Kotak Mahindra Bank Q2 FY19 Earnings Conference Call

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Moderator: Good Day, Ladies and Gentlemen. And a very warm welcome to the Kotak Mahindra Bank Q2 FY19 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, colleagues. Very happy to be on this call and to discuss, of course, the Kotak results and also a little bit of perspective on the financial sector as we stand at a very critical juncture.

My sense is we are actually now beginning to see some of the challenges which are coming out, essentially because of significantly broader financial sector than what India has seen for a long time. When I go back a little bit into the past, I think in many ways the turning point was the post demonetization period when we saw a significant growth in financial savings. And that lead to financial savings moving across the financial services sector, in addition to banking, into mutual fund, into insurance, and through that into the non-bank financial sector.

We have also seen a very significant growth in the non-bank financial sector in this period between 2017 and 2018. One of the challenges which the public sector banking faced, because of significant load of stressed assets, was some significant heavy lifting which was also done by the non-bank financial sector.

If you look at the total size of the financial sector, which is public sector banks, private sector banks and the non-bank financing sector, supported of course by sources of money which are mutual funds, insurance, pension funds and banks, the loan book growth of the NBFC sector is something which has been at a much faster pace than the banking sector.

And as we have seen from time to time with easy money, which is what we saw post demonetization, wholesale funding became cheaper than retail funding, which comes through the course of hardcore banking. And as wholesale funding became cheaper, it leads to a further fueling of the NBFC sector, supported by the fact that at the shorter tenure the rates were even more attractive. And that lead to significant ALM mismatches which is what we have seen happen.

Again, I think in addition to that, one of the issues is that a lot of the funds moved into essentially long-term assets, both in real-estate space and in the infra space, which were therefore not having the ability to create liquidity, should there have been a need at the shorter end. And combined with increasing stress, both in real-estate and infrastructure, as the money started getting delayed from the end use which is the infrastructure sector and the real-estate sector, we saw pressures coming in, particularly accentuated by defaults of some of the players which happened in August and September, starting with IL&FS. This was the first important trigger which took place in the market place. And then, of course, if you look at the size of money which has gone into NBFCs, and particularly housing finance companies, I think that has been the source of liquidity challenges which the sector has faced.

In my opinion, the way to address this is, the positive step taken by SBI to buy portfolios, and I would like to see larger, like NHB has done, a larger refinance window being made available to the housing finance sector to ease the liquidity mismatches which are prevalent in the sector. At the same time, it is very clear to me that the need for significantly higher focus on the quality of governance across the financial sector is clearly the need of the hour. And in cases where there are multiple companies being run under the financial services umbrella, the way the governance and management of different arms of these groups happens is extremely critical and it cannot be other than at arm's length and at fair value. We have seen practices in many cases which have not necessarily adhered to these levels of core governance, on the basis of which large amounts of money are raised by the financial sector.

And of course in this context when we are talking about governance, the roles of all the fiduciaries are extremely important and it is critical that the different fiduciaries which are the backbone of the financial sector, i.e. the management, the board, responsible institutional shareholders, rating agencies, auditors, regulators and policy makers, all have a role to ensure the fair governance of the financial sector.

With these initial comments on the financial sector and the volatility which we are going through, I am happy to report a steady set of numbers from our bank. We have grown at 21% standalone and 18% consolidated. I would like to say that our businesses are in good shape. One of the important things which we have kept the focus on is avoiding concentration, therefore whether it is on a sector or on single companies, including the bank's exposure to real-estate and to the non-bank financial sector, both at the sector level as well as at individual company level, we have managed the exposures which we believe are prudent. And therefore, we feel comfortable fundamentally with the quality of our balance sheet.

However, if the turbulence in the overall financial, infrastructure and real-estate sector dramatically increases, which I do not believe it should with proper handling by policy makers and regulators, but if it does get to more volatility and higher turbulence not only will we be stronger coming out of it, but like every other player in the same water we may at worst get some bruises but not get seriously impacted going forward. Of course, it is always dangerous to lower our guard, and I therefore encourage myself and my team not to lower our guard and continue our alertness to ensure that we withstand this volatility significantly safer than some of the challenges with players in this industry are currently facing.

And our capital base continues to be extremely strong, our net NPA at the consolidated level is 0.73%, at the bank level is around 0.8%. Continue to be prudent on provisioning, recognition; our SMA-2 is about Rs. 165 crore which is, again, probably amongst the lowest in the banking industry. So, hopefully we continue to do the right thing while seeing opportunity. And we are beginning to see opportunity, both in terms of better pricing power and ability to pick and choose the quality of credits we want, especially at the prices which we are more comfortable with.

Our liquidity position is extremely sound, in fact we currently run the challenge of managing surplus liquidity in our bank which we are handling with care, but always ready for opportunity as we go forward.

With that, I hand over to my colleague Jaimin Bhatt to take it further.

Jaimin Bhatt: Thanks, Uday. I will quickly take the earnings updatet which has been circulated. For the quarter we ended at the consolidated level with a profit of Rs. 1,747 crore, about 21% higher than the same period last year. The bank contributed Rs. 1,142 crore i.e. the highest.

Kotak Mahindra Prime had Rs. 157 crore of post-tax profit for the quarter. The life insurance company got Rs. 127 crore. Whereas the securities business raked in Rs. 112 crore. The mutual fund activity got us Rs. 52 crore, while the international companies got another Rs. 47 crore.

