Kotak Mahindra Bank Q1FY19
Earnings Conference Call

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Moderator: Good day, ladies and gentlemen and a very warm welcome to the Q1 FY19 Earnings Conference Call of Kotak Mahindra Bank. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should 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 am now glad to hand the conference over to Mr. Uday Kotak. Thank you and over to you sir.

Uday Kotak: Good evening, friends. Welcome to the call at the end of our first quarter earnings.

I will start with focus on three key areas: one is fixed income, second is the loan market and the third is the current investment strategy in some of our business segments and then a little bit of overview about what is happening.

So, first on fixed income, we have seen the government securities yields move from 31st March level of 7.4% to 30th June level of 7.9%, therefore our results are on the basis of fixed income yields as of 30th June 2018.

There are three factors. As you are aware, we have taken a total delta on fixed income MTM provisioning compared to last June of about Rs.200 crore. Last June the provision was about Rs.11 crore and this year the total provision on fixed income mark-to-market is about Rs.210 crore. As you are aware, three key factors which affect the fixed income, MTM from an accounting point of view are amongst others, but the three key ones are duration, credit spread and accounting treatment on portfolio between what is HTM i.e. hold to maturity and what is not. So, on the first one on the duration the bank runs overall fixed income duration book as of 30th June of modified duration of around two years.

Second, there is no major impact on account of any significant deterioration in any credit in the fixed income portfolio.

The third one is the treatment between HTM and non-HTM book. As of 30th June, out of the total fixed income book, the book which is in HTM category of our Bank is 46% and the book which is not in the HTM category is 54%. Therefore, this MTM provisioning is arising primarily on account of the book which is not in the HTM category. On the duration side, as you know, there is a sharp gap between one-year duration and a two year duration paper which from the point of view of your banking book at a repo rate of 6.25 gives us significant positive carry, therefore one year treasury as of end of June 2018 was somewhere around 7.10% to 7.15% and two year GSec paper was at around 7.65% with the repo rate being at 6.25%. Therefore, the Bank’s strategy was to focus on this carry which is significant from 6.25% repo rate and also the gap between one and two year has been pretty attractive. So, the Bank has taken an average modified duration of around two years because we see at this point reasonably positive carry though potential mark-to-market pain. As you are aware, whether it is in the past or whether now, the Bank likes to take the pain through the P&L and not doing any amortization of the mark-to-market book. So, this is on the fixed income side. As you are aware, yields are today lower than what they were end of June, but these are volatile markets, there is a monetary policy coming in but fortunately for us our book on fixed income is now mark-to-market very significantly on the 30th June levels. So, that is first on the fixed income side.

Second is on loan growth and what are we seeing in the environment on credit. So, on loan growth at the Bank standalone level I am happy to report 24% growth and consolidated at 22%. If you recollect, in the March earnings call, I had given an indication of loan growth in the 20s and we are continuing to be in line with that as our core loan growth. However, there are segments and pockets within the overall lending businesses which we have continued to see some challenges. The biggest out of that is the SME segment or what we call as the business banking segment. This segment continues to have a reasonable stress and if you look at our GNPA and net NPA ratios, our overall GNPA both in absolute numbers has only marginally moved up compared to the last quarter but our GNPA ratio is now lower than what it was in the March quarter, so we are now at GNPA ratio of 2.17% but we have significantly increased coverage particularly in the SME book and our net NPA therefore is now at 86 basis points, therefore well below 1%. So, this is consistent with our view that balance sheet is a crucial part of banking and finance and we believe it was appropriate to increase coverage particularly in the SME sector and we believe this is a broader industry challenge, we are finding behavior which has to be watched out for. Whenever we are finding SMEs getting into any stress, in many situations, the first thing we find is so called current assets which may be charged to banks or lenders, suddenly evaporate. When we go out to find the details of those assets, either they do not exist, or they have moved out of the books of the company. The second and even more disturbing fact and something which we have taken significant internal steps and I think it is a challenge back to the whole area of third party fiduciary responsibility, is the role of valuers of collaterals. I believe there is a reasonable reason to believe that there is significant overvaluation of collaterals across banking and finance industry. This applies not only to banks but probably also to the NBFC sector and time has come for us to really wake up in this mid-market and SME sector including on property loans where valuation of underlying assets is more appropriately done rather than having values which are not realizable.. So, we have taken a more conservative approach and increase our coverage though our overall stress levels are still well within control just as a matter of conservative and prudent policy. At the same time, we do believe that on the micro side, the loan growth opportunity for appropriate underwriting is attractive. Therefore, we are continuing with a loan growth in the 20s as has been demonstrated by the first quarter loan growth of 24%.

That brings me to the third point which is our continuing commitment of investment in the Consumer segment. In March 2017, we had gone out with the estimate of doubling our customer base from 8 million to 16 million by September 2018. I am happy to report that as of June 18 our customer base has moved from 8 million end of March 2017 to 14.5 million and we believe we are well on our way to achieving the 16 million number as of September 18 which would have doubled our customer base. We are currently adding between 811 regular account opening and also on the assets side a total number of new customers every one month which is about 5 lakh customers per month is broadly indicative range at which we are continuing our customer acquisition. As you are aware, this is a continuing front end acquisition cost which we are taking through our P&L and propose to continue doing that. Therefore, between the higher interest rate which we are paying on savings plus this continuing speed of acquisition, if I take a number, between higher savings plus customer acquisition, we are taking about close to Rs.1,600 crore of P&L pain through the Bank's P&L on a full year basis and obviously proportionate for the first quarter. The broad breakup of Rs.1,600 crore would be Rs.1,200-1,250 crore on higher rates on SA, while our overall average SA cost is around 5.6%, it still about 200 basis points higher than what most of the larger banks are paying which is the cost of around 3.5% and of course another Rs.300-400 crore on the acquisition strategy which we have implemented. Therefore, between fixed income where we have taken a delta provisioning on our non-HTM book which is the higher percentage of the marketplace, though our duration is well controlled at around two years, our continuing focus on loan growth but increasing coverage in segments which we think are problematic including SME and serious review on the overall collateral situation and the continuing investments in consumer is core of our overall theme and focus as we go into 2018-19 for the rest of the year. Our micro view continues to be positive with appropriate risk management and checks and balances as we proceed through the year continuing growth opportunity both in terms of market positioning as also return.

