"Kotak Mahindra Bank Limited Q4 FY 2017 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Kotak Mahindra Bank Q4 FY 2017 Earnings Conference Call. 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 now hand the conference over to Mr. Uday Kotak. Thank you and over to you, sir!

Uday Kotak: Good evening, friends. Glad to talk to you at the end of the full year 2016 - 2017 and Q4FY17. Just to give you a sense on the overall numbers, On a year-on-year basis the bank's standalone profit after tax reported a 63% growth. And on a consolidated basis, profit after tax showeda 43% growth over the previous year.

We have to keep in mind that the previous year was a little muted because of the impact of the merger with ING Vysya Bank which took effect for the full year of 2015 - 2016. And therefore, the growth of 63% and 43% in 2016 - 2017 has to be kept in mind in that context. If you recollect in the year 2015 – 2016, at the end of the first quarter I had shared with all of you the size of what we saw as the potential soft book which we got out of the merger which was around 6% of the ING Vysya book and 2.5% of the merged book.

I am happy to report back to you that at the end of 2017 virtually most or almost all of these so called soft book as we had assessed out of the ING Vysya Bank has been recognized in our GNPA numbers. I am also therefore, happy to report back to you that post the recognition we saw, we now have a situation where our total credit costs for 2016 - 2017 are 61 basis points including standard provisioning cost of about 6 basis points. And therefore, net of standard provisioning credit costs are about 55 basis points. These costs in the previous year were about 82 basis points and we believe that broadly going forward the directional improvement should continue in 2017 - 2018.

We also believe that in many ways the year 2016 - 2017 has been game changing for financial services and formal financial savings has seen a significant benefit coming out of the events of 2016 – 2017. In our case now with a fully integrated combined bankwe are seeing significant growth not only in terms of our liability franchise with the bank but also growth in our asset management business, life insurance business and a very significant growth in our capital market businesses as well.

Therefore, as we look at the year ahead, we feel that the overall financial services business from the point of view of growth opportunities has significantly expanded during this period. We are also seeing positive initial success of the launch of our digital 811 product and we do believe that traction will continue as we go into the first quarter of 2017 - 2018.

On the point about credit and loan growth, for the year we have grown at about 15%. However, the trend of the last quarter i.e. Q4FY17 is encouraging. We have grown for the fourth quarter at about 5.3% which gives us an annualized growth rate of about 21%. We believe that the trend of this quarter is something which we will strive to achieve as we go into the future.

One of the areas which I had mentioned to you in my earlier interactions with you was the challenges to the SME business integration and the growth of the business banking as we call it. For the full year if you notice, our business banking has not grown, in fact marginally de-grown. But, if you look at the fourth quarter, business banking has demonstrated a 7.6% growth which obviously on an annualized basis is in excess of 30%. So, this change in trend is also welcome and we are now seeing the benefits of whole integration and moving into the period post demonetization.

Therefore, all-in-all we end the year with a significant feeling of having a positive growth approach into 2017 - 2018 with a loan growth trend similar to what we saw in the fourth quarter. And going forward, credit costs also trending down from 82 bps in FY 2016 to 61 bps in FY 2017 and directionally lower in 2017 - 2018.

With that I will now hand over to my colleague Jaimin Bhatt to take you through the specific aspects.

Jaimin Bhatt: Thanks, Uday. Let me take you through the earnings update and start with the bank. This quarter the bank recorded post tax profit of Rs. 976 crore as against Rs. 696 crore for the same period last year. And we close the year as Uday mentioned with Rs. 3,411 crore, 63% up from the same number for the previous year.

The net interest income in the bank for the quarter had grown by 16% and we have seen an 18% growth on the NII for the year. Advances have grown as Uday mentioned for the year by about 15%. The other income for this quarter we saw a number of Rs. 1,003 crore. In Q4 we did see a jump in the insurance distribution sales as well as the mutual fund distribution income. Regular banking fees did contribute to the overall fees. Out of the Rs. 1,003 crore, Rs. 757 crore came from the fee income while the balance came from a mix of treasury and recovery on stressed assets; which contributed to some income during this quarter.

As regards our costs, our total cost for this quarter was Rs. 1,462 crore; the employee cost saw some drop from previous quarter thanks to some retiral relief which came in. Operating expenses did include some additional push on advertisement which we did post the launch of 811 in March.

During this quarter, we have taken provisioning hits of Rs. 267 crore taking up overall provisioning for this year to Rs. 827 crore which as Uday talked about is a 61 basis points credit costs as compared to the advances. This includes standard provisioning of roughly about 6 basis points.

So, pre-tax profit for this quarter we ended at Rs. 1,435 crore. During this period, we also had some relief on taxation as we got some orders and result of which we were able to write back certain provisions which we had made. So, you will possibly find a tax rate for the quarter being lower. We end the quarter with Rs. 976 crore and the year with Rs. 3,411 crore as post tax profit.

On our gross NPA as Uday mentioned, we have recognized e almost all of what we had talked about and the recognition during this quarter has nothing to do with the RBI circular which came earlier this month. We would say that we had nothing to report as per that circular.

Net interest margins continue to be robust at 4.6% for the quarter helped by a decrease in the cost of funds during the period. Restructured loans considered standard, we are at Rs. 102 crore which is 0.07% of our advances and our SMA-2 number as of March is at Rs. 131 crore which is 0.1% of our advances. During the year again, we have not transferred anything to the ARCs, no 5/25, no rectification and no new CDRs which we got into.

