Kotak Mahindra Bank Q3 FY19 Earnings Conference Call

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**Moderator:** Good day, ladies and gentlemen, and a very warm welcome to the Kotak Mahindra Bank Q3 FY'19 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I am now glad to hand the conference over to Mr. Uday Kotak. Thank you and over to you, sir.

**Uday Kotak:** Good Evening, friends and wish you all a very happy 2019. We are now more than 20-days into it and this is the first time we are meeting in the New Year. So, I wish each of you and all of us a great 2019.

On the big picture, as I look at the situation, I do believe that overall the broader economy in the last quarter has been slower which is reflected in the numbers as well, compared to what appeared in the first half of the current fiscal. There is some sort of overall slowing economic impulse which was particularly visible in the October-December quarter. I do believe the economic impulses in the private sector continue to be slower than what one would like to see at this point of time. And an economy in the private sector which is primarily driven by consumption and very slow private investment despite increasing capacity utilization is something which should be a concern about on a macro basis. But I do feel at the same time with the broader current account in reasonable shape and as long as oil behaves itself, we should hopefully see a more benign interest rate environment in 2019.

In that context, I would like to talk about three sectors where one needs to have a careful eye on from lending and business point of view in 2019. The first one is residential real estate. I worry about the significant changes which have happened in that sector, lot of the developer industry is stuck with projects which are pre-RERA age and in the RERA age with GST coming in on any pre-completion basis it is postponing the buyer demand till projects are completed which is putting significant pressure on the developers for their ability to finance. And from an interest-free working capital which they had in terms of buyer advances, it is now interest bearing loans which they have to take for financing through the construction period, and that is putting pressure on residential real estate. And I do believe in the pre-RERA age, fair amount of advances which were received from customers actually moved into land and there is fair amount of financing of plan which has also happened. Therefore, residential real estate is a sector which I would watch pretty closely as we go forward. As a spillover of residential real estate, I think it is having some implications on the NBFC and the HFC sector because a very significant amount of financing for the residential piece has also come from the NBFC and the HFC sector. Therefore, I think we need to watch those segments carefully as we go into 2019.

And the third of course is the SME segment where I think it is still in the correction phase and with the approach of the government and RBI to find solutions for the SME business; we should hopefully see that play out during the current year.

Therefore, these are the three inter-connected segments because there is a fair amount of SME lending also which happens through the NBFC sector as well. So, the real estate, the non-banking financial sector and the SME sector are the ones I would watch closely in terms of credit book of banks in particular.

From Kotak Mahindra Bank's point of view, I am happy to share with you that we are seeing a reasonably robust loan growth and stability after a long time to see a better realization of our risk adjusted margin approach to lending and we have actually seen our NIM expand after a long time in this quarter. We are also able to price our loans in that context more efficiently than we did in the earlier quarters and with an ability to grow the book simultaneously. If you look at our overall bank numbers, they have been pretty robust, our continuing focus on the quality of our book is paying ongoing results with our net NPA now down to 0.71%. I just hope that no new shoe falls in 2019, something which we currently may not be able to look at. Considering some of the uncertainties which we will go through in 2019 we continue to be alert while being open to growing our business at a pretty rapid trot.

Our overall revenues in addition to growth in NII, and banking services in particular despite a slowdown in mutual fund distribution has shown a very significant growth, and we are quite pleased with that in terms of the core banking business beginning to sort of drive wealth.

The other issue which I would like to highlight which is both macro and micro is the fact that with significant increase of currency in circulation in recent times, it is going to put pressure on the deposit and the liability franchises in terms of our ability to finance faster growth. At Kotak Mahindra Bank, if you see, and Jaimin will take you through greater detail, there is very high focus on granular retail deposits and broadly three big areas of focus are CA, SA and Retail TD deposits below Rs.1 crore and they are continuing to grow at very rapid pace compared to the other parts of the deposits. Therefore, the bank's reliance on wholesale deposits is consistently coming down.

Also, if I have to do a fair analysis of our quarter, we have also noticed that there has been some increase in our non-people operating cost and it is an area of focus for us and we have been focusing on it. There have been some items which have been on higher advertising and some other specific costs which are very much in our focus. It is something which we will keep an eye on to see how we are able to tighten ourselves on the overall operating cost side as we go forward.

Speaking for a short while on our subsidiaries, you would have seen a slowdown in both Kotak Securities and the investment bank. The investment bank, I think we are seeing a slowdown on the capital markets side. Having said that, we have a fair pipeline on the advisory side. So the third quarter was probably a blip that there was no booking of most of those revenues, we shall see that in the quarters ahead particularly the advisory fee. Of course, capital markets side is dependent on markets so that is more external.

On the pure broking businesses, of course, with the overall market volumes, it is reflective of that. But it is something which has been slower than we would like.