The overall capital and reserve position at the consolidated level now stands at Rs. 54,000 crore, which includes Rs. 40,000 crore of the banks.

Advances at the group level are at Rs. 2,22,000 crore, about 18% higher than same period last year. And as Uday mentioned, net NPA at the group level of 0.73%.

As for the bank standalone, we closed the quarter with post-tax profit of Rs 1,142 crore, about 15% higher than the same period last year. Net interest margin in the bank at 4.2% and the loan growth at 21%, we closed the period with a loan book of close to Rs. 1,85,000 crore.

We had started the launch of 811 in end of March 2017 with 8 million customer base. And we had said that we would want to double that in 18 month period. As of September, which is end of 18th month, we have crossed the customer base mark of 16 million customers.

At the bank standalone, we have seen the net interest income grow as well as the other income growing by close to 25% on a year-on-year basis, now at Rs. 1,205 crore. We have had provisions in this quarter, both on advances and investments which are, compared to a year-on-year basis, at a higher number. As a result, the provisional number for this quarter is higher than the same period last year. And we ended with a post-tax profit of Rs. 1,142 crore.

At the bank advances we have seen growth coming in variety of sectors. CVs and CEs grew on a year-on-year basis by 40%, the corporate bank book grew by about 19% odd, small businesses, credit cards and personal loans again did about 39%, whereas home loans which includes LAP did 23%. Our SMA-2, again, as Uday mentioned, at 0.09% of our advances at Rs. 165 crore, with gross NPA at 2.15% and net at 0.81%.

Our total exposures, and by exposures I mean not just funded outstanding but off balance sheet investments, derivatives and whatever, at the bank level aggregates to close to Rs. 2,50,000 crore. Of which our exposures to the NBFC segment is about Rs. 13,000 crore, which includes about Rs. 1,200 crore of exposures to the other entities in the Kotak Group, including subsidiaries and it includes investments in subsidiaries.

Our commercial real-estate exposure at about Rs. 7,700 crore, which includes over Rs. 3,000 crore of LRD and CRE exposure on a year-over-year basis, has actually come down.

On deposits, we closed the period with CASA number of 50.2% as against 47.8% last year. On average numbers, we have seen current account grow at 22% whereas the savings account has grown by 43% on a year-on-year basis. Our focus on CASA plus TD is below Rs. 5 crore; now that aggregates to 79% of our total deposits. And the CASA does not include the Sweep deposits which are about 6.6% of our overall deposit base.

At the period end we have 1,425 branches.

The total balance sheet size at the bank standalone level is now at Rs. 2,88,000 crore.

I will request Shanti to take the digital ones before I come back on the subsidiaries.

Shanti Ekambaram: Thank you, Jaimin. We continue to focus on digital, both in terms of adoption by customers, as well as moving customer transaction volumes to net and mobile. Towards this, we have revamped our digital platforms, both net and mobile, to offer best in class experience and convenience. So we continue to be amongst the highest rated banking apps in India.

On an incremental basis, 90% of our RD volumes and 69% of our fixed deposit volumes are sourced digitally. We have seen a volume growth of 260% in our mobile banking transaction. We have gone live with our chatbot, Keya. You may remember, we were one of the first to introduce VoiceBot, Keya, for servicing customers at the call center. We have gone live with chatbot for servicing customers on debit cards, credit cards and 811 and answering various queries.

As far as 811, we actually launched an India invited inclusive campaign, which really scaled new heights successfully across all platforms. From a customer perspective, as Jaimin talked about, we have crossed the 16 million total customer mark. In 811, 91% of the customers are between 18 to 40 years and we are completely focused on cross-selling into this customer base for TDs, RDs, credit cards, group personal insurance cover, etc.

We are reviewing the 811 strategy in view of the Supreme Court judgment. Also, UIDAI has introduced new guidelines yesterday, which will enable a paperless digital journey. We are revamping our processes and technology and will be following the new guidelines that have been outlined by UIDAI and in line with the SC judgment.

From a payment and digital lending solutions, we have seen volumes grow across our payment gateway, UPI transactions and our K-Mall, which is really the m-commerce and e-commerce transactions that customers can use on our platforms.

From a lending perspective, across all our products we have seen an increase in sourcing from digital channels, be it credit cards, personal loans, term loans, business loans. This is an area that we are continuing to invest in and we will see this continuing to improvise and scale as far as volumes for digital continue.

From a group company perspective, for Kotak Securities, mobile continues to be a way of life with increasing volumes i.e. 91% YoY on cash. And general insurance and life insurance as well, we continue focus on sourcing and servicing through the digital platform.

Jaimin, back to you.

Jaimin Bhatt: So, let me just quickly give some highlights of the subsidiaries. The life insurance company clocked a post-tax profit of Rs. 127 crore this quarter. Overall premiums, the new business premiums for this quarter at Rs. 824 crore, about 28% higher than last year. We have also had a change of mix, last year we had ULIPs for the full year at 36%, for the first half this year we are now at 25%. The solvency ratio there is at a healthy 3.1% as against requirement of 1.5%.

Kotak Securities clocking record volumes of Rs. 34,000 crore and an average market share in the cash segment on a half year basis at 8.7%, whereas for this quarter on an overall basis at 2.5%. The investment bank clocking a post-tax profit of Rs. 14 crore, has been involved in transactions both on the IPO side and the advisory side during the quarter.

