"Kotak Mahindra Bank Q1 FY20 Earnings Conference Call"

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Moderator: Good day, ladies and gentlemen and a very warm welcome to the Kotak Mahindra Bank Q1 FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I am now glad to hand the conference over to Mr. Uday Kotak. Thank you and over to you, sir.

Uday Kotak: Good evening friends and welcome to our quarterly conference call at the end of the June quarter. This is a good time for us to first sit back and evaluate the situation in the financial sector in India and how we see it; as also thereafter talk a little bit on the bank and how we are seeing our current performance and the road ahead.

First, I think we are going through a very important and interesting phase in the Indian economy. The fundamental falls in terms of Government policy has been reflected in our budget, which essentially continues down the path of fiscal prudence and discipline, which is 3.3% of budget deficit and this is consistent with this Government's approach to fiscal discipline over the last five-odd years and the Government has continued down that path of fiscal deficit. I do believe therefore with the Government demonstrating that and also taking some of the load of borrowing including from offshore sources, it creates a significant opportunity and room for the central bank to consider a further reduction in interest rate as we go forward. We can debate how much the interest rate drop be, but I do believe there is room anywhere between 50 to 75 basis points drop in interest rate between now and March 2020. And we think that is an extremely positive step at a time when we need monetary policy to be taking some of the load when the fiscal discipline is continuing to be maintained. This is of course my view that between now and March we should be seeing 50 to 75 basis drop in the interest rates.

What it does to the financial sector? I think the financial sector continues to be extremely fragile, but we have seen a significant reduction in bond yields and the markets of course are pricing in a certain level of drop in the policy rates and some of that may have been factored in and some more may be to go. But as banks are able to see a significant increase in its fixed income and bond portfolio i.e.. the banking system as a whole, there is a room to be more aggressive in terms of its ability to provision with a significant de facto increase in the capital basis of many banks coming out of the fixed income gains. However, I also see particularly in the financial sector, marketplace getting to be extremely discerning and therefore availability of credit will be linked much more to the comfort of the market on solvency and governance of financial institution which will play a disproportionate role in availability of liquidity, deposits or loans to any financial institutions than ever before. And this choice of being so much more differentiated between institutions which gets the funding and the institutions which find it more difficult to get the funding, would inevitably over time lead to primarily a combination of some level of mortality and some level of consolidation happening in the financial sector over the next year or so. And this is also consistent with what we have seen happened in the past and it takes me back to my own experiences in 1998 to 2002 and of course, prudential regulation was relatively less in early days then. There used to be more than 4,000 non-bank financial companies in 1997, 1998 and post to the events of 1998 to 2001 very few financial NBFCs actually sustained themselves through this period. And therefore, between banking, NBFCs and different segments of the financial sector, we are moving towards the time where consolidation and some amount of mortality is inevitable. However, I do believe that with appropriate policy approach, we should be doing our best to ensure that there is no potential systemic outcome out of this mortality risk which is more real than what we have seen in the past.

Moving from there, specifically to Kotak Mahindra Bank, our results which have come out and my colleague Jaimin Bhatt will take you more through it, but as I see it that the key to financial institution building which is something we have deeply cared about is the approach of, through thick and thin, having certain aspects of philosophy which are consistent. Therefore, fundamental philosophy of having higher returns relative to the levels of risk you take, which is what in our terminology called as "Risk Adjusted Return" i.e. ability to be disciplined in taking risks through good times and bad. That means we should not be scared of taking risks, but take risks commensurate with the returns we can make is our go to philosophy. Therefore, as I think about it while the economy certainly is slowing down and there are many sectors which are going through tough times, if you recollect, I had spoken about the real estate sector and the non-bank financial sector going through its challenges in my earlier call. As I do believe that taking appropriate risks for better returns is a core to banking and lending, and therefore, we are beginning to see this strategy play out, and that is reflected in Kotak Mahindra Bank's NIM getting better.

The second consistent philosophy which we have cared about is low cost and stable liability as a core to banking and financial franchise and that is something which we continue to play with. We have seen that reflected in our relentless focus on low cost deposits which is CA and SA.In terms of stable liability, a very significant continuing growth in our deposit base below Rs. 1 crore. Therefore, low cost and stable liability is core of our franchise and is something which we have continued to believe in.

In terms of loan growth core, the risk which we have been comfortable with, we have seen about an 18% growth in loans in the bank. Of course, we have to watch the situation closely over the next quarter or so, but we continue to believe that loan growth we will be able to gain some market share as we go forward for sectors we are comfortable with, and therefore around that 20% loan is something which we at this stage feel we can work towards, but we have to watch the space closer. Therefore, a continuing focus on low cost and stable liability, focus on any sort of investments for which we get our commensurate returns which we are beginning to see in the marketplace reflecting in our NIM and also therefore getting some market share as well, we actually feel quietly confident in this particular cycle.