On the Car finance subsidiary, the car sales and car volumes have been mixed and as a part of our conservatism and prudence both our NBFCs have had a very comfortable journey through this volatile period which the NBFC sector saw between September and December and we were therefore well stacked up on liquidity and some of that liquidity had negative carry which had an impact on the revenues and profits of the two NBFC subsidiaries as well. And of course, in the NBFC subsidiaries, we have been cautious in growing our real estate lending book for the reasons which I have already highlighted to you. But all in all, I do believe our continuing focus on some key health parameters of our financial business and the banking business is the reason why we feel pretty good about the health of our business and continuing momentum in the core banking business. We also see the life insurance business continuing to grow in a much tougher environment while our margins are very much protected and in fact we are feeling good about the level of margins which our life insurance business is having.

The Asset Management Company has seen a sharp jump in profits, because we may be seeing some moderation in the whole distribution model where distributors used to be taking disproportionate front end fees which have stopped especially after SEBI circular of October 22nd. So, this is the overall picture.

The health of each of our business is in good shape. The financial strength of the balance sheet of the subsidiaries and the parent continues to be in good shape. The overall stress levels in the balance sheet is under control. We feel the growth on the loan side in the 20s as we have guided seems to be very much in place with hopefully improving margin situation which has been reflected in our October-December quarter.

With that, I hand it over to Jaimin to take you through the presentation and the specifics.

**Jaimin Bhatt**: Thanks, Uday. Let me just take you through the bank standalone numbers first. For this quarter, we ended with post-tax profit of Rs.1,291 crore against Rs.1,053 crore for the same period last year, that is about 23% rise on YoY basis. The net interest income at the Bank again saw about 23% rise this quarter with Rs.2,939 crore as against Rs. 2,394 crore last year. On the other income side, the fees and services did see a jump of almost 25% on YoY basis. We clocked this year with Rs.1,000 crore plus on fees. The distribution side, while the insurance business did bring in good distribution fees, the mutual fund business, thanks to the circular which Uday mentioned, as a distributor had a negative impact on the fees. However, several items on the fee side which are linked to businesses; credit cards, mobile banking and several other business-related stuff, LC, BG, commissions, those have grown significantly during this period, overall clocking a fee growth of 25% on YoY basis. The other income which is the other part of other income which is a negative number of Rs. 74 crore. Honestly, that needs to be read together with slight accounting issue which we have explained on Slide #4 of the earnings update. Basically, what we have been providing the mark-to-market depreciation on both our AFS and HFT investments, all along as part of provisions and contingencies. So, just to give an example, if we had bought a security at Rs.100 and it has depreciated to say Rs.92, the Rs.8 instead of hitting the other income as a negative, was actually made as a provision and as I said this is as per our communication we have got from RBI, we have been following that consistently.

In this quarter, what would have happened is assuming we sold the same security say at Rs. 98, the other income shows a negative of the two but the other aspect is reversal of provision and as a result the reversal of provision itself is a big negative number. The provision and contingencies as we have explained on Slide #3 of the 'Earnings Update' the provision on investments is a negative number of Rs.287 crore which includes Rs.271 crore and in a normal accounting would have taken it as other income. If we do that adjustment, the other income itself has grown up by about 22% and the overall operating profit would show a growth of 23% on YoY basis. Of course, the provisions and contingencies would be higher at Rs.256 crore. The cost-to-income if I make that adjustment would then show up a number of 47.1% as against 50.3% based on the current number.

Coming to expenses, this quarter we talked about the fact that with the interest rates going down, we had the treasury showing gains which is part of the other income and the reversal of provisions; however, the flip side of that is some of the retiral benefits particularly the pensionable employees which are defined benefits are linked to interest rates and resultantly that cost has gone up on QoQ basis.

The other part of operating expenses as Uday mentioned have been growing, and some of it is related to advertisements where we ran a campaign during this quarter plus related to businesses, whether it is credit card or direct banking or business correspondent equation, the DICGS once again hitting us there, but as Uday mentioned we are keeping that under lot of focus in terms of the other opex. NIMs for the period at 4.33% as against 4.27% in the same period last year.

With regards to segmental, this is as defined by the RBI where everything beyond Rs.5 crore sanction goes into corporate banking. The corporate bank clocks PBT of Rs.867 crore for this quarter. The retail bank is Rs.446 crore; retail bank being hit both on the advertisement and the retiral provisions the largest. The treasury and BMU segment clocking Rs.658 crore PBT for the quarter this year. The advances in the bank at Rs.1,96,000 crore overall, about 23% rise the same period a year ago. We have seen growth on YoY basis in the corporate bank, clocking about 26%. The commercial vehicles, construction equipment continuing to grow at 36%. The small business; personal loans, credit cards again showing a robust growth at 36%. The home loan and the LAP business at 24%. The one business which continues to remain flat is the business banking segment which has been flat both on YoY and QoQ basis. Our SMA-2 number at the end of December at Rs.344 crore which is about 0.18% of our overall advances book. Our gross NPA at Rs.4,129 crore which is about 2.07% of our overall advances book and our net NPA at 0.71% of the overall advances book. This was 1.09% a year ago and in effect improved the coverage ratio from 53.5% a year ago to now 66.2%.