On the returns and the NIM side, we have seen some pressure come on to the historical book, but of course, my personal view is that we are close to bottoming out of the NIM cycle as well and we are seeing early signs of having some ability to price better than what we had over the last 5 to 12 months.

So, this is the broad picture and with that, I will hand it over to Jaimin.

Jaimin Bhatt: Thanks, Uday. I will quickly take you through the earnings update which was circulated earlier today. At the consolidated level, we end the quarter with the post-tax profit of Rs.1,574 crore, 17% higher than last year. Tier-1 at the consolidated level at 18%. Total assets at the consolidated level of Rs.3,45,021 crore and we end up with the book value of Rs.273.5 per share. Other than the Bank at Rs.1,025 crore, the contributors to the quarter's profit were Kotak Prime at Rs.139 crore, the Securities company at Rs.130 crore, Kotak Life Insurance at Rs.117 crore, Mutual Fund at Rs.51 crore and Kotak Investments at Rs.48 crore. Networth at the overall Group level now at Rs.52,000 crore. Advances book at the Group level was Rs.2,13,000 crore and Uday already mentioned 22% growth YoY. The net NPA at the Group level at 0.77%. For the Bank standalone, post tax profit for the quarter at Rs.1,025 crores with CASA now standing at 50.3%. We have seen good growth in both the average number for current and savings account; the current account if I look at average for this quarter versus the average for the same period last year has grown by 24% whereas the savings account has grown on average by 59%. CASA plus term deposits below Rs. 5 crore now constitute 79% of the total deposit base.

As regards the P&L, the net interest income for the quarter at Rs.2,583 crore. Fee and Services constitute Rs.989 crore out of the total other income of Rs.1165 crore. At operating profit level, we see total operating profit of Rs.2,033 crore, about 27% rise on YoY basis and Uday just laid out the reasons for the provisioning increase both on the investment side and the advances receivables, as a result we end up with the provisioning of Rs.470 crore this quarter which is against Rs.204 crore for the same period last year which results in pre-tax profit of Rs. 1,563 crore and post-tax Rs. 1,025 crore.

Our wealth management relationship value is now at Rs.2,54,000 crore. The advances at the Bank have grown to Rs.1,76,000 crore with the growth of 24% on YoY basis. We have seen growth across the board. The corporate book has grown by about 25%, commercial vehicle, construction equipment by about 40%, small business personal loans by another 40%-odd, the agri business is about 15%. Our SMA-2 outstanding at 0.11% of the advances at Rs.189 crore and GNPA at 2.17 and net at 0.86%. Our overall balance sheet size at the Bank level now at Rs.2,71,000 crore.

Before I come to the subsidiaries, I request Shanti to take the Digital one.

Shanti Ekambaram: So, on the Digital side, the enablers first. Our app continues to be rated amongst the highest at about 4.7 in the Apple and 4.5 in the Google Store. We have launched a new payment section for our customers which makes it extremely convenient to serve all the payment needs at one stop. Our Mobile Banking volume for the month of June crossed1 crore and Rs.10,000 crore in value. We continue to enrich Keya, our Chatbot at our customer contact center with new learnings towards servicing our customers and in this quarter we introduced "Whatsapp Banking", a new channel for servicing customers a certain type of services. 89% of our recurring deposit in terms of numbers 67% of fixed deposit continues to come through the digital channel and mobile continues to be a preferred mode for many of our customers and we have seen a significant increase in that aspect.

We continue with our thrust on 811 and if you look at some of the key metrics, 44% comprise of salary, 60% of our customers are from the top 20 cities, 91% of the customers, in fact, that percentage has increased, between 18 and the 40-years of age and we service customers across 6,700 pin codes. We have introduced many elements in our 811 and we will continue to do that with the focus on service as well as cross-selling.

On the payment and the lending side, payment gateway transactions in terms of value grew 70%, UPI saw 42x growth in transactions over the one-year period and including our mobile store. 30% of our incremental PL business comes through digital channel, we introduced Super-Fast Home Loan for Salaried segment in under four hours, that is showing very good traction.

We continue to enrich our branches with digital elements and introduce digital lobby to be able to service and help our customers' service themselves. In terms of our subsidiaries, Kotak Securities continues to focus in the digital side. In terms of the average daily volume, 78% growth in the cash segment on YoY basis and 99% on a total basis on average daily volume has come through the mobile channel. Both in Life and General, new acquisition continues to be the focus through the digital channel.

Jaimin, back to you.

Jaimin Bhatt: Sure. Taking the subsidiaries, the Life Insurance entity ended this quarter with the total premium of Rs.1,200 crore, which is 22% higher than last year, new business premium was Rs.659 crore for this quarter and ended with the profit for this quarter at Rs.117 crore. The securities company ended with the average daily volume of Rs.14,000 crore per day with the market share of 8.3% in the cash market and with the post-tax profit of Rs.130 crore for this quarter. The investment bank has been involved in several issuances, block deals as well as on the advisory side and clocked Rs.25 crore post tax profit for the quarter. The assets under management at the Group level is now just below Rs.2 lakh crore which is about 31% higher than what we had one year ago. The domestic mutual fund has seen assets under management grow significantly, we are at now Rs.1,28,000 crore as average assets under management for the period. Market shares have grown both on the average as well as on the equity side. The PMS which is under the mutual fund has grown 70% on YoY basis.