Other sectors which we need to watch closer, of course, and that is something which we have very significantly kept our Arjuna's eye on segments which we have concerns with and we will take tough calls wherever we need to. But, I would like to reiterate that through this turbulence which the financial sector is seeing, we see a quiet, consistent, medium-term opportunity which we are actually continuing to be excited about as we go into the future. And this is reflected in our business and execution strategy, some of it which is in the first quarter numbers but you will see it play out through the year as we go forward.

With that, I will now ask my colleague, Jaimin, to take you through the specifics on our financials and then of course look forward to Q&A. Thank you.

Jaimin Bhatt: Thanks, Uday. We circulated the numbers some time ago. So, I will keep it short and just talk about the highlights. Our post-tax profit at the bank standalone level for the quarter at Rs.1,360 crore, which is about 33% higher than the same period last year. As Uday mentioned, our NIMs continue to be healthy; we are at 4.49% for the quarter as against 4.28% last year same period. Gross NPAs at 2.19% and the net at 0.73% which is as against 0.86% last year. Capital adequacy again continuing to be healthy at an overall level of 17.8% with the Tier-1 itself at 17.3%. Uday talked about the CASA focus and the growth on deposit focus. Our CASA at the end of June at 50.7% which does not include TD Sweeps which is another 7%. Average current account growth this quarter versus the same period last year has been 23% whereas the savings growth has been at 21%. Our focus on the low cost which is low ticket size deposits of less than Rs.1 crore has grown 25% YoY. If we take the CASA plus Rs.5 crore and lower deposits, constituted now 82% of our total deposits. Advances growth for the year is about 18% on YoY basis. We have seen growth coming in various segments; the corporate book and business banking have seen a lower growth on YoY basis i.e. about 8% on growth whereas the Consumer and the Commercial side as we call as we look at it internally have both grown 20% plus. Our SMA-2 number as of June at 0.16% of our overall advances book.

On the P&L side, I am only going to touch upon is our employee cost for this quarter compared to the same period last year look little high. This year, thanks to interest rates falling, our provision on retiral benefits has been significantly higher. Last year at the end of Q1 in fact I touched upon the fact that with interest rates going up, the retiral benefits were much lower and that caused a decent difference between last year to this year. Other than that the P&L is with you. I will prefer Shanti to take the vision one and I will come back on the consolidated numbers.

Shanti Ekambaram: Thank you, Jaimin. Digital continues to be focused and Mobile First at Kotak and our Digital has continued to be highly rated. I would just focus on one or two key things: With the passing of Aadhaar regulation in the parliament, customers can now open 811 account through eKYC which is our digital savings account with voluntary consent on Aadhaar as well as biometric authentication which is paperless opening of account at the time of eKYC. We relaunched this in June and this hopefully should give us traction on both accounts in values as we go through the rest of the quarter.

The rest of the numbers are there for you to see. Suffice to say that the growth in volumes through net and mobile continue to increase across a variety of products for us.

On the payment side, UPI continued traction in terms of volume and our new initiative on "Open Banking" has begun to see results. We have about 34 API relationships across lending, payments and cash management and we would continue to grow this platform and thus providing a lot more products, services, convenience and experience for our customers.

In our subsidiaries again, digital whether it is in securities, life insurance or general insurance, focus continue to be digital first aimed at both customer experience as well as internal efficiency.

Jaimin, back to you.

Jaimin Bhatt: Sure. I will take the consolidated numbers. For this quarter, consolidated profit is Rs.1,932 crore which is about 23% higher than the same period last year. Apart from the bank, the contributions coming from Kotak Mahindra Prime at Rs.153 crore, Kotak Life Insurance at Rs.134 crore. The Broking Company Kotak Securities at Rs.110 crore which is in addition to the investment bank at Rs.45 crore. The mutual fund, the AMC and the trustee company, bringing in Rs.73 crore whereas Kotak Mahindra Investments getting Rs.63 crore for the quarter. Our net worth at the consolidated level at Rs.60,231 crore, giving us a book value of around Rs.313 per share. Advances while the standalone growth has seen an 18% growth, at a consolidated level advances is about 15%, coming from the fact that Auto which is in the subsidiaries has had a negative growth both YoY and QoQ.

Kotak Life has seen new business premiums grow 42% on YoY basis. Kotak Securities in cash volumes grew market share of 10% for this quarter. The investment bank has been in the middle of several transactions both on the equity and the advisory side. The assets under management across the group grew 19% on YoY basis. We manage about Rs.2,37,000 crore and the relationship value of wealth and privy customers which we advise is about Rs.2,80,000 crore.

So, those are the broad highlights. We would be open to take any 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 Prashant Poddar from Abu Dhabi Investment Authority. Please go ahead.

Prashant Poddar: Quickly, Uday, on the agri segment if we see, there is some difference in the way you have grown our book vis-à-vis some of the other well-run banks as well. So, the book has grown as well as the asset quality. We do not know the internals of agri specifically but if you could highlight that how agri has performed for you and how is the outlook going ahead?

