Kotak Mahindra Bank Q2 FY18 Earnings Conference Call

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Moderator: Good Day, Ladies and Gentlemen. And welcome to the Kotak Mahindra Bank Q2 FY18 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 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 a very eventful day for the Indian Economy and the financial sector. Interestingly, it takes me back to a tweet I did just two days ago on Sunday and the tweet went like this, 'Global interest rates bottomed out. Rise may be gradual. Global growth is back. Time for India to get growth mojo back that creates jobs.' May be providence, God and Government seem to have been listening and we have seen a very significant step taken by the Government yesterday on getting India's growth mojo back. And I think in many ways this boosted dose of capital is part of a more intense strategy of the Government of India to really get the Indian GDP back on its track at a time when the world economy growth is picking up and I think that is a big plus.

Having said that, we must keep in mind that on a global basis, as I have just said, there is a gradual bottoming out of interest rates and probably some sort of a gradual rise in interest rates, some of it is being reflected in the US tenure which is now in the 240s. So, in that context we have to really look forward to next few quarters and the year ahead in terms of growth with potential interest rate stability. And I would be very surprised if we see a significant drop in interest rates in this context from here.

With this significant recapitalization of banking I do hope that banks in India will be able to take bolder decisions, even if it means deeper cuts in getting settlements and cleansing of the stress assets in the system. And at the same time the new capital which comes into Indian banks is well utilized for better quality assets and more sustained growth in the future.

Coming specifically to Kotak, I think the earnings update must be with you. We are beginning to see a pretty reasonable stability on the quality of our credit. And at the outset, let me also share this disclosure with you which is that we have received the RBI inspection report for March 2017. We do not have anything to report on divergence.

In terms of our loan growth, at the standalone level we have grown at about 21% and on a consolidated basis 22% YoY. Overall, credit costs in line with what we have guided, we have said that we see it at levels which are trending down from last year's credit cost which was about 61 basis points. And we continue to maintain that we see the credit costs trending down from 61 basis points on a full year basis. Obviously, as we go for loan growth which we think we are beginning to get some traction, our NIMs as we have guided are in the region of around 4.25% and this is where we see a more sustainable level for our NIMs as we go forward. And simultaneously, consistent with our philosophy of going in for a concentrated India, diversified financial services strategy, we have bought back the stake of Old Mutual in our life insurance company and we now own 100% of Kotak Life Insurance. And as you are probably aware, this is part of our strategic view, different from the street on wanting to hold 100% of our life insurance business, our asset management business and now all our subsidiaries. We also completed the acquisition of a small microfinance company called BSS Microfinance which we had announced about 9 to 10 months ago; a very small one at that, effectively at a price to book of about 1.4x, which has also been completed as of September 2017.

All in all, we do believe that we are getting across all our businesses a pretty stable and a sustained outcome of growth with high quality credit and over time our philosophy of not being carried away by either hubris or despondency, but looking at opportunities as we go into the future continues as our core business strategy.

With that, I will request my colleague Jaimin to take you through some specific details of our performance for the quarter ended September 2017.

Jaimin Bhatt: Thanks, Uday. I will just take you through the highlights for the quarter. We closed the quarter with consolidated profit after tax of Rs. 1,441 crore which is about 20% higher than the same period last year. As Uday mentioned, we had a loan growth of 22% at the consolidated level. Our total balance sheet size now is in excess of Rs. 3 lakh crore. Our book value per share at Rs. 246.7 and as Uday mentioned two transactions of acquiring BSS Microfinance and the stake of Old Mutual. The Old Mutual stake happened in October, so the quarter numbers do not really reflect those details.

On advances, we have seen growth coming across all the verticals. The corporate book grew on a consolidated basis by 27%. The small businesses, personal loans &credit cards did a growth of 32% YoY while the CV/CE had a 33% growth YoY. Gross NPA at the consol level at 2.14% with a net number at 1.08%.

Apart from the bank which contributed Rs. 994 crore, the other big drivers for the quarter profits were Kotak Prime at Rs. 150 crore, the securities business at Rs. 118 crore and the life insurance company which delivered Rs. 100 crore post tax for the quarter.

With respect to the Net worth, we are at Rs. 46,975 crore at the consolidated level after adjusting minority interest and inter-company . We did a QIP in May which has seen the net worth jump from the previous year end. At the consolidated level therefore, we sit with a capital adequacy Tier-I of 18.6%.

At standalone level, our quarterly profit was of Rs. 994 crore. Rs. 152,000 crore of advances which is 21% higher than the same period last year. Again, for the quarter at a standalone level we had a 7% growth on advances. Tier-I, including the half year profits, at 18.7%. We have a CASA deposit now of 47.8% in the bank.