Our exposures on some specific segments has come down on a sequential QoQ basis. The NBFC exposure, the home finance exposure has come down. Commercial real estate other than the LRD business has also come down; now it is about Rs.4,000 crore, about 1.6% of our overall exposure book.

On the Deposit front, as Uday mentioned, we run a pretty strong book there; our CASA at the end of December at 50.7%, this is not including the TD Sweep which is another 6.7% of our deposit base. Our TD below Rs.1 crore, now stand at Rs. 53,000 crore showing about 27% growth on YoY basis. Our average savings account which is daily average of savings account versus the same daily averages for the last year show growth of 34% on YoY basis and the current account on the same lines showing a growth of 19% on YoY basis. At the end of December '18, we had 1,453 branches. We end the quarter with the balance sheet size of Rs.2,94,000 crore. At the bank level, capital adequacy overall at 18.1% and tier-1 of 17.6%.

Just taking some of the digital initiative which we did, we did launch India's first AI-powered voicebot in the banking sector which is called "Keya" which is now integrated into mobile apps and also on Google Assistant. We also during the month of December had 3 lakhs users on WhatsApp and got about 10 lakhs opt-ins. We are also live now on the Ripple blockchain platform for inward remittance transactions.

If we look at the recurring deposits, almost 89% of our recurring deposits are now sourced through the digital platform as well as 68% of our fixed deposits are now coming through the digital platform.

Mobile Banking growth in terms of volume on YoY basis showed a growth of almost 200%-plus and in December we recorded the highest UPI transactions in a month which is 31 million for the month. Our transactions on Kay Mall which is both (mComm and eComm) grew almost 200% on YoY basis.

The Aadhaar-enabled payment systems, again, the volumes have grown. Salaried personal loans, digital share was 35% whereas the home loans which are also acquired through the digital means have grown significantly.

At the Subsidiary levels, Kotak Securities mobile banking cash ADVs have grown 37% during the period. At Kotak Life, large number of policies being sourced through the "Genie" which is a tablet-based end-to-end solution. And in the General Insurance business, the digital volumes have shown almost 90% growth on YoY basis.

If we look at the consolidated numbers, this quarter we end with the profit post tax of Rs.1,844 crore as against Rs.1,624 crore for the same period last year. Major contributors other than the bank, Kotak Prime clocked Rs.139 crore for the quarter while life insurance company with Rs.125 crore. The mutual fund and the trustee company put together brought in Rs.76 crore whereas the securities business brought in about Rs.99 crore for the quarter.

Our consolidated advances at the group level at Rs.2,32,000 crore, about 19% rise on YoY basis. As Uday touched upon, the growth of both the auto business as well as the commercial real estate in the subsidiaries has been lower than what has been growing in the bank. Net worth at the group level at Rs.56,000 crore with the book value per share now at Rs.291.

On the Life Insurance business, Rs.890 crore of new business premium for this quarter against Rs.831 crores last year. Our ULIPs now share is 23% for the nine months this year versus 35% last year. Our AUM in the Life business is over Rs.25,000 crore and the solvency continues to be a healthy 3.1%.

Kotak Securities that we touched upon, lower volumes, lower realization, we therefore had a smaller profit this quarter and recognize that in the last year this quarter there were six transactions which in the ECM category a mix of QIP, IPOs and OFS.

At the Group level, our assets under management now crossed Rs.2,00,000 crore as at December end. The asset management company has now got close to Rs.1,40,000 crore as assets under management. The share on both the equity AUM as well as the overall market share has improved during the quarter and we improved our rankings in the overall ratings.

Prime and Kotak Investments, as Uday talked about, slower growth on loans, as well as the fact that we had negative carry on the liquidity amount which we had tanked upon, and to that extent we had slightly lower profit this year compared to the last year on both NBFCs.

Those were the broad highlights. Open to taking questions.

**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 Prakash Kapadia from Anived Portfolio Managers. Please go ahead.

**Prakash Kapadia**: I had two questions. On the corporate book, we have seen continued good growth over the last 7, 8 quarters. So, if you could give us some sense of the demand – is it NCLT-based lending, is it market share gains among very large corporates or large corporates and how much of this would be working capital? Secondly on your opening remarks, you did mention about business banking being cautious. So what will make us positive or change our view?