Uday Kotak: I will have my colleague, Kannan, answer in more specific but I think one of the things within agri which we have is also Tractor segment where we have a significant improvement in the market share and we have actually found that segment is doing well., But Kannan, can you give the overall picture on agri, on how have we performed differently.

D. Kannan: On the Tractor segment, as Uday mentioned, even though the industry has not grown, we have grown our market share in the various markets in which we are present. And we find that even on collection efficiency, nothing much has changed as compared to the previous few quarters. So, while the market has degrown, we have gained market share and that is how we have been able to grow our portfolio on the tractor side, so is the case with the agri lending on the SME side.

Prashant Poddar: Sorry, if you can help us understand, Kannan. Would you be able to highlight some reasons, as to why some of the other better-run banks and your performance is different in terms of asset quality? I understand growth could be a higher or lower for one or the other company but if I look at DCB Bank or HDFC Bank which are well-run banks, the performance in agri specially is very-very challenging in these banks. So, if you could highlight us what has really happened in that segment and how are you doing differently from them?

Uday Kotak: There is one segment within the agri segment which we have been very cautious about and that is the crop loan segment. We as Kotak Mahindra Bank did not do crop loan till the merger of ING Vysya Bank with us. ING Vysya Bank was reasonably aggressive lender in crop loan. One of the reasons when we acquired ING Vysya Bank is we thought that there is a very big advantage of acquiring this bank because we have always been very circumspect about crop loan while ING Vysya Bank was quite aggressive on it. And once we got ING Vysya Bank in and when we started going into detail on the crop loan segment where some of the other better run banks were also very aggressive, it took us about a year, year-and-a-half to really figure out that portfolio, essentially it was lending against agricultural land. And in the desire to achieve the agri targets which is required for priority sector as well as the ability to do larger ticket size particularly in states like Punjab and some of these other agri states, we found that the ticket size of lending including what ING Vysya Bank was doing was extremely large and when we started the cycle for repayment, this is another strange thing which is allowed under the RBI requirements that you do not need to ask for money for one year. So, you can easily merrily have a situation where for one year you are not asked the question. That is true even in tractors but we from day zero at Kotak while doing tractor financing were recognizing pain at the end of 90-days. So, that was a discipline which we always had in our tractor business but we were very surprised that in agri crop loan business, you could merrily lend against so-called lands, larger ticket sizes particularly in states like Punjab and for one year nothing has to be paid by the farmer when effectively it goes as real estate financing under the disguise of crop loan. So, when we saw that, we dramatically cut down our exposure to crop loan by design. In fact, I am actually happy to share with you that the size of our crop loan portfolio today is probably lower than it was what ING Vysya Bank of a much smaller balance sheet in absolute amount carry. So, one of the things in the entire agri lending which I think the banking sector has suffered is crop loan and the ticket sizes of crop loan have been significantly large with the banking sector. This is something which we by choice moved away from. On the other hand, over the years, since we are larger lenders than any other bank in terms of the tractor lending portfolio as a bank, it is a segment which we have understood, we have got a great level of efficiency into managing the whole cycle end-to-end and approach which is recognizing pain early rather than waiting for a year before you start recognizing. Some of those practices actually have held us similarly in agri and SME for a while. But when we saw some of these come out, we actually cut down our lending. And what we are now finding is as more and more people including some of the NBFCs moving away from the space it is now possible to do underwriting at better spreads then what we were getting earlier and therefore risk adjusted returns being something we are comfortable with, has enabled us to continue there. Having said that, we are obviously watching the monsoon, we are watching number of factors. Therefore, we will take a view as we go forward. But as things stand, the portfolio which we are running and considering that we have recognized this pain long, long ago and not allowed with one year and other things to really cloud our judgment, we are not seeing as much pain today as the system maybe seeing.

Prashant Poddar: One quick on the CV, CE also similar trends, I mean, both these banks have or some others also are probably likely to do the same. CV, CE also has been a pain point while if I look at your numbers sequentially the portfolio has been flat but year-on-year there has been a strong growth and from your slippage number which looks like a net number of 0.5%, that looks like even slippage here has been low. So, what has happened in this segment?

Uday Kotak: First of all, I think there is a slowdown QoQ and at times year is a long period. So, we are obviously watching the situation.

Prashant Poddar: On asset quality, is it okay?

Uday Kotak: We are in good shape and Kannan again back to you.

D. Kannan: Yes, asset quality has been good. As Uday mentioned, if you look at our growth as compared to the previous quarter, we have slowed down. But we are observing what is happening around. The collection so far has been good in spite of the fact that collection cycles for our customers have got elongated.

Uday Kotak: And I think what you also got to keep in mind is with the significant slowdown in the NBFC sector, we are able to get underwriting quality of the kind we want at a higher spread. And as we have always said we do not look at risk absolutely, we look at risk in relation to the returns we make and we are beginning to get our spread for what we think are the risk, that does not mean we are getting into a higher risk portfolio. But having said that, I do believe that one year ago versus one quarter, there is a difference in the market blip, market blip is slowing down.