Our overall assets under management, at the group level, grew by 18% on a year-on-year basis. We are just short of Rs. 2,00,000 crore at the group level. At the domestic mutual fund, average assets under management for the quarter has been Rs. 1,35,000 crore, and our overall market share has gone to about 5.53% up from 5.28% last year.

Our profit for this quarter at Rs. 52 crore. And the mutual fund also got the award for the best mutual fund house by CNBC for the last year.

Kotak Prime, an asset book of about Rs. 28,500 crore, clocking a post-tax profit of Rs. 157 crore for the quarter. Healthy capital adequacy at 18.2% and ROA of 2%. And completely sound on asset liability mismatches and pretty healthy on that front also.

Kotak Mahindra Investments, asset book just short of Rs 8,000 crore for the quarter, clocking a profit of Rs. 45 crore, again, capital adequacy at over 20% at the end of the period.

So, those were the broad subsidiary highlights. Open to take questions from you all.

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

Mahrukh Adajania: Could you throw some light on divestment of promoter stake as to what are you thinking? And if at all you think you would get an extension as you probably already applied to RBI for the same? And secondly, there was not much sequential corporate loan growth, so any comments on that?

Uday Kotak: We have had disclosures to the exchanges sometime in August about the fact that after the issuance of PNCPS that we are engaged with the RBI. So that is where we are right now, nothing further to report at this stage. And, however, if there is something we will ofcourse talk about it.

KVS Manian: Towards the end of the quarter, as you know, there were some serious spike in costs and rates are under pressure, so we manage our short-term loan book slightly downwards during the quarter. But by and large we continue to get 20ish kind of growth rate, I mean, we still are close to 20% kind of growth rate, and that is what the guidance has been.

Moderator: Thank you. Our next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: Sir, on the 811 initiative, post the Supreme Court ruling on Aadhar what is the current status? And what would be the cost implication for customer acquisition now post that ruling?

Dipak Gupta: Well, like Shanti mentioned, at this point of time with the court's judgment we have suspended 811i.e. any new acquisition for 811. However, what happened is UIDAI has given some clarification saying that some type of transactions are okay to be continued on the basis of Aadhar. Basically, the DBT and welfare benefits continuing with Aadhar enrolment. And we are working out on some technology solutions to take advantage of that and we will shortly come out with modifications.

Amit Premchandani: And there is no requirement per say for the customers who have already been on-boarded?

Dipak Gupta: At this point of time, no.

Amit Premchandani: And on the loan growth front, while the system loan growth has seen acceleration, from Kotak point of view consol growth has seen some relative slowdown. And you mentioned that you are having excess liquidity. So, why this shift in gears in terms of growth relative to the market?

Uday Kotak: First, if you look at on the bank standalone we have grown at around 21% and we think as we did earlier 20% growth rate, overall, is something at the bank level we are comfortable with... After middle of September we are also beginning to see pricing to improve, especially through September and beyond. Therefore, we see better pricing in what we are doing. And as far as the consol is concerned, keep in mind, if you look at the two places where the growth has been relatively slower, one is car loans; and the second is, as capital markets slow down the demand for financing on the capital markets by the NBFC segment also slow down a bit as we went towards the second half of the year. But overall we continue to guide 20s growth rate for the loan book and hopefully as we go forward we think pricing is getting better.

Amit Premchandani: And finally, do you see the current liquidity environment for NBFCs impacting the real economy as of now, or what are the risks like that?

Uday Kotak: I covered some of this in my opening comments but I want to give a balanced picture. I do believe that the factors which are going to affect the overall economic growth are going to be global macro and with a very high correlation to what happens to the price of oil which I think that is certainly an important factor. Second, as far as the NBFC sector is concerned, I think it was a scorching pace of growth, maybe partly driven by also the market pressures, maybe I think the analyst community also should be more realistic about kind of growth which is sustainable over long period of time, particularly managing risks and ALM along the way. Therefore, growth has to be managed along with management of risk. So, when the two get disconnected you see the risk of discontinuity, which is probably what you are seeing. The early sense is that both in car demand as well as consumer durable demand in October, so far it is looking a little less enthusiastic then what we would like it to be. But I would say that, frankly, as some of the banks, as long as we get our risk return metrics we are happy to be there available to finance the growth required. And of course, with proper underwriting standards which are the key, therefore that is important, you do not want to see growth in consumer durables, cars and the broader economy, while this proportionate risks are being carried on balance sheets of financial institutions. So, getting that balance right I think is the key.

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

Manish Karwa: Sir, I just had two questions. First, do you think that the current liquidity challenges which our system is facing will or could eventually lead to some credit issues? Are we there? And if this continues do you think that can lead to credit issue, something especially in housing or real-estate?