Kotak Prime clocked profit of Rs.139 crore for the quarter. The overall advances book is about Rs.28,000 crore, of which Rs.20,000-odd crore is passenger car financing with the non-car book actually slowing down over the last year. The book is seen with 0.39% as net NPA and CapAd at 17.7% there. The investment company with net NPA of nil, Rs.7,700 crore advances book and with the healthy CapAd of 19.3%, clocked Rs.48 crore profit for the quarter. That has broadly been the highlights. Would be open to take any questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Mahrukh Adajania from IDFC Securities. Please go ahead.

Mahrukh Adajania: My first question was on corporate credit growth. Is that driven by NCLT the general growth that you see, amidst the PCA noise, is it now fair to assume that 20, 25% is the sustainable run rate of corporate credit despite all the noise on PCA banks and also opportunities in NCLT? My second is your reading of the CV cycle because there are many views on fuel hikes and other issues?

Uday Kotak: The first question will be answered by Manian on the corporate side and there after Kannan on the commercial vehicle side.

KVS Manian: On the corporate side, it is not only driven by NCLT, I think it is a reasonably secular market share gain and yes of course as you have said PCA is helping us gain market share here. So it is not only driven by NCLT. Second, we do think anywhere between 20-25% kind of growth is sustainable here.

D. Kannan: On the CV cycle, the growth during the last 12-months has been reasonably good. There is some confusion because of this recent notification on overloading but still not clear. We expect the market to grow by about 10-15% still but if the old vehicles are also allowed to be overloaded, then we might not see too much of growth on the M&HCV segment.

Mahrukh Adajania: Just a follow up question on this NCLT thing. So, how many cases would you have funded?

KVS Manian: We have not yet funded any.

Mahrukh Adajania: Are they many in the pipeline?

Uday Kotak: Yes, there are a few in the pipeline.

Moderator: Thank you. We will take the next question from the line of Rahul Jain from Goldman Sachs. Please go ahead.

Rahul Jain: A couple of questions; first one is what has happened to the yield on investments during this quarter, can you just share some color on that, did they go up or down?

Uday Kotak: This is one of the reasons why you are seeing some moderation in the yields as we have moved towards lower duration. Sometime in the second half of last year, we began to reduce our duration, therefore as of end June we have brought down our overall duration down to two years and you know that as we go towards the shorter end including on T-bills, your yields get lower. So, this is a trade-off between price risk on duration versus current yields.

Rahul Jain: How do you see that kind of shaping up in the next few quarters?

Uday Kotak: Broadly on the investment side, our view is modestly cautious. At this stage of course depending on a lot of factors including politics, fiscal, impact of price increase, MFP increases as also the state deficit, but our view is reasonably cautious on bond yields and we can debate whether the range is 7.60% to 8.20%, that is broadly the range in which we would like to believe, the 10-year bond in India should behave. As you know T-bills are now at 7.20%, so we carry between a 1-year and 10-year, similar to what you have seen Rahul happen in the U.S., you are seeing the yield curve between 1 and 10-year getting significantly flatter and interestingly two years is giving you 7.65%, 10 years today at 7.77% today. Particularly where you are holding the book, a very significant part of your book is not for trading, but for holding as a banking book. The carry on yields for longer tenure risk has moderated.

Rahul Jain: What would be our average yield on the AFS portfolio?

Uday Kotak: We run the book much more as one single book and on HTM if it is above a certain tenure, only then we put in HTM. Therefore, we do not put one or two-year paper into HTM.

Rahul Jain: The second question is on your view on the lending spread. So, for the last couple of quarters, we have seen the spreads have been kind of trending a little bit southwards, I understand you guys are financing in AAA market, AA market, but typically how would you guide us for the following quarters in terms of lending space, do we see those further go down or will remain flattish, how do you see those play out?

Uday Kotak: From our point of view, we believe that we are going gangbusters on increasing our CASA, okay. So, now 50% of our deposit base is CASA and that is not a feeling, we would like it to keep on going up. As you know CASA is a fixed rate book and if interest rates in the economy go up, we obviously would like to get benefits out of that over time, particularly since we are growing our SA and CA book at a reasonably quick trot. So, if that fixed rate book of ours keeps on going up faster, than the rest of our deposit base and obviously if we can go faster than the loan side then obviously the juice is there. We do believe interest rates on the lending side will go up. However, in the short run, one of the things which I think we have to keep in mind is there is a fundamental difference between the base rate regime of interest rate increases versus the MCLR regime. What do I mean by that? Bulk of our floating rate book is priced of our six-month MCLR, say, for example, if we have given a loan in month of June and we increased base rate on July 1, then in the base rate regime the transmission of the higher rate would have been passed on to the customer effective July 1. In the MCLR regime, the increase for a June loan will be transmitted to the customer only in December, so there is a time lag for transmission in the MCLR regime depending on whether your customer floating rate is linked to three months, six months, or one year. The transmission time is something which is like work-in progress. Very significant part of our book is six-month MCLR. Therefore, you have seen the beginning of interest rate increases in our MCLR start around March. As we go forward, we see this beginning to transmit itself into the floating rate on the assets side.

Rahul Jain: Because the other part was actually a little bit more philosophical because traditionally we have kind of stuck to maintaining risk adjusted NIMs margins of 380-400 basis points excluding the credit cost out of it, but for the second time we have gone below that threshold, so I was just kind of interest in understanding are you comfortable with these kinds of pricing?

Uday Kotak: I think the fundamental reason why you are seeing this time lag gap is coming out of the MCLR regime versus the base rate regime.