Prashant Poddar: Do you think the financial sector stress that we are seeing across the market as well as lot of smaller companies almost getting close to the verge of bankruptcy, lot of companies will get delisted it looks like from stock exchanges, the smaller ones but they have large loans if we put together all of that. If you look at these two things combined, NBFC and stress, as well as the small companies in stress, could this have a second order impact on the economy, part of it is happening, part of it can it stretch further, probably risk adjusted pricing getting better, could that stance change?

Uday Kotak: No, it is one thing we have to be nimble on our feet certainly. But I think if you look at the stress in the sector, there are two lenses which we need to constantly keep and both of them at the same time. On the one hand is the opportunity of getting share. On the other, the risk because fewer and fewer people are getting funding and what was weak underwriting in the past, whether we do not make the mistakes of getting some of that weak underwriting on our portfolio. Therefore, it requires a very close watch and I would like to tell you that our team is looking at it with hawk's eye. We are certainly aware of the fact that there are challenges in the broader economy which we need to be aware of. Let me give you the example of cars. I think the problem in the cars financing industry is not availability of finance. It is that the few NBFCs which are not financing. But there are many of us who would for the right risk adjusted pricing love to lend more against the security of car but if the ultimate car demand is low, we cannot keep on hitting our head against the wall. Therefore, what we are focused on is for the risks we are taking #1 is the return commensurate and do we need to take a view on some sectors where it is just not worthwhile taking the risk irrespective of the return. And that is also something which we are watching. For example, lending against illiquid land, as many of the financial institutions have done, we have been cautious on that for a long-long time. Irrespective of returns, some of that you have to be careful about. But at the same time while keeping some areas where you just smartly lend, there is a very significant flow of opportunity which is coming which on the other hand there were five other lenders out there to take the opportunity and without distinguishing between good or bad. Therefore, if there were five lending opportunities, out of which one is good, earlier all the five lenders would lend at the same price. Now, we have the ability of choosing one or two which we think we can lend and get our price.

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

Prakhar: This is Prakhar. Sir, couple of data points to start with. One is in terms of your loan book break-up. So, this time we have clubbed corporate and business banking together. Can I have a separate break-up for each of them?

Uday Kotak: Let me first clarify; Merger can be external and internal. So, we have done an internal merger. So, within the corporate bank, we had large corporate and mid-market corporate. Actually, we have three categories: very large corporates, large corporates, mid-market corporate. Then we add the SME segment and then we add the small business segment in the consumer bank. In the interest of efficiency and getting tighter in terms of how we run, we decided to do an internal merger of mid-market and SME. So, this internal merger was done in April 2019. So, as we have done these two mergers, we have moved some of the mid-market customers into large corporates and some of the mid-market customers into SME. And the very small end of SME we have moved into the consumer bank along with small businesses. Therefore, there is a rehash which we have done in terms of managing our book better and reducing the number of overlaps and verticals. Therefore, the reason why we have combined the two and written it that way is that there is a mid-market piece, some of it has gone to large corporates, some of it has got merged with business banking, there is a business banking piece which has been merged with the corporate bank and there is a business banking, small business piece which has moved to the consumer bank. Therefore, what you are seeing is an outcome of that and we have therefore tried to compare it in totality with last year but individual breakup of this is much tougher for us to be able to give you in a precision which all of you love.

Prakhar: Where I was coming from sir is the fact that probably we are alluding to 20% growth for the full year. So, essentially my point is if I look at going forward basis where do you think that probably?

Uday Kotak: We have said around 20% which can be plus/minus a bit either way but if you look at for the quarter wholesale banking with the business banking piece has had a growth of 7-8%.

Prakhar: Sir, I was coming from a perspective that going forward do you think some opportunistic pickup happening in corporate side or do you think that this auto loan, vehicle thing that probably is currently witnessing a slowdown, that will grow on overall basis?

Uday Kotak: I will ask my colleague, Manian.

KVS Manian: Just a clarification. Uday clarified corporate and business banking combination. The other one if you just notice, last year June figure and the March figure you will see that there is a base effect involved here. Our June number was Rs. 76,000 cr. roughly and the March figure was about Rs. 80,000 cr. So, there were some DCM assets we carried at the end of June last year and they have caused some base effect to the overall growth. It is not 20%. You have to adjust the 8% for that. So, we are hopeful that the following quarters will have better growth figures than this in the corporate and business banking segment.

Prakhar: Sir, in terms of margins, what we have seen is that we have been pretty much holding up our margins. So, where this benefit is coming from – it is from better pricing that we have at a sector or probably because of funding cost benefit first? Any thoughts on rationalization of saving cost that occurs in our mind as of now?