Uday Kotak: I think we must separate liquidity issues and credit, I mean, obvious thing is, let me just say that if we look at any issue there are really three categories of players i.e. good players, middling players and not so good players. So, highest pressure obviously comes on the third, and normally the biggest beneficiary is the first. What the system and the policy need to ensure is that the middling players sustain their way through this turbulence. And that is where policy and communication of policy in a coordinated manner is extremely critical for the system. But we have to be clear, again, since you are talking about liquidity, one of the issues has been the challenges which the mutual fund industry has faced and it is back to Finance 101 risk management on concentration risk. Yes, regulator allowed concentration of 40% of a scheme into NBFCs and HFCs into a single mutual fund scheme. But that did not stop from a risk management point of view, and that includes all mutual funds, to have their own risk management guidelines for concentration of risk in a particular sector. And rough and ready, if you look at the three segments between mutual funds, insurance and banking, the concentration risk on NBFCs and HFCs of mutual fund industry is the highest amongst the three categories. And we all know that open ended mutual funds are like current accounts, therefore if you have a 35% to 40% exposure to paper, and particularly in the case of real-estate and housing finance where the tenures are 5, 10 and 15 years and you have open ended mutual fund on the other side, with such a high concentration there is a fundamental risk management issue which needs to be addressed. And it is here that the competitive populism element of investor desire to get 10 basis point higher returns from Fund A versus Fund B, drove funds to take more and more exposure on illiquid paper and forgetting better returns. And from the point of view of ALM of NBFCs, the question you need to ask is, were they competitive because they were borrowing short? Was their pricing of loans consistent with ALM or maturity risk? They may have taken a view that since interest rates are variable and floating I can take the liquidity risk since my interest rate risk is covered by floating rates, but that is where I think the problem is. There are two kinds of risk in long-term lending, one is interest rate risk and second is fundamental liquidity risk as well. And it is in this two that there has been some disconnect. And I think some moderation in percentage exposures, particularly of the mutual fund industry to the NBFC sector, and it has to be gradual, you cannot allow it to be something which is disruptive, but a gradual reduction in percentage exposure of mutual fund industry to the NBFCs and HFCs is the long-term sustainable answer. And for that, that is why I believe refinance lines from institutions like SBI, which is a good thing, as well as from NHB can help that correction of process. And on a relative basis, I think both insurance companies and banks percentage exposure to NBFCs is pretty much controlled and contained.

Manish Karwa: And just two small questions on the subsidiaries. First on auto loan, growth has been fairly muted for some time, in fact, last six quarters now. Why? And on the securities business with huge volumes, there is a decent market share pick up, but PAT has still declined, is there some one-off provision that we have taken here?

SA Narayan: Let me take car business. Yes, our volumes have come down little bit. We have consciously not gone for growth because we sense the margins on new cars essentially come down. And we always believe on the risk return matrix. So while we have retained our overall presence in a good manner in the market, on our growth, we have curtailed to ensure that our risk return matrix is maintained. As far as the securities firm is concerned, you are right, we have seen a growth in top-line but our profit before tax is on the same line, that is because what has happened is our overall market share in the options market in this quarter has gone up and has resulted in some costs being incurred i.e. the transaction cost and the stamp duty which we incur at the expense level. So that is why it is reflecting, besides we had an ad budget for this year incurred in this quarter also contributing to the expenses.

Moderator: Thank you. Our next question is from the line of Anisha Khandelwal from Edelweiss. Please go ahead.

Kunal Shah: So, firstly, if you look at it maybe in terms of how we have evolved over last three years, so CASA of 50% odd, Tier-I of 17%, much lower asset quality stress, now the system is also looking at risk averseness. Then what is stopping us from growing at a pace higher than the industry average when pricing power is also returning and we could clearly see some gained momentum. So what would stop, I think return matrix definitely we have managed. So still not why grow better than the industry average over last five, seven years what Kotak has seen.

Uday Kotak: We are clearly open at risk return matrix which is appropriate. And keep in mind that some of the stress to the NBFC and the rest of the financial sector came towards the much later half of the last quarter. So what you are seeing in October really began sometime in September. And you saw the first signs of that actually around first or second week of September really beginning to play out. Because this is a very short time in the last quarter when you have seen some of these developments happen. So, we are clearly open as long as we get our risk return matrix we have absolutely no issues in growing faster, while we keep that fundamental discipline in place. And we will take advantage of opportunity, but keep in mind there is a lot of stuff out there done by different players which you have to question about sustainability of that stuff from a basic underwriting point of view in the first place. Therefore, are we getting the returns for going down so much on the risk curve, that is the question we have to answer? Therefore, if you are going down the risk curve I think pricing of return is important. But for the first time we are beginning to smell that the risk return matrix is certainly getting much better and more appropriate then it has been, especially for last three years. And you know last three years as a combination of taking greater risk and doing significant ALM mismatch for lower cost of funds was the game played by many players which, therefore, lead to us being pretty disciplined about what we do. But if the marketplace is beginning to price these risks in, and therefore credit spreads are based on pricing that risk in the borrowing market, we think that is a good position for us to be looking at from where we are.

Kunal: Yes, because the competitor dynamics is also now changing in our favor, so that clearly suggests that maybe in terms of outlook is it more in terms of the wider implication of the current liquidity crises which it could have on the economy that is making us worried or we want to preserve capital for some inorganic growth. So, besides these two, is there any other reason why we shouldn’t be growing at much higher than the industry average?