**Uday Kotak:** Manian heads the Wholesale Bank and also the SME business. Maybe Manian, you can go ahead.

**KVS Manian**: Most of the growth is coming from market share gain, as you know, overall corporate credit in the system has not grown too much except the last two months, but even if you look at the last two months, the RBI data, large part of that growth has been lending to NBFC which is not the case as Jaimin presented while back. So most of our growth is essentially coming from market share gain in corporate lending. Our book is about 60% working capital, 40% term, out of which around 25% will be what we call the long term about 3-year plus loan. So it is largely medium term and short term oriented book. So that was your question on the corporate side.

**Prakash Kapadia**: Will it be very large corporate?

**KVS Manian**: It is a mix, across, in fact this year we have seen the large corporates side, not the very large corporate, mid-market and large corporate, both have also shown quite healthy growth. So, yes, very large corporate also we are focused on, that also is growing, but our growth is fairly spread across sectors. And on the SME, I would say that we have just now seen some stabilization on the slippage side and we have less slippage and we seem to be getting more in control of the portfolio, and I am hoping that in a quarter or two we will start seeing the growth on that. But SME as you know, there have been destabilizing instances of GST as well as demonetisation last year. I think lot of that sector is yet to come out of these. With the recent measures announced on restructuring as well as GST relief for Rs. 40 lakh, but the Rs. 40 lakh part is more in the consumer bank side, SME side is bigger than that, Rs. 40 lakh exemption on GST does not have the segment much positively. I would say that this segment has gone through rough times in the last couple of years. So we need to remain selective, because if you see the industry averages on NPAs on the sector they are fairly high. So we need to remain selective, but we hope to get that right in the coming quarters

**Uday Kotak:** Within the SME sector also, one specific segment which has taken the most pain is the trader segment. So, lot of the intermediaries which were essentially arbitraging tax and other things, that is where there has been a pain and we carried a historical book including out of the acquisition of ING Vysya and now we feel we are bottoming out of this and as we feel better we will think about growing it over the next couple of quarters

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

**Rahul Jain**: I have got two, three questions; First one is continuing from remarks on business banking. In commercial, retail even including loans against property, how has been your experience about the early delinquencies maybe both for yourself and for the industry because we are seeing some signs of early delinquency sort of inching up. So that is question #1. I will ask my follow up question later but if you can answer me on this first please.

**Uday Kotak:** I think there has been excessive focus on two segments within so-called smaller business or retail, which number one is LAP and the second is unsecured loans to retail. I think on both of those while the business continues to grow, I would certainly be more alert and it may still be early days, I mean, LAP again I think issue is level of valuation of the underlying assets. So, I would certainly be more alert. From our point of view, I am not sounding a panic button yet of any nature, but if you ask me, do I see a challenge to unsecured consumer for example, my sense is it is a second half 2020 around that period is when we should worry what happens, but the early signs are there, I would not say, it is as smooth as it was one year ago, and certainly time to be alert.

**Rahul Jain**: And even in loans against property, given the fact that real estate sector has been passing through a rough patch, property prices have been correcting, so do you think even LAP is alright for now, but of course as you said, you would be alert, so nothing to be concern about at this point of time but maybe future could be little uncertain?

**Uday Kotak:** Yes, the trouble in all this is early signs, they get ignored for a long time and then suddenly there is the investors and analysts and the lenders themselves will say "oh! this is a big problem". But I think the early signs for being alert are certainly there.

**Rahul Jain**: The second question is did you buy any loan portfolio in this quarter from any of the NBFCs and if yes what would have been the spreads at which you would have bought it?

**Dipak Gupta:** We have not bought any portfolio, but selective assets we have bought.

**Uday Kotak:** But nothing out of the ordinary.

**Rahul Jain**: Last question is around our Car subsidiary, Kotak Prime. As we know now that the environment for NBFC is getting little tougher with more liquidity transfer is required on the balance sheet, so maybe the competitive intensity versus operating this business out of a bank has clearly diminished. So, any thought process around if you would like to do this business from the banking umbrella rather than continuing to do this from the NBFC arm? Because clearly, I think now you have got cost of funds under control at the banking business, so maybe it would make more sense to do it out of the banking umbrella, any thoughts around that?

**Uday Kotak:** We constantly evaluate that from time to time. However, we are always are very cautious about taking a decision which is based on flavor of the season. So, right now the flavor of the season is NBFC cost of funds is high, but we have seen times when NBFC cost of funds was even lower than the bank. So, if you take the overall book there, which is about Rs. 30,000 crore, in the context of a Rs. 2 lakh crore book at the bank, it is not that large relatively. So, it is a good diversification, very high quality operating cost metrics, well-seasoned group focused, I mean it is always possible for us to look at. But keep in mind that we are obsessed with building a stable and low-cost liability franchise, that is our obsession number one, over everything else. And we think there is a long way to go for us on that, and at some point of time if it makes sense we can always take that call. And we are also watching at the bank our credit deposit ratio where our mix has changed, but we need a lot more throughput of that retail deposit flow to come to sustain a higher growth and make our credit deposit ratio much more robust for us to be taking that next move.