Uday Kotak: I think the benefits on margin are from both sides – more efficient liability management and second is of course on the assets side you get adjusted pricing. On the savings side, as you are aware in the quarter April to June, on savings deposits below Rs.1 lakh, we have dropped the savings deposits rate to 4% instead of 5%. So, our current savings deposits rate up to Rs.1 lakh is 4% versus 5% earlier and we have not at this stage changed between 1 lakh and 1 crore and above 1 crore. We keep in mind a number of factors; #1 is the growth rate at which our savings is growing; #2, what is the deposit rate in the market. Even now one year deposit rate offered by banks is at 7%. Therefore, at our overall weighted average savings deposits cost which has come down post this reduction to 4%. We still feel that at say 5.3% or 5.4% cost of savings versus term deposits at 7%, there is still a significant positive carry between savings deposits and term deposits, and the rate of growth of our savings deposits base. I mean, improving our franchise in CA, SA, retail TD overall is core to franchise and we will think very hard before we let go this thing.

Prakhar: Sir, what were the margins impact because of the SA change during this quarter if at all we can quantify?

Uday Kotak: It is in two stages and only for part of the quarter. Therefore, full benefit will come from the second quarter.

Prakhar: Sir, your thoughts on unsecured business ? So, we have been adding some concern in there. Anything that incrementally we would want to add into that?

Uday Kotak: I think we have made our point clear. We are not hostage to being in love or out of love with any segment. We are only hostage to our principle of risk adjusted returns. And if we believe the risks are worthwhile, we will do it. If we believe that is not worthwhile, we will not just chase absolute return. Even within unsecured, there is hell of a lot of work you can do, you need not be reckless, you can choose your segment, you can choose your CIBIL score, you can choose geographies, you can choose segments of customers, you can do a variety of cards. As long as we maintain the discipline, you will always be better off than what I call as "*taka ser bhaji, taka ser khaja*" lending in unsecured.

Moderator: Thank you. The next question is from the line of Sachee from Columbia Threadneedle. Please go ahead.

Sachee: I wanted to pick your brain on the macro a little bit. Everything that you said in your previous remarks and response to questions frankly sort of talk of a slowdown maybe in certain areas driven by real estate, NBFCs, etc., and liquidity tightening. Contrast to that, the Hon'ble Prime Minister has laid out a vision for a $5 trillion economy by 2024-2025 and if assuming a 4% inflation that equates to an 8% growth, that is needed to achieve that target, so my question to you is a) Do you think things need to sort of get a big force before they sort of get better? b) Do you think there is a political will and tool to actually drive the economy towards that target? Now the national economic survey said that they need to do massive reduction in cost of funding. So, I am wondering if that is the only tool they have and whether that tool works? I am just curious on your thoughts on the macro.

Uday Kotak: First of all, I believe we have seen Swachh Bharat in the financial sector. So, we are going through that phase of Swachh Bharat in finance and we are in the middle of it. I do not think it is fully done and some of it is playing as we go forward and we are all going to be very alert and paranoid to make sure that we take care of ourselves and we see this cleansing process going through our financial sector. If you notice the economic survey, the survey for this year predicts 7% GDP growth. The economic survey also recognizes that in this aspiration for the 5 trillion economy we are starting slow which is the fact and we can debate what the level of inflation is, last inflation count was 3.1%, 3.2% and therefore as we go down this path, the climb on the hill gets steeper if we start slower. That is undoubtedly the fact. The key question we are going to ask is we need to ensure in the financial sector in particular that as we go through this cleansing process, we need to ensure that this is not systemic and is more specific rather than getting more across the board. I think that is the first thing we should see. And if we can get the act right, then you have much stronger foundation and base to be able to accelerate the growth as you go forward. Getting the foundation right from some of the practices and issues which the financial sector is faced are extremely important. And of course, there are number of structural things which the Government has to think about. I think we should do it on a separate discussion altogether including the role of different segment in the financial sector, long-term thinking on state-owned banking especially when we are on the 50-years of nationalization, we need to ask the questions on measuring of outcome, point #1 and point #2, financial returns of tax payers over 50-years because finally it is the tax payers money, so outcome independent on financial returns and the financial returns both need to be looked at and wait. So, we need to think structurally, we need to think fundamental improvement in the solvency, quality and governance of the financial sector in this country and of course lower interest rate additionally will also help. So, a combination of lower interest rates to monetary policy, fundamental structural changes, how ready we as a country are and third is how good is our governance mechanism in the financial sector are the factors which will have major input into the growth of a company. So, I think we should have a separate discussion on this, but most of us in India are very keen on ensuring that we work towards the 5 trillion dream and if we do not dream with boldness we would not even get close.

Sachee: Just as a follow-up, as the Government hopes to achieve the dream of the financial sector particularly private sector banks are at least I would like to believe that they are seeing as key participants i.e key partners in achieving that dream. However, last year, one of the things, we have been frustrated by how heavier hand RBI has come down, whether it is the retirement age for a bank CEO, whether it is sort of your own bringing the stake down. Do we see any sort of respite in that or do you think that RBI will continue to kind of have a formal-like approach regarding this particularly at the time when the sector itself is struggling on many other fronts?

Uday Kotak: I think Sachee, the right people to ask this question is the Reserve Bank of India, they would be in a better position to answer this question.