Uday Kotak: First, let me step back and make one point clear, I do not worry about a dramatic systemic risk of the kind which you saw in 2008. I do not see that. I think the problems are broadly manageable. However, I think there is a risk of volatility in the next few weeks and months, therefore any of us believes that there is going to be no volatility, I disagree. What we have to be careful about is that the practices of how the financial sector governs itself meets to be significantly introspected. And that is where I do see challenges for the financial sector, and that is where policy and overall conduct of financial sector players is critical in not making this a broader systemic risk issue. Therefore, the behavior of financial sector players, the approach of policy makers and regulators in handling this transition is critical for us to have, what I would call, a soft landing out of what is otherwise perceived as reasonable volatility. And that is important when I say that I do not see a broader systemic risk, I am assuming that these two corrections will happen in the market place. And subject to that being in place, we are certainly open for risk return matrix, undoubtedly.

Kunal Shah: And secondly, as you highlighted that RBI has taken various measures, so how Kotak would be placed in terms of be it either buying out the portfolios or even in terms of providing the further credit to NBFCs. So how would we be participating in these measures?

Uday Kotak: We are open to buying portfolios; we think that is a good way to find a solution versus disproportionately increasing entity risks, especially of the weaker players. Because in the entity risk for the weaker players, the challenges are unknown, while buying a portfolio it is more known s.

Kunal Shah: So, any specific segments wherein we would look towards buying the portfolio?

Uday Kotak: I think particularly retail segment, including home loan segment, we are certainly open. We have been looking and we will continue to look at it certainly, and that is something which we are quite open to. And I know Shanti and team out of the retail also are quite eager to look at appropriate portfolios at the right price.

Shanti Ekambaram: Yes, right risk, right price.

Kunal Shah: And lastly, how long do you think that this liquidity situation would continue? So what would be your stance looking at various activities which have been there in the debt market? So, maybe broadly when we look at it in terms of spreads, call rates, they are still likely at a very manageable level. So, do you see these as a near-term issue or do you see it slightly prolonging beyond December?

Uday Kotak: I think it is back to the behavior of individual, retail and HNI customers having monies in mutual funds. And that is where I think the core of this issue is. Therefore, if each of you starts looking at your mutual fund portfolios in the debt schemes, and say these two-three names I am a little worried about and you start pulling out money, then the mutual fund has no choice but to sell. And especially when you have a concentrated book where 35% to 40% of your book is NBFCs plus HFCs. So the issue which we have to ask ourselves, how do we get mutual funds refinance ability out of that portfolios to be able to handle the ability to manage redemption by individuals based on advisors who start looking at portfolios and get worried. So you have to look at it granularly bottom-up. And this is the marketplace; one of the reasons why we are beginning to see significant liquidity in the bank is because money has moved from elsewhere. So, how do you make sure that this behavior is stemmed, only way you can do it is by the level of percentage ownership of mutual funds in NBFCs and HFCs being steadily moderated to a more reasonable percentage of the total scheme AUM as a percentage? And one of the questions which we have to ask is, and this goes back to history, until February 2017 the regulatory requirement for mutual funds was 25% NBFCs and 5% housing finance companies. In February 2017 that regulatory limit was increased from 25% per NBFCs and 5% of housing finance was increased to 15%, I mean, I do not want to get into merits or de-merits of it, as a result of which this concentration was further accentuated. Therefore, this needs to be moderated by refinance, by buying of portfolios whereby the NBFCs and HFCs can moderate their dependence on mutual funds and the game was simple. Mutual funds were 100 basis points, 150 basis points cheaper than banks in terms of the pricing at which they were giving money and they were giving more and more short-term money which is what NBFC did. So you need a structural fundamental correction and it is here that policy needs to look at the financial sector more holistically.

The history of Indian policy in the financial sector has always been looked at much more bank led. We now have number of players in this jungle with different animals of different sizes and shapes and risk management and policy management is therefore much more holistically required then what we needed in the past and you have seen a new breed of animals whether it is NBFCs, apparently NBFCs but really into infrastructure or apparently NBFCs, but really into disproportionately into real estate. So all those dichotomies need to be thought through.

Moderator: The next question is from the line of Nakul Gupta from CLSA. Please go ahead.

Prakhar: Just a couple of things I wanted to understand your views, one what is the optimal CASA mix for the bank which you have done fairly well, but CASA growth has been at one end term deposit and borrowings are working in a very divergent way. Term deposits is hardly early-teens whereas borrowings are growing quite fast, so where does the CASA mix within deposits settles that is one and I will just ask a few follow up questions after that?

Uday Kotak: Fundamentally, my view about the bank is very clear. The bank liability side should be primarily driven by three things i.e. CA of course because it is lower cost, SA and Retail term deposits. Therefore, if there are three things I monitor it is these three things – term deposits below 1 crore, saving account growth, current account and therefore, for me wholesale deposits whether it is in the corporate market or even so-called retail or others are like any other purchase market. For me term deposits below Rs.1 crore is a very crucial aspect of a long-term stability. Therefore, we are seeing very significant growth in term deposits below Rs.1 crore and I have been consistently shading wholesale deposits which is why the mix of term deposits' gross percentage which you see is not representing the mix change which we are undertaking. The mix change is significantly getting more retailed term deposits compared to wholesale that is point number one. Why should I have a target for CA and SA? Tomorrow, if I can keep on growing that it is much cheaper cost of money than other sources of money. Therefore, why have a target for something which is good. Infact you should be asking me the reverse question i.e. is 50% your floor.

Prakhar: Is it possible to share some numbers on how the mix of term deposits is moving as the direction that you mentioned? What is the share of less than Rs.1 crore term deposit, etc.?