**Moderator:** Thank you. Our next question is from the line of Ojasvi Khicha from Axis Capital. Please go ahead.

**Ojasvi Khicha:** Just wanted to understand where does Kotak Mahindra Bank stand on its review for 811 strategy on the back of Supreme Court judgment? If you could comment on how is it impacting customer acquisition engine, specifically also on the cost front as we have mentioned in the opening remarks that increase in non-staff expenses. And lastly, if you could share your customer count data at the end of Q3 FY19?

**Dipak Gupta:** Well, post November we stopped acquiring through the OTP route. But acquisition of customers on the 811 platform through the wallet route continues. So the acquisition is on, the numbers are significantly lesser than what we were doing during the Aadhar days. What we have done really is we have reworked the entire process and we have just about launched the OTP mechanism on the net banking platform voluntarily. We will, over the next three, four weeks, also launch it on the mobile browser, which is when hopefully the volumes should start moving up again. In the meantime if we do get confirmation that the revised Aadhar Bill gets passed by the Parliament, then it is great, then it is business as normal. On the operating cost, since we really did not do any significant acquisition, those costs have been saved.

**Uday Kotak:** And the customer numbers, Jaimin, can you?

**Jaimin Bhatt:** Yes, broadly what is happening is, when 811 was on we were doing more than 500,000 customers a month, that would have come down significantly as we speak, about 150,000 to 100,000 per month.

**Moderator:** Thank you. Our next question is from the line of Mahrukh Adajania from IDFC. Please go ahead.

**Mahrukh Adajania:** I just wanted to know if there is any one-off in interest income? Or this is all co-margins and do you expect margins to stay stable for the next few quarters?

**Jaimin Bhatt:** No, Mahrukh, there is no spiky thing in the net interest income which we talked about. So it is pretty much the regular business. And we had in fact in the last quarter call talked about the fact that margins are coming back, and I think we are seeing that actually play out. So, at this rate at 4.33% we do expect margins to be somewhere around that range, maybe 10 to 15 bps either side.

**Mahrukh Adajania:** And that is largely because of pricing power returning to banks?

**Uday Kotak:** And also our stable liability base continuing to grow robustly, that also is helping us, because margins are a combination of two things, one is obviously the pricing power on the pending side and second is consistent improvement in the liability mix and cost.

**Mahrukh Adajania:** And just one more question for the record, you never do have any divergence, have you received this year's divergence report from RBI?

**Jaimin Bhatt:** No, we haven't yet got any final report from the RBI, so as of now we can't talk about it.

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

**Kunal Shah:** Sir, again, touching upon in terms of margins, so do we see the pricing power having fully played out or we are much more confident in terms of margin trajectory being on the up side? Because as you highlighted, there is obsession with respect to building the low and stable liability franchisee, so that is very much there, and pricing power is also returning. So do we see that happening and maybe at what point in time would we see the tradeoff between the NIMs and slightly higher growth? So maybe NII also moving upwards of 25% on a sustainable basis in the near-term?

**Uday Kotak:** Kunal, as you know, the margin is a scissor, scissor has two parts, the cost side and revenue side. We believe we will continue to improve, so that is clearly there. On growing NII faster, the answer is clear, if we believe for the risk we are taking we are getting the price, we will lend and we are not obsessed by a number which is 20%, 25%, 30% growth, we are obsessed by the fact that the trouble with stress is it never comes at the time when you lend, it comes two years later so, we like to think about this as a journey. And on that, at this stage we are comfortable growing our book faster as is being demonstrated by this December quarter numbers. And as long as we get our metrics and as long as our improvement on the liability side continues and the risk is good, we have no hesitation in growing and getting share and exploring new avenues. We think banking is a business which you have to think about in a continuum rather than a quarter. And my sense is, if we think about banking as looking at a block of one, two, three years at a time rather than three months at a time, we will take decisions which are consistent for a sustainable growth. And on the liability side, I do not think it is even a two, three year picture, it is like how are we going to transform who we are. And then on the asset side we have the ability to get our risk based pricing and be more competitive and aggressive if our stability is stronger. And if there is one thing which the last three or four months has shown, is a deep value of low cost and stable liability over everything else.

**Kunal Shah:** And in terms of this unsecured you highlighted early signals, so would that be largely in terms of the behavior of the portfolio or maybe in terms of the competition which is there or some kind of a dilution which we are seeing? So what is the kind of early warning signal?

**Dipak Gupta:** Basically it flows into 30 day bucket, cheque bounces, all these are early signs.

**Kunal Shah:** So we have seen some kind of a deterioration?

**Dipak Gupta:** Yes, it is a manual one, so still early days. But like Uday said, it is quite possible that it continues for the next one year or so.