Sachee: I believe you are lobbying for it?

Uday Kotak: I am in no position to comment what the RBI does.

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

Sanjay Parekh: I have one question on this monetary transmission. We have seen reasonably liquidity provided by RBI and 10-year GSec also had significantly come down. As the regulator has clearly spelled out that the monetary transmission is not happening properly, so do you see this ramp down coming through the PSU banks and then impacting margins ahead, how do you see this piece?

Uday Kotak: On monetary transmission, let us first see the fact clear. The MCLR formula has been transparently laid down by our bank. I do not know the formula for the bank which is transparent and available to a regulator. Therefore, the regulator is aware of the MCLR formula which has been approved and which has been in practice for quite some time. So, it is out there transparently available to the regulator. And based on that, we just have to fill in as per that formula over a long period of time the numbers and which gives an output and an outcome. It is not that, we have to fix our MCLR. Therefore, I am actually surprised that any bank including a PSU bank can fudge a number higher or lower, different from the formula and especially when we have a regulator who is certainly looking at what each of the bank does is reference to the formula. As long as the formula is met, I think it has to go with that. In the absence of there was a move earlier which has been dropped by the RBI which was linking MCLR to market benchmarks, the regulator must have had good reasons to not pursue with that, but if you ask me, if we believe that we really want to see transmission, maybe that is something which the regulator had envisaged and regulator has always the ability and opportunity to think but for good reasons the regulator decided to drop that which was supposed to be implemented from April 1. As far as we are concerned, we believe that transmission is a transparent process by which we have to manage this within a framework and we will adhere to that framework and there is no question of massaging or doing something which is dramatically different from what those numbers will throw up. In that context, I know a lot of people have talked but the fact of the matter is MCLR drops by banks have been larger than drops by the Government on small savings rate.

Moderator: Thank you. The next question is from the line of Prakhar Sharma from CLSA. Please go ahead.

Prakhar Sharma: Just had a couple of questions. One, in the Annual Report that you discussed a bit of pressure that was evident in the portfolio for the SME book and you have taken corrective measures around it. Just wanted to get a sense like have things stabilized and from the reclassification perspective, does that book get reflected in the corporate book or is it part of the small business and PL card sort of a book?

Uday Kotak: I will hand it over to Manian but bulk of the SME book has got merged with the mid-market corporate book to the extent that mid-market has been further split between large corporates and SME.

KVS Manian: So yes, it is part of the business banking and corporate portfolio. We have seen clear progress on that. A little additional slippage has happened on the assets side here. Therefore, clearly it seems to be under control. Now, we are hoping that if the environment permits us, we are hoping to grow that book from here.

Uday Kotak: Let me also highlight, over the last two years and every call, I used to get a reverse question, which is, why are you not growing your SME book faster? And we said that till we are comfortable for the risks for the returns, we will take a very circumspect view on that.

Prakhar Sharma: And have things changed since then or you would still be a little cautious on that part?

Uday Kotak: See, my point is back to we are open as I said, in the past if there were five loans and 10 bank jumping over it, we are now able to out of the five pick up one or two loans with relatively much less number of banks or finance companies jumping into it.

Prakhar Sharma: Got it. On Kotak Mahindra Investments, the NPL ratios have moved from 0% last year and like 30 bps to about 60 bps, probably an early sign, but is there an imminent stress here, right ?

KVS Manian: No, we do not see overall stress. It is one single account and we are fairly confident that we will not lose money in this account. It is very well secured. So, it is just an isolated case. There is no stress in the portfolio otherwise.

Prakhar Sharma: Last question. In the Life Insurance part, can you clarify what portion of the new premiums have guaranteed returns?

Uday Kotak: No, I think let me just step back. I have asked Murli to speak. But roughly, about 20% to 25% of the book is guaranteed returns. Everything else is not guaranteed or not a part same product. Between 20% and 25% is guaranteed return, not in terms of age and in terms of new business.

Moderator: Thank you. The next question is from the line of Susmit Patodia from Motilal Oswal Asset Management. Please go ahead.

Susmit Patodia: See, in your Annual Report you had mentioned about getting into the Consumer Durable Finance business and that being an exciting opportunity. Could you give us a little more thoughts around that?

Uday Kotak: Yeah. First of all, we normally like to enter a sector when things are not in the best and we like to do it slowly. And we now see the opportunity coming, so we will do it in our own slow way, build it gradually and build it up. And we are also doing a lot of stuff which is very different on technology. I will ask my colleague Shanti to share with you, how on differentiated basis, we are going about that opportunity.

Shanti Ekambaram: Thank you, Uday. So, Uday mentioned three things. First, look for the opportunities within the space which is both risk and price. Second, look at the process differential which is largely digital, which is we are probably the first one on the street to do that with Aadhaar based end-to-end processing. And we are finding spaces which from a risk-adjusted return perspective we are looking at. And you have got to build it slowly, you have got to be careful given the business matrix environment and risk, that is exactly what we are going about.