The segmental classification as prescribed by the RBI which takes everything over Rs. 5 crore as Corporate was Rs. 81,000 cr. Treasury for the quarter contributed Rs. 339 crore and Rs. 1,283 crore pre-tax for the year. The corporate bank contributed Rs. 738 crore for the quarter and Rs. 2,670 crore for the year.

As regards advances, as Uday talked about we had a 15% growth for the year. For this quarter, we saw a 5.3% growth quarter-on-quarter We have seen increases in the fourth quarter in CV/CE, in agriculture division, in the business banking side which Uday talked about as well as in the small business banking side. The total book of Rs. 1,36,000 crore as advances in the bank roughly as per RBI classification, the retail constitute about Rs. 55,000 crore of that.

We end the period with a CASA of 44% and in addition to that we have active sweep deposits program which constitute another 6.4% of the deposits. So, CASA plus sweep, we are now at 50% plus. During the year, our average savings account have grown 44% whereas, our average current account has seen a 21% growth which are average and not year-end numbers. Cost of savings account continues to be at 5.5% and we have had a measured growth on branches and we expect to continue with the measured growth going forward.

At the balance sheet level of the the bank, we are Rs. 2,15,000 crore roughly as an overall balance sheet and ending the year with 1,369 branches with a fair mix between north, west, and the south.

Before I take the consolidated, I would request Shanti to take the digital slides

Shanti Ekambaram: Thank you, Jaimin. We continue to drive the digital agenda in the bank and the group across acquisition, transaction, banking products and services, and digitization of customer journey's and processes.

Acquisition as Uday has already mentioned, in the fourth quarter, we launched 811. This is India's First Downloadable Bank Account on Aadhaar, OTP based account opening . An account that can be downloaded anytime and opened within five minutes with a Virtual Debit Card, Zero Balances, Zero Charges, and no Documentation and Paper Work. As Uday mentioned, the response has been positive and we hope to continue to drive the same.

As far as transactions are concerned, we really aim to provide best in class services to our customers, our mobile banking app has been rated amongst the highest and you can do more than 100 transactions on it. You can look at the value and volume growth on mobile banking transactions. We have seen a 138% increase in volume Y-o-Y and about 143% in value. 52% of thebank active base is digitally active. Our mobile banking usage is more than 3x of net and 54% of bank's customers who are digital use only mobile.

So, our strategy really has been mobile first. The banking products and services across the deposit side which is recurring deposit, term deposit, we seem to have a significant share in the volume coming through digital. In terms of the loan side, 19% of our salaried personal loan actually now comes through the digital mode. We have also launched an instant in principle decision making for our home loan and we will be launching more on the asset side. So, that covers the transaction side and the payments.

As far as the payments are concerned, we have sort of brought in many facilities, the India Stack into our main Banking App including UPI, Bharat QR Code with which you can Scan and Pay. And if you look at the transaction highlights for the month of March our value n mobile was Rs. 6,500 crore. Payment gateway growth in transaction is again 115% for the year. The online shopping has seen about 51% growth to payment gateways and we have had 150k UPI transaction in Q4 across our app.

In addition to the bank, across our Subsidiaries, Securities, Life Insurance and General Insurance, we continue to focus on digital both for trading transactions, for acquisition of customers, for renewal of premium as well as sourcing policies and this will continue to be a critical and important driver.

Jaimin, back to you.

Jaimin Bhatt: Sure. If you take the consolidated numbers, for the current quarter at the consolidated level we closed the period with a post-tax profit of Rs. 1,404 crore with year closing at Rs. 4,941 crore which is about 43% higher than the previous year.

The loans at the consolidated level we are at Rs. 1,67,000 crore got a 17% rise on a year-on-year basis. Capital adequacy at the consolidated level 16.5% Tier-I versus 15.9% at the standalone bank level.

On the overall advances, other than the bank growth we did see the auto loans grow by about 10% and a lot of the other growth in the non-banking entity came from the advances growth on the capital market side. This quarter actually saw overall \ advances growth of 5.9% at the Group level.

Other than the bank, the big contributors for the profit this quarter has been Kotak Securities clocking post tax profit of Rs. 121 crore as against Rs. 51 crore last quarter of the previous year. They end the year with an overall profit of Rs. 361 crore. Kotak Prime had a post-tax profit of Rs. 133 crore for the quarter and Rs. 515 crore for the year. The insurance entity clocking Rs. 101 crore profit for the quarter and Rs. 303 crore for the year.

At the overall consolidated level our net worth now at Rs. 38,500 crore roughly with the bank constituting Rs. 27,600 crore out of that. Prime now having a book size in excess of Rs. 25,000 crore; roughly 73% - 74% constituting the car and auto advances. As I mentioned having a post-tax of Rs. 133 crore for the quarter and Rs. 515 crore for the year. Capital Adequacy at a healthy 17.2% and a ROA of 2% at the entity level. Moving on to Kotak Investments which is largely capital markets and commercial real estate led advances having total advances book of Rs. 6,900 crore with extremely low NPA, net level at 0.07%. We have Capital Adequacy of 16.8% and ROA of 3%.

Kotak Life ranking now at number five among private insurers on individual new premium basis having a strong investment performance with equity funds in Quartile 1 on one, three and five year basis clocking a Rs. 303 crore post-tax profit for the year.