On the P&L side for this quarter we have seen NII at Rs. 2,300 crore. This quarter we had some interest reversals on recognizing some agri loans which was a long period reversal, so that has taken some hit during this quarter. The other income of Rs. 954 crore does include fees of Rs. 810 crore which is about 28% higher than the previous year.

Cost for this quarter includes some expenses which we incurred on 811 as well as expenses in the last year on PSL certificates which we have also incurred during this year. Provisions increased compared to last year and we ended with a pre-tax profit of Rs. 1,508 crore and with post-tax of Rs. 994 crore.

Our NIM for the quarter is at 4.33%. We continue to be very small on SMA2, our number at Rs. 250 crore which is 0.16% of our net advances, and restructured standard at Rs. 65 crore which is 0.04% of net advances. And as Uday mentioned, we have got the March 2017 RBI report and there is no divergence to report as per the RBI requirements.

At the standalone level, as I mentioned, the total advances of Rs. 152,000 crore, very broadly evenly divided among the three verticals in which we operate such as consumer, commercial and wholesale, each around Rs. 50,000 crore mark.

If I go with the RBI classification of wholesale and retail, of the Rs. 152,000 crore around Rs. 61,000 crore is categorized as retail which have loans below Rs. 5 crore. CASA at 47.8%, we have seen a CA growth of 18% and a SA growth of 57% if I look at averages. SA we had some government deposits which has helped push up this quarter. SA is now in excess of Rs. 50,000 crore. Current, savings plus term deposits which are below Rs. 5 crore now constitute 77% of our overall deposits. At the bank now, we have a net worth of Rs. 35,000 crore which is post the issuance earlier in May this year.

I request Shanti to take the digital before I take the subsidiaries.

Shanti Ekambaram: Thank you very much, Jaimin. Mobile continues to be the preferred form factor for most of our customers and our mobile banking app continues to be rated high. As well as we launched a new website which is customer centric and keeping mobiles first as the primary base. So, compared to Q2 FY18 versus Q2FY17 the mobile banking volume growth was 125% and value was up 96%. In terms of our products 77% of recurring deposit, 60% of fixed deposits and 29% of salaried personal loans came through digital channelsa. We have seen a reasonable growth in our personal loan and credit card business through digital channels, in fact roughly about 20% of our incremental cards business and 25% of our personal loans comes through digital channel which is virtually stable.

In terms of payments, we continue to see increased transactions. On a YoY, monthly transactions on mobile volume grew about 147%, payments gateway volume growth at 20%, and online shopping was about 70%. We were among the first banks to launch the UPI QR code.

We continue with the focus on customer experience and customer services which we call transformation. So, whether it is digitizing a service request of a customer which really brought down TAT in terms of services, back end robotic automation processes as well as launching digital elements in our branches which we call Digital Branches and we see a significant amount of cash and cheque transaction move to digital routes. 811, just to give a little bit of flavor, 45% of our customers constitute salaried employees. 91% of our customers are between 18 years and 40 years,. 63% of our customers come from the top 20 cities and our total customers with the bank are around 10.5 million.

Not just in the bank but including the subsidiaries the digital focus continues, particularly mobile. In securities we have seen 81% growth in average daily volume through mobile and constitute about 18% market share on that. And both in life insurance and in general insurance we see an incrementally large percentage of policies coming through digital channels.

Jaimin, back to you.

Jaimin Bhatt: Sure. I now take the subsidiaries, the two NBFCs, both of them have seen decent advances growth. Kotak Prime now sitting with an advance number of Rs. 28,000 crore, 21% growth over the previous year. At Kotak Investments advances of Rs. 7,200 crore is about 27% higher than last year. Auto itself is now close to Rs. 20,000 crore, both the NBFCs are sitting on large capital adequacy, Kotak Prime at 17.2% and KMIL at 16.8%.

The securities business with rising volumes, with the current average daily volumes at Rs. 12,400 crore. We closed the quarter there with a profit after tax of Rs. 118 crore. Kotak Old Mutual, total premiums during the quarter at Rs. 687 crore, with individual regular growing at 31% continuing to be pretty high on conservation and the settlement claim ratios.

KMCC, we were involved with equity offerings last quarter. SBI, Bajaj Finance and SIS as well as involved with the buyback of Infosys and advisor to Acko**.** This quarter which is in October, we have had closures of few IPOs which hit the markets as well as QIPs which we were involved with which includes GIC, Godrej Agrovet, IEX and Apollo.

