Kotak Mahindra Bank Q4 FY18 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day and welcome to the Kotak Mahindra Bank Q4 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. During the Q&A Session, participants are requested to limit their questions to two per participant. 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. Happy to do the conference call today and share with you our thoughts on the Bank and our financial services business. On a big picture basis, two important thoughts on the overall situation. First, consistent with the Bank, we have a very good micro, though a tougher macro, our numbers reflect that reality, good micro, tougher macro. Second, our belief that the formalization of the Indian economy in the financial sector is continuing to gain momentum and in that context our fundamental business model of concentrated India, diversified financial services is continuing to play well.

With this background, just a few highlights before I hand over to my colleague, Jaimin. On a consolidated basis, our profit after tax grew 27% on YoY basis. The bank standalone grew at 15% YoY on a post-tax basis that is after Rs.82 crore hit on account of gratuity. As some of you may be aware, on 29th of March 2018, the Government of India changed the gratuity limit from Rs. 10 lakh to Rs. 20 lakh, as a result of which there is a one-time hit of Rs.82 crore which we have taken on gratuity and fully provided in our books of accounts for the quarter ended March 2018. If that hit was not there, on a post-tax basis, the growth in bank standalone profit would have been in excess of 20% on a YoY basis. Loan growth at the bank has been about 25%.

If you look at the other points which is the forbearance which RBI has provided, we have not taken any forbearance benefits into our financial numbers, whether it is on account of MTM or on account of provisioning for IBC cases. On the overall numbers with reference to credit and provisioning, net NPA is now below 1% at 0.98% and there is a steady decline in our provisioning cost year-on-year. Last year the number was about 61 basis points on provisioning cost, this year we are down to about 56 basis points. My view at this stage is that this downward trend in our provisioning cost would continue subject to of course no major upheaval in the bond markets which are not within reasonable limits.

On the stress itself, our SMA-2 number now is probably amongst the lowest in Indian banking at 0.04% of the net advances or Rs.72 crore. This is consistent with the view which we have held and implemented over time of being conservative in recognition and also on provisioning.

Another important fact which I wanted to discuss with you is on our low cost and stable liability. While of course our EOP numbers on SA and CA are pretty good, what is even more encouraging is our average CA and SA growth numbers. Therefore, the January to March quarter, our average CA growth for the quarter YoY has been 25% and SA growth is 58% YoY. We continue our focus on building even further the low cost and stable liability base.

With that, I want to talk about a significant increase in terms of sharing information with investors which we are doing from this quarter and for the year in three important segments: #1 is the Life Insurance business. As you are aware, Life Insurance business until last year was a joint venture between Old Mutual and Kotak Mahindra Bank with the bank's ownership of 74% and Old Mutual's ownership 26%. We bought back the Old Mutual stake in October 2017 and since then Kotak Life Insurance is now a 100% subsidiary of the Bank. We are happy to report for the first time our Indian Embedded Value number as of 31st March 2018 which is Rs.5,824 crore and our Value of New Business margin or VNB margin as many of you analysts are familiar with, which is 29%. We have also shared, which my colleagues from Life Insurance, will take you through, our product mix and other details. We believe we are building a strong sustainable and high quality life insurance business which gives us great pride.

The second important area where we are making an important disclosure is in our Wealth Management business and our Priority Banking business. We, for the first time are disclosing the relationship value of our customers in that business, and that relationship value number is in excess of Rs.2,25,000 crore. We believe we are market leader in this and we would continue to strive and improve our positioning in the Wealth Management business even further as we go forward.

Lastly, in Kotak Securities, we have for the first time shared our cash market share number which is 8.5%.

Also, on a separate note, our Assets under Management have grown at 30%. So when I look at the combined picture starting from loan growth, quality of our stress book and the overall parameters in our core banking business to insurance, wealth management, securities, asset management and the overall financial services franchise, I feel that there is a lot of momentum which we are seeing at this point of time.

On customer numbers of the bank which we have been sharing with you post last year, when we first announced 811, our customer base then was little over 8 million customers. I am now happy to inform you that as of March 2018, the customer base of the bank in standalone has now crossed 13 million customers. Some of you may be aware that we had mentioned that we aspire to double the customer base in 18-months which is 16 million by September '18 and as of March '18 we have crossed the 13 million mark.

With that, I will now hand over to Jaimin to take you through our results further.

Jaimin Bhatt: Thanks, Uday. As Uday mentioned, for this quarter we ended at a consolidated level profit post tax of Rs.1,789 crore, 27% higher than the same period last year. For the year, we recorded post tax profit of Rs.6,201 crore at the consolidated level which is about 25.5% more, over the last same period. Big contributors to the post-tax profit this quarter: The Bank contributed Rs.1,124 crore; Kotak Prime delivered profit of Rs.160 crore; Securities Rs.134 crore, Life Insurance business at Rs.114 crore and Kotak Mahindra Investments at Rs.95 crore. In fact, each of these Entities, i.e. Bank, Prime, Investment, Securities and Life Insurance company for the year recorded highest ever profit numbers. As you are aware, all the subsidiaries are now 100% owned by us. At the group level, we ended the year with Capad of 18.4% overall and the Tier-1 of 17.8%. Loan book at the Group level is over Rs.2 lakh crore now and the net worth is over Rs.50,000 crore. Book value now at just under Rs.265 per share. Overall advances have grown by 23% on YoY basis and at the bank level the growth is 25%. At the Group level our GNPA is at 1.95% and the net NPA at 0.86% with customer assets at Rs. 2,15,000 crore. The Bank has achieved 25% growth on YoY basis in terms of advances, we will come to that when we talk about the Bank, but before that, just request Murli who is the CEO of the Life Insurance Company to take us through the life insurance segment.

