"Yes Bank Q2-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 Private 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. Should you need assistance during this conference, please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Anil Agarwal from Morgan Stanley. Thank you and over to you sir.

Anil Agarwal: Thanks a lot Inba. Good evening everybody; thanks a lot for joining the conference call to discuss the Yes Bank's results strategy and outlook. Gives me great pleasure to welcome the senior management team of the bank. We have with us Mr. Rana Kapoor – the founder, Managing Director, and CEO. Along with him, we have Mr. Rajat Monga – the Senior Group President, Financial Markets and also CFO. We have with us Mr. Pralay Mondal who is the Senior Group President, Retail and Business Banking. Mr. Jaideep Iyer – Senior President Financial Management and Mr. Aparajit Bhandarkar executive VP and Head of Financial and Investor Strategy Team. What we will do is, Mr. Kapoor will basically give opening remarks and then Rajat will discuss the results and then we will open it up for Q&A. Thanks a lot Mr. Kapoor.

Rana Kapoor: Thank you very much. Thanks to Morgan Stanley for hosting this investor interaction. Ladies and gentlemen I am pleased to share with you along with our top management team, the results of Yes Bank's second quarter performance as you would have noted, we have had a fairly satisfactory quarter against the backdrop of heightened risk conditions with our increase in PAT of 30.2%, with PAT at a level of 306.1 crores compared to 235 crores in the corresponding period. Net interest income in this quarter increased to 524 crores, representing an overall increase of 35.9%. This is a very good sign and also augurs well for the future quarters with a steady reduction in cost of funds and overall spreads also improving somewhat, NIMs improving to 2.9% in this particular quarter. Non interest income went up by 29.3% to approximately 277 crores and overall net income increased by 33.6%. The operating profit this quarter was at a level of 484.7 crores representing an increase of 25.6%. Non interest income was fairly steady at around 34.6% quite consistent with prior quarters as well. The cost to income ratio of the bank continues to be fairly efficient at an overall level of 39.5%, so still well below 40% overall. The yield on advances steady at 12.4 and as I mentioned to you that there has been a fairly perceptible reduction in cost of funds, now at a level of 8.7%. The ROA of the bank was at 1.5% and ROEs fairly stable again at 23.8%. As you know that the last four years now so for the last 16 quarters Yes Bank's ROA has been around 1.5% or better and ROEs have been in excess of 20% now for almost 16 quarters four years in a row. The overall half yearly results demonstrated an overall increase in PAT of 32.2%, just shade short of 600 crores at 596.2. So we are keeping a fairly good run rate to get to what I believe will be a much better second half as this is natural in our profession, in our business. So moving on, the loan growth was at a level of 22.9% with total advances in excess of 42,000 crores. Including credit substitutes, the overall growth over the corresponding period was 32.5% at a level of around 54,000 crores of total loans and credit substitutes. Deposits increased by 18.6% and have crossed 52,000 crores. CASA was slightly more than 9000 crores at our highest level with a growth of 86.7% compared to last year and with the CASA ratio improving further to a level of 17.3% with SA increasing by over 351% over the corresponding period last year. I also wanted to mention that CASA as you may recall, September 2001 was at an aggregate level of 11%. So from 11% in one year's time, it has improved to 17.3% and so we are very much on track to getting to a 30% CASA in consonance with our Version 2 strategy by 2015. The balance sheet of the bank stands at approximately 83,000 crores representing an overall increase of 32.2% compared to the same period last year. Asset quality has been able to remain fairly intact, in fact sequentially gross NPA has improved to 0.24% compared to 0.28% as of June 30th 2012 and net NPA was at a level of just around 5 basis points, 0.05 compared to 0.08% as of June 30th 2012. Overall provisioning cover is at 80.2%. As you can see, it has been fairly steady at levels of around 80% for quite sometime now. The total capital funds of the bank have exceeded now 10,800 crores which is a fairly sizeable improvement compared to 7860 odd crores same period last year. In this quarter, we have raised 800 crores. In the September quarter, we raised 800 crores of upper Tier-II which was 200 crores and 600 crores of lower Tier-II which came, the lower Tier-II entirely came from LIC and we are hopeful of raising another 400 odd crores in the current October to December quarter as well to ensure that we are fully capitalized and take full advantage of the remaining window for hybrid capital raising. Consequently, the capital adequacy of the bank was at a fairly healthy level of 17.5% with core Tier-I at a level of 9.5%. The book value of the share is just shade short of Rs. 150 at 149.2, so fairly steady and this is without any capital raised now for the last 2-1/2 years. Headcount of the bank has crossed 6300. We have added about 1537 people in the last one year and as you can see the number of branches have touched 400 with the number of ATMs now touching 694 as of September 30th which is an increase of almost 414 ATMs which have been added since last year. So basically lot of investments in the retail infrastructure, in branches, in ATMs and considerable deployment of additional sales staff in generation of liabilities, in service, and branch operations.

Just moving on, overall as I am sure you would have observed, we have achieved fairly granular noninterest income with transaction banking as in trade and cash management contributing about 29% of the total noninterest income. Treasury was just about 17% in this particular quarter. Advisory businesses across corporate finance, i-banking, and corporate banking was the single largest contributor and fairly steady at a level of around 43.2% and the good news is that we are seeing a steady improvement in the retail fee contribution which stood at 11% as of September for the quarter September 2012. Other couple of points relating to liabilities I wanted to highlight that CASA plus retail liabilities is now at a level of around 36 plus percent which about a year ago was about 28.6%. So in a year's time, the retail contribution of liabilities has improved by approximately 8% in less than a year and we will see this trend continue with retail heading towards contributing about 60% of our liabilities by getting to a 30% CASA and 30% coming from retail FDs by 2015. There have been quite a few other highlights, but just a little bit of comments on our overall advances portfolio. We continue to be fairly diversified with no single sector contributing more than 10% of our total exposure. Corporate banking as of end of September was about 67.4% of our total exposure. Commercial banking which is mid corporate stood at a level of around approximately 18% and retail including micro SMEs was just short of 15% at 14.7. So this in a nutshell is our financial summary. I think some additional comments from Rajat, Jaideep, Pralay.

Rajat Monga: I think we can answer as part of taking questions. Can I request the moderator to start the Q&A please.

Moderator: Sure sir. Thank you very much. Ladies and gentlemen we will now begin the question and answer session.Our first question is from Nikhil Poddar of Barclays. Please go ahead.

Nikhil Poddar: Sir I had one question, why did Yes Bank want to exit the CDR process in context of bank's lower credit cost?

Rana Kapoor: Basically we have been deliberating on the CDR participation and seeing the pros and cons. I think along with risk management, we came to the conclusion that instead of being a small medium player and being compelled to get into CDR situations, we have realized that over a period of time it is better to get into bilateral problem solving rather than in a larger format where the bigger banks get more or less their terms through in the CDR because of share volume and voting capacity. So I think our independence as a mid size bank in bilateral restructuring and negotiations we believe will be far more effective and I think it is something that we believe will work in our favor.

Moderator: Thank you very much. Our next question is from Manish Ostwal of K R Choksey Shares & Stocks. Please go ahead.

Manish Ostwal: First question on your saving bank deposit sir. Deposit mobilization continued to be strong during this quarter, could you throw some light on the key driver for such a strong sequential growth because some of the mid sized private sector banks which are offering similar rates to you, there was some moderation in their sequential growth rate, so whether it is related to rising every balance of high ticket segment or pure customer acquisition thing?