Rahul Jain: The last question is on the business banking portfolio and the NPL concern. The slippages seem to be maybe lower than some of the previous quarters and the book in business banking actually has kind of remained broadly in the single digit growth. So, for how long do we kind of watch this portfolio, when do you see that portfolio start to grow again, any color on that?

Uday Kotak: Rahul, what has happened is the segment which has got most hurt whether it is demonetization or GST, it is the business banking segment, and as you know essentially lot of the SMEs in India have traditionally been financed by the public-sector banking system, a lot of these SMEs have been significantly undercapitalized on the equity side. Therefore, a combination of external changes in our equity and some of the challenges in the banking system have all converged. This will put pressure on this segment. As a result of which the ability to absorb shock by this segment is limited. The more important point is it is not only in the SME segment, it could be in some other segments also. Also, we have seen challenges in recent time which you got for third party fiduciaries including auditors. But one other big, big spot in Indian finance is the role of valuers of collaterals. And I am not giving you some big secret, the history for a long period of time whether it is a borrower or a friendly flexible banking officer in many places, the easiest way to give more money to some of these guys has been valuer giving significantly higher value to a collateral, whether it is a factory or land or plant and machinery, call it what you want. This was one of the best public secrets of Indian finance and we are beginning to see that in some of these cases when you are going out to actually realize value on these collaterals, the collateral realization is a fraction of what these valuers have given. If you and I spoke in 2011-2012 about project finance and large corporate loans, I was the one who raised concern for fundamental creditworthiness of some of these large project finance loans. I am today raising similar concerns on fundamental role of collateral valuers and the real truth of those valuations. That is something we have recognized it, we have started taking the corrective measure. We think this something which is a system undergoing a fundamental correction and there is no real authority or body which is regulating these valuers. Anybody in India can become a valuer.

Rahul Jain: So, for how long do we see this transition?

Uday Kotak: Having said that Rahul we are not shy of loan growth, but our fundamental belief is if we are giving our money we must first have reasonable comfort we are going to get it back and the so-called security which we are supposed to have is really the security we have, and therefore we continue to guide on the 20s loan growth overall, but we would certainly not want to give money on some bogus collateral.

Moderator: Thank you. We will take the next question from the line of Nilanjan Karfa from Jefferies. Please go ahead.

Nilanjan Karfa: Just going back to the previous question and your commentary, Uday, if we look at any loan book, whether it is Kotak Mahindra Bank or any other bank, there is huge amount of secured loans. If we just exclude the pure personal loans and credit cards, practically everything is secured. How do we value then, if you are raising a question on valuers, do we have so many number of internal valuers?

Uday Kotak: One of the things we are doing is investing in getting stronger and stronger technical value inside the Bank. For regulatory reasons we may need an outside valuer, but we are dramatically strengthening our internal technical valuation capability.

Nilanjan Karfa: If you could give an example that would be useful?

Uday Kotak: You have seen in some of the so-called real estate valuations or factory valuations and others, the realizable value versus the valuation we get, some of it came to us from the acquisition of ING as well. As per RBI valuers, fixed asset valuations are valid for three years. In some of those accounts when they went into stress between what was the valuation report on paper we had versus what we are able to sell, the number is not 20%, 30% lower, it is 50%, 60%, 70% lower and that is when about a few months ago we started looking at this closely and really focused on getting the fundamental valuation of so-called secured assets, because the trouble is on the one hand, you price secured assets loan at a more attractive rate and then if it is effectively unsecured and a lot of your core lending and comfort comes out of security, we are burning our boats on both ends. Neither are we getting the spread of a unsecured loan nor are we getting the real value of the security we are supposed to have.

Nilanjan Karfa: Let me ask it in a different way, maybe we knew about these issues, but let us say our last year credit cost was Rs.700 crore roughly. If you average it on a quarter, maybe we should have done 150, 160. I am assuming therefore that additional Rs.75, 80 crore that we have taken, do you think that adequately values our collateral?

Uday Kotak: There are two points when you look at our numbers, look at it, #1 our absolute level of net NPL is now down to 0.86%; #2 in terms of flow, look at our SMA-2, our absolute number on SMA-2 is about Rs.180 crore. So, these are the two important numbers you got to keep in mind and take a view about what we will be needing to do. Obviously, we do not believe the value of a stress loan is zero, but even if you took the value of stress loan at say 30% or 35%, we have probably post this provisioning already at 60%, therefore we are holding the entire NPL book of ours already at 40% or 2.17% of GNPA and net NPA of 0.86, it means we have provided 60% on the entire book and we do not think the value is zero, but the value is lower than what we would have thought six months ago.

Nilanjan Karfa: On the SME pain that you have been highlighting looks like you are getting a little more cautious about that. Which specific segment do you see…?

Uday Kotak: We are not cautious about fresh lending, but we will do better underwriting, that is what we are moving towards. If it is secured what is true collateral value rather than being taken in for a ride on bogus valuations. And the good news is thanks to some capacity tightening, our ability to push what is right is better today than ever before.

Nilanjan Karfa: There was this assumption right with GST for example, while there will be a transitory pain maybe that continues but you will have better tax information available as banks you get larger, larger data to underwrite, is that not happening?

Uday Kotak: Not fast enough yet but having said that I think it is a very important point, we do see the value of cash flows in our views and therefore cash flows are very important aspect about how we will look at lending in addition to collateral, but we would not fool ourselves with artificial collateral numbers.

Nilanjan Karfa: Just a data keeping question, could we have the risk weight asset at both Bank level, the consolidated level and the third is the credit substitute on the bank?

Jaimin Bhatt: About Rs.2 lakhs crore at the Bank level and at the Group level about 2.7. Credit substitute, I will give that to you later.