G. Murlidhar: Thank you, Jaimin. We are disclosing the Indian Embedded Value for the first time and it is at Rs.5,824 crore for the year ended March 2018. Our VNB margin is at 29.3% and the value of new business is Rs.522 crore. We have had a good growth of 27% YoY basis on the new business premium which has grown to Rs.3,404 crore in FY18 from Rs.2,680 crore in FY17. We have had a good share of products; the mix has been pretty good. Our participating, non-Participating products and ULIP are at 35%, 29%, 36% respectively. Our Renewal business has shown a healthy growth of 32% YoY in FY18 and the sum assured has grown by 25% YoY. In our new business, the share of Banca remains at 53% while the agency and others is at 47%. We have shown a good persistency growth and our 13thmonth persistency stands at a healthy 85% and our 61st month persistency stands at 61.7%. Our total reserve now stands at Rs.2,238 crore, profit after tax for the year is Rs.413 croreand our solvency ratio is at healthy 3.05.

Jaimin Bhatt: Thanks, Murli. Let me just take the bank standalone numbers; This quarter we recorded net interest income of Rs.2,580 crore which is about 19% higher than the same period last year. Other income for the quarter at Rs.1,151 crore, notably the fee income which is a component of the other income crossed the 1,000 crore mark for the first time, the fee income showed a growth of 33% on YoY basis. The employee cost for this quarter, as Uday mentioned, took a hit on account of the change in the regulation relating to the payment of Gratuity Act and the entire hit of Rs.82 crore which was there, had been taken in this quarter. Other operating expenses for the year does include about Rs.158 crore which is spent on items relating to 811. Number of other OPEX increases are linked to what we have seen as increase in income. On the investment provision, again, we have not taken any dispensation which the RBI permitted with respect to amortization of the MTM losses, so the entire MTM losses of Q3 and Q4 are things which we have taken the entire hit for this period itself. At the pre-tax level, for the quarter, we have shown growth of 19% YoY, even after taking the hit on account of gratuity. At post-tax level, last year in Q4, we had some favorable orders on income tax which came in our favor and as a result of which the tax rate last year fourth quarter was much lower, and that is one reason you see the pre-tax difference YoY is significantly higher than the post-tax number. Capad at the bank at the end of the year is 18.2% overall and 17.6% at the Tier-1 level. GNPA at 2.22% and net number now at below 1%, we are at 0.98%. Slippages during the quarter about Rs.590-odd crore, about Rs.1800 crore for the year. As Uday mentioned, SMA-2 numbers at Rs.72 crore being just 0.04% of the net advances. On a segment basis, purely going by the RBI classification of retail and wholesale, where anything which is over Rs.5 crore is corporate wholesale bank. The Corporate Wholesale bank recorded Rs.784 crore profit before tax for the quarter whereas Retail came up with Rs.500 crore for the quarter, and treasury, BMU profit before tax at Rs.427 crore. The advances in the bank grew 25% on YoY basis and we have seen growth coming across all segments– the corporate bank grew at 25% YoY, commercial vehicles, construction equipment doing a growth of 40% on YoY basis, the Agri division again doing 21% growth YoY, Home Loans at 24% and personal loans and credit cards again doing (+40%) growth on YoY basis. Deposits, as Uday talked earlier, the CASA number crossing the 50% mark for the first time and we are at 50.8% without taking to account the sweep deposits which are another 6.2%-odd. If we take averages on the basis of which we earn, current account average this quarter versus same period last year had a growth of 25% and savings showed a growth of 58% on YoY basis. CASA plus term deposits below Rs.5 crore are now 77% of our deposits. At the balance sheet level, the bank is now having overall balance sheet of just short of Rs.2,65,000 crore. Uday talked earlier about Wealth and Priority. I just request Dipak to take that.

Dipak Gupta: There has been a lot of debate on the size of our wealth business, and like Uday mentioned, we have not disclosed in the past, this is the first time we are disclosing wealth number. We believe we are market leaders with Relationship Value exceeding Rs.225,000 crore. This represents assets in banking, mutual funds, alternate assets and depositories, all of that really. We basically follow an open architecture philosophy in this business and hence we do end up being large distributors for varied range of wealth products and services. We cater to practically the Who's Who of India and like we mentioned there we get practically 40% of India's top 100 families. We are seeing a lot of opportunity in continuing to grow this business as India opens up we see mergers, selling and growing of businesses by promoters, the wealth management opportunity is looking like growing a lot. This is largely relationship driven business and historically we have seen like that, but going forward, we are seeing a lot more of technology and digital coming through in the distribution and the services part of business, and we are doing our business for meeting this requirement.

I hand it over to Shanti to take on the Digital piece.