Rana Kapoor: Actually if you see our deposit growth for a bank of our size year-on-year has been at a level of 18.6% in terms of the totality of the deposit growth, but within the composition of the deposits as we have been saying in our various investor interactions, the highest emphasis within the bank is on improving granular CASA and granular FDs. On both fronts as you would have observed, we have had a fairly significant progress. CASA has improved to an overall level of 17.3 and we have fair amount of visibility that if the current momentum sustains, we should cross the magic number of 20 by end of fiscal year 13 and most definitely then inspired to get to 30% CASA by 2015 which has been our uncompromising target since the beginning of Version 2. The best part is that the growth is happening in SA. SA growth year-on-year has been about 351% to be very precise and it is coming due to accelerating momentum on our corporate employee accounts program so our B2B, B2C strategy in acquisition of salary accounts is garnering in a momentum and that is a very important development within our bank because SA allows us significant cross selling and mining ability, 2) it is a switch over to some extent from high cost FDs because our FD cost is slightly more than 9% and over a period of time we will see FD costs coming down and volumes coming down as well and moving into savings account. As you also aware, the savings account allow us to also work towards a higher share of the wallet through third party product distribution over a period of time as we build more client vintage. We should be able to also sell consumer asset products, car loans, housing loans and we are making rapid forays in consumer lending in terms of new product introductions. So a savings account has a lot more depth and lot more opportunity than our FD account which is far higher priced. So definitely SA is taking pole position in the bank followed by CA. CA is coming to a large extent from our cash management solutions across our small, medium, large corporate businesses through our ERP connectivity with a lot of our corporate clients and the good thing is that today savings accounts have become really an origination product because the employee value proposition for employers to offer 6% and 7% SA rates is very compelling for them to review their empanelment of banks who are offering traditional rates at 4% and actually invigorate their HR departments to empanel Yes Bank and to offer this combo 7 and 6% to employees at various income points. So the point here is that SA is also a driver for CA in a way and therefore we have far greater confidence that with concerted focused efforts, CASA will continue to rise. Needless to say there is also a fair amount of emphasis in terms of retail deposit acquisition and that number CASA and retail now stands at 36.6%, the hardwire target to get this number up to minimum 55 on a very good day to 60% by March 2015. So fairly long comment, but this is the number one objective of the bank is to build a very stable reservoir of very granular diversified liabilities including diversification in geography across the country and with 400 branches short of new branches opening in Nagaland and Manipur and Lakshadweep and Andaman, we are present in all parts of the country now.

Manish Ostwal: Secondly sir when we compare 30% CASA by 2015 and the retail book of 30%, how do you see the fee opportunity through retail banking in the overall totality of the Yes Bank?

Rana Kapoor: Very critical question. As I conveyed some data points, as you know retail fees as a percentage of the total noninterest income was at a level of 11%. So 11% was the retail contribution. It is our, I would say a mission critical objective to make retail fees the number one contributor as you see in HDFC bank and probably in one or two other banks, this 11% number is a number that we would want to take minimum to about a level of 25% by 2015 and as and when they get into Version 3.0, this will definitely become the single biggest number anywhere between 40-45% in the longer horizon, but our medium term target is to take this number to at least 25% of total noninterest income and there is a lot of stretch potential and there is a lot of cross sell untapped potential in some of our newly acquired SA accounts because the first thing is to stabilize them in the bank, give them a good service proposition and then deep dive into these accounts, get the CRMs in place and start cross selling and we are at a very early stage because now are opening almost 40-45,000 savings accounts a month.

Manish Ostwal: Out of the 400 branches that we are having, how many branches we are offering retail loan products?

Pralay Mondal: This is Pralay Mondal here, I look after the retail part of the business and SME. Coming to the question on retail assets being offered from the branches, the objective is to offer from most of the branches as we go along because our focus is to be customer centric and as Rana was talking about it that we want to have the largest share of wallet.

Having said that, we will build into the geographies and the different branches as we launch these products in each of these branches. Right now the way we are looking at it is every customer who has a requirement we have that product on the shelf and we will offer this on a relationship basis to the customer and as and when our portfolio becomes larger, then we will look at enhancing the portfolio size. So the clear answer to that is we are offering to most of our customers on a relationship basis mostly into the top 100-150 geographies, but beyond that we will do it based on the customer requirements.

Manish Ostwal: And lastly data point, what is the AFS book size and the duration of the book?

Rajat Monga: Which book size?

Manish Ostwal: AFS, available for sale book size.

Rajat Monga: The book size of available to sale in terms of rupees crores?

Manish Ostwal: Yes sir.

Rajat Monga: That should be about 10,000-11,000 crores.

Manish Ostwal: And sir what would be the modified duration?

Rajat Monga: Between 2 and 3 years.

Moderator: Thank you very much. Our next question is from Rajatdeep Anand of ICICI Prudential. Please go ahead.

Rajatdeep Anand: I had a few questions. I think the diversification on liabilities is going on quite well, I would like to understand if you have similar plans for assets because right now I think the concentration of corporate loans has only increased in your loan books over the last few quarters, so that is one question and secondly I think after many quarters investments have lagged advances growth. So, will the investment growth from here look similar to advances and deposits growth that is second question and thirdly as you scale up to be bigger bank I was just trying to understand if only 30 bps of credit cost are sustainable because other bigger banks in the country even the private ones have much higher credit cost, or they tend to provide for much more at least that way. So I was just trying to understand if these credit cost is some thing that is sustainable.

Pralay Mondal: I will answer the first question first, on the retail assets question. Retails assets, the growth once we build up basic platform and it is a question of customer acquisition, it is not difficult to build the scale there. The critical part of any retail asset business is to build up the right quality of the book, the right customer acquisition and the granularity of the book is very important. Secondly based on our experience, we have seen that cross selling to internal customers with support of course from CIBIL and other credit bureau etc., it is a much better proposition than going through the channels through the DSOs and going to the open market and picking up customers. So clearly the strategy is to first build up the granular liability book and then cross sell and build the larger share of wallet to the customers.

Rajatdeep Anand: So I am just trying to understand, when you are saying granular and granularity you mean all different kinds of retail loans that is what you mean by?

Pralay Mondal: The thing is we have almost already on the shelf all the products with us already except for credit cards and to some extent home loans. We have all the other products now launching including gold loans also we have launched.

Rajatdeep Anand: Of all 400 of your branches, these products are available for customers to walk in and..

Pralay Mondal: This is what I answered before that most relevant branches we have it right now because one needs to create an infrastructure to support at retail assets products in the branches. So depending on the customer requirements and the size of the branch and customer relevance in those branches, we are launching these products. Having said that, I think as we move into deeper geography and the smaller branches, the kind of customers on the retail asset size will be quite different to the auto loans and this thing. There could be more two wheelers and there could be more on the smaller SME side and things like that. So it will vary from branches to branches and geography to geography, but simple strategy is that get the customer through the doors through the liability season the customer well, ensure that we understand the life cycle of the customer and cross sell more products. That is exactly, so initially we will grow slowly or surely with a good quality of the portfolio and as we grow, then scaling it up is extremely in retail assets once you have the right platform.

Rajatdeep Anand: So what kind of timelines should we be looking at on this especially on the retail assets space?

Pralay Mondal: It is extremely difficult to give a timeline, but let me put it in the perspective that you have seen the way the liability franchisee has grown and typically within 6-12 months of a seasoning of a customer on the liability side based on his need because this guy also will have an auto loan, it will have something else etc. We are putting lot of systems upfront whether it is our own in-house build CRM or lead management systems and those kind of stuff. So as an when we understood the customer and as and when we can offer the customer relationship based pricing based on his requirement, we are bringing this, but based on my experience I have seen that typically through the doors if he comes 6-12 months is where the cross selling starts and as and when it grows, the multiple products get cross sold. So, to that extent I will say that it is a function of a size of the base and the vintage of the customer with the bank.

Rajatdeep Anand: No, I am sorry, I am just persisting on this point, because I think the savings got deregulated in Q3 and at that time branch banking in terms of your reported advances split was 15% and now it is 14 something. So, I was just trying to understand if probably retail assets is going to take more time than the six months that we were thinking initially, so that is why?.

Rajat Monga: See the retail share of that 15% was actually below 1%.

Rajatdeep Anand: It is SME and retail.

Rajat Monga: Yes and most of our pool positions that we have, that we acquire from other originators, which are largely granular retail type or SME type positions are also in the same number.

Rajatdeep Anand: Okay I understand now.

