions in the bottom layer of ratings are getting better and actually there has been more recognition as well in terms of whatever was not going to get better, some of that has been provided for us well. So generally speaking, I think it is fair to say that there has been an improvement in the overall risk rating. But I am not willing to give that a majority factor in your sort of the argument of fall in yields of about 150 basis points, I think the majority factor still is the underlying rate movement, a minority factor would be that there is a little bit of portfolio shift in favor of, let's say, higher ratings so to say, that is also going to be sometimes a function and trade-off between what is there in off balance sheet, what is on balance sheet, etc.

Adharsh P: And just the other question I had was that last year we have seen in FY16 some exits from some well collateralized, maybe exposure to stressed names or the better exposures to some of the stressed groups. I think given our credit cost guidance of 70 bps this year, it does not look like we will have very large negative surprises. So does one expect some of the exit that we saw last year to continue, the monetization of some of those, either self liquidating collaterals that you call, or those structures self liquidate this year as well, or…?

Rajat Monga: Yes, they will. And that is an ongoing process and these liquidations, as you see more equity events or more M&A events in the marketplace, the kind of structure you are referring to have sort of such takeout sort of covenants in place. So you can expect that those structures will self liquidate as and when those sort of events materialize.

Moderator: Thank you. Ladies and Gentlemen, due to paucity of time, that was the last question. I would now like to hand the floor over to Mr. Rajat Monga for closing comments. Thank you and over to you, sir.

Rajat Monga: Thank you very much for patiently listening to the details of our results and we hope to see you again at the time of next results. Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of YES Bank, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.