Uday Kotak: I think Jaimin has given you the data on less than Rs.5 crore.

Jaimin Bhatt: So if you look at CASA, it is 50%. If you look at the total deposits and if I just take term deposits as the next 50 close to a high 40s number coming from less than Rs. 1 crore and maybe another of about 10% of the term deposits coming from the Rs. 1 crore to Rs. 5 crore. So we see significant growth coming in less than Rs. 1 crore that it if we look at year-on-year has grown by (+20%).

Prakhar: Secondly few data points questions, one what does the investment provision relate to and what is driving other OPEX spending?

Jaimin Bhatt: The Opex spending is where we have seen growth across segments this time around. So in terms of marketing cost on advertisement if you look at year-on-year it is gone up because last year quarter one we had launched 811 making that a significant expense in quarter one. So quarter two was a subdued number.

Uday Kotak: I am sure you would have seen Ranveer Singh ad. This quarter we relaunched that. And we did not have any inside information.

Jaimin Bhatt: Several cost items which have gone up there are linked to businesses. So a lot of credit card related stuff, POS related stuff, 811 related were significantly higher spends this year compared to what we had last year.

Uday Kotak: 811 was a large front- end acquisition cost, remember that.

Prakhar: That is why sometimes question whether digital is cheap or not?

Uday Kotak: It is not cheap front end but it is ultimately cheap.

Prakhar: And the investment provisions?

Jaimin Bhatt: Investment provisions typically I mean if you look at it is significantly lower than last quarter. Last quarter we had Rs. (+200) crore this quarter it is about Rs. 130 crore which includes largely coming out from fixed interest, but we have also equity led provision which has happened this quarter.

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

Roshan C.: Just wanted to understand your view on the SME business. I know this has been covered but my apologies if you can just repeat yourself?

KVS Manian: On the SME business like we have still seen some slippages in the book this quarter as well. So we think like last time last quarter also we said it will take us two quarters to stabilize this. So I think we have at least one more quarter to go to stabilize that business and then we will look for growth in that business.

Uday Kotak: I think the SME business at the smaller end actually is something which Shanti will speak?

Shanti Ekambaram: So the small business which is really across small businesses SME. We continue to see growth, we continue to see demand, some amount maybe because coming from what the banking sector is going through and we continue to see reasonably good trend as far as delinquency, etc., is concerned. So that segment you are seeing growth and it is okay from a risk perspective as of now.

Uday Kotak: And just for clarification, the very small businesses are out of our consumer bank and the rest are run by Manian as a separate arm within the wholesale bank.

Roshan C.: And I presume you see better delinquencies in the smaller SMEs when compared to the one which Manian runs?

Uday Kotak: That is correct.

Roshan C.: And the other question I had is given the tightness of liquidity, do you see this percolating to real estate sector affecting it and therefore more problems going forward?

Uday Kotak: I think real estate sector again if you divide it into three categories within the real estate sector. One is financing against land which I think is probably under the biggest pressure. Second is financing residential particularly anything above mass residential is facing the pressure and commercial is still reasonably okay. I do not think commercial is as bad, but the real pressure is a lot of financing has gone out of the financial sector to finance land and that is where the lot of problems are coming or very high-end residential. So these are the two segments which are continuing to face the challenges and also in many cases there is pre-RERA era construction. A lot of these developers who have not completed construction on time are now reaching a situation where the projects have become fundamentally unviable and those projects are therefore languishing and it is these things and I think a lot of funding has gone to these companies which is why the stress has been seen in the sector. The commercial side is fine, the mass residential is also still holding up, but the other pieces are what are coloring the environment.

Roshan C.: From a policy standpoint you are alluding to policy measures that can be taken to curtail this crisis from blowing up, now what kind of policy measures are you eluding to when you say this?

Uday Kotak: I mentioned refinance line say for housing finance company from NHB. I think they have given a line of Rs. 6,000 crore incremental. I would recommend a much larger line to finance some of the housing finance companies who have portfolios of reasonable quality and that would ease the pressure because to that extent a lot of the money which has gone from mutual fund can get sorted out and mutual fund in a non-disruptive manner moderate the percentage portfolio exposures they have to housing finance.

Roshan C.: But do you think monetary transmission will happen or will it get choked at the HFCs end as that is also a risk given fear psychosis in the system?

Uday Kotak: As I said that whenever you have friction in the system of the kind you had and friction happens when we let something grow for a while. Therefore, easy money post demonetization, banks dropping the deposit rates, financial saving growing up dramatically, a very high growth of mutual fund AUMs, in addition to equity in the fixed income segment, increase in limit of exposures in February '17 to finance companies and HFCs which basically allow the mutual fund to take 40% exposure to this segment and then cheaper money compared to what banks were ready to lend led to a significantly faster growth not matched by very character of an open-ended mutual fund and massive ALM mismatches at the financial institutions' end. So this is a classic structural issue which has developed over last two years and therefore it needs time to heal.

Moderator: The next question is from the line of Seshadri Sen from Alchemy Capital. Please go ahead.

Seshadri Sen: Firstly, if you could give us some color on the quarter-on-quarter margin decline that you have shown because the loan mix and the liabilities mix seems to have panned out fine, is it because of the rising cost of term deposit and is there a lead lag here, is it likely to bounce back in the second half?