**Uday Kotak:** And one of the things about these early signs, which I feel is what the industry at the street very often ignores is that the spreads are large enough therefore a little early sign is fine. But when the water fall or the deluge hits, there is nowhere to hide.

**Kunal Shah:** And lastly in terms of subsidairy, at least the earnings of many of the subsidiaries have been quite volatile, be it Kotak Mahindra Investments as well as Prime and if we get into that it is largely the other income. So, does maybe this accounting change, I do not think it will flow through that, but there is lot of volatility out there, so how should we look at it? Like Kotak Mahindra Investments was going steadily in terms of the earnings, all of a sudden, we had seen a dip, same is the case with Prime as well, maybe in terms of the one-off it is largely other income.

**Dipak Gupta:** Like in Prime and all relatively higher spread businesses which we have consciously cut down, so Prime for example as Jaimin mentioned, the cars business is literally okay, growing normally, the CRE part of the business is sort of cut down. So those impact profitability margins a lot more. And that is why you see some of these spikes in the quarter.….

**Moderator:** Thank you. Our next question is from the line of Darpin Shah from HDFC Securities. Please go ahead.

**Darpin Shah:** Sir, you mentioned about some stress or early signs to be watched for real-estate, LAP and other businesses. So if you can share your thoughts on agricultural portfolio as well?

**Uday Kotak:** I think agriculture is a mixed bag. Kannan, you want to go for it?

**D. Kannan:** There have been slight disturbances because you hear about these loan waivers often. But the term loan portfolios on equipments and agriculture seems to be behaving okay, while the tractor portfolio, especially the tractor industry is growing and our share is also growing. On the working capital side or on the crop loan side, you see some amount of stress because of all these waivers getting announced and delays happening in some repayments coming in.

**Kunal Shah:** And one last thing, if you can just provide me with the movement of the NPAs?

**Kunal Shah:** Overall for the bank if you can provide the slippage number for the quarter?

**Jaimin Bhatt:** Slippage for this quarter was about Rs. 345 crore compared to last year if you look at it would be Rs. 422 crore.

**Moderator:** Thank you. Our next question is from the line of Ravi Singh from HSBC. Please go ahead.

**Ravi Singh:** First question on liabilities, clearly you have done a great job in terms of the low-cost liabilities without opening too many branches in recent years. And if I look at CASA per branch its one of the best in the industry. Do you think there is further room for productivity improvement or at some stage distribution related expenses will pick up? And you made a comment around deposits at system level being under pressure because of the cash in circulation being high, at system level do you see deposits interest rate maybe rising faster than maybe how the loan pricing rate moves?

Second question on the asset side, any thoughts on the external benchmark which RBI proposes to introduce for retail, mortgage, MSME, personal loans, given not applicable on the corporate loans, relatively larger part of your loan book could be exposed to that? Any thoughts on that side please.

**Uday Kotak:** I think first on the distribution side just let me give you a sense that we are continuing to add branches but selectively and in a measured rifle manner. Our view is we need to have a fair distribution, but the future is less density than the past. Therefore, if you added a branch at a gap of say 1 kilometer earlier, you can now afford to have a branch at a gap of two or three kilometers. And I will ask Virat Diwanji to give his thoughts and include him on the branch network target which we are going by March 2019, and the current branch strategy. Virat, over to you.

**Virat Diwanji:** Look, as what Uday mentioned, we are going ahead with the branch expansion in a measured way and where we are focusing on particular area where we want to go and setup the branch. Means, if I tell you this year itself we will add close to about 100 branches by the end of March, which is incremental branches. Mind you, we also had advantage of shifting some of the branches which are in close proximity with the ING branches and that in that sense is an additional out let which we have created over last say 1, 1.5 years. So, from that point of view, our footprints are increasing and we will continue to grow the branch network in the coming year as well.

**Uday Kotak:** And to that let me also add to what Virat said, I believe the combination of smart, physical plus digital, what we internally called as Phygital, gives us a lot more bandwidth. And therefore one physical branch actually gives us a disproportionate expansion, thanks to the digital expansion as well. So the multiplier effect of the branch with really strong digital is how we see the future. We do not see ourselves on our own in any organic manner going to 5,000 branches. But do we see ourselves going to say 2,000 branches over the next few years? The answer is, probably. And as you saw the deposits growth, the TD growth, bulk of it is coming digital now. Therefore a smart branch strategy combined with digital gives us a huge ability to expand the productivity of our low-cost liability and deposit base. And there is a culture, a culture which has been created which is highly focused on liability franchise, is something which takes a long time to build and which is a very different culture from pure distribution culture which is trying to make quick money on mutual fund distributions and insurance sales alone. What was the next question?