Rajat Monga: So, the organic part of retail assets is growing but it is not showing up in the overall number, because what is also happening is which was part of the first question we are asking is that the share of corporate book is growing. That is also because we are not in an acceleration mode in retail. We are in a build out mode. Not a scale up mode, it is still an establishment mode.

Rajatdeep Anand: It is a pilot kind of a thing.

Rajat Monga: More than a pilot, we want to establish many of our retail lending products in our retail liability customer base. We don't want to just begin to expect walk-ins out of 400 branches now. We want to target sale mine the CRM to establish the credit processes, the CIBIL test and all of that. So, I would say more than a pilot but not yet ready to scale up. But also happening like it happens in many other parts of the cycle is that the share of the corporate book grows when the risk is little bit challenged because whatever business we do in this environment, we obviously find more comfort either in mortgages or in known corporate lending. So, we are not that aggressive in mortgages but therefore our share of corporate book is to that extent responding to the current environment. You will notice that happened in 2009 as well. In the growth phase the diversification, there is no flight to quality as such. There is actually a little bit more balance of risk. But now there is a little bit of element of, I mean one is happier with the known understood corporate exposure than in this environment and try too hard with commercial vehicles or construction equipment etc. So, we are taking that into a strategy in terms of what is possibly a reflection of the risk environment more than a growth environment. On the split between investment and loans, I think there would be I would say an element of let us say deal driven outcomes in investment book unlike the loan book. The loan book is not this quarter was better but may not sustain. We don't want to leave a message here than this loan book growth can be extrapolated, not really. I think we still remain cautious; there is at least two quarters of caution that we have to observe because on the ground risks are not yet mitigated. Yes, the policy, the government speak an action is lot better, but it will take its time for de-risk on the ground situation. So, investment book will have its role to play. What also happens is that, off late the distribution opportunity has been also quite brisk. We have also been moving out of our let say investments that we have sourced in the earlier months. So, the churn in quite heavy in the investment book as we speak. So, there will be a little bit of I would say a give and take in these two books, but the message I wanted to leave here is that the loan book growth which was little bit higher than recent quarter and this quarter need not be extrapolated. I think we are still cautious. Investment book remains opportunity and deal based distribution sensitive. So, there is a growing propensity of corporate to look at corporate bonds as a issuance mode because the gap between the base rates and corporate bond yields is widening. So, there will be more and more corporate who will want to refinance loans through bond routes and that is happening. We have seen many large names hit the market in the last three four months. So, there is reasonable momentum and more will come in course of time. I think the last part of your question was on credit cost and sustainability of credit cost. I think it relates to risk. So, if we are going to take and do more risky business we are going to get more credit cost. In fact, you will see there are plenty of banks in the Indian space itself, where they have 14-15% yielding portfolio but have even lower credit cost. I am not sure if…

Rajatdeep Anand: No, I will ask that question bit differently. So, there are many corporate which are standard assets yet with the kind of revenue and EBITDA they have, it seems very difficult that they will be able to make the interest payments and these are large corporate mostly and so I was just trying to understand and many banks have exposure to different of these large corporate. We are just trying to understand that any slippage of any provisioning which might come, might be lumpy. So, we just trying to understand if 30 bps over the cycle is a reasonably good number, because other banks are much higher, even if you look at other corporate banks they have much higher credit costs. So, I was just wondering about you.

Rajat Monga: Don't think so that those banks are getting credit cost and we are not and that we have the same exposure. So, either we got better exposures relatively speaking or that there is more to what other banks are also disclosing. So, it is very difficult to, because disclosers reasonably in perfect now I can take this case which possibly we will any way discuss on for example there is a current situation with one medium sized account. I can promise you that we are the only account, only bank which are shown recovery on this account. Which means that there is something different about us either or whatever, I mean either we risk manage better; yes, we have situations; may be we resolve them better; may be we restructure them better to begin with. So, why do we have very degree of exclusive collateral pledge to us in the particular account and many other banks cannot even show NOCs from the lead banks to the charges that we are claiming that they have from this particular account. So there will be difference in this.

Rajatdeep Anand: I think you also talked about some wind energy company, I saw that on Bloomberg, so I was just asking?

Rajat Monga: Wind energy company is again a function of structure. We have a self liquidating structure; we are not lending as such we actually in situations where there are some of them are self liquidating. So, we have performance risks related exposure there in that company and it is not a large exposure. We possibly are the bottom quartile in terms of size of lenders in that company, if you can call that lending. So it is not, I am sure we will have situations.

Rajatdeep Anand: So, I was just wondering if you do some internal stress test and all that, then what is the kind of credit cost that you people look at? What is the base case and what is the bare case? I was just trying to understand that.

Rajat Monga: Our best case is zero. I think over the last cycle which was let us say our experience over the 2009 -2010 period, I think the worst we got in one quarter was 70-80 basis points of annualized credit cost.

Rajatdeep Anand: This is we are talking on loans.

Rajat Monga: Yes. This is like loans to loans, there is no like for like. This is not being deflated by customer assets denominator like for like. So, that is our experience from 0 to 80 let us say 1%, you can put that because as long as we do not have a risk management situation in our top 30-40 exposure as long as that we and many banks will have similar outcomes as well, we will get little below average credit cost, because that is the averaging. If at all you get one knock which is coming from your larger accounts, if they don't then there is no knock, then you will possibly remain and if you can choose those 30 customers well and so it is not like choosing may thousand customers well. You will not see dramatics on the credit quality. It should be within the absorption that we are holding on the credit cost lines that other banks are holding in their respective credit cost lines.

Rajatdeep Anand: And investments book is restricted to top of the quality even in your loan book, or like I am just trying to understand because it is a lot of..

Rajat Monga: Lot of things in the investment book actually are where we can never lend, because those guys borrow below our base rates also. So, those guys will invariably issue a CP or a corporate bond. So, the lending is not necessarily substitute product sometimes in those situations, but it is very safe to that the investment book is predominantly of that nature. With that it is were pretty much loan is not necessarily a very easy substitute. These companies have ready access to capital markets and you would have already noticed some of the bond deals that we have handled. The last 3-4 quarters we have done work with Hindalco, Tata Steel, with Tata Power. For example, I don't think we can lend these companies. We can, it is not that lending is not possible but why would Hindalco take money at 10.5% when they can place a bond at 9% today. So, it is actually that trade off. So, it is a wrong statement to make, but yes our investment books credit quality will be better than a loan book credit quality in that respect. So, that doesn't mean that loan book is bad, but that the investment book is better.

Moderator: Thank you very much. Our next question is from Suruchi Choudhary of Edelweiss. Please go ahead.

Suruchi Choudhary: Just coming back to the investment book, now as the percentage of the overall balance sheet, this is grown over the last couple of years and so we have built that book up just wanted to understand the strategy going forward, when do we start off loading or when does advances actually become more meaningful part going forward and just on the investment side what is the kind of gains because now yields on that book has dropped and with the kind of duration that we are running, what is the kind of mark to market that we are setting on, if any?

Rajat Monga: Well, I think the book will have little bit of I would say like I was possibly explaining in an answer to the earlier question as well. There would be an element of I would say interest rate structure that will dictate some of these outcomes which we are experiences as an opportunity in the market and then it is up to us as Yes Bank and other bank to respond to that opportunity and convert that into business. So, we run this the investment part or corporate bond, commercial paper part is being run in the bank as business. So, as long as we have that balance of risk and return we will continue to be working through this investment book. There would be comfort periods of the cycle; there would be discomfort periods of the cycle. In 2008, late we would have been scared because of liquidity risks that were prevalent at that point in time. Today, we are to have take views on the basis of the credit risks, thankfully it is more like classical cycles that we are experiencing. So, we can have outcomes being expected and our business strategy commensurate to that outcome that we are expecting and so as rates come down naturally we should make money on this portfolio but that is not the design behind this. The design behind this is distribution. We want continuous churn in this book. We are not waiting for rates to come down, but we are taking comfort from the fact that the rates will come down. So, we are not running this book like a trading book. This is a distribution book. So, which means that we will have timelines by which we will have to rotate out our exposures. It cannot be something that we are going to keep piling on. It will be throughput based. There will be times when input is more than the output, so the book will grow and vice versa when the book will shed as well. So, it is my humble submission would be not to budget some trading in element out of this. If that happens it will be not the design; it will be a concurrent outcome to the part of the cycle and once we reach a little bit on the lower end of the interest rate cycle we will be worried about piling on to the book, because that means your short losses as well. So, the distribution part will become that bit less than comforted by the fact that the interest rates can yet go down in the fallen environment we will be worried about this is going up. So, we will be very hot on distribution at that point in time but yet we have to do the business.