Moderator: Thank you. We will take the next question from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: You spoke about the SME loan part. Can you quantify the total amount of SME loan in the Kotak book?

Uday Kotak: In one of our earnings update slides we have given, essentially when we are talking about SME, we are talking about business banking and that number is about Rs.18,000-odd crore and on year-on-year basis we have grown that at only 3.5%, primarily business banking, but this issue about collateral and fair valuation we think permeates much deeper across banking and finance on many-many categories of secured loans. This is a banking and financial sector issue, not necessarily a Kotak issue.

Amit Premchandani: Sir, your staff cost in the Bank is now at four quarter low. Are we reducing employees in the Bank over the last say three, four quarters or are we seeing the impact of digital-led kind of initiative that you have taken?

Jaimin Bhatt: I think we need to recognize looking at a quarter-on-quarter basis, previous quarter we had explained the fact that thanks to change in the payment of gratuity rules, we have taken a one-time hit in the previous quarter. If we take that out actually there is an increase on quarter-on-quarter basis.

Amit Premchandani: But even on YoY basis the growth is only 2% and the balance sheet has grown almost 20%?

Jaimin Bhatt: As I said, you get on account of the fact that you have retiral benefits which kind of discounted on the basis of interest rates and to that extent because the interest rates have gone up you will get some benefits then.

Amit Premchandani: Sir, finally on the consumer durable side, what is the book size as of now and what is the strategy that you are kind of implementing on that?

Shanti Ekambaram: We just actually in the Bank launched Consumer Durables, so it is as you know these are small ticket loans and reasonably short tenures of around six months, so the book is just building, so we will have to wait a few quarters.

Amit Premchandani: Broadly, consumer bank loan growth has been in excess of 30%.

Shanti Ekambaram: That is a consumer bank retail asset growth has been above 30%. You asked for durables specifically, that is just building out.

Moderator: Thank you. We will take the next question from the line of Vishal Goyal from UBS Securities. Please go ahead.

Vishal Goyal: Two questions; one, in the net interest income line, especially the income on other sources, so that line clearly has gone down, while there is no significant increase in the interest on investment also, like QoQ basis, so if the carry trade were to work, I am just trying to see whether it should have reflected somewhere at least in the interest on investment line, what explains the significant decline in the interest income from other sources, Q4, Q1 like balances with Reserve Bank of India and all that?

Jaimin Bhatt: Those are very small numbers anyways, Vishal, that is about Rs. 100-odd crore and the average balance we need to look at with those entities have also come down significantly, it is not that the ratio gone down.

Uday Kotak: You are talking about Rs.92 crore versus Rs.183 crore?

Vishal Goyal: Yes, if you add that, correct.

Uday Kotak: It is not a big number.

Jaimin Bhatt: The amount of balances which have been kept there also have been lower on an average.

Vishal Goyal: Other thing is on Kotak Prime, obviously, there is hardly any growth and I think there was a plan to do other than CAR business also there. So, any thoughts on that?

Uday Kotak: Yes, I think first on Consumer Durables which earlier we were planning to start in Kotak Prime and we were ready with everything else, it is now going to be done in the Bank and we are very focused on launching it as we talk, or we have done the test market launch already, so we will see that happen in the Bank. In Kotak Prime, we are in the process of getting into two-wheeler business… I will ask my colleague, Narayan, to speak about when he is launching two-wheeler finance business. So, we think the time has come that in addition to four-wheelers which is what KMP primarily does time has come for two-wheelers as well.

Narayan S. A.: As Uday said, we have done the homework, the board approvals in place and we should be launching it anywhere next month, we have done all the necessary build up for it, the infrastructure, etc., so next quarter or before the end of March you should see good assets coming out of this business.

Vishal Goyal: Just one data book-keeping question. On the insurance business, was there any impact of increased interest rates in terms of like mark-to-market losses or so?

Uday Kotak: There are two parts to insurance business, particularly if you are running a non-par business. Yes, there is a mark-to-market impact that happens when rate go up, but also the flow of future premiums, investment rate of those premiums because your non-par in the fixed rate book on the liability side. Your future premium investment rate also goes up. So, depending on whether your stock is larger or flow is larger, based on that is the net impact of interest rate on your overall insurance IEV. Having said that we have taken views in order to build the business steadily, we will be giving the insurance EVs once a year.

Moderator: Thank you. We will take the next question from the line of Nitin Agarwal from Motilal Oswal Securities. Please go ahead.

Nitin Agarwal: My question is on savings account. SA accretion this quarter is one of the slowest in the past many quarters. So, are you seeing some movement from SA balances with high return assets? Relatively, if you can give some color on how the average SA balance has moved between 811 and the other regular SA accounts?

Uday Kotak: I think you are comparing with last year's March.

Jaimin Bhatt: Also, I think average numbers which I put out in the earning update also, if I look at the average numbers this quarter is about Rs.56,300 crore versus previous quarter Rs.52,000 crore which is about 7.6% growth, not annualized, but about 31% growth on an annualized basis and if you look at the year it is significantly higher at 59%.

Nitin Agarwal: How the average SA balance has been there between 811 and the other regular SA accounts?

Uday Kotak: We will share with you at an appropriate time.

Nitin Agarwal: Not even like some directionally how it is trending.

Uday Kotak: 811 balances are building up quite well. We think there is still lot of juice out there which we want to get and we are seeing a clear steady pickup and we think its something which we are very committed to and we are quite happy with the progress.

Nitin Agarwal: Our SA strategy like will it remain the same to offer a higher SA rates?