**Ravi Singh:** Sir, on deposit interest rates do you see any pressure?

**Uday Kotak:** First of all, system liquidity, as is known, is negative and likely to be negative till March. Our research believes that it should be in the region of negative around 100,000 crore by March. And there is continuing increase of currency in circulation, which is also a reality. And you can see the credit deposit ratios of most banks, they are inching up, which is where we are focused on the liability strategy as a very important component of the overall banking strategy.

**Ravi Singh:** And your thoughts on external benchmark for loan pricing?

**Uday Kotak:** I think external benchmark, it does not bother us. If our internal cost of funds is low or is stable through our significantly higher liability franchise, and if the external benchmark is dependent on the wholesale money, we are at a place where we have a disproportionate amount of pool of low-cost stable liability, in fact who knows, it may be better for us, we do not know how it works but it could be better for us.

**Ravi Singh:** And if I could squeeze in last question, any medium-term ROE targets for the sort of risk pricing you are comfortable with?

**Uday Kotak:** We believe if we strip off excess capital, we are in a position to earn a 20% ROE.

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

**Nitin Aggarwal:** Sir, three questions. On real-estate side which pockets are you seeing signs of stress apart from premium properties in Mumbai and Noida in general? So if you can give some color as we are getting varied views here. Secondly, our SMA-II number this quarter has increased slightly, though the number overall base is low, but anything to read into that, what has driven this? And thirdly, over last one year our coverage ratio has improved quite significantly, so what levels will we look to maintain here over medium-term?

**Uday Kotak:** On real-estate, Manian?

**KVS Manian:** So, in the real-estate we see higher stress in high value kind of properties, and in specific locations it is even worse. What we see is in again selected areas in Bombay and even Noida, Gurgaon of course still remains very slow, in selected areas in Noida and selected areas in suburbs of Bombay, the affordable, I wouldn't say affordable housing in definition of affordable housing under PMJAY, but I would say lower cost range of housing is moving better, broadly that is the sense. And of course, if I go city wise, Hyderabad is looking better than it has looked because Hyderabad has been extremely slow in the past. Chennai, again, lower cost properties have moved better.

Yes, broadly that is how the real-estate is. But overall if I look, overall view if I take, housing does continue to be slow. The commercial is where we are seeing most cities reaching unutilized, I mean available commercial space is low and we are seeing demand for commercial going up.

**Uday Kotak:** And on SMA-II we do not think it is at this stage a major signal. There are a few accounts, no major large account out of this. But this is like a little bit of volatility up and down, if you look at year-on-year we are pretty flat, quarter-on-quarter movement last quarter was low. And we are quite comfortable at this Rs. 300-odd crore SMA-II book on a loan book of Rs. 1.96 lakh crore, 0.18%. So we are watching it carefully, but at this stage we do not see that as an early sign of something major.

**Nitin Aggarwal:** And lastly on coverage?

**Uday Kotak:** On coverage, the way we think about coverage is what we think we will recover on a present value basis in a loan. I know the IFRS is still not on and coverage is an outcome of what we think is realizable value of our loan.

**Nitin Aggarwal:** So, where we will look to have it settled down?

**Uday Kotak:** I think if you look at most statistics, a coverage ratio of around between 60% to 70% is a decent ratio, depending on the nature of the security and everything else.

**Nitin Aggarwal:** And one more question if I can squeeze in, you mentioned that as a bank you are obsessed with building up the liability franchise, though we already have one of the highest CASA mix in the industry. So, any aspirational CASA level that you have and you would like to share?

**Uday Kotak:** Why should we think about a number, it is still very early days, we are barely 50%.

**Moderator:** Thank you. Our next question is from the line of Sameer Bhise from JM Financials. Please go ahead.

**Sameer Bhise:** Just quickly, if I look at sequential growth in some of the vehicle driven asset books, how do you see the growth outlook there, especially CVs, even the agri piece or auto where underlying is probably not as strong as it was in CY18?

**D. Kannan:** CVs could moderate, because if you really look at it quarter three numbers are even slightly lower than quarter two numbers. So, CV is moderate. Tractors are doing fine at this point in time.

**Sameer Bhise:** And from a medium-term perspective if one says that you continue to be cautious on the residential mortgages side?

**Uday Kotak:** Sorry, I am saying residential mortgage to the end consumer is a different ball game from lending against land to developers.

**Sameer Bhise:** So, from a medium-term perspective you still think that with this mix a 20%, 22% growth is achievable?

**Uday Kotak:** We have said that, I think we have given our guidance that we believe 20% growth rate is what we see as sustainable.

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

**Adarsh Parasrampuria:** Question on credit cost, just looking at this year you all had NPA provision of like Rs. 730 crore, out of which about Rs. 300 crore, Rs. 400 crore is only a ramp-up in coverage, implying that credit cost related to incremental slip has been pretty low. So, how should you look at it, this implies like a 20, 30 basis point kind of a credit cost. And when you look at CIBIL data or some other retail banks, they are indicating that we are off the bottom. So it is inching up but pretty much in control. So, given your business model, your cautiousness, what is the kind of credit cost you think is safe to kind of factor in?