Assets under management across the group now at Rs. 169,000 crore which is close to a 40% growth on a YoY basis. Domestic equity under management has effectively doubled on a YoY basis and the debt has also in the domestic segment has shown a 30% growth. The domestic mutual fund performance again remaining in the top quartile. The PMS which is managed by the domestic mutual fund has grown four times on a year-on-year basis.

So, broadly these are the highlights for the quarter. We would be open to 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 Veekesh Gandhi from Bank of America. Please go ahead.

Veekesh Gandhi: I just had a couple of questions. One is, I would like some color on whatever has happened in terms of recapitalization of bonds today to the PSU sector and probably the consensus fear has been in the market that the growth that was being driven by private banks and non-banks will get transferred as and when these guys have a lot of capital in hand. So, just wanted your perspective. And the second question is around your margins which obviously have come off a bit, just wanted to get a flavor on how much of your loans are MCLR linked to that extent?

Uday Kotak: Okay. First is on recapitalization of bonds, let us divide it into two parts. First, is this a steroid for the economy? Obviously, it is. And therefore, on a big picture basis should this help give a kick start to potential growth of the economy? The answer is yes. The second question which we need to ask is, what are the potential issues arising out of this? Therefore, as the public-sector banks get a lot more capital I think first they will be bolder, as public-sector banks, going for what may be appearing as more aggressive settlements which means in the past many of the PSUs were hesitant to take hits and find one-time settlement. Of course, there is old CBI/CVC, I am assuming that is something which will be taken care of particularly if it is through the IBC process. But if in a committee of creditors or creditors in an IBC, I do believe that the public-sector banks, if it is appropriate, will be more open to taking more haircuts and going in for settlements, because they have the ability and the capital to do it and cleanse their books. I mean, obviously one hopes that this does not move to the other end where disproportionate capital hits are taken by banks for the benefit of existing promoters of some of the companies, because that would be inconsistent with the philosophy with which they are being given capital in the first place. Therefore, would there be cleansing and purging, I think the chances of that are certainly better. And this would obviously throw up more appropriate valuation opportunities for the distress asset businesses as well. It would also mean that all the banks in this committee of creditors will be open or will have to take these calls and move on, I think therefore from a cleansing point of view certainly very useful. But a lot of the capital which is being used to recapitalize the banks will effectively enable the banks to take these haircuts. After that I think the whole area of new lending, you just got to go back to a very fundamental principal of banking, you do not lend money if you do not think you can get it back. And that philosophy does not change just because somebody has sweets in the pocket. We have to continue with the core philosophy of risk adjusted return. Now, there have been times when we have seen euphoria in lending coming into private banks, not just PSU banks, we have seen euphoria in lending in many non-bank financial services sector. So, this euphoria in lending is a little bit of a high fashion gain and people love to focus on fashion rather than keeping a very simple principle in mind, of getting risk adjusted returns. And if there is one lesson I have learnt long back in the banking business is, unlike the investment business, since you also come from the investment business, that errors of commission in banking are far more expensive than errors of omission. In the investment business, like you have seen today, errors of omission can be very expensive but in banking business errors of commission are very expensive because you have got 10:1 leverage against you. And as long as you keep risk adjusted returns in mind and follow a philosophy of making sure that whenever you are taking decisions of commissions which is taking decisions on taking loans on your books, keep in mind you are 10 times leveraged, you have to invest your money well. And fact of the matter is, you cannot take your lending decisions based on the fact that there is some capital provider, whether it is private investors or government and then lend on that basis, because when you really have to go and get that capital you know the kind of strain it creates on you as an institution. So, keep the simple principles of business in mind. And nothing has changed, the business continues to look fundamentally good. If some exuberance of some segments of the economy like the NBFCs and all get a little tempered or even private sector banking gets a little tempered and some of it comes back as exuberance in public-sector so be it, as long as we stick to our knitting and we stick to our course. So, that is how I see this, I do not necessarily get too perturbed or excited by what happens in terms of accounting or effectively recapitalization in some shape or form. Do what you think is right and be open and alert to the changes in the environment but do not fall into the hubris or get carried away. So, this is one.