Uday Kotak: One-year bank CD rate is 8%. What is the problem in getting average SA at 5.6%? We are not driven by what others do, we know we have got a huge positive carry. We are growing SA steadily for many years at 40%, industry which is growing at 10% to 15%. We think we have got a good thing growing. We have got a 2.5% spread versus one-year CD, why should we worry about what others are doing and why should we worry about short term. We are adding on our base we are adding more than 50% new customers, and this is the time to go out there and in the market place and get customers engaged there broad based and really get market share on customers accounts. This is our time to really grow why bother about what happens to me in one quarter or two quarters. I mean we can talk this game over next two years.

Nitin Agarwal: Lastly like what is the plan on reducing the promoter ownership are we requesting for any change?

Uday Kotak: We are evaluating all options.

Nitin Agarwal: So, the December timeline still remain the same?.

Uday Kotak: We have disclosed to the market whatever the RBI requirement is and in that context we are evaluating all options.

Moderator: The next question is from the line of Kunal Shah from Edelweiss Securities. Please go ahead.

Kunal Shah: Firstly, in terms of the overall advances so given what is happening on the commercial vehicle side plus what you highlighted on the business banking and we very much getting into the election year as well, so how are we overall positioning in terms of the mix in the near terms over the next one and half odd years and also in terms of the overall quantum of growth what we should be comfortable with?

Uday Kotak: We continue with our guidance which we did at the end of March quarter which is growth in the 20s, we continue with that guidance.

Kunal Shah: And in terms of mix should we see that given the opportunity which is there on the corporate banking side and maybe what are the challenges made on the commercial vehicle or business banking and the other secured segment, do we see that proportion inching up further?

Uday Kotak: It is a very fast changing environment. One week ago, the view on CVs would be very different from what it is today, so as they say one week is a long time in politics, the same principle applies to any risk business and we will keep flexibility, keep the philosophy of going out there and giving money where we think we can get it back with reasonable returns.

Kunal Shah: On the unsecured side, would that focus would still be continuing in terms of the unsecured play?

Uday Kotak: I think at this stage we think things are okay. My personal view on unsecured, the challenges are 2020, till then the market should be happy as banks and NBFCs keep on compounding and keep on booking profits when really in unsecured the profits are only in the last few quarters of the loan.

Kunal Shah: But overall maybe in terms of penetrating into our existing customer base is that largely? **Uday Kotak**: We are adding half a million customers a month.

Shanti Ekambaram: I think if you look at unsecured business in credit cards. Today in fact 90% of all our incremental sourcing comes from our existing customers, increasing base on personal loans and home loans. So, I think our focus as Uday said we are adding customers quite substantially and on the retail side, on the unsecured we are going deep into our customer.

Uday Kotak: So, where the question of reaching all our customers. If we had 60 lakh new customers a year and our view is that we may add, we may get a customer on the liability side, but we will certainly try and leverage that customer across our product range.

Kunal Shah: Lastly in terms of the saving deposits so given that now we are almost like say 50% CASA and even on a per branch basis when we look at it we are like much ahead of the peers, so we would say maybe in terms of at least the benefit which was to flow through from maybe the ING Vysya customer and deposits customers we have largely got that benefit and now the pace should slow down from here on?

Uday Kotak: See Kunal let Shanti answer that but let me tell that our ING Vysya customer base and actually I have got a new colleague of mine who I want him to answer on this call is Virat. You know our ING Vysya integration took longer therefore we started doing synergies a little later, but I think there is still more juice, but Virat you want to answer that?

Virat Diwanji: You see in terms of the customers they are getting used to the products that we are offering earlier in the ING Vysya version they did not have. So, those customers who were relatively maintaining lower balances they have started getting in and more importantly we have now got a network where we can go and catch the customers. 811 of course is adding value to it because in and around those branches we can go and acquire new customers. So, the CASA growth rates now I think we are more or less at par with what used to get before the merger.

Kunal Shah: Okay, but in terms of the industry we would still be better in them.

Uday Kotak: We have to do our work that is our job, why drag our line based on what other line may or may not be.

Kunal Shah: Yes because in terms of per branch ratios when you look at the productivity for Kotak it has improved very significantly over last two years. Firstly, congratulations for that, but maybe where do we finally settle so are we largely done with it or we still have more potential?

Uday Kotak: You know 50% is half of 100.

Moderator: The next question is from the line of Krishnan ASV from SBICAPS Securities. Please go ahead.

Krishnan ASV: This is just pertaining to your throughput commentary about over valuation in the business banking segment and that may actually permeate other business segments as well. Given this risk is not something I mean as you rightly said this is very well-known secret or public secret I mean obviously it was always understood that Kotak would be far more conservative in their own internal valuation, why necessarily benchmark yourself just what the external valuers are telling you, just wanted to understand could it be a tradeoff between when you start looking for high growth this is necessarily evil that you need to new live with?

Uday Kotak: See first of all it is always let me say one thing. Project finance and large corporate loan issues came into being in 2007-2008 and they are playing out over 10 years. So, when all these major issues come out it takes a long time for it to play out. We believe valuer is a thing which is just now beginning to flow out. So, you have seen issues around auditors I think valuers are issue, which nobody has really questioned what is the basis of these valuations. Keep in mind we got a fair amount of business banking book out of the merger and we are now very clear, we are strengthening our technical valuation and if the true value of the security is less we are still open to looking at those accounts provided we can justify on strong cash flows independent of the security, but if your decision is based on security and less on the cash flows then we are doing a wrong underwriting. We are not scared about lower value of securities if we can lend base on cash flows of the company, but to not look at cash flows as closely, but to look at security value as the basis of lending and then getting surprises on that which are disproportionate is the issue and which I think will be an issue in the financial sector over the next few years.