Suruchi Choudhary: Yes, but logically now with rates coming off spreads on this business, pure interest spreads would be lower or at best flattish and probably you can actually garner more from the loan book because the rates loan side will take some time before they come off.

Rajat Monga: Absolutely, today on a carry basis, loan book is lot more attractive. On a risk adjusted basis I don't think we can simply just say that okay we want to grow loans, absolutely credit spreads have come to a low, at least a 2-3 year low. I don't think we have seen the today's credit spreads for the higher rated corporate being as low as what they are currently. So yes, there has been that correction that has happened in the market. So, today if you ask me I would rather, if I am a trader I would rather buy G-secs than buy corporate bonds because the spread is so narrow. If RBI is going to cut rates, possibly the spread will widen because the G-sec will rally more if I am a trader, but if I am running beside the business I have to take both the views. I will have look at the credit spread curve; I have to look at the underlying government bond curve, I have to look at the distribution opportunity. So, it is not a trading call that we will take; it is the distribution call that we will take and it does comfort us that even if we have to take three months to distribute the interest rate environment is likely to be flat or lower. So that helps, even if the interest rates go up a bit we know they are not going to be stable at higher level. They will ultimately come down. So that benefit is there. So, the kind of confidence with which we do this business today is not the confidence we will be able to express when the interest rates are lower, but at that time the lending will become more attractive because at that time when rates are fallen, economy possibly and are beginning to look up is possibly when the economy is looking better. The lending will look viable all over again, not viable but more attractive relatively speaking. So, there will be interest cycles and interchange, nothing is permanent.

Suruchi Choudhary: Fair point. Just on the other side on the margins, when we look at our spreads, spreads seem to have moved up by about 30 bps on a quarter basis and on a calculated basis investment yields have also moved up. So just wanted to understand why our margin improvement restricted to 10 bps, you can explain that and does this actually preempt much larger improvement in the second half of the year?

Rajat Monga: I think couple of reasons, may be one is that we are hiding the second decimal. So, may be the second decimal would have been better and the other is that we have been a little bit excess SLR heavy. So, we have been basically been financing let us say some excess SLR positions of TB bills may be which we can buy at between 825-835 and repo that at 8. So that burden on margins which gets benefited from spreads gets hurt from one is the corporate bond book and the other is the excess SLR

Suruchi Choudhary: But you don't disclose the number on the investment yields but if I just do a calculated one, there seems to be a 20 bps uptick in that on a quarter-on-quarter basis; again this the total investments including the SLR parts also. So, when your investment yields have moved up, your loans spreads have also actually moved up by about 30 bps and margin improvement has been restricted to 10 bps; it is something that I couldn't kind of...

Rajat Monga: I will get back to you because I don't see why investment yields would have gone up because the G-sec yields have been flat in this quarter. But they have been flat at a lower level in the recent history. So, we have seen the 10 year bonds stay between 8.10% and 8.20%. So, what ever we have bought in this quarter must have been at that yields. But historically the yields have been higher. So, our addition to investment would have been at lower yields. We also bought a Hindalco paper towards the end of the first quarter which was at a coupon of 9.55%, for example. So, I don't think investment yields have gone higher intuitively speaking.

Suruchi Choudhary: But Tata power would have been higher, right?

Rajat Monga: Tata power was bought in towards the middle of first quarter.

Suruchi Choudhary: So the impact may be would have…

Rajat Monga: Impact would not have been, plus it is not a game changer in the sense that it is significant but it can influence 1-2 basis points.

Suruchi Choudhary: No issues, we will take it off line.

Moderator: Thank you very much. The next question is from Anand Vasudevan of Franklin Templeton. Please go ahead.

Anand Vasudevan: I was able to login a little late so I might be repeating something that you have already discussed but I heard that you say that the top 30-40 exposures, you are not in a risk management situation, is that correct?

Rajat Monga: Yes, I was answering a question on expected credit cost and why credit cost can be at a 30 basis point or that they should be higher on an average or in the medium term when some other banks end up showing higher cost. So, whatever we are saying is that as long as the top 30 exposures are intact, I don't think we will average.

Anand Vasudevan: So what is the size of the largest account that is under stress or under watch?

Rajat Monga: It will be I would say, see every account is under watch. So, under stress is what I will try and answer.

Anand Vasudevan: That you are concerned about.

Rajat Monga: The element of stress would be where we have either some chronic delinquencies or we have restructuring, let us say potential or we have any such similar, let us say one company is well known now that there is an imminent situation in that company. So, I think typically this will be double digit basis point of the loan book. So, none of the top 30 accounts are in this list.

Anand Vasudevan: And on Deccan Chronicles, since that name is very much in the public domain now, have you taken any charges, have you made any provisions against that account?

Rajat Monga: Yes, we have more or less, I would say provided for more than all the uncollateralized exposure we have there. So we have, if I can very quickly summarize that; we have recovered one-third; we have provided one-third.

Anand Vasudevan: Okay and what is the total size of the exposure?

Rajat Monga: The size of the remaining exposure is 60-70 crores. The net exposure remaining, where we still have collateral worth 60 crores is about 70 crores and we still expect collateral realization in this account going forward.

Anand Vasudevan: The other question is data point. Your credit substitutes in Q1 you would see a pretty significant jump and I think at that time Rs. 108 billion that time you said you warehousing some bonds for selling down, so has that happened and what is the credit substitute balance as of now?

Rajat Monga: The credit substitute balance, it is slightly higher about 5-7% higher than last quarter. But the churn has been ongoing. We had two known names and deals that we had done in Q1 which was Tata Steel and Hindalco for example. I think there has been continuous churn in these positions.

Anand Vasudevan: What explains the 23% year-on-year growth and 9% sequential growth in advances? Last time we spoke I think you had mentioned that you are pretty cautious about loan growth during the year right?

Rajat Monga: I think we are still maintaining that and therefore we are strongly recommending that we do not extrapolate this particular number. Which is that this has been an opportunistic outcome may not repeat. We continue to be cautious on the loan growth fund, because we want to see on the ground de-risking takes place particularly with balance sheet which are currently bearing more stress and possibly also poor system at risk on the lending front. So, some of these balance sheet need to be de-risk is when we can begin to believe that the lending environment is beginning to look up. So, this quarter has been relatively I would say influenced by more refinancing opportunities that have come about because of the interest rate structure that has been moving and expectations on top of that, that have been changing. So, no real trend that we want to leave a message behind. This is very likely we may actually have a lower loan book in December on a sequential basis.

Anand Vasudevan: So was this some short maturity funding that you have done?

Rajat Monga: There could be all type of funding, but yes there is a little bit of a short influence as well.

Moderator: Thank you very much. Our next question is from Pranav Tendulkar of Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar: I had just one query on the corporate book what is the split like in between term loans and working capital loans if you can provide that, thanks a lot.

Rajat Monga: Yes, working capital loans on one side and term loans which will include short term loans on the other side would be 40-60.

Pranav Tendulkar: So the working capital will be 40?

Pralay Mondol: Yes.

Moderator: Thank you. Our next question is from Ramnath V of Birla Sunlife Insurance. Please go ahead.

Ramnath V: Just wanted to ask you this question on the CASA ratio. The CASA ratio has definitely shown an improvement but if I look at CASA as a percentage of overall asset, it has remained fairly static over the last one year. It is hovering around 10-11%. So, is this more to do with the fact that you are opportunistically using the market given the interest rate environment to use borrowings to fund a balance sheet and do you have any particular numbers in terms of trying to push this CASA as a proportion of overall balance sheet as you have for the version 2 for the CASA ratio and stuffs like that.