As a second part to this is the whole area of margins. And it goes back to risk adjusted, when you look at margins you are looking at margins as an absolute number. Our core philosophy is to look at margins as risk adjusted, so there are times when you find that we want to balance our risk, we will adjust margins for that risk, which is why if you recollect over the last few quarters we have been consistently saying that we believe a net interest margin in the region of around 4.25% is reasonably sustainable. And we are more or less in that range as I talk to you, and we believe at around that range give or take is where we see a sustainable ability to build a defense book on terms of risk adjusted returns which suit us. And we continue to believe that the guidance which we gave you at the beginning of the year of 20% is something which we will continue to hold irrespective of ecapitalization bonds. **Veekesh Gandhi:** Fair enough, sir. Just the other part of the question was, how much of your loans will be linked to MCLR now?

Jaimin Bhatt: As of this date our total fixed loans, I am talking bank standalone, fixed rate loans would be about 30% and of the balance which be in floating rate MCLR will account for close to 70% of that.

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

Kunal Shah: Sir, again in terms of this entire question on recapitalization plus GST, and since we look at the risk adjusted returns does it make us much more comfortable now that we can confidently say that we would be growing at say a higher pace than what we have been guiding for or we have reported in this particular quarter? So, is the underlying situation in India conducive enough for higher than 20% growth trajectory?

Uday Kotak: I think recapitalization is a big event; we have to see how it plays out. We need to see how it gets used, what are the final details and everything else. But if economic growth gets better it certainly helps play us, so that goes without a doubt. But we really need to see it translate to economic growth and I must say that particularly in the last few months we have seen a very proactive approach from the government to kick start the economy. I mean this banking sector recapitalization is also a signal, openness to be more aggressive on investments and infrastructure, supporting SMEs, you are now seeing a government which seems to be wanting to move and move reasonably fast to kick start the economy as a priority rather than assuming it as a given. And it is consistent with what I started my conversation with is that the world is beginning to see growth improve and India now needs to get its mojo back without compromising on macroeconomic stability. And it is hear that we have to keep in mind the global situation in addition to growth, what is happening into long-term yields and prices of commodities. So, we have to take a holistic view as we think about the future.

Kunal Shah: Sure. And secondly in terms of this entire NCLT process and the bankruptcy code we are almost halfway through in terms of 180 days deadline and we also had four accounts. So, how do you think the overall process is going on, what is the practicality in terms of say the promoters coming and bidding for the project? And how would you evaluate this entire process and the entire resolution process as well, how effective would it be?

Uday Kotak: See, first of all, as you know we are more than adequately provided on all these accounts as we have already highlighted to you. And I think with this recapitalization the committee of creditors will get bolder in terms of making settlements even if the haircuts are deeper if they believe it is appropriate. Therefore the hesitation to take deeper haircuts because of lack of capital adequacy which would have bothered a lot of banks, that hopefully will be out of the way. Therefore to that extent settlements should happen. Obviously we need to be worried about the other side, are the deals which buyers are promoters getting too sweet compared to the fair value, so that is something which we have to watch how it plays out. But I am happy, if system cleanses and if the deals are sweet, I am sure we will also on our distress asset side will certainly look at it. But when I say sweet it must meet our IRR requirements. So, we are looking at this from both points of view.

Kunal Shah: Okay. And in terms of second list of RBI, so what would be our exposure towards the RBI's second list?

Uday Kotak: Again, our exposure, as I said, in the first list all the four exposures we got was out of the merger and on our own underwriting, as you are aware, we had zero accounts out of the first 12. On the second one also I think our exposures are relatively small and in our view we are adequately provided for the entire list of second accounts as well.

Kunal Shah: Okay. And lastly in terms of IFRS, so have you done some working in terms of what could be the overall impact be it in terms of the fee income or the overall earnings once it kicks in?

Uday Kotak: No. First of all on a first principle I have said this earlier. I am very proud to say that in the state of our banking industry, I have no doubt our reported net worth is lower than what we should get under IFRS. Our net worth under IFRS, I have no doubt will be higher than our current reported net worth.

Kunal Shah: Okay. So in terms of amortization of the fee income or something is…

Uday Kotak: After everything.. This is something which we really care about that when investors are looking at us and when we look at ourselves, our reported net worth should be more conservative than what is the net worth based on an IFRS or an IndAS basis. That is the conservatism which we are giving.

Moderator: Thank you. We will take the next question from the line of Mahrukh Adajania from IDFC Securities. Please go ahead.

Mahrukh Adajania: I just wanted to know have you sold any loans to the ARC and there is one account that seems to be slipping everywhere. What would be the status with your bank?

Uday Kotak: Which account is slipping everywhere? The one account which you think which is slipping everywhere, if you think and we think it is the same account then I would say that it is not slipping and it is not with us. We think you are thinking about we don't have exposure there.

Mahrukh Adajania: You don't have exposure. But I think some newspapers had reported long time ago that you had a debenture outstanding.