Shanti Ekambaram: Thank you, Dipak. Digital continues to be a way of life at Kotak right from acquisition engagement, servicing and operations, aimed at better customer experience, higher productivity and efficiency. Some of the key initiatives this quarter: Biometric Authentication which is thumb or facial recognition for Scan n Pay transactions below Rs. 2000. Instant online FOREX remittance portal for both customers and non-customers for the purposes of LRS and the authentication is through Aadhaar. On our deposit side, 88% of the recurring deposit, 69% of fixed deposits came through the digital mode and 32% of our, salaried, personal loans came through digital. On the assets side, we continue our journey of increasing acquisition through digital in both cards as well as PL, and on home loans we introduced for Salaried Class, "Superfast Home Loans" which has really seen a significant increase.

In Q4, we launched India's first Bi-Lingual Voicebot, Keya at our customer care centre to help customers navigate quickly on their needs. Keya speaks both English and Hindi currently. We have also increased digital elements in our branches for customers either self-serve or assisted serve including opening several e-lobbies for customer convenience.

On the payments gateway, one notice point, we are among the top three banks in terms of digital payments, and this is as per information put out by the Ministry of Electronics and Information Technology in FY'18.

On 811, the acquisition continues to be strong. As Uday mentioned our total customer base at the bank is greater than 13 million customers and 90% of our 811 customers are between the age of 18 and 40. We offer free credit scores and credit cards, and engagement model, we have cross sell across credit cards, investment, insurance, and focus on better transaction experience on 811. In Kotak Securities, there is continuous focus on increasing market share in digital trading volumes and our cash market share in trading. In Life Insurance, 86% of the policy in Q4 was sold through the tablet called Genie and 93% of the Banca channel came through Genie, general insurance as well digital is the way of life. I now hand it back to Jaimin.

Jaimin Bhatt: Let me take some of the subsidiaries there. Kotak Securities, the volumes have kept going up. This quarter the average daily volumes at Kotak Securities is at Rs. 15,839 crores which is almost a 50% rise from the same period last year. We clocked our post-tax profit for the quarter at Rs. 134 crore and for the year, ended with Rs. 531 crore post-tax. As Uday mentioned, our market share in the cash segment where you really make brokerage money is 8.5% for the year. At the investment bank, we have been in the middle of a number of transactions. We did the Rights issue for Tata steel, the IPOs among others, Bandhan Bank, and the QIP placement for HDFC, number of transactions on the advisory side for Birlasoft, the buyback for Pidilite, working for the fairness opinion for IDFCs and Tata's. For the quarter, the investment bank recorded a Rs. 25 crore post-tax profit and for the year Rs. 65 crore of which almost all of it came in the second half of the year. The Assets Under Management, we end the year with Rs. 1,83,000 crore, a 29% growth on the year-on-year basis. Interestingly, at the domestic mutual fund, the equity fund under management grew by 78% and we end the period about 48,000 crore of equity Assets under Management.

The asset management company and the trustee company of the domestic mutual fund recorded Rs.115 crore post-tax profit for the year. Kotak Prime which is primarily into car finance saw the asset book at close to Rs. 28,000 crore at the end of the year. Having a very healthy net NPA number now at 0.37%, capital adequacy at 17.7 and annualized ROA of 2.1. Kotak Mahindra Investments has an asset book of about Rs. 8000 crore now for the quarter recording a post-tax of Rs. 95 crore and for the year at Rs. 245 crore. Again a healthy capital adequacy, we are at 19% Capad at Kotak Mahindra Investments, so those are the broad highlight for this period and if you notice this quarter almost a third of our profits have come from non-bank entities. We would be open to questions coming.

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

Mahrukh Adajania: Could you share the ROEV for the insurance business?

Jaimin Bhatt: If you look at the traditional number, my net worth in the insurance company is about Rs. 2,300 odd crore and as I said we did a post-tax profit of Rs. 413 crore in the year.

Mahrukh Adajania: The other question I had is that do you have any plans of inorganic growth in the Life Insurance business?

Uday Kotak: We are always open to all opportunities Mahrukh, therefore, if you have got any bright ideas you can certainly suggest to our team.

Mahrukh Adajania: The third question I had is on the corporate loan book and obviously you have seen corporate loan growth this quarter, but everyone is talking about huge opportunity and huge pie being shared by the state-owned banks in that light, do you think you can grow your corporate book much faster or is it still risky, because everyone talks about a big pie, but no one wants to take it up, like even HDFC Bank did not grow sequentially very strongly?

KVS Manian: You are right, there is opportunity to grow that book and within our parameters of risk and returns, if we can find the growth, right now we think we can grow at 20% to 25%. If we do find the market favorable and the opportunity comes, we do not mind growing it faster as long as it meets our risk return parameter.

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

Manish Karwa: I just had a question on the 811 and the customers that we are accruing now, what is the nature of these customers and how easy is it to raise balances there and what are the cross-sell opportunities that we are looking at, and also to supplement this, in this digital backdrop, how do we see the branch rollout and what do we see as cost-to-income ratios going forward?