Rajat Monga: I don't think there is, I am not very clear. Because the CASA has grown by about 80% and the balance sheet has grown by about 30%.

Ramnath V: If I look at the numbers, the CASA is a proportion of overall assets. It was around 9% on the third quarter of FY12. Right now it is around 10.9%. So what I am just trying to understand is that is this movement because your borrowings have gone up, may be you are using the interest rate scenario to kind of improve the yield and stuff like that, that is fairly well understood. So, I am just trying to understand any particular number that you have for this as a proportion of the overall asset size and stuffs like that?

Rajat Monga: No really, I don't think the target is particularly to chase the asset share. I think we will take as much CASA as we can at some level because there is no better book which is 100% CASA funded in the current context. So, the idea of CASA is to maximize without creating an inordinate operational or service burden, we also have to synchronize that with the ability. It is not about just, getting a balance but also being able to service the customer along with that. So not really, we don't target any CASA to assets number, like I said our idea is only to maximize. We are only disclosing numbers, which market conventionally would like to see. I mean, there will be several ways of looking at the same number as well. It could be proportional, relational. So, the bottom line is CASA is little short of double.

Ramnath V: Fair enough and the other question is in terms of the average savings deposit balances how are they moved out of the last 2-3 quarters, any material difference that you are seeing?

Rajat Monga: Not really, the average balances will be some where in the range of 55-65,000.

Moderator: Thank you very much. Our next question is from Rishab Jhaveri of Emkay Global. Please go ahead.

Rishab Jhaveri: Just couple of initially book keeping questions. If we were to have audited accounts for first half what would be our Tier-I ratio in that case?

Rajat Monga: Audited.

Rishab Jhaveri: These are audited number?

Rajat Monga: Yes, these are audited numbers.

Rishab Jhaveri: And what is the quasi Tier-I out of this 9.5% that we have?

Rajat Monga: What is quasi Tier-I, what is that name?

Rishab Jhaveri: Anything which is not core-Tier-I?

Rajat Monga: We look at it may be little differently. There will be some capital which will is not equity capital. But there will be some assets which are also disposable assets which are taking up capital. So, if you allow a little bit of therefore core capital it is similar. I hope you are getting my point. While there is a quasi capital like you are saying in the Tier-I, there is also quasi risk that is currently taking up capital. So, if we shut the quasi risk and we shut the quasi capital we are going to be back to almost the same number.

Rishab Jhaveri: Sir if I am understanding clearly, in case any part of our Tier-I capital is not allowable under Basel-III, probably we will shut of those assets also, is it?

Rajat Monga: It depends, because we can firstly internally accrue more capital, we can raise more capital. There is also Tier-I and Tier-II capital available under Basel-III. The current capital will also get grandfathered. So, we are talking about a five year plan. So, everything will happen in that, we have planned, because Basel-III is actually a 7-8 year, I would say implementation period. So we will raise more capital core Tier-I; we will retain more earnings.

Rishab Jhaveri: So do we have any capital raising plan in near future?

Rajat Monga: Well it depends on what near future is. There is no plan on the table right now. But we have shareholder empowerment to raise equity capital when we believe the market condition and evaluation are appropriate.

Rishab Jhaveri: And to put it differently what is the minimum Tier-I that we, I mean in past we have raised even it touched like about even 9% or even.. So, is there any threshold level up probably, below which we wouldn't want to go.

Rajat Monga: Well it depends again. There is some regulatory minimum. The computation of Tier-I has been changing for the last several years from Basel-I to Basel-II to Basel-III. So, we ourselves are looking at three answers for the same number. So, there is a Basel-I capital adequacy, there is a Basel-II capital adequacy; there is also now Basel-III capital adequacy. So one of them yes will be high and one of them will be low. So, is there a number in our mind, not really that we are looking at a hard floor nor are we looking at our Tier-I ratios dropping off, because our growth is well within our means at this point in time. So, we are growing loans which are lower than the ROE that we are making or earning, which means that we are not consuming capital.

Rishab Jhaveri: Sorry I didn't get the last.

Rajat Monga: Capital adequacy is capital divided by risk. ROE is growth of capital. So, if ROE is 20, capital will grow every year at 20. So, if loans also grow at 20, we have 1.2 and 1.2 cancelling. So, your Tier-I ratio is the same. So, which is what I am saying that our growth of loans is in the ROE, as of now.

Rishab Jhaveri: So you are talking about RWA growth here?

Rajat Monga: Correct. I don't want to use RWA, because some of the RWA is disposable. I mean, we have plenty of AAA bonds. If we sell them, capital will be released, for example, and we can sell them. But that is not really necessarily the compulsion that we are dealing with.

Rishab Jhaveri: And the question on earlier we spoke about this, B2B and B2C selling of our SA accounts, if I look at your SA balances as Mr. Rana Kapoor rightly mentioned earlier they have grown by about 3.5x over last one year. If I look at your transaction banking business which would be more or less probably B2B has also grown quite distinctly over last couple of quarters. But if I look at CA balances which would be probably also part of that B2B selling, that has not grown in line with all these businesses. So, in terms of your B2B business why would you take a SA balance from corporate or why would he give you a SA balance when he is not giving you a CA balance.

Rajat Monga: No he gives the CA balance. Firstly CA has grown in line. It is not grown like savings account, which has grown out of line.

Rishab Jhaveri: Yes, but we would have had more enrollments in terms of clients?

Rajat Monga: But CA, if you look at the industry statistics, we as a business model are already mature on CA. We have been doing CA for 7-8 years because that is all that we were doing. We were doing commercial banking. You get as a consequence is CA. So, you have to assume that our CA model and outcomes are more matured than SA. If you look at the industry outcomes lots of PSU banks have 5-6-7% of their deposits in the form of CA, which we have about 10%. Even good, more matured, stable, old private sector banks have between 11 and 14, for example. So, there is a little bit of maturity in this business already. We cannot expect 10 to become 20. Nor do we like some banks do disclose escrow accounts under CA, for example our CA is actually pure transacting accounts, not escrow account, we don't include dividend account, we don't include capital market issue accounts, so none of that is included in this number, which can be volatile otherwise. So, this number is yet growing, but it is relative more mature.

Rishab Jhaveri: And question on your asset side, couple of sectors have grown dramatically over last about 2-3 odd quarters like for example if you get metal and metal products, if you look at electricity, if you look at chemical, dyes and paints, they have grown something like 2x, 2.5x, 3x over last 2-3 quarters. So is that the exposure has gone up in those or there is some declassification which has happened?

Rajat Monga: What we are compelled, I must mention in this quarter is that RBI has given a relatively modified disclosure requirements on sectoral exposure and industry exposures. Number one, these have been aligned to that. So, there have been certain sectors which RBI has removed from the new classification. But we have retained them in our disclosure, so that we have at least some continuity, because we have seen, for example RBI removed NBFCs from the exposure list requirement that we have to give in our Basel-II disclosure. But it should have gone in others but we have removed it kept it out, so that we have some continuity from our past disclosures.

Rishab Jhaveri: No, my question is particularly to this couple of sectors like metals which used to be about 3.5% has suddenly gone up to 9 odd percent.

Rajat Monga: Because we have added Hindalco, Tata Steel.

Rishab Jhaveri: So, this is including credit substitute?

Rajat Monga: Yes, the denominator is loans plus credit substitute. 100% is there. What we are doing is there is no loan which has not been included in this pie. It is not like only corporate or only retail or anything, this is 100% of the bank's loan book and credit substitute book.

Rishab Jhaveri: Sure, just one last question total of your pie chart on deposit is not totaling to 100. So, what is missing in that?

Rajat Monga: We will have to check. The only error could be in the larger part, the corporate deposit. The others we know are intuitively close to the correct numbers. If at all if it is not totaling it would be the corporate deposit will be. It might be some rounding off, but if at all the error is in that, the corporate book will be wider.

Moderator: Thank you very much. Our next question is from Anand Laddha of HDFC Mutual Fund Please go ahead.