Uday Kotak: You know we have got a very active debt capital market. This is you are talking about 2 years ago and if I think it is an account which you are thinking about, we did not have that exposure for more than a week in our books.

Mahrukh Adajania: Thanks. That is very helpful and any asset sales, sale to ARC?

Uday Kotak: No. We don't sell to ARC. Other than for cash, if we do any sale to ARC we don't believe in SR, okay? We are believers in SR if we have to buy something and if there may have been sale to ARC in ING time, but if we have to do any sale we will sell a loan only on cash basis to an ARC not on SR basis.

Mahrukh Adajania: Perfect. Okay, just one more question. Just in terms of savings, even IndusInd Bank has reported on their toll about government saving, so do you think that is a sustainable strength or you think maybe in the second quarter there was some one-offs and some lumpiness?

Uday Kotak: Mahrukh, the logic on savings is simple. And we give our cost of savings transparently. Our cost of savings account deposits is 5.57%.

Mahrukh Adajania: No. I was not coming from a late angle perspective. I was just wanting to know more about government saving?

Uday Kotak: More savings growth even without this government savings which Jaimin mentioned about is well above 40% per annum.

Moderator: Thank you. We will take the next question from the line of Ojasvi Khicha from SBICAP Securities. Please go ahead.

Ojasvi Khicha: Again my question is with respect to CASA which has grown impressively in this quarter. As Jaimin had mentioned in his opening remarks, if you could just throw some more light what has led to this growth, I mean what kind of accounts have we been able to acquire within the government account that would be helpful.

Uday Kotak: First of all I am sure you may have had a chance to look at it. We have given our total number of customers' accounts at the end of September and June, 2017 both. The total number of customer accounts as reported at the end of June was 9 million + customers and that . at the end of September is around 10.5 million. There is a strong acquisition engine which is going through. There is a very high focus on building the savings account granular deposits which is the core of what we are building. .CA obviously I think we are growing better than the industry and SA, I think we are growing much faster than industry. But keep in mind that there is a price we are paying . We. We are roughly paying about close to 200 basis points higher than the industry and if we wanted to come and show you higher profitability and just bring it to industry levels from which most of the other banks have benefited in the second quarter, which we have not , it would be Rs. 1,000 crore a year. But for us, it is building the long term stable franchise,adding customers and growing AUM over time which is core and that is what we care for. We think the trade is worthwhile for the price we are paying compared to the present value gain of what this delta growth will give us over time..

Moderator: Thank you. We will take the next question from the line of Manish Karwa from Deutsche Bank. Please go ahead.

Manish Karwa: My question is also on SA deposits. So when do you think or what do you think is the right time for probably reducing SA deposit cost? At what level do you think it will be a right time for our sized bank to reduce SA deposit cost?

Uday Kotak: No. First of all Manish, our aspiration for what we want to be is reasonably significant over time and we think we are still not there in terms of our aspiration of where we think we should be on a reasonable basis. If you look at many of the larger banks, they are well above Rupees one lakh crore of SA and we have just barely crossed Rs. 50,000 crore. Number two, we are getting significantly higher delta growth than the industry. Number three, keep in mind that even now our carry is positive. If today our retail term deposit is at 6.75% quarterly rest and my SA cost is around 5.5%, the growth of SA is still a positive carry and is a reasonably positive carry for me. Yes, there are costs to SA but that is cost to branch banking which is a fixed cost. But having taken that as fixed cost, we still have a positive carry on the trade and if we are growing delta much faster than this, we have got people who have done reasonable DCF and present value calculations on that, the transaction is still significantly present value accretive for us provided our delta growth is much faster than the industry.

Manish Karwa: Okay and second question is on erstwhile ING branches, are they now reasonably efficient as the Kotak branches or there is some more juice left for improving efficiency of these branches?

Uday Kotak: I will have Shanti answer that, but before that I will just say that we are now in this year, which is the first year where we are beginning to see the revenue sized synergies begin to flow in and I will have Shanti who is looking after bulk of consumer bank branches and Kannan who handles our rural branches, lot of which are ING related to give their feedback from the ground.

Shanti Ekambaram: Wee have begun to see and have seen significant traction on 3 broad counts; a) cross-sell to existing customers as well as increasing the flow of customers in catchment around the erstwhile ING branches. b),Customer products, for example asset products still have significant uptick on assets and investment products. So to answer the question yes, we have begun to see synergies. I think we have started seeing the benefit of synergies in a significant way and perhaps have a little way more to go. I think we can extract a little more, but significant synergies are beginning to see**.**

D Kannan: In the rural branches we see significant improvement in customer acquisition, so typically we have even doubled customer acquisitions in most of the places, same thing with the SA deposits, ,the growth has been substantial and we have also seen good traction in asset disbursements in all these branches. As Shanti said, we have improved quite a bit but there is still some way to go.