Securities entity as I mentioned had a good quarter at the entity level, we have seen a 19% rise in average daily volume. The income has grown to Rs. 366 crore for the quarter with post tax profit of Rs. 121 crore in this period. The investment bank has been involved in marquee transactions. This quarter we were involved with the merger of Vodafone and Idea and we were part of the managers for the DMart issue.

At the group level our assets under management now at Rs. 1,41,000 crore with domestic mutual fund at the year end had Rs. 92,000 crore. We did touch Rs. 1 lakh crore during the quarter sometime in March during the year. The growth of the AUM in the domestic asset management continuing to be healthy and we are gaining market share both on the overall numbers as well at the equity side.

Those are broadly the highlights at the group level. We are now open for 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 Ashish Sharma from Enam Asset Management. Please go ahead.

Ashish Sharma: Just a macro question first on the systemic credit growth being weak and we sort of guiding that there will be an improved credit growth outlook for the bank. But given the system, credit growth still weak, an opportunity to grow at 20% to 25% would be challenging or still possible, just some color on that. Second would be an outlook on the net interest margin. Actually, the year-end numbers are distorting the yields on our models but could you just give some highlight on the retail and non-retail yields for Kotak specifically? And just lastly on Kotak Prime, what is your strategy, the growth is there but sort of a challenge for last couple of quarters. How can we sort of leverage given the capital at the entity level. Just some color on that, sir.

Uday Kotak: Okay, thank you. First of all, you got to keep in mind that some of the challenges we faced during last year came out of merger integration which was followed by demonetization and one of the areas where we had identified significant revenue synergies was in the business banking or the SME business as we looked at it. If we look at the last year, our business banking book was flat to marginally negative because we suffered from challenges of integration in the first-half and then of course, a slow down because of the demonetization in the quarter of October to December. On the basis of that, if you look at the last quarter, our SME business reported a growth of 7.6%. Therefore, when you look at a trend growth, you also have to think about the base effect, so that is one factor which we have to keep in mind. And if you look at our trend growth in the fourth quarter, it shows an annualized number of about 21% at the trend level. So, we believe in an overall banking industry level of loan growth, there is also a shift in share which is beginning to happen. So, , we can look at capitalizing on some of that, and some of the loan growth which we have seen which has gone out of the banking industry has actually moved in the form of bonds and debentures into credit substitutes and some of it is between banking and mutual funds. So, some of that transfer is happening. But if you look at the whole space of mid markets, Corporates, SME and retail I think there seems to be a reasonable potential. On the other hand, if you look at our own numbers for the fourth quarter, in the area of commercial vehicles and construction equipment there is a 12% quarterly growth. Yes, there is an impact of Bharat III, Bharat IV. But we therefore feel that some of our businesses have a relatively low base and therefore the ability to have trend growth which is higher than the system growth is something we are broadly comfortable with. If you go back even to 2015 - 2016 when we began the year, we had guided around 12% growth and we ended the year at 15% with two major events. One was the fact that integration took a little longer than we had bargained in the first-half and thereafter some impact of demonetization in the October to December period. But the fourth quarter actually has seen us bounce back which gives us reasonable confidence on the trend growth based on the previous quarter numbers. So, that is as far as the system credit growth is concerned. NIM, if you look at our history over the last eight quarters on a quarterly basis, they have moved between 4.2% to 4.6% and on an annual basis between 4.3% to 4.5%. Therefore, broadly in these ranges we think we can sort of sustain. Whether it is 4.2%, 4.3%, 4.4% or wherever we end. I think it is something we got to see how the year goes. But our past pattern shows a trend and we do not think we will be dramatically outside the trend as it looks today. And third is on Kotak Prime, It is primarily a car finance business which is an extremely competitive business. We are focused on margins and for the risk we take we think it is a business which continues to require discipline in terms of achieving ROEs and that is something which we have been focused on. But we will see some traction on growth across that as well. And we are also looking at some new initiatives in the consumer space in that company which will take effect in the current year.

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

Vishal Goyal: So, I think one question you answered briefly about Prime because for last almost three years the profit number has remained the same while the loan book or the advances book has grown may be 40% - 50%. So, clearly you are seeing a lot of pressure on profitability in that particular piece.

Uday Kotak: Yeah, but you also got to keep in mind that we have two NBFCs. So, earlier we were active for most of the businesses through Kotak Prime alone. So, now as we have developed Kotak Mahindra Investments more for capital markets financing and commercial real estate some of those businesses which otherwise have may have been happening earlier in Prime are now happening in this focused subsidiary which is Kotak Mahindra Investments. If you look at Kotak Mahindra Investments over last three years which is another NBFC, it has shown pretty good growth. Therefore, when you are looking at the overall NBFC space, earlier bulk of the business was done in Prime. Now as we got specialization in capital markets and commercial real estate, we have seen growth in Kotak Mahindra Investments as well. As a result of which, on a relative basis Prime may be looking more stagnant. The entire approach to businesses is that we like to create focus which is what we have created in Kotak Mahindra Investments for the areas of capital markets and also commercial real estate If you look at the numbers on Kotak Mahindra Investments between 2016 and 2017, we are showing a nearly 28% growth that is from Rs. 154 crore PAT in FY 2016 to Rs. 196 crore in FY 2017. So, maybe you should look at these two in a manner keeping in mind that some of the businesses which historically Prime was doing have been moved in a focused manner to be done out of Kotak Mahindra Investments.

Jaimin Bhatt: By the way, the number of Rs. 154 crore Kotak Investments in FY 2016 was higher than Rs. 105 crore in the previous year which is FY 2015.

Uday Kotak: And this is with a really reasonably subdued real estate market.