**Uday Kotak:** See, we are going into a volatile phase in 2019. This is also a political year, it is an election year, there are lots of moving pieces in the country. If you go back last year we had given about a year ago when we came to you with March 2018 results our credit costs were around 60 basis points and we had guided you, trending down without giving a number of 50 but we had said we are trending down from 60 towards the 50 region. Therefore, my sense is, it is also about how do you want to have your risk mix in the pricing. If we have a significantly higher book which grew on, say for example unsecured which is not necessarily what I am saying, therefore do not read into that, but the level of credit cost is also linked to the returns you are making for the risk you are taking. Therefore, credit cost is a part of that risk adjusted return metrics. And if we took a little more risk, down the line credit cost will go up, but I have made it up in returns. Therefore, it is not a number in isolation, and this is what I find very difficult to explain that finally credit cost, NIM and my overall loan growth are all interconnected.

**Adarsh Parasrampuria:** What I am trying to ask, Uday, a good part of the 40, 50 that you are talking about is also a ramp-up in coverage, right, you are not going to go to 80 or 90, so you have experienced much lower than the 50 that you probably would have guided to. So, given your profile, your growth levels, your portfolio mix and your metrics, like obviously 20 something one cannot factor in, so the point I am trying to ask is, is still 50 okay or you think 50 is something you all can stick with because you are all more doing like 20, 30 basis point now?

**Uday Kotak:** I would not give you a guidance but I will give you history. If you look at pre-ING, we were at around 40 basis point, but this is not guidance.

**Moderator:** Thank you. Our next question is from the line of Kshitij Bansal from Albatross Capital. Please go ahead.

**Kshitij Bansal:** Most of my questions are answered, I was just hoping if you can give some color on the issue with the RBI where they are asking the promoter stake to be diluted below a stipulated amount. Just wondering, what would you possibly believe that the counter solution that you have proposed, the chances that your confidence level of that getting accepted, what could be as investors we could expect out of that?

**Jaimin Bhatt:** I don't know where you get the fact that there is a counter proposal or anything, as you are aware we believe that we complied and we have made that disclosure that RBI has come back to say that they believe that we have not complied. It is also known that we filed a writ petition in the court which is being heard, and to that extent right now it is sub-judice and that is where it stays.

**Kshitij Bansal:** Gentlemen, what I actually meant, I know that the compliance is in place but by virtue of this PNCPS instrument that you have proposed to bring down the stake, that is somewhere I believe the current debate is on. So I was wondering from your perspective what could you believe would be like a reasonable acceptance of this solution?

**Jaimin Bhatt:** I do not think we can comment on that, that is exactly the issue which we had and which is right now a subject matter in court. So I do not think it is proper to comment on what will be taken and what not.

**Moderator:** Thank you. Our next question is from the line of Monika Agarwal from Bernstein. Please go ahead.

**Monika Agarwal:** Sir, I just have one question on the unsecured loan book, that is the small business personal loan credit card book. So, what proportion of that book would be the small business part, if you could just give some rough proportion mix?

**Uday Kotak:** We do not give that breakup. But this is the consumer bank piece, it is done out of the consumer bank, it is a combination of personal loans, business loans, loan against property, working capital for small businesses, that is the piece which you are referring to. And we believe that piece is actually growing quite okay. And what we are finding interesting is that the small business, PL and credit card is in very good shape, while the business banking which is SME is showing a very different trend.

**Monika Agarwal:** So, another on this follow-up, if you would be able share on the personal loan and credit card, what proportion mix do you have in existing versus new customers? Like how much are we sourcing from our existing customer base versus new to bank kind of a mix?

**Virat Diwanji:** As far as the sourcing from the existing customer base is concerned, in credit cards it is in excess of 80% of our credit cards that we do is through the customers that we already have. And in say personal loan, that percentage is also in excess of closer to 50% where, again, from the liabilities customers as well as the corporate salary customers that we have. So, in both these product mix perhaps our share to our existing customers is fairly large.

**Moderator:** Thank you. That was the last question. I now hand the conference over to Mr. Uday Kotak for closing comments.

**Uday Kotak:** Thank you very much. I really appreciate all of you taking the time on this call. As I said, this is the beginning of 2019, it is going to be very interesting, exciting and a challenging political and economic year ahead. We are positioned and to be able to navigate through this with a strong balance sheet and a business model which we feel should be able to not only withstand but also survive, sustain and grow through this reasonably volatile period which may come ahead. And I once again appreciate the time you have taken to be with us on this call. Thank you very much.

**Moderator:** Thank you. Ladies & 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.