Uday Kotak: My view is, this is a lead lag issue because the base rate versus MCLR as I mentioned in the last call also is MCLR as you mean bulk of your lending is six months MCLR. So when you increase your MCLR for six months which is what our book is bulk of our lending is there. Therefore, assuming I say it is equated over six months it takes an average of three months for the MCLR transmission to move on the entire book. So that transmission period MCLR started moving sometime after April, May and that transmission is now beginning to play out as we talk and we believe that this is a classic lead lag issue unlike base rate where the moment you change base rate it had an impact on the entire book.

Dipak Gupta: Some of it is just simple leverage increase, as the leverage increases your equity saving come down and some of it is impact of that.

Seshadri Sen: Sequentially, that would not have a major impact.

Jaimin Bhatt: There is one technicality on that. There are certain loans which go as a quarter interest and to that extent on the daily basis if you look at quarter one has actually one single day which is higher than what we call quarter two had and that in fact has about if you look at about the 7 days difference that accounts for about half of that.

Seshadri Sen: Secondly, on how are you looking in post the Aadhaar Judgement, etc., are you relooking at your distribution strategy because earlier you had articulated that you would not look at significant expansion in your branch network. Are you revisiting that philosophy and are you also looking at diversifying your branch network little more across the country because at the moment you have a fairly large concentration in the West and South.

Uday Kotak: No, I disagree. Now if you look at our balance we have followed equal across all.

Jaimin Bhatt: The three geographies now almost (+30%) in each look at the Page #24 of the EU. We have got 32 in South, 31 in North and 31 in West.

Uday Kotak: So we are very well balanced. Having said that bottom line is I think we have gone out and said that this year we are adding 100 branches i.e.in 18-19 and we will add more branches than that next year.

Dipak Gupta: Like you mentioned digital will still be a strong part of the acquisition. We should come back with alternate shortly.

Uday Kotak: In my view Aadhar is not dead. Aadhar will be modified and in a manner which meets the requirement of the Supreme Court it will come back.

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

Krishnan ASV: Just two questions, one is about given the fact that NBFC a lot of them are withdrawing because of their own ALM issues, how much of the NBFC lending is something that banks can actually find fungible that is part one and part two is given that you are now wearing the hat of maybe the key board member at IL&FS. Just want to understand there could be cases when the sum total of the assets may not be quite equal to the liabilities, just wanted to understand your sense of how big that would be?

Shanti Ekambaram: So if we look at the NBFC sector you have broadly seen two trends. One, a lot of home loans and LAP home loans particularly at a smaller end and in different parts of India and the LAP as well-being portfolio which had increased. Suddenly something banks are doing and banks have continued to be in that segment and can step up as far as that is concerned. The second segment has been very aggressive unsecured loans that have been given. I think that is really what you have to look at the risk return and one will have to see how that business pans out, but certainly as far as the retail home loans and some amount of LAP business that can be seen and from a risk return perspective some parts of the unsecured business, but the size of the plate were very large. So to that extent quantum in entirety is what we have to see.

Krishnan ASV: Would it mean to say at about 20% - 30% of the NBFCs withdrawing may actually not be credit worthy? I mean I just wanted to understand your sense, as would that number be at 20%-30% that you should not be touching?

Shanti Ekambaram: No, we are not saying anything like that. I am saying that to that extent in any case is fungible is not an issue.

Uday Kotak: Out of the total NBFC books he is asking whether 20% to 30% is non-touchable that means 70% is touchable, we cannot say that.

Shanti Ekambaram: We cannot say the number like that.

Uday Kotak: On IL&FS we have been communicating through media from time-to-time and all that I will say is that I am humbled by the responsibility which has been put as national duty. All that I can assure you is that the board will do its best to ensure that we preserve value to the extent feasible in the extent of everything that is there and our job is to really to do in a manner which is fair, transparent and meeting the best standards of what I think is good faith governance and whatever we can do to ensure that the interest of various stakeholders, different stakeholders in the different role is appropriately respected that is the best I can say and rest I am sure the board of IL&FS is fully ceased and we will do our best that is what I can say.

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

Nitin Agarwal: So firstly kudos to you for raising red flag on the inflated collateral values being used as a basis for lending. My question is that if I have to connect the current situation to what you had pointed out earlier, do you think there is a danger of a contingent coming in from the real estate sector? I mean if I look at the buyouts of the portfolio happened, some HFCs will be left only with a known unknown which may be difficult to handle. So what is your view on that?

Uday Kotak: As I said there is a two part to this whole thing. One is the part of the balance sheet of institution which is related to the core business and then what part of their balance sheet is not linked to their core business is something which is very difficult for us to answer on an analyst call. And I think the biggest concern which needs to be addressed is a comfort that the noncore balance sheet portfolio for whatever reasons are sitting on balance sheets of institutions that needs to be identified, measured and dealt with rather than letting them festering, uncertainty in the minds of investors that is all I can say.

Nitin Agarwal: Secondly, do we plan to further increase our provisioning coverage and what is the PCR on NPL in the business banking segment now?