Manish Karwa: Okay.. Lastly one book-keeping question, Insurance will get consolidated 100% from next quarter, as in third quarter onwards?

Jaimin Bhatt Yes, effectively from 13th October.

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 yield on advances. Obviously, we are gaining a lot on the cost of funds, but while the margin stands as guided, would it be fair to assume that the incremental lending that we are doing is coming at a fairly steep discount? So is it Kotak Bank's specific or is it the general industry where the yields are compressing much more?

Uday Kotak: Its all linked to the risks as far as we are concerned. Therefore we are ready to get our yields adjusted if it means the risks are lower. Manian you want to answer on the wholesale bank where you are seeing some pressure on yields?

K. V. S. Manian: On the wholesale side and I am sure on the retail side also, there is pressure on spreads, but on the wholesale side, we are clearly seeing pressure on high quality credits because of two reasons. One, lack of overall growth in that segment and second is competition coming from the bond markets, securities markets, commercial papers and MCDs. Obviously, the rates come under serious pressure because of this, so yes, we are seeing some compression, but like Uday mentioned, we want to remain focus on the quality of the credit. So the way we look at it is, as long as our risk return ratios are okay and our risk adjusted return on capital is fine, we will continue pursuing that business, which will have some downward effect on the NIM as can be seen in our numbers this quarter.

Moderator: Thank you. We will take the next question from the line of Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal: Sir, any guidance on the reduction in promoter stake, any timeline and way to reduce this stake?

Uday Kotak: Nothing as of now. As on appropriate time, we will certainly get back.

Moderator: Thank you. We will take the next question from the line of Prakash Kapadia from Anived Portfolio Management. Please go ahead.

Prakash Kapadia: If I look at the cost-to-income for the bank, we were at 48.5% as on last year end and broadly we are there as on date. So directionally, where do we see this in the next year or two. What are the drivers to reduce this especially in the context of digital and less physical which we have always been, that is the first question. And secondly, if you could give some thoughts on SME side of lending in terms of formulizations, GST, Is there a risk reward which is getting more favorable, is that an opportunity which excites us?

Jaimin Bhatt: Let me take the first one on the cost to income. This quarter if you look at, we would be at about 47% compared to what we were last year, we are down and directionally continuing to be down. Also recognize that, this quarter as I mentioned if I do a YoY comparison, we have got 811 cost as well as the fact that we have spent on the acquisition of PSLC which was a very small amount last year. So these are the incremental costs which were not there,but we are very conscious of the cost-to-income and certainly the trending should be down.

Uday Kotak: And on your second question on SME, I think that sector obviously is reasonably vulnerable. I do not think the banking industry has fully come out with a shoe dropping on that, which I think is something which the banking industry should certainly keep a watch on. As far as we are concerned, if you look at our business banking growth keeping in mind the challenges around this, we have been a little more conservative within the overall advances growth of 21%-22% and therefore we are watching that space carefully. We are not just rushing in blindly and we will continue to keep a close watch and pick the things we want and if the banking system is going to get a lot more capital and they want to support some of the more marginal SME areas, that is fine.

Prakash Kapadia: What I was trying to understand is with formalisation,do you believe that risk reward will get favorable and is that a trend which you believe will happen going forward?

Uday Kotak: On this formalisation, you must have your views on this, but I think formulization, there are two parts. There are parts which are keeping out of the formalisation. At the end consumer level, I am hearing many stories where the seller to the end consumer is saying- "I am going to sell to you only in cash because I will save 18% GST" and the consumer is quite fine taking that deal because he or she is completely avoiding GST. It is only where the buyer is an institution and not an individual where the issue about getting more formal for an SME is increasing. So I think this adjustment between B2C and B2B, B2C continuing to be highly vulnerable to avoid GST and one of the more interesting aspects is with the cash in the economy; we are seeing it in our own situation, cash coming into branches and going out of branches has not reduced and in fact has reasonably increased compared to the same period pre-demon last year. Therefore, we are seeing cash not necessarily coming down in transactions.

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

Manish Ostwal: My question is on the post recapitalization of PSU banks, how do you see the impact of the pricing environment of the corporate MSME segment and secondly, the compulsory registry of SME with PSU entities, do you see the impact of the working capital ease out at the MSME level?