Anand Laddha: If you can explain what proportion of your corporate loan book has a rating and what could be the bifurcation of that?

Rajat Monga: 60-70% will be rated.

Anand Laddha: What could be the breakup bifurcation in terms of how much are into BBB category and how much are into AA and single A?

Rajat Monga: Among the rated one, I would say, the once which are rated, 80% will be A or better. The ones that are rated, I think 1-2% will be below investment grade.

Anand Laddha: Balance?

Rajat Monga: Balance will be investment grade.

Anand Laddha: So BBB?

Rajat Monga: Or may be, see investment grade is BBB or better, BBB minus or better is investment grade. So there is BBB-, BBB, BBB+, A-. A or better is 80% plus and BBB- not included but worst is between 1 and 2% on the rated book, it is not 100%.

Anand Laddha: I am just confused. 80% is A or better, 1 or 2% are below investment grade.

Rajat Monga: The rest is between BBB and A-.

Anand Laddha: Okay and if my understanding is right, if I were to believe the average yield on all those books will be about 13%?

Rajat Monga: No, average yield on whole book is 12.25%.

Anand Laddha: Okay, whereas the average yield on the whole portfolio of the bank including agri…

Rajat Monga: It is fully loan book, 12.25% is only loan book.

Anand Laddha: On the corporate loan book?

Rajat Monga: No, total loan book.

Anand Laddha: Okay.

Rajat Monga: 100% on the loan book, corporate loan book will be slightly lower.

Anand Laddha: Okay so the balance 40%, because the corporate loan book is 60% of the balance sheet, not alone.

Rajat Monga: Yes, I would say 11.5 -12.25 -13 should be let us say the large, mid and small yields.

Anand Laddha: Fine and the 40% of loan book which are SME retail will be upward of what, 13%?

Rajat Monga: The SME which is classical SME in terms of where we are doing working capital in banking would be 12-13% in terms of yielding. Retail book actually will be a wider range, because mortgages will happen lower, car loans will happen at 13-14%; some lending can happen even higher, but that book is tiny. So, our retail exposure will be 2% of our total book. Then we also have an element of acquired book, particularly PSL, those yields are lower.

Moderator: Thank you very much. Our next question is from Subramaniam PS of Sundaram Mutual Fund. Please go ahead.

Subramaniam PS: My question was on the third party distribution fee that has seen a good ramp up this quarter. Wanted to know what kind of products are we now doing on third party distribution and what is the outlook on this line of revenue? Any products that we still would be adding?

Rajat Monga: If I can just say what we are distributing in general. Some of that could be third party; some of them could be also be like gold. So, it will be third party, but not necessarily like a mutual fund, which is third party. So yes, we are distributing insurance both life and non-life; we are distributing mutual funds; we are distributing gold; we are also distributing some asset products of other manufacturers which could be, for instance, housing loans. We are planning to add not classically distribution but broking to this product suite.

Subramaniam PS: Okay and what would be the mix of this third party between life insurance commission, nonlife and gold?

Rajat Monga: There will also be an element of transactional fees which comes from retail in this through cards and ATM usage which is the more transactional type fees also. So, the fee share that we are showing under retail for others sometimes in some presentation, that is predominantly third party and transactional. The largest piece there will be insurance. The second largest piece there will be the charges, the card usage income that we get.

Subramaniam PS: So life insurance followed by….

Rajat Monga: Card usage. The third part there actually will be penalties because we also have penal charges or customers don't maintain balances or have such other requirements.

Subramaniam PS: Is it fair to assume that the large part of this growth is because of this growth that you are seeing in savings and related card fees?

Rajat Monga: Predominantly yes. The growth is driven by franchisee improvements.

Subramaniam PS: Okay the second question was on branch network expansion, by the year end what target do we have in terms of branch roll out?

Rajat Monga: I think this year will be short of 500, may be 450, 475 should be the year end number.

Subramaniam PS: Okay, so the large part of the expansion is happening in the second half unlike what we have done in the past.

Rajat Monga: Yes, actually it is also a little bit of function of how quickly the RBI moves on some of these things. So, it is a little bit of that timing risk that we are running into Yes. Plus we are okay also because we do feel that there is an element of need to also consolidate our last 18 months of growth. We have doubled our branches in the last 18 months. March '11 our branch number was 150 and in September '12 it is 400. So, may be it was 170-180 or something, but we have more than doubled the branches, so I think there is also a little bit of thinking that we are okay, if we are consolidating, stabilizing the branches and making sure that they are in good critical momentum before we – there because productivity is also very important because if we don't take branches to a productive outcome, it will take very long for us to turn them around, culturally speaking, so it is very important for us to make sure that we are seeing productivity before we are consuming more bandwidth of leaders in that business.

Subramaniam PS: In terms of cost of this 475-500 branches, I mean we have seen sharp increase even in the overall OPEX, it has grown very close to 50%, so has some of these cost already been incurred or are you saying that the cost growth will be inline with the branch expansion that we would see over the residual part of the year?

Rajat Monga: Growth should be less than in line, because newer branches are no longer that expensive or that headcount consuming. The older branches are more expensive because a lot of them are downtown branches in metros and all of that. So, we are not going to put another branch in Nariman point in hurry for example.

Subramaniam PS: Sir why I am asking this question is the growth in OPEX has been higher than the growth in the branches that we would have opened. So it is in that context that I was just trying to understand. See this was the statement that you made even earlier that the growth in OPEX might be at a slightly lower pace because lot of these branches are spoke branches but that doesn't seem to be paying out.

Rajat Monga: The costs have grown at less than 40%. Branches have doubled in the last 18 months. So, that is actually a 120% growth rate on the branch number. So, the branches, we also have to look at the incumbency of branches as cost. So branches, the cost will evolve also in branches to be fair. Day 1 rent will start, but we don't have to populate the branch to the maximum, because there are no customers. So, there will be sales focus at the beginning in the branch cost, but the electricity meter, rent meter and AC meter and maintenance meter are all running. So, the people meter is more calibrated to business. So, there will be an increase of cost also when the people meter has been calibrated to increase business in branches. There will also be a shift from sales to service over the lifecycle of branches because one you have matured in geography your burdened is lot more serviced and deepening rather than adding new customers.

Subramaniam PS: And sir one last question on your savings rate. We have actually seen an increase in momentum of savings accretion this quarter. Just wanted to understand your views on how much would you attribute this to the differential between the rate that you offer and the rate on term deposits kind of narrowing which is increasing the attractiveness of this product and any thoughts because of this for you to keep this rates high even if interest rates come down or are you thinking of bringing down savings rate even when term deposits rates comes down.

Rajat Monga: See for us term deposit is a form of funding, savings account is also form of funding. In fact, savings account also comes with the cross-sell opportunity not as much as FD. Savings account is also transactional account as far as the customer is concerned. It is lot more engaged an account versus an FD. FD is a onetime deal and may or may not even rollover. So for us, even if FD is 7 savings account will still make sense. Even if FD is 7% and let us say even if we have to deploy long away we are not even thinking about it, because FD currently is 9-9.5 in terms of the current pricing, even if we have to, we don't have to lower pricing. We can lower the hurdle or raise the hurdle. We can increase the barrier from Rs. 100,000 to may be Rs. 200,000 or something like that.

Moderator: Thank you very much. Our next question is from Parag Jariwala from Macquarie. Please go ahead.

Parag Jariwala: Yes sir, just one clarification on Deccan Chronicle, you said that you have recovered one-third, you have provided one-third and remaining is around 70 crores, I mean, seeing your credit cost for the past two quarters where you have provided for 70 crores roughly?

Rajat Monga: There is some give and some take in all the numbers, so one-third's were a quick estimate of what is happening. So, the costs of the order of 50 crores have been taken in this quarter.

Parag Jariwala: Yes, but your net credit cost is like 30 crores.

Rajat Monga: Because we have recovered some past bank loans.

Parag Jariwala: And sir there is no provision that says that once you have already provided 50 crores and then credit cost, so this remaining 70 crores should reflect in gross NPA right?