Uday Kotak: So if you look at our provisioning coverage we are at 2.15% gross NPA and 0.81 net NPA and quarter-on-quarter you can see that percentage is improving. So along with that you got to keep in mind our SMA-2 is only Rs. 165 crore that means all loans Rs. 5 crore plus more than 60 days old is only Rs. 165 crore in our book and we disclose this every quarter. Therefore, you are going to keep both these things in perspective and finally the stress on the balance sheet is a combination of various things and our provisioning is based on what we think is our estimate of what we will recover. It is not about what we can afford.

Jaimin Bhatt: SME business has normally some collateral, so your LGDs are not normally so bad. So the current coverage seems to be adequate.

Nitin Agarwal: So if you can disclose like the PCR on the business banking segment is it possible?

Dipak Gupta: We don't calculate it separately, so it is difficult.

Nitin Agarwal: So lastly like if you can share their performance on some of the key matrix on insurance business like margins, what is the business mix like ULIP we have mentioned but amongst the other categories protection power, non-power if you can give that and any adverse economic variance that we might have absorb this quarter?

G. Murlidhar: The unit linked product that share in the total business has come down and it is now 25% and the year ending last year it was 36% and we do not disclose our margins quarter-on-quarter, but our margins will be disclosed only at the end of the year, but it continuous to be robust and our other parameters on quality like persistency and surrenders are been extremely good. So overall, we are in a good tick. On the total term business which you are doing now is 9% on an APE basis.

Uday Kotak: But I think the business mix changes making the overall mix more profitable.

Moderator: The next question is from the line of Nilanjan Karfa from Jeffries. Please go ahead.

Nilanjan Karfa: It is good to hear from you Uday about significant climb down I would think from the risk that you had highlighted for last several quarters now and specifically on the point of this pricing getting better which I understand is primarily because of current crisis and things are probably getting aligned. Could you elaborate within this context therefore, how do you look at your risk adjust at lending spread. Let's say a year from now on how much improvement do you see so that is one. Second is on the saving or the overall CASA piece should we assume that the entire CASA is less than Rs. 5 crore i.e. whatever disclosure we make in our presentation but does the entire CASA is less than Rs. 5 crore this is second one. Third, I think last quarter we talked about possible two wheeler kind of program that we might have reached as we broached that topic, any thoughts on that and lastly if you could share the movement of nonperforming loans of basic the slippages, upgrades recovery at both the banks as well as the consolidated level those are the four questions.

Uday Kotak: First on the margins I think margins we have to be very careful not to look at margins absolutely. Margins have to be looked at in the context of nature of risk we are undertaking, but for the risk we are taking we think the margins are moving up, but you want to moderate that with the mix which we will run therefore for example nowadays I get scared to say AAA credit therefore I am saying high quality credit. So I am saying high quality credit we are ready to work at lower margin because we believe the risks are lower. Therefore, two things will determine our final margins. Number one is the mix of our business and number two whether we are getting price for the risk for each segment of that business that is how we are going to look at the overall combined margin ratio. At this stage our sense is it is getting better on a combined basis, but we have to watch, we are going to see the situation if one year from now you say oil is going to be at $30 and the world may be different though it does not look like but I am just saying. Secondly on CASA we are saying term deposits below Rs. 5 crore CASA is the total CA and the SA numbers therefore I just want us to be clear about it.

Nilanjan Karfa: I am sorry will you give out that CASA plus TD less than 5 crore?

Uday Kotak: So it is TD less than Rs. 5 crore. CASA in totality plus TD less than Rs. 5 crore. Two-wheeler we are continuing with our plan and I think Kotak Mahindra Prime has begun that business and we will continue to develop that business, there is no change.

Nilanjan Karfa: The data points on slippages and all those.

Jaimin Bhatt: At the standalone level at the subsidiary honestly there is very little movement. The standalone level we have got slippage of about Rs. 420 odd crore this quarter if we look at the same period last year where we were at about Rs. 550 crore and recoveries upgrades would be maybe Rs. 200 odd crore this quarter.

Nilanjan Karfa: Could you talk about the MFI business?

Uday Kotak: So far looking good.

Moderator: We will take the last question from the line of Bharat from Quest Investment. Please go ahead.

Bharat: Uday, just on this 811 cost of acquisition when we see will be really a turning around and will be more beneficial what timeframe that we look and second we are also talking of converting of this liability in to asset so what are exactly your roadmap in that?

Uday Kotak: I mean 811 acquisition cost as we say is the front-end cost is taken. So 8 to 16 million, 811 plus regular account opening the cost are all in. We think now is a very big opportunity for us to be mining this better and while we navigate our way to the strategy on fresh acquisition on the digital channel which is what we are working on, but independent of that I think there is enough material we have with us in terms of customers for us to be doing significantly more in terms of deepening that relationship. So, while in the short run acquisition cost will drop because of the 811 currently been on hold, but we do not like that as a strategy. We like fundamentally to continue with our growing of acquisition as a core philosophy of what we are, but I think overall, I think 811 we are seeing reasonably good matrix on cross sale and we see deepen even further.

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

Uday Kotak: Thank you very much colleagues and I understand a lot of your questions were on the overall financial sector related concerns and issues. I still believe that with some amount of turbulence and volatility we should be able to navigate our way through this as long as we have significant focus on conduct, governance and how we as a financial sector run our business including in managing risk on the one side and also with support from policy makers and regulators to be able to ensure that this is not a hard landing and with that cautious optimism I look forward to talking to you over the next few quarters. Thank you very much.

Moderator: 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.