Krishnan ASV: You are raising this red flag I understand Uday, but all I am trying to highlight is the fact that this is not a new risk I mean this has been broadly known that you tend to inflate your working capital, your receivables, your inventories I mean that is the way the MSME have been functioning for a fairly long period of time. I am sure your bank has generally been at the most conservative end..

Dipak Gupta: You know what happens really is these are okay and acceptable under normal growth time, but when stress level start increasing, NPL start increasing and you get on to resolution and recovery that is when some of these really get heightened and I think we are seeing some of that play out just now.

Uday Kotak: You know what is also happening in the SME segment that should a loan get into strength. So, one is a collateral, secondly you are supposed to have current assets, but you will find it difficult to find out where the promoter is or the current asset and then you are seeing an empty factory or an empty some place and then you try and say okay this collateral was valued at Rs. 20 crore and if you go and try and sell it is single digit.

Krishnan ASV: I mean if you are flagging it off as a red flag I mean I am assuming Kotak Mahindra Bank is probably in the top docile in terms of your ability to underwrite and you know highlight these risk. I am just wondering what this means for the rest of the system that is the only thing I am trying to get.

Uday Kotak: I think that is a good question, it is a system level issue. As far as we are concerned we are at net NPA of 0.86% on a GNP of 2.17% which is 60% provision and we have increased the provisioning in April to June quarter clearly by design because we believe balance sheet is far more important than anything else in banking and finance.

Moderator: The next question is from the line of Ashish Sharma from Enam Asset Management. Please go ahead.

Ashish Sharma: Sir just two questions first on the strategy side. One is on your rationale for doing the consumer finance business in a bank now instead of earlier when we had mentioned that we would want to do it through Kotak Prime what is a rationale on that and second would be are we also exploring whether we can do even the microfinance business because we had done a very small acquisition in BSS Microfinance, but given that we have seen some successful companies who have demonstrated that this MFI business under a banking architecture is profitable and t lastly on general insurance it is a work in progress, but given the opportunity in general insurance business, are we looking at any inorganic opportunities in that space

Uday Kotak: Three questions in one. Answer to the first one on the consumer finance business the reason why we have decided to do it in the bank is because we think technology can be managed better in the bank and we have a much better and speedier process thanks to our experience of 811 in terms of KYC and ability to grow that book better. So, we have done a pretty detailed analysis on that and then taken a call that we will do it out of the bank. Second on Microfinance our experience on the BSS Microfinance is good. The reason why we feel comfortable about it because we have a quality team not very large, manageable and we believe that it has been a very good acquisition for us, as long as we think it is managed well and not sort of let go out of control in terms of relative size, but keep in mind BSS Microfinance now is acting as a BC to the Bank. And third is on general insurance. Yes, we think general insurance business is good. We are always looking for opportunity and in the meantime, we are continuing to grow it organically and we will report back progress on either if there is or both.

Moderator: The next question is from the line of Roshan Chutkey from ICICI Prudential Asset Management. Please go ahead.

Roshan Chutkey: In your assessment, what is the two-wheeler finance penetration like based on your survey that you have done?

Uday Kotak: Two-wheeler finance.

Roshan Chutkey: Finance penetration what does it look like for the two-wheeler segment?

Narayan SA: Finance penetration is very high. We think it is about more than 80%.

Roshan Chutkey: How many 811 customers do you have now?

Uday Kotak: As I mentioned we have a total of 14.5 million customers and we are seeing a faster growth both in 811 and regular customers, both are growing at a pretty good clip.

Moderator: The next question is from the line of Gurpreet Arora from Quest Investment. Please go ahead.

Gurpreet Arora: The CD ratio the credit deposit ratio for us has been inching pretty high for last 2.5 years, so is there any internal benchmark we are working around as a sustainable or stable level and related question to that is it fair to assume that had the CD ratio been slightly lower we would have grown the advances at a slightly higher pace that is one question. The second question is what has been the conversion run rate of 811 customers into normal accounts and what sort of cross sell are we able to leverage on that these two please?

Uday Kotak: Okay first on CD ratio I think you got to divide it into two or three parts. Our view is a good CD ratio would be the early 80s, 80% to 85%. In an environment where SLR is about 19 odd percent and CRR SLR at about 23%. What is happening is structurally we are moving our deposit base more retail. Therefore, our mix is changing much faster and we are beginning to reduce our dependence on wholesale, but the retail takes longer time to build up. So, we are significantly increasing the focus on retail deposits which is primarily deposit below Rs. 1 crore in addition to CA and SA. So, the mix change is beginning to work in our favor, but while you are doing this transition if the loan growth is at 24%, 25% we need to make sure that we fund the balance sheet. The next important issue is that loan growth is coming to banks at a time when there are many banks who are continuing to take deposits but having no loans including the PCA banks. So, it is a very strange situation which you are going through. There are really two parts of banking both are getting deposits, but one part of banking is getting deposits but not adding loans. The other part of banking which is growing faster than the banking sector average and at a time when the interest rates are moving up also money going into liquid funds and competing instruments. So, there is a chase for deposits by people who are growing faster loans.

Gurpreet Arora: For us to achieve 80%, 85% CD ratio you think 811 itself would suffice or we need to do another round of branch expansion?

Uday Kotak: This year we proposed to add about a 100 branches in the current year and these are not designated branches they are real branches.

Gurpreet Arora: My second question related to 811 conversions into normal accounts and the cross-sell opportunity there?

Uday Kotak: Let me say one thing on 811 as we said we will keep on sharing with you information at the right point of time. All that I can say we are very happy with the progress.

Moderator: The next question is from the line of Prabal Gandhi from Nalanda Securities. Please go ahead.

Prabal Gandhi: As you mentioned that you are targeting loans growth of 20%?

Uday Kotak: We are targeting loan growth in the 20s. So, anywhere between 20% and 29%.