Rajat Monga: It is not an NPA; it is a servicing loan; it is performing. We have recovered interest and principle in Q2 from the receivables of the company and we have monetized some of the collateral that we had from the company.

Parag Jariwala: So this 50 crores is you can say cautiously provided?

Rajat Monga: Yes, at the moment this is just a contingency provisioning. It will be more like of the nature of a general provisioning as opposed to specific provisioning, but it is specific in effect.

Parag Jariwala: And this collateral is the tangible or immovable property, I mean 60-70?

Rajat Monga: We still have more than the remaining uncovered exposure, we have collateral or immovable tangible the whole charge.

Moderator: Thank you very much. Our next question is from Abhishek Bhattacharya of Violet Arch Securities. Please go ahead.

Abhishek Bhattacharya: Sir what would be your non funded exposure to Deccan Chronicle and total non-funded balance sheet size?

Rajat Monga: The non-funded exposure of the Deccan Chronicle is zero, now depends what non-funded is because if we include FX forward contract wherever it is, the interest rate swaps all of that, the off balance sheet is in excess of 1 lakh crores.

Abhishek Bhattacharya: And a book keeping question, what would be your RWA at the end of the quarter?

Rajat Monga: 62,000 to be exact.

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

Vikesh Gandhi: Just one question I have, actually we are seeing your CASA, SA everything moving branches, but can you give some color on the number of retail customers that you have now versus some trend or historic trend of how it has been shaping up?

Rajat Monga: Yes, without trying to excite our competition I will try and answer. So, we have about 4x more customers we had same time last year. Our acquisition rate is about 3-4x more than we were acquiring in savings about same time last year.

Vikesh Gandhi: Okay and secondly couple of times you tried to explain this. Am I reading this correctly, you provided 50 crores on Deccan in this quarter?

Rajat Monga: Yes.

Vikesh Gandhi: And you have a net exposure left of 70 crores?

Rajat Monga: Less than that because we still have some, technically we can say DSRA, Debt Servicing Reserve Account, which is the credit balance of the company lying with us.

Vikesh Gandhi: And against this 70 crores you said you have a collateral of 60 odd crores?

Rajat Monga: If you ask me, we have a net exposure of between 60 and 65 and we have as much collateral at comfortable valuations. So, the problem is not as much as whether we have collateral, but the problem is can we recover and there have been some success on recovery, but the easier collateral has been monetized, the relatively harder collateral is still to be monetized.

Vikesh Gandhi: And with in this whole thing you also said that that I think you recovered one-third of it right?

Rajat Monga: Yes.

Moderator: Thank you very much. Our next question is from Prashant Shah of Vantage Securities. Please go ahead.

Prashant Shah: Sir, if you could just let us know you have given the overall segmentation of your customer asset portfolio, now in terms of large commercial and retail what would be the breakup and which segment drove the growth for this particular quarter?

Rajat Monga: Segmental exposure is between large, mid and small, with small include SMEs and retails 7, 18 and 15%.

Prashant Shah: Sorry, that 7% for small?

Rajat Monga: 67 is large, 18 is mid, and 15 is retail and SME.

Prashant Shah: And which particular out of these three books which particular segment do this book contributed to, mainly to the 35% growth during the quarter?

Rajat Monga: Largely the corporate banking.

Moderator: Thank you. Our last question is from Shweta Mane of Arihant Capital Markets. Please go ahead.

Shweta Mane: Sir, it is sounding little repetitive, but just trying to understand the trend. Actually, the credit substitutes have outpaced the growth of advances, not getting into extrapolating the numbers, but if you could comment that this trend would be sustainable or going ahead the picture would be the same?

Rajat Monga: No, it is actually a function of the cycle. It is a function of credit risk appetite, it is a function of issuers wanting to issue paper. It is very difficult for us to predict how things will go, but as we have seen in the past, the loan book becomes the dominant business driver in the up-cycle and in the down-cycle the bond books have also become a meaningful participants in the financing scenarios. So, as and how we approach the up-cycle you can assume that the loan book will begin to take over the dominant role all over again.

Shweta Mane: And sir one last question, what is your current status on PSL because you mentioned in last quarter that there was a rundown in branch banking and commercial banking portfolio.

Rajat Monga: PSL status is reckoned for on the last reporting Friday of March. Have 6 months to deliver and we will do our best to make sure that we comply with RBI requirements.

Shweta Mane: Sir, you mention in the last quarter, correct me if I am wrong, it will be almost like by FY14 that you actually endeavor to fulfill the target, so it was true?

Rajat Monga: Yes, thankfully RBI is helping; so they are also relaxing some of the guideline that for example just two days ago they have also partially relaxed the guidelines, so it is an evolving situation. We don't know what RBI will do next in terms of perfect clarity. But as far as our view is that though difficult we will do our best to achieve priority sector compliance requirement by RBI even on this March. If there is a trade-off between excessive risk and noncompliance, I think we will fall for noncompliance, we will not take excessive risk and expose the business model or the depositors of the bank to just do mere compliance. It has to be done well. It has to be done with some risk balance.

Shweta Mane: Sir, one last question again, might be sounding little repetitive, but the margins have been range-bound now for past say more than a year between 2.8 – 2.9%. You also mentioned last time that it is partly due to the non CASA cost push, and you also targeted 3-3.5% going ahead, so how do you strategize for this?

Rajat Monga: Margins are still increasing. So, if again we have to keep responding also to the rate environment and competition in this environment, as far as margins are concerned we should be adding anywhere close to 10 basis or 12 basis point of margins improvement even in the next two quarters, should be heading into that range as soon as this March. That is the current estimate. If RBI tightens liquidity, does not relieve liquidity, like was the situation same time last year, we might see margins not breaking out at all. We have anticipated that RBI will **throttle** liquidity as much as it did last year. So, as per current estimate it looks that we should have a margin uptick in Q3 as well as Q4 and then there is an underlying CASA improvement which is anyway aspiring which will touch to 3.5 in 3 years' time.

Moderator: Thank you very much. Our next question is from Nitin Kumar of Quant Capital. Please go ahead.

Nitin Kumar: Just wanted to check why are we raising so much of Tier-II bonds when they will be of limited use under Basel-III as the focus would be more on common equity then. So, why are we loading so much of long-term high cost capital?

Rajat Monga: Yes, good observation. But there is still a grandfathering element that old Tier-II is available for in Basel-III also. We will also raise Tier-I, that also extends the life of Tier-II further into time, even in the Basel-III environment. Basel-III does not, there will be common equity focus, so we are not saying that there is no common equity focus and that we will not plan for common equity, of course we will. But there is also role of Tier-II which is also enabler of business, for example group exposure. Group exposure limits are driven by Tier-I plus Tier-II capital. So, we want to do more business with Tatas. We want to keep that ability to do business with the larger conglomerates open and more. Most of this long term capital is too tiny in front of the opportunity that it brings to us, plus it is not that expensive. So, if you are raising today 10-year money at 9.9 equalized, it is actually cheaper than a 2-3 year deposit, on a like-for-like.

Nitin Kumar: And secondly what has led to an improvement in our Tier-I capital ratio this quarter, have we included the profits?

Rajat Monga: Yes, we have this is the audited number. September 30th is an audited balance sheet in P&L.

Moderator: Thank you very much. Our next question is from Alpesh Mehta of Motilal Oswal. Please go ahead.

Alpesh Mehta: Out of your total financial markets income of roughly 1.4 billion, how much of that would be profit on sale of investments?

Rajat Monga: It is less, it should be 47 crores, so 470 million and profit on sale is minimal.

Alpesh Mehta: I didn't get you sorry.

Rajat Monga: Minimal, as in might be some 1-2 crores number here and there, it will be very ordinary number in that.

Alpesh Mehta: Okay, for the quarter, but for the first half your total amount is 140 crores. So, out of that how much would be profit on sale of investments?

Rajat Monga: 45 crores would be profit on sales on investment.

Alpesh Mehta: And for the second quarter it would be minimal almost zero.

Rajat Monga: Yes.