Susmit Patodia: And this would be in the bank not in Prime, right?

Shanti Ekambaram: This is in the bank.

Susmit Patodia: Yes. And second question was on East India, a number of branches there are significantly lower than your national average, any thoughts there?

Uday Kotak: The thoughts are we will increase it, but we are very clear, we must get more than our normal bang for the buck. If we get more bang for the buck, we will open more branches.

Susmit Patodia: Is that the reflection of the credit culture there or the kind of business that is going on ?

Uday Kotak: Also keep in mind that our overall strategy on branches i.e. we will certainly grow branches.

Susmit Patodia: For East India, yes, I mean is that a reflection of the credit culture of that part of the country?

Uday Kotak: Our approach to any branch is both liabilities and assets. Therefore, on liabilities East India continues to be a good marketplace. On the asset side, obviously, it is something we are a little more cautious about therefore, when you are looking at a branch strategy you look at both. But also, you know on the liability side, we are combining the significant physical and digital strategy. So, we will certainly grow East India and keep in mind, before the merger with ING Vysya Bank we had a disproportionately large presence in North and West. And our South presence was relatively low, which is what we filled up with the merger with ING Vysya Bank. Please do not read into that, that we are going to merge with a bank which has got large East India presence We are quite open to growing our branch network in a measured manner. And simple bang for the buck. Bang for the buck not in six months or one year, but over three years to four years.

Moderator: Thank you. The next question is from the line of Saurabh from JP Morgan. Please go ahead.

Saurabh: Sir, just on this digital strategy, sir. On your operating cost on OPEX-to-asset or cost income depending on how you want to guide it. What kind of reduction one should expect over a two-year view?

Uday Kotak: Yeah, with Aadhaar coming back, we are going full speed in terms of getting customers both physical and digital. And I will ask my colleague Mr. Virat Diwanji, who is responsible for the highest operating costs, how he sees it over two years, and how he is going to improve it? Virat Heads Branch Banking and Retail Liabilities.

Virat Diwanji: Look, customer acquisition, is what you call, a number game with the number of people that you apply. But with this kind of technology help coming in, where you can acquire and the efficiencies goes up, we continuously drive to improve the productivity year-on-year. And from that perspective, as the number keeps growing up, perhaps and the productivity going up, we would be able to breakdown the cost means we have attempted in the past, we were midway when this Aadhaar thing came up. But even without that now, we have the various methods of relationship management also in-built which brings in efficiency. Yes, the virtual relationship management thing that we have set up and we have seen the early results, it is yielding good results and we will expand that base whereby customer is contacted regularly. He feels engage with the Bank, his value builds up and hence, that will make him feel happy to be with the bank. So, maybe around 10% - 15% cost control can be impacted through the use of this technology as well as the differential relationship model that we are talking about.

Saurabh: Sir, and acquisition cost, I mean for new customers, what will be the acquisition cost like if you can help us quantify?

Uday Kotak: Yes, on that just to give you a sense between the physical world and the digital world i.e. the 811 World, the acquisition cost is 15% to 20% of what is it in the physical world. So, this is very significantly lower. Of course, you got to keep in mind, the balances are lower, the revenue per account is lower, therefore, you just got to keep that in mind. But in the digital world, you will be just dramatically able to increase the size of our footprint at a much lower acquisition cost compared to the physical world though the physical world ticket size per account is larger.

Saurabh: Okay, sir. And sir, second question is on your HFC portfolio. Sir, exposure has gone up sharply quarter-over-quarter, so I am guessing you are now comfortable with that.

Uday Kotak: Housing Finance, right?

Saurabh: Yeah.

Uday Kotak: Housing Finance portfolio does not include real estate development. That is Housing Finance consumers and we do not put any real estate developer portfolio in that number, rest assured on that.

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

Nishant Shah: So, around last year this quarter, you had given some details about the number of customers you have acquired through the 811. You also mentioned that roughly around 70% of them have the same kind of profile as your normal branch banking customers. Would you now be able to give some more color about how have you been able to monetize these customers like, any gradient of the average CASA balances that are maintained or dormancy or frequency of transactions or any gross sales achieved? Any numbers here about this whole 811 experiment?

Uday Kotak: Okay. First of all, on the digital with Aadhaar coming back, keep in mind, Aadhaar was ordinance and it has become law, post elections and post the new Government passing it through Rajya Sabha. We are back in business. We have made changes including voluntary Aadhaar in June. All the changes have been made and we are quite confident of a very significant run rate, maybe at least equal to the run rates which we have achieved last year and maybe if we find the going good; we could even accelerate it further because we see this as a very significant long-term acquisition strategy for us. I will ask Virat to take you through broad contours of how for the physical world and the digital world accounts are shaping up and his experience with that. Virat?