Vishal Goyal: Yeah. And sir, just one request, on the fee income some of the other banks, give slightly more detailed breakdown of the fee businesses while I think what we give is fee and others which does not actually provide enough information. And also like just quickly a data point on that like how much from the others is treasury or trading versus the stressed assets?

Jaimin Bhatt: If you look at it Vishal, Rs. 245 cr odd is a mix of trading and treasury assets as well as ARD**.** ARD as I said did give us kicker this quarter which would be close to 100 plus would be ARD. Yes, treasury investments this quarter on a prop basis would be lower than in the previous quarter but yes, we did have a decent number there too.

Vishal Goel: Okay. And just last question, I just want to squeeze in is in the AMC business like why the profits are down?

Uday Kotak: Vishal, you are coming from UBS which is the master in this business. If you book a lot of corpus; distributors you have to pay fees which they want therefore to muster the growth in corpus, higher is the front end cost and we do not amortize.

Vishal Goel: You do not amortize.

Uday Kotak: That is a philosophy**.** Our fees, whatever we pay, we provide at cost. Therefore faster growth in corpus in the short run leads to drop in our profit. But we are building a stronger and a healthier business for the future.

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

Rahul Jain: I have actually two - three questions, the first one is on productivity on savings deposit side, it has been quite impressive for the last two - three quarters. I just want to understand from the perspective of the erstwhile ING branches. Have we kind of improved the productivity to the extent they are operating at the same level as Kotak standalone used to operate and how much more juice is left there? I have more questions but after this.

Uday Kotak: So, Shanti.

Shanti Ekambaram: Yeah. So, all I can say is that, yes, there has been a reasonable uptick in productivity in the erstwhile ING branches. As Uday said, integration took some amount of time which is around five - six months. But thereafter, we have seen a significant traction. I can say that this year probably you will see a lot more coming out of it. But I think during this year when we look at the last five - six months we have been able to bring up the productivity. The journey will continue.

Rahul Jain: So, is it fair to say that now the gap would not be much between Kotak and ING branches or there is still some more way to go?

Shanti Ekambaram: There is some way to go.

Rahul Jain: Okay. The second one was on employees. So, how should you think about it in terms of employee at a branch level because if I just simply do the math of employee per branch it is about close to 24 odd employees and of course there is a huge focus at your end also on digitization. So, how this number is going to move and there is one large bank who has been actually not replacing a lot of its employees. So, how do you guys think about that?

Shanti Ekambaram: So, in our stage of evolution acquisition still is a very big part of our strategy and just like I talked about digital acquisition earlier, physical acquisition is equally important for us. So, from an acquisition perspective you still need feet-on-street. So, some of the numbers that you are talking are may be from feet-on-street. Second, when you look at the branches in entirety, different branches have different sizes, we sort of staff them separately. So, both from service and acquisition perspective given that acquisition is still a center of focus for us. We continue to look at how we staff our branches. Having said that, we have been working on the productivity factor which again has gone up this year as compared to last year reasonably as far as digitizing processes are concerned, service request are concerned, servicing the customer, etc., which will bring about efficiencies. Even in the physical acquisition side we have enhanced productivity significantly this year from last year and that will continue to be a focus area for us.

Uday Kotak: Yeah. And Rahul in terms of answering your simple question, just because we have reached 44% are we satisfied with our liability franchise? We continue to be very hungry on growing that franchise even stronger.

Rahul Jain: Understood. The other question was on again, Kotak Prime and KMIL. So, first of all, what is the logic of having two separate NBFCs when we can do this business out of the bank, point number one? Point number two, you talked about the car business being extremely competitive. Now that the CASA portion is improving at the bank level, why not may be or may be is there a thought that at some point they will look to do car financing business out of the bank itself?

Uday Kotak: See, I think Rahul, you should be clear about the nature of the businesses. One of the NBFCs is an asset finance NBFC and which is Kotak Mahindra Prime. So, asset finance NBFC as defined by RBI is the one where more than 60% of your assets and profitability should come out of asset financing business. And for banks to lend to NBFCs which are asset finance NBFC, the risk weights are much lower for asset finance NBFCs versus other NBFCs. So, Kotak Mahindra Prime is what is known as an AFC. Kotak Mahindra Investments is not an asset finance NBFC and therefore is focused on lending to capital markets and commercial real-estate which are not considered for classification as asset finance. So, there is a strong logic why we run these two businesses independently, simultaneously the focus of the two businesses is also different. Therefore, Kotak Mahindra Prime is about 75% of its business is essentially car finance and car dealers and everything else, which is the focus; and Kotak Mahindra Investments' primary focus is commercial real-estate and capital markets. And it does give us a significant ability to be responsive to customer needs in both these businesses. And the point which you raised about NBFC versus bank, I think it is a fair point, something which we review all the time, but at this point of time we believe that commercial and economic logic of what we are doing, the way we are, still makes sense, but it is something which we will always continue to evaluate and take a call based on what we think is sustainable commercial logic.

Participant: And just one last question on this capital raise which you have proposed, how do you plan to deploy this? Of course, you did mention that you have got variety of plans there, including inorganic expansion. So if you can just elaborate on that point that will be great. Thank you so much.

Uday Kotak: Rahul, we have given out the entire rationale including when we had the board meeting on the 30th of March the Board has put out in the EGM notice and which says the purpose of the raise and the objectives of the raise. We believe that all the objectives of the raise which we have put down are something which we think is consistent with where we are going and we are working towards many of those objectives. So as and when some of those objectives do fructify you will see the progress.