Uday Kotak: Manish, first of all on 811 roughly the cost of customer acquisition is about 80% lower. Against that of course balances are lower than what we get from normal and one of the reasons for that low balance also comes because it is a completely different age profile that we are getting and for us this is a great way of diversification of our customer segments and it goes back to our history essentially being a mass affluent and higher kind of a bank with not being able to have a model which gave us the ability to penetrate the broader consumer segment. With this and combined with the fact that even in normal branch banking, we are now able to do biometric. We now have the ability to build a cost to serve efficient model in the mass banking business, therefore as we become broader our aspiration goes up, our ability to serve a much broader and a larger customer base in India is now significantly possible. Yes, we are fully aware that the frontend acquisition cost even at 20% of normal cost is going to hit our frontend P&L, but that is the price we are ready to pay for what we think is building a sustainable business in addition to the mass affluent segment into the mass segment and we actually believe that this is something, which will change the way banking gets done in India in the years to come and we will continue striving on that with a higher frontend cost, which comes as a result of significantly larger customer acquisition than the past.

We are also working on a number of areas of cross sell, which is obviously we are making some success on debit cards, on getting customers going to branches, which are unbundled charge for specific transaction we are getting entry into credit cards, therefore, Manish some of this is philosophic.

We believe this is a game changer and we are continuing to commit to it. It is similar to the kind of conviction we have had on the whole area of savings account deposits when many of our competitors took a call last July-August to actually cut down their savings deposit rates, we held on conceptually because we believe that we need to keep on getting a lot more sticky customers to build a sustainable low-cost stable franchise because that is what will serve us over the years and today with the changing interest rate scenario, we believe our call is right, yes, does it cost us the P&L on the savings account of nearly more than Rs. 1,200 crore now in a year, yes, but when you are building a business for sustainability, this is the price we have to pay and build the business and the franchise, and in that context on branches, most of our integration is done, therefore, the rationalization of branches, cutting through different common branches all that is now significantly behind us.

Our "Phygital" strategy which is physical plus digital together is now beginning to play, therefore, we actually need branches to be able to serve even digitally better, therefore, we are going back to a point where we will add more branches may be about give or take around 100 a year to places which give us a greater penetration in the physical and digital world combined, and therefore, we are not shying away from investing whether it is through 811 or branches as long as we believe our fundamental philosophy of sustainable low-cost and stable liability franchise is worked and we are beginning to see lot more cross sell success across the board including on assets which is a part of the reason why we are getting loan growth including in the retail segments, so we feel the synergies are working, customer flowing is much better, we are ready to take the upfront cost of it whether it is in terms of 811 and other acquisition cost of customers that now 5 million new customers a year on base of last year's 8 million which is a 60% growth in customer base. We are ready to spend more on savings account because that gives us faster growth, our SA growth average is 58% year-on-year. so we are truly excited and not scared of investing.

Manish Karwa: Sure, your customer acquisition has been phenomenal like 60% increase in last six to seven months is great and cost-to-income ratio, do we continue to expect to decline as we move forward despite the investment that we are making?

Uday Kotak: Manish, if you look at for the quarter we are around mid-40s, we got the synergies out of the merger a little late whether it was demonetisation, whether it was technology, whether a whole host of reasons, therefore, the synergy benefits of the merger have started literally in '17-18 and more towards the second half, so we continue to see synergy benefits flowing further out of the integration in the next year and that benefit will continue. At the same time, we will continue to invest, and where does this combined box bring our cost-to-income, we will see but at this stage I do not want to be shortsighted in our investment philosophy, therefore, I would say currently around the mid-40s is where we think we should currently assume where we are and if we improve, we get greater productivity good, but not at the cost of under investing in our future.

Moderator: Thank you. The next question is from the line of Rahul Jain from Goldman Sachs. Please go ahead.

Rahul Jain: Great earnings, across the parameters you have seen the improvement, now I have two to three questions, number one, on the lending growth, so it is really heartening to see that we are getting convinced about the environment, now if you were to kind of take or maybe just try to understand the visibility of this growth that you have, do you think your confidence is there for the next few quarters or only in this quarter we have seen and hence we have grown?

Uday Kotak: Rahul, once upon a time you may be aware we were joint-venture partners with Goldman and this is when Goldman was a partnership firm in the 90s, so one of the messages I used to get from Goldman partners was under promise and over deliver, so when we gave out guidance to you last year, we said we would like to see around 20%, then we changed it to 20% plus in the second half and we are happy to report better than that to you. In the same spirit for next year, I will guide at 20% plus, but I am not saying we will necessarily over deliver, but this is where we are.

Rahul Jain: Within the various loan products, across the board we have seen improvement but business banking continues to remain a bit subdued, so when do you see this piece particularly turnaround?

Uday Kotak: If you look at the segment, if you look at small businesses' working capital, personal loans and business loans, that has grown at 40%. The SME piece which we call as business banking by design, it is all based on risk assessment and risk adjusted returns in a GST world, but Narayan you may want to talk.

Narayan S. A.: Thank you Uday, first to explain the business banking has borrowers where the lending will be upwards of Rs. 10 crore. In this segment while it did get majorly affected post-demon, started recovering and then the GST came in. They were adjusting for GST, which took some time for them and at the same time we became cautious because we were not sure how r all these businesses across various segment especially SME space are going to adjust themselves. Post that, we see that the large and formal players are growing and capturing market share in their respective spaces. We have started increasing our acquisition now, so to summarize, yes, we have not grown in this segment, but to some extent was conscious and also we were waiting for the GST to settle and post that start our growth engine.