Prabal Gandhi: Can you mention the segments which are going to get you this loan growth?

Uday Kotak: Yes as we mentioned there are segments which we are careful about at this stage, one of which is SME and business banking. Now we have to watch commercial vehicles the impact of the new law so that is something we need to watch, but segments which are doing extremely well are construction equipment, pockets of wholesale banking, tractors are beginning to do extremely well, consumer loans, consumer lending division is growing at (+30%), so these are the ones which are in good shape.

Prabal Gandhi: In terms of balance sheet in quarter one of FY19 this time total asset went up by 2% whereas the deposits went down by 2% and my borrowing increased by 33% and that money which came from the borrowing, from the increments of cash and balance as you mentioned earlier went into investments and my investments rose by 10% whereas my advances only rose by 4%, any particular reason why investment had such a rise given the yield situation that we are in?

Uday Kotak: We are moving towards a 100% LCR requirement by December and some of the credit substitutes also may have been done.

Dipak Gupta: So, investment includes not just G-Secs, SLR, LCR basis so what you are seeing is combined impact not just standalone SLR investment in that.

Uday Kotak: And also, we know with liquid surpluses we may have put something in mutual funds end of quarter which we may not have put end of the year. See for example in mutual funds, liquids funds, our limit as per RBI is 10% of our net worth. And for the end of June we could put about 3,500 crore in liquid funds and end of March this number was zero. So, the delta between March and June on mutual fund liquid is R.s3,500 crore.

Prabal Gandhi: But on the investment yield side we have been getting investment yield of 7.4% and this time it went down to 6.7% which you explained that because of the provisioning everything. Whereas yield on advances we are getting yield of around 9.5%, so why not put all that money into advances and get higher yields when the demand is already there?

Uday Kotak: There is also credit risk no, and we have a liquidity requirement and LCR requirement as per RBI. We have got to maintain LCR at 100% and this is another issue. On the whole investment thing even at 100% LCR out of the 19.5% SLR only 13% is considered as valid for LCR, additional 6.5% SLR is not concluded as valid for LCR. So, technically in the world of 100% LCR which we start from January, the SLR should be fully allowed to be allowed for LCR and should not have a 6.5% number.

Moderator: The next question is from the line of Dhaval Gada from Sundaram Mutual Fund. Please go ahead.

Dhaval Gada: Just one question so we have seen a very strong growth in the relationship value of wealth and priority segment, just wanted to understand the number of clients that you would be engaging in the segment and also what would be the broad contribution to our total income or fee income from the segment?

Jaideep Hansraj: The total number of clients in this would be approximately 34,000, 35,000 families that’s what would be across the entire relationship value.

Dhaval Gada: Its contribution to fees and services or the total income for the Bank broadly?

Dipak Gupta: Well we do not disclose that separately, but you know it will form part of each of the sub-business the SA, the CA, the deposit, the distribution each of those will have component on that.

Dhaval Gada: If you could broadly classify the full year FY19 or this quarter what would be a broad fee income breakdown between corporate and retail?

Uday Kotak: Lot more in favor of retail. We do not have investment banking revenues which are dramatic in the Bank.

Dhaval Gada: Would you say 75-25?

Jaimin Bhatt: If I look at what Rs. 989 crore, at least about Rs. 600 crore rupee coming from the consumer and commercial banks.

Uday Kotak: So, about nearly two-third.

Jaimin Bhatt: This does not include credit finance.

Uday Kotak: About 75% give or take.

Moderator: The next question is from the line of Pranav Tendulkar from Rare Enterprises. Please go ahead.

Pranav Tendulkar: Uday so as you hinted that there is some kind of risks emerging in business banking, do you think similar risks are emerging in home finance after 15 years of credit cycles and in retail after say 10 years?

Uday Kotak: I think the simple question we need to ask is when we are lending in the retail segment, it has to be one of the three. Pure cash flows of the borrowers, pure security of the borrowers or a combination of cash flow and security. What I am just highlighting is this that in the one part which so-called security is whether it is pure security or cash flow per security. When we as financials lend in that any segment where we think the security value is x which is the basis for our comfort. I am just making a point that there is an issue. And issue might differ from company to company, bank to bank, ability of technical underwriting, but there is no regulation of valuers in finance. Anybody in India can become a valuer. And therefore, what is the basis of banks and NBFCs or finance company depending on a valuer's report and there is no liability nothing, no accountability and we all merrily lend. And therefore, the underwriting standards of each of the financials in the absence of industry standards for example your rating agency standards, you have auditors which there are basis they are supposed to be registered charted accountants, who is regulating the Collateral Valuers based on which banking industry is giving lakhs of crores of money.

Pranav Tendulkar: But you do not think that similar underpricing of risk is happening in any category of retail?

Uday Kotak: On consumer I think -post 2008 with the development of credit information bureaus was a big transformative change in terms of how consumer behavior change, which particularly helped the unsecured consumer. The challenge is as more and more players come in, more and more people start lending to that same consumer, at some point of time there is no back-testing models and we will reach levels of over leverage, but at this stage I do not think we are there. Could we get there in two years, possibly.

Moderator: Thank you very much. Ladies and Gentlemen due to time constraints that was the last question. I now hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak: Thank you very much friends. I believe that the broader theme of a reasonably stable Indian micro other than pocket of challenges is the story which plays out. Macro will have disproportionate factoring in terms of how the risk and opportunities in the financial sector develop over the next few quarters and years. There is, of course the full political situation which we need to watch out for, but within these broad contours I do believe for a firm like Kotak this is a time for significant opportunity to be increasing our positioning and market share and I thank you all for being on this call. Thank you very much.

Moderator: Thank you. Ladies and Gentlemen on behalf of Kotak Mahindra Bank that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.