Participant: So the reason why I just asked was because our Tier-I ratio is anyways fairly rich, so why not first exhaust that before we consider.

Uday Kotak: I think the Board has taken a variety of considerations, those considerations have all been put down in the explanatory statement to the EGM notice. And my suggestion is just have a look at that. That will give you the full picture of how much the board has debated on that and thereafter taken this call.

Moderator: Thank you. We will take the next question from the line of Avinash Singh from Jeffries India. Please go ahead.

Avinash Singh: My first question on your life insurance business, are you looking to open the bank distribution platform to other insurers? And vice versa, are you as an insurer exploring to utilize platform of other banks? And what is the status of your partner increasing stake, because they were the ones who had expressed their desire to increase the stake, so what is the status there? And in terms of growth strategy, what is the plan going to be, I mean if you grow faster, particularly new business, it will have some bearing on your immediate profitability, so what is the strategy there?

Uday Kotak: First of all, at this stage we have no intention to open the bank platform for other insurance companies, at least at this stage. It is something which we keep on evaluating, but currently that is not the plan. Number two, as far as other insurance companies, Gaurang why don't you say as far as other banks are concerned?

Gaurang Shah: As an insurance company, we would love to have other banks selling for us. We incidentally got just one bank in South, it is South Indian Bank which has signed up with us. But it is difficult unless all the banks are completely opened up.

Uday Kotak: And on your third point between the joint-venture and partner and us, it is something which the two partners have to decide between them and if and when the partners decide anything I am sure we will come back to you as soon as we can.

Avinash Singh: And on digital, can you provide any sort of update on how many accounts have been opened on 811 platform and what sort of a balance you have got? And in addition to that, there were some sort of changes from your side on daily transaction limit on the UPI platform BHIM, is there some security issue that has caused? These are my two questions.

Uday Kotak: First of all, on the number of accounts and transactions, it is still work-in-progress. We would like to come back to you at an appropriate time when we feel we are ready to share with the market. But the progress is very good and we are very optimistic about the platform and the growth. As far as the BHIM thing is concerned, I will ask my colleague Dipak Gupta. Mohan, you want to comment?

Mohan Shenoi: Yes. We reduced the limit from Rs. 50,000 to Rs. 20,000. The reason why we did was not because we had any incident which was untoward on that but it was only because as a precautionary measure to protect customers. Otherwise we had no negative experience on operation of UPI.

Moderator: Thank you. We will take the next question from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question is on the operating expenses growth during this year at a standalone level. For the full year, the growth is only 2.7%, obviously we have done excellent job here, but going forward now we are expecting higher credit growth also, so how do you see the operating expenses growth in the Cost-to-income ratio in the next couple of years?

Uday Kotak: Okay. Cost-to-income, if you recollect, we had given guidance that we will be first digit four, if you recollect post-merger we were at very high ratios, as you know the merged bank who had a ratio which was 57% odd which is the ING Vysya piece. So we are now at about 48% odd. Directionally I think we are continuing down that path of reducing the cost-to-income ratio. Long-term, you always got to balance between how much you want to invest in the business versus how much you want to have the productivity gains, and it is always a delicate balance. And now what I am seeing is much more a blue sky's approach to where I think the correct number is. But I would say somewhere in the early to mid-40s is what I would consider as a reasonably fair basis of growing this business between investment and productivity.

Manish Ostwal: And the second question on this housing finance business growth and opportunity in microfinance space, how do you see as a management on these two lines because compared to the market our book growth is very low, especially on housing finance side.

Shanti Ekambaram: So, our growth has been around 14% - 14.5%. Two reasons, one, of course this year we had some integration matters on the book and we had some book adjustment that we had to do on customer attrition, but there are two things – Firstly, when you look at the industry, almost 55% - 60% of the industry is really more secondary taking market share and maybe about 35% - 40% is the new business that is happening, and that is also largely in the mid to lower-spec. Second, foreclosures in the industry continue to be high, so on an absolute volume business it is reasonably good. And third, I must tell you that it is highly competitive. At some stage, some of these rates from an economic perspective may not and does not make sense. So, we made sure that we have a combination of economic rational of the business growth when we look at the home loan business. The metrics of the business continued to be strong in terms of quality, credit, etc, but these are the three reasons why you see the growth is around 14%. At industry level, I think it is growing at around anywhere between 16% to 17% right now.

Manish Ostwal: And how do you see this microfinance business opportunity and are we building a sizable book at Kotak Mahindra Bank?

Uday Kotak: We have announced the acquisition of BSS Microfinance which is awaiting regulatory approvals. I will ask my colleague, Dipak to comment.

Dipak Gupta: So microfinance, we basically look at it from the point of view of meeting the requirement of priority sector and weaker section. So, to the extent, given our credit risk appetite we can meet those requirements, we really do it. But it is a sector where one has to grow cautiously and carefully and keep looking at all the political and economic developments which are happening around while you are growing there. So, it is still a cautious guarded growth from an overall point of view.

Moderator: Thank you. We will the next question from the line of Adarsh P. from Nomura. Please go ahead.

Adarsh P.: Sir, again a question on the cost side, I just wanted to understand last couple of years you would have had some rebranding exercises and all those on the overhead side which you would have done but you advertise a little bit more. So, apart from the employee cost how do you see that going forward? So more to squeeze in from the combined entity or you should start seeing a normal growth on the overhead side?