Rahul: Is it possible to get some sense in terms of the disbursal growth in business banking because the period and balances might be getting impacted by the repayments also, right?

Uday Kotak: That is correct, and I think Rahul what has also happened is fundamentally in the whole SME space, there were a fair number of players which were essentially on some sort of tax arbitrage, so that whole model was based on the formal sector, larger players paying taxes and indirect taxes fully and then there was a model which was informally on economy model in this segment. That part of the model has actually got seriously affected and I have said this, I think the soft underbelly of the stress in this space may not be fully out and fully represented overall in banking and it is something which we saw coming about 18 to 24 months once when we were doing the ING Vysya merger with us and ING Vysya as you know had a significant SME book, so when we emerged the two, we got a lot more insights into the issues around this business and therefore on a combined basis and I am not saying Book A or Book B, on a combined basis we did a very thorough sort of analysis and screening of the book and now we feel actually far more confident that we are getting a much better handle on risk adjusted returns in this segment, and therefore, we are always very open to a slowing down any particular vertical where we feel the risks are something which are not commensurate with returns and once we feel comfortable, we are ready to ride the engine back, and I will give you an example, if you go back in 2012, we had significantly slowed down construction equipment, which went through a very rough phase post-2012-13 and about two years ago, we rekindled that engine and now we are growing that business at 40%.

Rahul: Just one last question if I may, is it possible to get a broad mix of small business, personal loan, and credit card portfolio within these three categories?

Uday Kotak: May be Jaimin off-line if you can just look at it, but there is a lot of stuff, Rahul, there is so much of segmentation we can do, finally from the point of view of even analysts you have got a lot to cover.

Moderator: Thank you. The next question is from the line of Adarsh Parasrampuria from Nomura Securities. Please go ahead.

Adarsh Parasrampuria: I had couple of questions on the life business, one the margins that you all have indicated I believe that is post overruns, is that a correct understanding?

G Murlidhar: Yes, it is correct.

Adarsh Parasrampuria: The second question I wanted to ask was on the protection side, you all mentioned as a percentage of total premium it is about 22%, what I wanted to understand is on an APE basis or on a weighted basis, what is the protection mix?

G Murlidhar: We have mentioned that 22%, on the APE business, it is 7%.

Adarsh Parasrampuria: Again putting the things in perspective, your non-PAR product share is like 29% and that is on an APE basis, of that 7% will be protection and the rest of it will be non-PAR savings?

G Murlidhar: The 29% which is referred here is relating to individual products and the 7% which I told you is on the APE business of the entire business.

Adarsh Parasrampuria: Another question relating to the banking business, you just mentioned about the 150 Crore that you would have spent on 811, I believe that would be some form of recurring or it is more like as you grow, and you get more customers then it is more fixed cost model, so this you will kind of not keeping incurring your 20% to 25% growth on this number over a longer period?

Uday Kotak: We believe that our customer acquisition engine will continue to grow to a certain extent. At the same time, the base which we have acquired will start giving us returns in terms of our revenue lines on that and our incremental operating cost of 811 customer is very low, the acquisition cost will continue for new customers, but as our base grows the revenue comes on the entire base.

Moderator: Thank you. The next question is from the line of Nishant Shah from Macquarie. Please go ahead.

Nishant Shah: First question is on life insurance, sorry I may have missed this, was the operating ROEV declared for life insurance?

Uday Kotak: We have just initiated this year, so going forward we will start giving you operating ROEV as well.

Nishant Shah: Secondly, on this 811 account, it would be really helpful if you can like show some productivity metrics on this, like say a gradient of what percentage of accounts have what kind of balance like these are lots of like new young customers, so how many of them would be maintaining say at least Rs 5000 of balance or something or any other productivity metrics like what is the cross sell ratio here or something that we can track and see the efficiency of this new customer acquisition engine?

Uday Kotak: Keep in mind we always have to balance between more and more sunshine versus making sure that we also want to keep our competitive edge.

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

Kunal Shah: My question is with respect to the deposit mix, so phenomenal job being done on the savings, but if we look at the retail term deposits, in fact the growth has been almost like 10% or 11 odd percent, so currently may be in the interest rate scenario wherein we are plus say more than 20% of balance sheet growth, how do we overall see may be the outlook on the retail term deposits, some of the banks have been very aggressive this quarter and we have seen significant rise, but what would be our view given like we are more than now 50% CASA?

Shanti Ekambaram: Last year, actually two things happened. One, you saw the reduction in the rate at the beginning of the year where the interest rate cycles started dropping and at the same time you saw also the fund flow starting into alternate investments like Mutual Funds etc., so on the term deposit front you really had to fight the battle between allocation between term deposits, investments and other alternate investment, so while our drive continues to remain, we saw some amount of money actually flow out through us itself into other alternate investments. I think from January this year again we have seen a turn in the cycle, we have seen rates starting to get better and you know across the industry deposit rates have gone up and again we are beginning to see better accretion actually in Q4 of term deposit rates, so I think it is a function of rates and it is a function of investment allocation of customers, we have no choice but to make sure that we focus on and keep growing our term deposits as Uday mentioned, low cost stable deposits, the retail deposits particularly below 1 Crore is a very important focus area we will continue to do.