Moderator: Thank you. Our next question is from Amit Ganatra of Religare Asset Management. Please go ahead.

Amit Ganatra: What is the status on PSL, priority sector right now, in terms of what is the total exposure as a percentage of overall book?

Rajat Monga: Exposure will be typically, priority sector is seasonal. So, it drops off in the September quarter and it begins to build up again as the agri season cycle is. So, today the reckoning is not important whether it is 20-25, it will not matter, because finally we have to be at 40% as of last reporting Friday of March.

Amit Ganatra: And based on your targets will you reach 40% this year or there might be a shortfall?

Rajat Monga: Well we will do our best to reach. I think our plans are all there in terms of from what segment, what kind of origination has to be done, in what part, near about what kind of pricing, I think execution is still to be tested like every year. This year is obviously going to be harder than the past years, because the definition of the priority sector have been realigned. Some new opportunities have opened up, but we don't know how scalable they are and how much can we penetrate in those opportunities. So, that is the execution risk that we are dealing with, and some parts have been withdrawn and some there is still to and fro. RBI is still thinking about whether to relax or not relax some of the other parts of priority sector. So, it is very difficult to say with confidence that we will achieve, but what we can say is that we will do our best to achieve and in the process we are not going to take unreasonable risk. If it comes with unreasonable risk we would rather have a shortfall on priority sector.

Amit Ganatra: And last question is that in your provisions and contingencies do you book any mark-to-market gains on investment portfolio or those are booked in other incomes level.

Rajat Monga: Provisions will be booked there. All realizations of loss and gains. Realized gains and realized losses will be shown in the top-line, income line. Provisions, which means they are unrealized losses, it will be shown in the contingency line.

Amit Ganatra: So, this quarter say for example, 30 crores is provisions and contingency, does anything relate to investment book?

Rajat Monga: There is a small reversal. So, we have provided in the earlier quarter that has been reversed in this quarter, so there is a minus entry.

Amit Ganatra: So, how large is that, small number or?

Rajat Monga: Single digit crore number.

Moderator: Thank you very much. Our next question is from MB Mahesh of Kotak Securities. Please go ahead.

MB Mahesh: Sir just can we have the breakup of provisions for the quarter?

Rajat Monga: Basically fresh provisions are about 50 crores.

MB Mahesh: You have 50 crores of provision..

Rajat Monga: Yes, the other is recovery and/or reversal of investment provisions.

MB Mahesh: Which you said was about 2-3 crores is it?

Rajat Monga: Well, some high single digit number provision on investments.

MB Mahesh: Okay, the second question is this quarter we have seen a very sharp decline in, when you look at the breakup of the loan book, the total exposure, agriculture has declined to about 3% from 10%, has that been the reason why you have seen an improvement in the yield side.

Rajat Monga: No the problem is, this quarter disclosure of industrial or sectoral breakup is that RBI has put out a new format.

MB Mahesh: Is that the same for metal and metal products too.

Rajat Monga: New format yes.

MB Mahesh: And the last question is on your PSL which you had mentioned earlier, in this definition for the current, in the current guidelines, does it include the investment book too.

Rajat Monga: HTM investment book yes, the denominator you mean?

MB Mahesh: In the denominator, yes.

Rajat Monga: If you are holding, non-SLR investment in the helt-to-maturity book it is included.

MB Mahesh: There is an usage of this word, called other investment eligible to be treated as priority sector.

Rajat Monga: Those are the RIDF and NABARD and SIDBI, EXIM, and NHB bonds.

MB Mahesh: So AFS as of now corporate bond is excluded in it. So, that has been clarified.

Rajat Monga: There was never a clarification, we have always had.

Moderator: Thank you. Our next question is from Jyothi Kumar of Spark Capital. Please go ahead.

Ganesh Ram: Hi Rajat, this is Ganesh from here. Two questions, one is want to understand your real cost of savings account including say the ATM, the capital cost of putting ATMs or maintenance cost, or cash needing to be maintained there on a day-to-day basis. The fees you pay for other banks using, your customer using, what he pay for other banks largely. Just want to get a sense of a real cost of a saving.

Rajat Monga: So, some specific answers to your questions. Other bank customers use our ATMs more than our customers use other bank ATMs. We are a net acquirer means that we make money. Which is very simply said, basically we have, I mean it is not a very great answer we are giving but we have more ATM share in the market than we have customer share. So, therefore, see the problem in answering this question is that there is a very classical variable cost versus fixed cost argument that I am going to bring in, because firstly a very difficult number to compute and secondly my commission in there it does not matter, because we should look at this business only on a variable cost basis, because the more you scale up, your fixed cost are not going to grow, I will have the same branches with more customers potentially. The same ATM can service far many more customer, because there is plenty of whatever servicing time available at ATMs. So, we are more or less worried about the variable cost of that business and the variable cost of savings accounts business is very little.

Ganesh Ram: It could be how much, how many basis points over and above the 7%?

Rajat Monga: Negligible, because the only variable cost that we have to incur is statement sending home, which is every quarter. May be semi-variable cost, which is the one time origination cost and the once in a while cheque book and once in a while new card, if that is not charged in that account format. There is no variable cost, it is very little.

Ganesh Ram: And the cash that you need to be maintaining in ATMs is that should typically have a reasonable cost.

Rajat Monga: That is if the cash is in the branches also. The cash is the ATM, the cash can be the branch as well. That is the franchise cost. That has nothing to do with the savings accounts, even a current account customer can withdraw from our ATM if he has a card. So, it is very difficult to be able to attribute cost to savings account. We can do apportioning, but those will be full of assumptions. Even that you can assume in the fixed cost, because we will always maintain some cash under ATM. If more customers use that we still have to have once a day servicing. It cannot be that we do not service the ATM once a day, irrespective of Rs. 100 being withdrawn or Rs. 5 lakhs being withdrawn. So, the guy are outsourced company employee will go the ATM everyday to service it, pickup cheques or any deposits, because there are tats agreed there. If there is a cheque deposit dropped in the ATM we have to clear it, if we don't go one day the tats will fail. Lot of that is predominantly fixed cost heavy. So, the idea of business strategy is very simple, maximize.

Ganesh Ram: Got your point. Second question is what will be the quantum of loans that you down sold the first half or this quarter specifically or first half in general, down sold two PSU banks specifically?

Rajat Monga: Well, if I can combine, syndication and down-selling put together, I think may be 2000 crores.

Ganesh Ram: Okay, I am asking this because of the recent Ministry of Finance Directive asking PSU banks to have a policy or to be more selective in buying loans from other banks. So how could that affect you in some form, your syndication income or…

Rajat Monga: Not buying, the difference in syndication is that they are not buying, all banks are buying into the syndication on day 1. We are only the arranger and a participant.

Ganesh Ram: I was looking more not really from a syndication perspective, more from a down selling perspective?

Rajat Monga: Down-selling would be may be, firstly it need not be a profit opportunity, because see incidents happens at syndication, it does not happen at sell-down. Sell-down is more exposure management, it is more risk management also because we don't want, if I have a group exposure constraint I can sell some exposure in one company to a bank and I open up opportunity in another company. So, I don't think it will stop, I think the Ministry might also be worried because there are still brokers in this business. Whenever we are selling or syndicating we participate in that, we don't wash our hands; we are always participants. So, we will deal with whatever the consequences are, at the moment we haven't seen any push back from PSU banks.

Ganesh Ram: Out of the 2000 crores that you mentioned how much will be down sold?

Rajat Monga: Syndication would be majority, may be 1500, down-selling will be 500.

Moderator: Thank you very much. Due to time constraints that was our last question. I would now like to hand the floor over back to Mr. Sumit Kariwala of Morgan Stanley for closing comments.

Sumit Kariwala: Thanks a lot Rana and Rajat and the entire team for this very useful call. Thanks and best of luck for the third quarter.

Rajat Monga: Thank you Sumit and thank you all for listening in. Thank you.

Moderator: Thank you very much gentlemen of the management. On behalf of Morgan Stanley India Company Private Limited, that concludes this conference. Thank you for joining us.