Uday Kotak: I think cost synergies are continuing to play out on the merged entity side, so there is one stream which is giving us cost synergies, that is clearly working and will continue to work in to next year. And some of the cost synergies which we were expecting in the current year has taken a little longer. At the same time, for example, if we have to invest for our digital growth, we will do what is right for that business from the point of view of investment. And in another context another question was asked on this question about AMC, our Asset Management Company which saw a very sharp growth in AUM because we were gaining market share and there was some cost which was the distribution cost which had to be paid which we paid out through our P&L account. So, philosophically our view is health of the business, growth of the business of fundamentally sustainable business is something which we will continue to do.

Dipak Gupta: And there will be productivity gains which one will keep getting, both out of digitization. For example, if the entire account opening costs are going to come down because of increasing digitization in future, all of those ultimately will reflect in lowering of cost. So directionally it should come down and that too the broad range which Uday mentioned earlier.

Adarsh P.: Sir the second and the last question that I had was, when you look at the way your balance sheet on the bank has grown, it has largely been CASA funded, the term deposit growth has been pretty low. I just wanted to understand, given that you got that opportunity, how did that deposit piece behave in terms of granularity of that, if you can just talk about it?

Uday Kotak: Okay. I think first let me say that the term deposit piece also includes Sweep, so Sweep has grown very well as well and the cost of Sweep is significantly lower than term deposit, marginally higher than SA. And therefore, our core philosophy of low cost and stable liability stays and we are still gunning for it and we are not obsessed with a percentage. Low cost and stable liability, whatever it takes is the heart of our franchise.

Adarsh P.: I was just trying to understand if numerically you can give some color, you have kind of indicated some data in terms of how Rs. 5 crores and Rs. 1 crores term deposits have behaved. But if you can just give it on a more comparative basis that will be helpful.

Jamin Bhatt: I think we have talked about the fact that our big focus about CA and SA remains and we have seen big, big growth on the current and savings account. Plus, here the focus at the term deposit level has been on the below Rs. 1 crore deposit base, that we do believe is far more sticky. And therefore, when I monitor the total CASA plus deposits which are below Rs. 5 crores, that is now 73% of our total deposit base, and that is clearly something which we expect to be growing.

Moderator: Thank you. We will take the next question from the line of Kunal Shah from Edelweiss Securities. Please go ahead.

Kunal Shah: Sir, again coming on the growth side, when we look at particularly ex the corporate banking, the growth across maybe in some of the areas wherein we have seen other players very aggressive in terms of business banking or say LAP or everywhere, or even in terms of the personal loans, our growth has been quite muted. So how do we see it over next two to three years, particularly with respect to SMEs as well? You answered it on the home loan side, but on the SMEs and the unsecured piece?

Dipak Gupta: On SME side also we did mention, you see that until pre-demonetization we were busy with integration and hence there was a very marginal growth and then there was demonetization. But if you look at the last quarter, the SME and the business banking piece has grown pretty well really, and I think those growth rates which we saw last quarter should be sustainable.

Kunal Shah: Okay, on a quarterly basis, so that would take it to more than 20%?

Dipak Gupta: Yes.

Kunal Shah: And secondly in terms of commercial vehicle, so we had uptick in this particular quarter, but how do we see this entire transitioning to BS-IV and how are you seeing the environment on the commercial vehicle side? So, is it slowing down a bit, the utilization levels are not that great, so what is your overall view?

Dipak Gupta: Well, actually since March was heavy because of the conversions, I think April will be subdued. But I think as an industry and a sector, it is growing pretty well. I think mid-May onwards you should get the growth back in. April generally tends to be subdued and because of the heavy pre-demand of the March piece, the BS-III to BS-IV conversion March was good, but I think it should come back by mid-May or so.

Kunal Shah: And in terms of the impact of GST on the various segments, so what would be the overall view in terms of that impacting any of our product segment bit on the commercial vehicle side or say the auto loan side or be it even with respect to the business banking. So what are your views in terms of the implication of GST implementation for us?

Uday Kotak: Kunal, if you can give us guidance that will be very useful.

Kunal Shah: No, so be it either in terms of growth or asset quality, if you can just let us know as to what is your sense.

Uday Kotak: At the moment we have a fair assessment that we will do it. At this stage, we just want to see how it all pans out, and we are keeping very alert, it is an area which we are very focused on in terms of how to play it out. But at this stage we have to see how it all pans out, it is an area which requires great amount of focus and attention and also the way the rules are in individual states. So whole host of things are out up in the air, so maybe on the July call we should be able to give you greater clarity.

Dipak Gupta: One of the things is what happens to the product, as you mentioned CBs and others, and the other thing is what happens to the services themselves. So they are two different things.

Kunal Shah: So may be that would be very useful if you can give it during the next call. Lastly in terms of demonetization deposits, I do not know if you have highlighted, but what is the rundown we have seen both on the CA and SA side on the deposits which were mobilized during the demonetization period?

Shanti Ekambaram: It is difficult to quantify exact percentages, I would say roughly about may be 25% of CA and about 30% - 35% of SA, rest continues because we have grown on that base. Since the time demonetization happened and our CASA has come down you can see the quarter-on-quarter numbers, there has been a growth in both CA and SA. So there has been that also and we have also grown.

Moderator: Thank you. We have the next question from the line of Shubranshu Mishra from Anand Rathi Securities. Please go ahead.

Shubranshu Mishra: I wanted just some qualitative comments on the corporate banking in terms of how you see the growth, one, on the systemic level? And second, where do you see yourself growing in the corporate book?