Kunal Shah: But hasn't the overall term deposit in Q4 been lower as compared to that of Q3 because if I just look at the numbers, it suggests that there has been a sequential decline as such rather than the accretion?

Jaimin Bhatt: Not exactly, if you look at that coming purely from the fact that the certificate of deposit number, which is primarily in the bank that has gone down.

Kunal Shah: As you highlighted at the start financial realization of savings is the key interesting trend, but still when we look at it even in FY '18, the contribution of banking business to the overall profitability has been say 75 odd percent, so do we see may be the nonbanking businesses going up significantly, a trend was there in Q4 but is it more sustainable and out of the nonbanking businesses, which would be more growth oriented be it in terms of either the asset management piece or may be in terms of the capital market, what is your view out there?

Uday Kotak: We are going to divide this into three parts; one is, what you call as sort of stable, less cyclical businesses which is what banking core deposit and lending franchise of the banking business is, and then there is a piece which is again more annuity like life insurance and some part of the asset management business, and the third part of it is what you call as more cyclical, which is capital markets whether it is securities and investment banking. Layer all this with levels of risk we take in each of these segments, therefore, while we are completely open to growing risk businesses for returns we make, we are also very focused on making sure what percentage of our total revenues come at lower or no risks from a credit or a financial point of view, of course, there is a reputational risk in everything we do, therefore the whole mindset of the form is for the levels of risk taking, what are the returns we are making and that is the DNA which drives us as we sort of build our businesses. We are always a little more careful to come back and tell you that we are taking disproportionate risks because we want to grow our earnings. We would like to grow our earnings where our risks are commensurate with our returns and overall are there a set of annuity businesses, whether it is wealth management, asset management or other agency businesses which continue to give as high profitability at much lower credit or financial risks, while we continue to take credit risk on the core banking business. Therefore, coming to an answer is more about return for the risk we take and for the franchise which starts producing returns without commensurate financial risk.

Kunal Shah: Lastly in terms of the data points, what has been the other income in the Kotak Mahindra investments, it is quite significant?

Jaimin Bhatt: One particular investment gain which we have had so we booked some capital gains during this period, so that has been one spiky thing which has happened this quarter in KMIL.

Kunal Shah: And quantum?

Jaimin Bhatt: About Rs. 40 odd crore that is pre-tax.

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

Ashish Sharma: Most of my questions have been answered, just one on the ROA and ROE for the bank, we are at 1.7% ROA for FY '18 and we are little off from the ROA we had before the ING merger, what sort of a timeframe do we see in terms of reaching to the premerger ROA of closer to 1.9% and what would be the levers for the same, and do we see also an increase in the leverage because we remain little lower capitalized just this one bit on ROA and ROE, Sir?

Jaimin Bhatt: It is like if you look at 1.73 and if you are looking at premerger, we would have been at around 1.85 or 1.9 thereabouts, so we are improving there though the time when we had gone low post-merger to 1.3 to 1.4, we have steadily improved from there at 1.76 for this quarter, so it will have to come from both revenue improvements and the cost, we have worked on both of that and we are seeing improvements there. This quarter as you are aware, we have taken some provisioning hit also, so to that extent this number we are talking about is after all of those. ROE, yes, the fact that there is a higher capital, Tier-1 particularly which is pure equity does drag my ROE and if I was therefore looking at the ROE number on a normalized capital at the bank standalone itself we would be about 16% -odd, and at the consol level this would be 18%-18.5% thereabout. So, yes to that extent we need to kind of sweat a little more.

Uday Kotak: Yes, and I think you also got to keep in mind we continue to pay 6% on savings, we continue to make big investments in customer acquisition, all those are continuing investments we are making. So to that extent we have to think about this as a growth business which is how we think about it rather than a mature business.

Ashish Sharma: And sir just lastly, have not heard much about how we want to leverage this stress asset management opportunity we have been talking that this is a very big opportunity. I think when we had raised capital we had mentioned some bid that we would use that as capital, but we have not understood directly what is the structure for the same?

Uday Kotak: First of all, I am sure you would have read in the media about us having made a bid for Jaiprakash Associates along with our fund partners where we obviously would put some capital on this. Therefore, we are obviously working on this area, continuing to put money to work where it makes sense but the whole area of IBC as you know is currently in an evolutionary process and therefore this first foray into Jaiprakash Associates bid which you would have seen comes as a partnership with a few other players including a sovereign where we put some capital to work along with partners. So, we are not shy of making it work, what we are also seeing is a whole IBC process is evolving. There are number of projects we are working on as we talk to you well I will ask my colleague Dipak who is driving it to take you through this.

Dipak Gupta: Like Uday mentioned, see the opportunities in the segment are numerous but they are evolving like the laws in the segment. And in the beginning the way we really looked at it is, let us not jump fully into it. Let us just get our feet for experimenting where we fit, the bite side is and the structuring is comfortable from the returns point of view. So, we along with appropriate partners and for testing the waters in some of these segments. Once we see first 12 and maybe the next 40-odd come closer to closure which probably will happen over the next 2 to 3 months. Anyway, we far more clearer about the realities involved, issues involved, what works, what does not works, what is appropriate, what is not appropriate and I think by this first round most of the strategic will really be out of the picture really and then we have a very long tail. It is really challenge which we have on stressed assets and I think we will really have a lot to play in the remaining long tail and that is what we are really heading to.