Virat Diwanji: Yes. Look, especially on the 811, as we said that the cost of acquisition is lower. The profile of the customer is extremely important. Here, we find people in the age group of 25 years to 35 years, and that means that we are catching them early. The second thing is majority of them are salaried class. So, that also gives us an opportunity to do a cross-sell and the blessing in disguise is between this period of this downtime because of Aadhaar. We have developed strategies and the processes whereby we have been able to connect with 811 and cross-sell of our personal finance products like credit card and the personal loans have seen significant improvement. As we mentioned earlier, as far as the upgrades of the customers from 811 to the normal banking type of accounts, continues to be hovering between 12% to 15% and we see an opportunity there as well. So, that is on the 811 customers. As far as the physical world is concerned, what you call the numbers, we were doing the full KYC kind of a thing, using Aadhaar in the physical world as well. With that opportunity not being available from September to now, I think it had impacted the productivity but now with Aadhaar back in work, we will be able to get back to our productivity levels that we had got earlier. And this time also gave us an opportunity to get our systems and processes whereby we would be more efficient in managing the customer relationship. So, overall, opportunity to get more customers higher with this Aadhaar back in terms of cross-selling products to them, we have seen some good results and we hope to even better it going forward.

Nishant Shah: Okay. I did not quite understand this upgrade from 811 to normal of 12% to 15%. What does that mean?

Uday Kotak: What it means is these customers want full-fledged branch banking facilities and all the services which the physical world customer wants where they keep much higher balances. So, there is an upgrade program also, which is the choice of the customer and that is also working well.

Nishant Shah: Okay. Actually, I do not understand completely. So, the context of this question is like, I am an 811 customer, I am a salaried employee, I already have a bank account. So, the likelihood of me banking with you now, it is limited. What I am trying to understand is how many of these customers have you been actually will to monetize, cross-sell a credit card to, cross-sell a home loan or a personal loan to or you know, even taken away some wallet share in terms of the CASA balances that are maintained by offering a higher rate. In implementation, what kind of progress have you achieved in the year or maybe a couple of years now since you have had this?

Uday Kotak: I think, we have got fair amount of cross-sell percentages. We are monitoring them every month. The ratios are improving month-by-month and we believe, the breakeven level including the acquisition costs of the digital customer are coming down and on a fully costed basis. The breakeven level of our digital customer now faster than a normal branch banking acquisition customer.

Nishant Shah: Okay, fair enough. Just one more question, separately on the auto space. So, how is your asset quality moving in like, some of the other spaces like dealer finance or loans to other auto anxieties or something like that? Because logically it will affect the entire ecosystem. So, how is the other ecosystem generally fared?

Uday Kotak: Please keep in mind the auto sector, knowledge of which dealers have what situation, our understanding of the dealership space started from mid-90s. And in general, the broad dealership space has been around for a long-long time. Therefore, all our key dealerships have an inside out view about what is going right and what is going wrong. And, if there is one thing which we are very clear about that when we feel that there is a risk of losing money, we just make sure that we first protect our money. And therefore, we have actually had a negative situation in our dealer finance business in terms of the growth of the book. And we have also found in the last two years in particular, some of the newer banks have been pretty reckless in how they lend to dealers without adequate security. And in some cases, we hear that wherever just because we are there, some of the other banks and financial institutions have blindly lend on that basis and there will come a time when we have actually quietly pulled out and let some of them carry the same.

KVS Manian: On the auto component side, we are working the situation on case-by-case basis but let me just give you an assurance that most of our limits on the auto component side are self-liquidating in nature and they are not limit that the company can use irrespective of their volumes. So, some of our volume determine the utilization of our limits. So, we manage that quite closely and we will act suitably if we see a reason to act.

Moderator: Thank you. We will take the last question from the line of Kabir Gulati from HL Capital. Please go ahead.

Kabir Gulati: So, even as the Y-on-Y growth numbers still look quite decent at around 18%. But the sequential trend at just around 1%. I think, so in that context, just two things first, in the context, where sequential growth is just around 1%, which are the segment which are offering you some kind of pricing bargain? And second, what are the downside risk in this sequential growth context to the overall year and growth number?

Uday Kotak: My advice to you is first, you should go back to history, in most of the situations between fourth quarter and first quarter, fourth quarter normally and there is some element of seasonality which happens. The fourth quarter to first quarter normally shows a sequential growth which is lower. Therefore, be very careful not to misread it as a more sustainable trend quarter-on-quarter because normally fourth quarter there is a certain level of peaking which happens. And therefore, do not compare fourth quarter versus one quarter sequential as the basis for making a trend for the full year. That is my only advice to you.

Moderator: Thank you very much. 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 this. We are in a very interesting time. And once upon a time, as it is said in politics, one week is a long time in politics. I can assure you one quarter is a long time in banking. So, we are now of course, we are discussing the June quarter lot scan and will happen in this quarter. We are very alert. We are focused on doing the right things. We are both making sure that we do not take undue risks. At the same time, we do see whenever we find that there is a sustainable opportunity to build, we are out there taking advantage of that opportunity through this turbulence and thank you very much for being on the call.

Moderator: Thank you. Ladies and Gentlemen, on behalf of Kotak Mahindra Bank, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.