KVS Manian: On the system level, obviously we have seen the RBI data, actually there is no significant growth at all, almost negative growth. But we believe that we can gain market share and continue to grow at the 20ish kind of growth, which is what we have done last year and we are confident we will be able to keep up with that.

Shubranshu Mishra: Which sectors are these which you think will take the market share?

KVS Manian: Actually, we do not work on a sectoral basis, we work more on bottoms up approach in terms of good quality credit companies. And in fact, therefore we do not really chase a particular sector, we would pick good companies in any sector. Of course, there are sectors we avoid, but it is not that we build in a particular sector we focus on the sector, we would rather pick good companies in multiple sectors.

Shubranshu Mishra: And what percentage of the corporate book would be in consortium lending?

KVS Manian: It will be very low, generally we do not participate in consortium lending approach, we try to keep it outside consortium. So, in the mid-market side, of course we might be the sole bankers or one of the two bankers, but otherwise in largish companies we tend to lend outside consortium, most of our book will be that kind.

Moderator: Thank you. We will take the next question from the line of Nitin Agarwal from Antique Stock Broking. Please go ahead.

Nitin Agarwal: Sir, I have a question on branch strategy. Like last quarter call we talked about relocating and rationalizing certain branches, especially in metro cities. So has that exercise been completed and is this having any bearing on our branch count as we are also planning to open like nearly 1400 branches?

Shanti Ekambaram: The process of rationalization and relocation was continuing. In fact, from the period from September to March we had significant activity and it will continue right through this year right up to March 2018. So, in a way when we look at rationalization, we get the license to look at another place and that is like a new branch. So that gives us significant headway. And relocation, obviously, some locations that are aside from a customer perspective. So, this activity has been continuing on a reasonable pace from September to March and it will continue right through this year up to March 2018. And that will, like I said, look like a new footprint but the number of branches may not grow up, and we will continue to add as Jaimin has said majorly based on the gaps and business strategy continue to add branches….

Uday Kotak: Reinforcing what Shanti said, when we merge two branches and open a new branch the branch count does not increase but capacity increases.

Nitin Agarwal: And secondly sir, we have been reporting our SMA2 number, that number has been particularly very strong. But if I look at the sequential increase in gross NPL, so that number is probably around Rs. 400 crore odd, but if I look at SMA2 number at 0.1%, that amounts to nearly Rs. 130 crore odd. So what is driving this increase in gross NPL because I would tend to believe that a lot of our NPL formation should happen from the SMA2 accounts? What am I missing here?

Uday Kotak: You are right. Having said that, there are also accounts which the RBI allows banks to do recognition based on inherent weakness in an account. Therefore, even if the 90-day period account is not, from a rule point of view, more than 90 days. If the bank believes that a particular account has inherent weakness, the bank is free to recognize it as an NPA and we have followed the RBI guidelines both in letter and spirit and done what we thought was right rather than kick the can.

Nitin Agarwal: So, how much was that amount, sir?

Uday Kotak: Because a lot of banks have been doing the rule book thing, which is, if it is not 90 days or some interest rates come on the 89th day you take it out and all that. We said that even if it is not 90 days, if our assessment is that if there is an inherent weakness in the account then we are allowed to classify it as an NPA and which is what we have gone ahead and done. And we believe that in many ways with the coming end of March 2017, the fact that it has been now nearly two years after the merger we just felt that we needed to do this and get on with life.

Nitin Agarwal: So, this was in respect to the divergence notification or was it something else?

Uday Kotak: No, there is nothing with respect to the divergence notification, there is nothing which was required by RBI in any form whatsoever.

Moderator: Thank you. We will take the next question from the line of Shri Shankar from Prabhudas Liladhar. Please go ahead.

Shri Shankar: Most of the questions got answered, couple of questions. Take off from Nitin's question again, the Rs. 400 crore incremental addition to NPA, what is the kind of provision that we have done? Has it brought down our provision coverage ratio quite significantly?

Uday Kotak: We have done what we thought was appropriate provisioning. And the Rs. 400 crore, let me repeat, it is not one account, it is a few accounts. And we just took a call that if an account has inherent weakness, even if it is not overdue for more than 90 days, based on that we are entitled appropriately from a letter and spirit point of view to recognize it as an NPA and get on with it. And we just wanted to do this and completely the basic recognition coming primarily from the acquisition.

Shri Shankar: The next question is on your cost of funds, actually in your opening remarks itself you were speaking about the range at which you probably will have your NIMs. This quarter definitely cost of funds have been on the lower side, what is your call going forward, especially when some of the banks are offering auto loans at 8%, etc., do you think that that part of the business may face challenges going forward?

Uday Kotak: See, our view on cost of funds is pretty simple, focus on stable liability and keep on increasing the quantum of low cost liability. And CASA percentages should not drag your behavior, it is just a cultural and philosophic thing where you want disproportionate part of the franchise to be low cost and stable liability, and we will keep on doing that as long as we need to. And in terms of that, obviously, our cost of funds has been steadily coming down, which is what you have seen. If you go back to the time before the merger, our NIMs used to be in the range of around 4.7% to 4.8%. ING Vysya which we acquired had NIMs of around 3% to 3.1%. So, on post-merger basis we are now for the quarter at NIMs of 4.6%, over last eight quarters our NIMs have ranged from 4.2% to 4.6%.

Shri Shankar: The last question is on your risk weighted assets, how is the mood during the quarter?