Moderator: Thank you. The next question is from the line of Harshit Toshniwal from Jefferies. Please go ahead.

Harshit Toshniwal: Couple of questions. So, starting with the life insurance business currently the VNB margin for FY18 as you reported is somewhere around 29. Can you give a color of how has this evolved over say last 5 to 10 years basically the cycle what it was at the bottom of the cycle and how is that evolved over the period?

Uday Kotak: I will ask Gaurang to answer much evolved question and a long-term question.

Gaurang Shah: I think over the years we have always focused on risk premium and we were one of the first one to ride the bus. We started as early as may be in 2004 and 2005 and we always have gone for an extremely balanced product mix right from the beginning, between say ULIP on traditional, traditional participating, non-participating overall on a group or an individual business and one good thing we had we always had a bank which is the promoter bank which helped us in terms of keeping that balance. We also invested in agency and all these things combined together, have helped us maintain relatively higher margins all throughout.

Harshit Toshniwal: And if I look at your business mix over the period of time, the unique part about your model is that group business for you has been around 40% to 50% since last 7 to 8 years. So, as you said that in the presentation the mix is based on individual APE, within the group can you help us explain that what kind of products are we more concentrated into, credit protect must be a good part of it and apart from that also?

Gaurang Shah: Yes, I think we do all the 3 protections. Number one is credit term then we do the employer employee group and then we do the individual term. So, I think in terms of profitability as you know the best would be credit term, individual term and then rest will be employer employee. So, I think throughout we focus on all three.

Harshit Toshniwal: Any broad mix which is there currently, of all these three within group?

Gaurang Shah: I think the largest would be credit term and employer-employee is steady but low margin business and in terms of individual we believe we need to improve from where we are because there is a lot of scope and lot of focus which is going on. But there also we have been growing consistently.

Harshit Toshniwal: And sir most of this group credit protect would have been done from Kotak, so any other Banca partnership which we have apart from Kotak Bank?

Dipak Gupta: We just about started disclosing information. So, leave some questions for the next time.

Harshit Toshniwal: And just last data point question, number of employees at bank level if you can disclose?

Jaimin Bhatt: Overall about 50,000, Bank would be about 35,000.

Moderator: Thank you. The next question is from the line of Nitin Agarwal from Motilal Oswal Securities Limited. Please go ahead.

Nitin Agarwal: Sir, my question is on the credit cost. Now that we have seen sequential improvements in asset quality and the SMA-2 number is like unbelievably good this time. So, what is the outlook on credit cost? Is there any change to it that we can expect?

Uday Kotak: Yes, as I mentioned at the beginning our view is that overall credit cost continues to trend down. Therefore, in the absence of a big economic shock, our view is credit costs will continue to trend down.

Moderator: Thank you. The next question is from the line of Manish Shukla from Citi Group. Please go ahead.

Manish Shukla: If you look at the loan mix, unsecured loans for you are growing at around 45% and we kind of see the same trend across the banking system where personal loan credit cards are growing in excess of 35%-40%. What is driving this? Because obviously the underlying income at the individual levels are not necessarily rising at this pace?

Uday Kotak: Yes, I think a very good question. Let me first say that in addition to our unsecured, if you look at our construction equipment and commercial vehicles that is also growing at 40%. And this is the view, first of all our unsecured base is a much smaller base compared to some of the cases where you may be.

Jaimin Bhatt: If you look at across the Group, our unsecured number would be about just about 21% thereabouts, in the Bank would be slight marginally high.

Uday Kotak: So, this is very small, relatively small percentage of our total mix. Having said that the base is smaller and we at this stage really care about, as we look at our credit is we do not like excessive concentration on any single segment disproportionately. Therefore, you will not find us to be at 60% or 70% unsecured as a part of our total loan book. So, that is what I would just want to highlight to you. Therefore, mix, risk-adjusted returns, focus on avoiding concentration disproportionately to any segment like microfinance or unsecured loans or credit cards and we look at margins not in absolute terms but on a risk-adjusted basis. And we understand the very significant difference between the margins of an unsecured book versus secured book.

Manish Shukla: My second question is your thoughts on how the February circular impacts the banking system? I know it is not much relevant for you but the thoughts on the broader system impact?

Uday Kotak: I think it is not just February circular, something which some of you analysts almost thought about me to be like an old broken record who kept on saying there is stress in the system since 2012.. The fact of the matter is overall stress in the system we can debate and this is purely judgmental but in my sense it is certainly more than 20% of the loan book of the banking industry and so far whether that number would be close to around what, 16 lakh crore? What is disclosed so far is give or take 12 lakh crore, stress plus NPA put together. So, we have some way to go and there is some which has also been sitting on banks' balance sheet and off-balance sheet. So off balance sheet exposures were taken by banks some time in 2011-2012-2013 with 5 and 6 year tenures. Some of them are also beginning to bite and frankly I still think there is some more recognition to go and certainly a lot more provisioning to go.

Manish Shukla: Is that a bunching of these cases you see that this pushes up LGDs across the system?