Uday Kotak: Too early to say. I think we want to see how it goes, but certainly helps. If electronic transactions help and access to credit becomes easier, I think every such step is certainly positive and if more and more flow happens, I think that is a good sign. On the whole area of recapitalization and what it does it to do the flow of credit, I think one is public sector banks would certainly get more confidence to lend and as long as they are able to maintain better risk management and governance practices in this lending, I think that is good for the system and good for the economy and to that extent, if the overall economy grows, we are very happy with what that does to the system.

Manish Ostwal: Yes sir, but the past experience says that even in the case of the earlier infra cycle, the discipline of the PSU bank was not there. So that will disturb the overall pricing environment of the market?

Uday Kotak: We are very clear. We are in business long enough to have seen exuberance by public sector banks and other banks in 2006, 2007, 2008, 2009, 2010, 2011 and our approach is stick to a very simple risk adjusted return basis and do it on that. And trouble with banking is a bad loan decision today bites you 2 or 3 years later.

Moderator: Thank you. We will take the next question from the line of Krishnan ASV from SBICAP Securities. Please go ahead.

Krishnan ASV: Just wanted to understand your competitive intensity on both the retail and corporate book. Essentially, there maybe a finite number of well capitalized lenders, banks plus NBFCs which are chasing with a large amount of liquidity, finite number of good quality opportunities. So why is it not yet reflected in asset yield significantly cooling off greater pressure in terms of what banks such as yours need to do in terms of yields coming off?

Uday Kotak: I think it is a good question because there is still a significant need for the economy. We are talking about an economy which despite the slowdown is still growing at 6% on the basis of last quarter numbers and probably will grow a little faster and there is also a whole element about customer orientation, customer service, ability to do at turnaround time and whole host of things around that and finally it is about an overall customer experience which is going to be the key and of course there is the whole platformization and all that which is also happening and which we have to be aware of which will put certainly pressure on margins as we think about the future, but for that I think we all have to be future ready with our operating efficiencies and cost as well and as Jaimin mentioned, we have a consistent focus on our cost-to-income ratios. Just to give you a perspective, in April ,2015 when we had bought ING Vysya Bank, ING Vysya Bank's cost-to-income ratio was 59% and we were at around 50% odd. Now on a combined basis, we are at 47% for quarter 2 and also keep in mind that obviously our operating cost to efficiency is higher, but we are also investing. If we are getting customer acquisition which is in excess of a million customers a quarter, there is a cost to it upfront and the franchise value of that comes overtime. So there is a front ending of cost which we are taking in this 47% cost-to-income ratio as well. As our cost gets more efficient, our ability to be maintaining our returns on capital at thinner spreads obviously improves and the other big acquisition engine and growth which we are putting in compared to all other banks on the street is Rs. 1,000 crore a year cost on savings. Our margins, we have the ability and whenever we decide, if we decide to correct that, that is a significant advantage to our ability to be competitive in the future, but we do not want to do that because we think the competitive advantage of being a larger savings and long-term stable and low-cost deposit bank, there is a huge play out there in the market.

Krishnan ASV: So Manish from Deutsche had asked you this earlier. I just wanted to understand when we as a bank believe that the franchise has arrived. So you have been saying for a while that you are looking to build this as a customer franchise, now that is what you are looking at just the SA deposit. So I just wanted to understand, what is that we will look for, what is that inflection point or what are the key metrics that you are looking at which will make you believe that now the franchise is in place and hence you can have some elasticity as far as those mid costs are concerned?

Uday Kotak: Right now, we see a huge opportunity for getting market share gain. I am sure you asked similar questions for other sectors like telecom sectors also.

Krishnan ASV: So you are saying you are essentially looking at a certain market share which will then make you believe that the franchise doesn’t play?

Uday Kotak: We think the opportunity to get share is huge and if it is coming at a Rs. 1,000 crore a year current cost, I think it is a price worth we are paying for our shareholders because we think we can get a much larger customer footprint through this route.

Krishnan ASV: Just one last question which is around 811. What proportion of the customers that you are now acquiring under this platform have a primary banking relationship with Kotak and what kind of trends are you seeing with the kind of customers that you have been acquiring on this platform?

Uday Kotak: Too early yet, we are right now looking at it. We are obviously doing our own internal analysis and seeing how it goes. Obviously, in the early stage if your customer profile is younger which is what Shanti talked about, the balances are low, but we have to see how we can grow it and build it.

Moderator: Thank you. Due to time constraints, we will take the last question from the line of Seshadri Sen from JP Morgan. Please go ahead.