Arvind Kathpalia: It has improved during the quarter.

Shri Shankar: What is the amount outstanding, RWA?

Arvind Kathpalia: So, we do not report that number but it is 78%. And we will upload it in our Basel III reports, but it has improved during the year as well as over last quarter.

Moderator: Thank you. We have the next question from the line of Saurabh Dhole from Trivantage Capital. Please go ahead.

Saurabh Dhole: I just wanted one clarification on this two wheeler financing business. I think in one of the previous calls you have mentioned that you do not do this particular financing. So I just wanted to know some underlying reasons for that.

Uday Kotak: No, we have found that business to be pretty challenging from the point of view of sustainable ROEs. And it is effectively a quasi-unsecured business, therefore if you have got to do quasi unsecured business do an unsecured business then, why try and do a two-wheeler financing in the garb of it being a secured business when in reality it is a quasi-unsecured business. When you go out to pick up the two-wheeler, will you find it? And the ticket sizes are pretty small and the operating costs are pretty high.

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

Nilanjan Karfa: Question on the savings deposits. So, if I look at the growth as well as savings percentage, we have seen a very phenomenal growth and the rate has continued to be in that 40% range even at a higher base post-merger. If you can elaborate, if it because of productivity or is it because of a product and which product is it? Because I find it a little hard to figure it out, when I look at the advances it is just about guys who typically keep savings account, let's say the agri segment or the home loan segment, that is just about 33% of the loans, the balance are typically your commercial customers.

Uday Kotak: But there are fair amount of consumers out there, bulk of your agri customers and others will put it in current account, there is a very large consumer base. And keep in mind, we are taking at an average savings cost which we again disclosed which is 5.5% weighted average, though we pay on the margins at higher rate of 6%. At 5.5% there is a cost which we are incurring which is more than Rs. 600 crore to Rs. 700 crore a year, this is a price we are paying for it. And if you go back to our history from 2011, we have grown between 40% and 50% through this period of six years and we believe that we have to continue this because this is a very strong franchise point giving us a significantly disproportionate growth compared to the industry. Most of the comparisons are done certainly and appropriately on the loan growth side, industry growing at 5% and what is the loan growth. On the savings deposit side, I think the industry is growing probably at 10% and 15%. And we believe that this growth rates which we have produced consistently over six years are sustainable, it is a part our strategy, you can call it product, you can call it passion, you can call it process, it is called philosophy, but it is a deep commitment to build a deep consumer savings pool with us.

Nilanjan Karfa: I completely agree with that, but would you say it is just the rate which is pulling in the customer…?

Uday Kotak: No, it is a passion, we just want the customers.

Nilanjan Karfa: The passion has to be with the customer to keep his deposits with you, so that is the point I am trying to figure out.

Shanti Ekambaram: I think it is a combination, rate is just an acquisition tool. Once the customer comes in it does not mean he has to sort of keep his balances. I think the engagement as a passion with which we drive that philosophy, we want to grow, so it is acquisition, deepening, widening, engagement, product, process, the whole experience. And I think that is what has driven it over the last five, six years and that is what at the very heart of our savings account.

Uday Kotak: I think let me do a sales job on you, you should open a savings account with us. And if you want to do it on digital you can open it on 811 as well.

Nilanjan Karfa: Okay, I have already done that.

Uday Kotak: 811 right now is on Android, we are shortly coming with Apple as well.

Nilanjan Karfa: Sure, thanks for that, probably I will take it offline. The second question is, this RBI circular on looking at higher GPs, what do you think is driving that and how do you as a bank or as a management want to figure out what the appropriate level of provisioning is?

Uday Kotak: We are going to the Board before June and I think, again, it is blue sky therefore a big picture thinking, my sense is in addition to sector it has to be the quality of companies in the sector, it is the rating of those companies and you will have to work out a metrics on sector plus rating. And ultimately it has got to be linked to risk, bottom-line.

KVS Manian: If you see the circular, the primary driver in that circular is about interest coverage ratios of the companies or the sector, average of that sector. I can assure you that all the companies that we have interest coverage ratios, not only interest coverage ratios but debt service coverage ratios in multiples of what the numbers that are being talked about for the overall industry. So I think it has also got to do, like Uday said, about the companies that you have exposures in within that sector.

Nilanjan Karfa: Right, I referred to the same circular it looks like banks should take over some of the rating agencies, that is what banks have to do with the circular. Would you agree or you do not agree? Because you are doing pretty much the same thing that rating agencies had to do, maybe they did not do their job correctly.

Uday Kotak: If I give you an answer which is yes, tomorrow it will be a flash in all the newspapers.

Moderator: Thank you. As there are no further questions, I now hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak: Thank you very much, friends. I really appreciate the time and the interest which all of you are showing in the Kotak Story. I just wanted to say that at Kotak we are very passionate and excited about the future of financial services in India. We are committed to growth in whatever shape and form, both organic and inorganic as opportunities come. And we believe our core model of concentrated India diversified financial services in the context of the transformation of India's common financial savings and Digital India make it a very exciting place for us to be. We are committed to continuing with our strong risk management focus as we grow our liability and asset management franchisees hopefully at a pace which is significantly better. We would like to, as we have said, for our capital raise as well, explore opportunities where we can deploy capital and we are constantly on the lookout for those opportunities. And we would continue to look at those and hopefully come back to you with progress on that as we go forward. So, thank you very much and wish you all a wonderful summer holiday as well. Thank you.

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.