Uday Kotak: Yes because when we have got disproportionate supply in a short funnel, it is bound to have an impact no? And therefore again we can debate but I do not see total recovery on loans exceeding 40% probably lower. That means the loss ratio is going to be in excess of 60% and I don't understand this but when I am looking at pricing of stress, I am looking at present values. Therefore if I get repayment of a loan where I take a 10 years 0 interest debenture and show it as a regular asset in my book, the present value of that is pathetic. So, I have to write the stress at present value and I do not think that is still fully priced in.

Moderator: Thank you. The next question is from the line of Rakesh Kumar from Elara Capital. Please go ahead.

Rakesh Kumar: Sir, just wanted to get your opinion on this IBC matter because since it started now we have 700 or perhaps more cases including the cases referred by the RBI. So apart from this the number of cases here and couple of frauds which were already NPA are coming on surface. So, the abilities of large corporate and the promoter-driven companies to operate is even lower now. So, what would your impact of these 2 events which have started taking place now of late and last some months on the second layer of businesses mean to say the MSME segment going ahead?

Uday Kotak: Yes, I think I have believed that the intent of IBC process is good which is cleansing the system. But when you do the cleansing in a very narrow funnel, there is a risk of some purge and there could be high frictional cost of that which is what we are going through right now. For us to be able to give you a better view probably it is about a year from now Venkattu, my colleague, is here who is our expert on managing distress assets, I am going to ask Venkattu your sense on this IBC process and distress in the system and how do you see play out?

Venkattu: It is still very early days and every day we see different kind of judgments coming across from various courts. The entire process is evolving, and every judgment is getting over thrown in some other courts and understanding it various levels are also found wanting. So, it is a new law, it is evolving, it is taking time but as a process it has got a lot of good. If it really works out well, it could clean system but in my view, it will at least take 3 to 4 years for it to settle down.

Uday Kotak: I think it is faster but that is an internal difference in view.

Rakesh Kumar: And what could be the impact of this resolutions on the relatively a smaller companies like SME and all?

Uday Kotak: I think the problem is if there is only one bidder or zero bidder that is where the challenges will come and overtime I think there may be a need for the policy makers to think about this promoter not bidding and the impact cost of that in total loss given default, finally. So, I think it is a fast-evolving thing, I understand the moral hazard of huge haircuts been taken by banks and promoters getting the companies back cheap, that is one part of the story. But there is other part of story finally how much is the hit the system will take because of this huge pressure and lack of enough buyers for all the assets.

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

Roshan Chutkey: So, if you can disclose the VNB margins at a product level how much is it for PAR, non-PAR and ULIP?

Uday Kotak: The child is just started walking, this is the first time we have disclosed it. You guys are well ahead because you have been covering other public listed companies. So, give us some time because of the nature of consolidated entity we will overtime try and see how we can get investors and analysts access to the individual businesses separately. So, I have been telling my IR team to think about sun shine day where we can think about that at some part of time but let us see how it goes. But this is a first important start and over time we will see how we can improve disclosures even further.

Moderator: Thank you. The next question is from the line of Sanjay Parekh from Reliance Mutual fund. Please go ahead.

Sanjay Parekh: Uday bhai, one question on this recovery in micro and macro deteriorating update. With such large size of problem do you think if it gets delayed, it can actually also impact the delay in recovery of micro?

Uday Kotak: Yes, but what is happening is capacity utilization in many sectors has gone up now. Therefore what was 65% to 70% capacity that is going up because you just look at steel. There is a huge pricing power which is come into steel industry. You ask auto companies, they have to wait queue to get steel. So, if pricing power comes in and if capacity utilization goes up then for guys who are in business and who are not having any issues they will continue to get more and more share. And I think overall across sectors you are beginning to see some sort of consolidation into a fewer handles, whether it is steel, now whether it is telecom, so you are beginning to see that trend also develop.

Moderator: Thank you. The next question is from the line of Ritesh Badjatya from Asian Market securities. Please go ahead.

Ritesh Badjatya: In your asset management business last year we grew 71% in the equity AUM side. So, how much is the SIP contributed for?

Uday Kotak: I can tell your SIP has become a very important component and we have added a very high focus on SIP. As you know Nilesh Shah who runs that is very passionate about SIP and we have lots of things like SIP day, this day, that day, he is a great believer in SIP.

Moderator: Thank you. The next question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: I have only one question. In terms of some media reports I have seen that big acquisition for Kotak Mahindra Bank in private banking side. So, one is the, is not question of the acquisition confirmation but in terms of managing the large corporate balance sheet or managing your infrastructure side of this business, how open we are for that?

Uday Kotak: First of all, I just do not want to comment on any rumors or speculation or anything like that. If there was anything we had to share with you we would have shared with you. There is nothing for us to at this stage there to be able to share with you, your concerns about what the future may or may not be. So, if ever there is a situation like that I am sure my management team will think about all those risks before we do anything stupid. Let us be assured on that.

Moderator: Thank you. I would now like to hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak: Thank you very much. Really appreciate the interest and response which we have got on this review. It really matters to us as you cover us and sort of communicate with the entire investor base and investors also who are on this call. We will continue to do our best and stick to really building a strong financial services franchise. And at this stage we are quite confident of the continuing growth trajectory despite some of the macro challenges which will continue to play out. Thank you very much, ladies and gentlemen.

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.