Seshadri Sen: I have two-three questions. First is this PSL certificate, I remember Kotak is to be completely PSL compliant. Was that particular sub limits that you are missing out and is it a large quantum and is it a one-off or given the growth in corporate, you now see a sustained sort of missing onthe priority sector targets and therefore the PSL certificate cost will stay?

Uday Kotak: First, Seshadri, Kotak was PSL compliant, but there were individual segments earlier which was agri where we used to have a shortfall. When we acquired ING Vysya Bank, they were having significantly larger shortfall. On a combined basis, our shortfalls even before PSL certificates has come down and earlier shortfall used to be in the area of direct agri. Now actually the shortfalls are much lower, but we have done our mathematics and if PSL certificate premium are cheaper than the present value of putting money for 6 years in RIDF, we do that maths very closely and we then go ahead and do this and the net basis income and expenditure, the impact is not that high. But what it is doing is it is on a present value basis saving us money over much more than what we are paying today, but again strange as accounting is, if I put the money in RIDF, you will see my pain over 6 years. If I buy PSLC where my present value is superior, I take the pain upfront. And on a net basis, we are much better off.

Seshadri Sen: So this cost will persist for a while because presumably PSL certificates will remain more attractive than RIDF?

Uday Kotak: Yes, but on net basis, my cost overtime actually is lower.

Seshadri Sen: On a PAT basis, it is lower, it just excuse the cost income a little bit.

Uday Kotak: On a front end basis and front ending of the cost because my loss in RIDF is amortized over 6 years and if my present value of that cost is higher than what I am paying on the PSLC upfront today.

Seshadri Sen: Absolutely, make sense. The second is the impact of the recap on your stressed asset business both in terms of acquisitions and in resolution. So do you see PSU banks will be now not so keen to sell assets, so acquisitions will slow down and secondly, will it help resolutions on the other hand because the environment for resolution is probably going to improve?

Uday Kotak: My view is PSU banks if they had the capital, they would have been more open for settlements and I have got my colleague Venkattu is an expert on this. His thoughts on this.

Venkattu Srinivasan: Actually, this will help banks as Uday rightly pointed out for settlement.

Uday Kotak: It will help PSU banks.

Venkattu Srinivasan: Here, I am talking about PSU banks and secondly what it will also do is that once you have taken the provisional hit, then whatever they sell will be a profit to their P&L per se. So they will be far more open to sell these accounts in the open market through ARC auctions or bilateral auctions with the bank. So they can do that. So that will pave way for a lot of stressed asset to come in the market and there will be a lot of investors who may be interested in buying this asset. So it will help the PSU banks and also the investors as well.

Uday Kotak: Because earlier PSU banks were not ready to take write-downs because they did not have capital.

Seshadri Sen: And therefore the market will move from a SR structure to a cash sale structure which benefits your ARC model?

Uday Kotak: We hope.

Venkattu Srinivsan: That is for sure and in fact in any case SR model in the last one year has significantly come down and it will continue to come down even further.

Seshadri Sen: And if I may slip in a third question. I do not know if I am barking up the wrong tree here, but the new wallet guidelines, the prepaid instrument guidelines from RBI. Is that positive for 811 or is there no correlation at all?

Uday Kotak: I am sure you have figured it out, that is why you asking the question.

Seshadri Sen: Yeah. I just wanted to hear it from you.

Moderator: Thank you. 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 and as always it was enlightening to get questions from the group, we continue to feel that the steroids which have been introduced in the system in the last 24 hours should give at least some kick-start or some boost to the economic growth. We believe as financial institutions and intermediaries, anything which leads to higher growth is beneficial to us. It also enables us, to ensure that the system does not come to such a slowdown that the systemic issues would also hit the systemic credit quality. Therefore, in a way if there are more lenders out in the market place, we think it is good because then we can still pick the quality of credits we want and at least there is ability for others to make the choices on credits and risks and a more vibrant market is certainly better. We are not worried about competitive intensity. We think the opportunity size is significant and for our relative size, we have significant ability to add to our share. We are very relentlessly focused on higher customer acquisitions both on the liability side and cross-sell on assets and investment products. We think the whole story; the nonbanking story is evolving beautifully. We are very happy that we own 100% of our insurance, asset management, securities businesses. Of which, we have no plans to monetize and do quick-fire sales because we have got significant capital and it is in the interest of our shareholders to continue to hold disproportionate positions in this and all in all, we are quite comfortable with the positive news which is in the system and look forward to an interesting period ahead. Thank you very much.

Moderator: Thank you very much. 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.