



## KOTAK MAHINDRA BANK Q2 FY05 EARNING CONFERENCE CALL NOVEMBER 02, 2004

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Moderator: Good afternoon ladies and gentlemen, I am Parimala, the moderator for this conference. Welcome to Kotak Mahindra Bank's Q2 FY05 earnings conference call. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. I would like to hand over to Mr. Uday Kotak of Kotak Mahindra Bank. Thank you and over to Mr. Kotak.

Uday Kotak: Good afternoon friends. I have got here with me Dipak Gupta, Ajay Sondhi and Jaimin Bhatt on this conference call. Welcome to our conference call at effectively mid-year performance. And as I look at it, we are now about 18 months post our conversion into a banking company, and I feel looking at the situation, and I will talk about it in greater detail, I feel fundamentally positive about the way our business model is moving forward and it is on the lines of what we have projected. We are beginning to see us generating momentum in terms of the overall business model. Some of the highlights are - our fee income, which obviously we for the purpose include insurance premium as well, is 38% of our consolidated revenues compared to 29% as of Q2 last year. Another very significant development is the growth in our consolidated advances and we are 48%



up year-on-year compared to last year. In terms of the bank branch network as of 30<sup>th</sup> September 2004, we have 23 full fledged branches and have a network across 16 cities. We would like to be somewhere between the 75 to 100 branches network by FY08 across 30-40 cities, and this is something which we are upping from our earlier plan of 50-75 by FY07.

Our net interest income in the bank is up 50% in Q2 FY05 versus last year. Another very significant development is that we are now finally getting significant traction on the current and saving deposits that is CASA and I am separating temporary IPO floats from that calculation, and we have grown to Rs 2.8 billion from Rs 1.7 billion in one quarter and we are currently looking at a growth of about Rs 400 million every month in our CASA numbers as we go forward, and I think this is also gaining traction and momentum and we will have Dipak talk a little bit more about it.

Our investment bank was the book running manager as you are aware of the NTPC IPO which has generated the highest ever demand in any IPO with close to 1.5 million applications. Our life insurance business has recorded over 130% growth over last year. Another very significant development is the equity assets managed by the group across the mutual fund, portfolio management, and offshore funds, and the number as of 30<sup>th</sup> September 2004 is Rs 25 billion versus Rs 11 billion at the same time last year, and this business is continuously generating more and more assets under management as we go forward and is picking up momentum.

Similarly, on the distribution side, our AUM of funds distributed by the Bank and Kotak Securities has grown to Rs 46 billion. We have also launched a private equity fund initiative and we believe that we will collect somewhere in the region of around \$100 million by end of the year. We have already got commitments in excess of \$40 million within the period of about week or two since we have launched the fund.

Another major development is the growth and the size of our employee base which is significantly being added both on the retail bank and the life insurance business. Our current employee strength is about 3,700 employees, which number as of 31<sup>st</sup> March 2004 was around 3,100, so we are adding about 100 employees every month and we see this momentum continuing. We are basically now moving on from an initial, probably a little slower start as a commercial bank in March 2003 to full throttle and gaining momentum in both our network, employee additions, and also the business roll out and the build out.

Moving to page 3 of the Earnings Update, I would like to focus on the bottom part of the page to give an analysis of the consolidated profit performance this quarter versus same quarter last year. If you look at the top row, the total operating profits before retail liabilities and life insurance are at about Rs 885 million in Q2 FY05 down from Rs 985 million in Q2 FY04. This is primarily on account of drop in treasury profits of Rs 290 million, which means that our other operating businesses, primarily the lending business, has contributed significantly to the make up of Rs 190 million out of the Rs 290 million loss on account of treasury profits.



We are continuing our reasonably aggressive investment in the branch network and the life insurance business, and compared to last year same time, the investment and branch network is probably moving at a faster pace. We hope to add somewhere between 6-9 branches in the current quarter and this pace has actually picked up, a lot of the work has happened and we are opening about roughly 2 to 3 branches every month.

So on a consolidated profit after tax basis, there is a drop from last year's quarter from Rs 389 mn to Rs 325 mn, and I have just explained to you the key reasons for it.

On the advances side, and that is on page 4, the 48% growth which you are seeing, one of the main contributors to this growth is our growth in the commercial vehicles business which we have grown at about 64%. The personal loan business has also grown very well at similar rates of growth. On the auto loan side, the growth has been lower, reason being that we are more focused on value creation rather than just adding assets at any price, which is probably happening in the market place.

We are getting more and more focused on in the advances portfolio in areas where we can improve our returns and one of those areas is what we call as sub-prime lending, and we have selectively started building that business under the brand 'Saraal', and we see that actually in addition to the personal loan side which is giving us good returns, as a key areas for our growth.

Another very significant development is on the corporate bank (including SME) side, we have grown at 56% and we are making sure that while we are obviously maintaining asset quality and reasonable return on assets on those loans.

On page 5 coming to our ratios, book value is Rs 108, the net NPA number very much under control at 0.3%, and overall I think we are in good shape. At this point in time we have sufficient capital adequacy. If we include the profits for the first half, our capital adequacy is in excess of 14% and without that it is about 13%. In addition, this does not include any Tier-II. In this quarter we will raise somewhere between Rs 80 to Rs 100 crores, that is Rs 800 million to Rs 1 billion of Tier-II capital, and we are in the process of completing this very shortly. So no issues on capital adequacy at this stage. We have got significant room in Tier-II, we can go up to 300 crores, and we have still barely scratched the surface there.

With that I will now hand over to Dipak to take you through some of the highlights on the bank standalone and then quickly talk about specific subsidiaries.

Dipak: Thanks. Standalone if you see is practically at the same level about Rs 206 million in Q2 FY05 as compared to 198 million in the comparable quarter of the previous year. If you look at the segmental analysis at the bottom half of page 6, you will see that the increase in losses are in the retail liabilities and branch banking business where we continue to make significant investments, and I will talk about that shortly, and second - really in line with overall interest rate scenario, the significant reduction in the treasury profits in Q2 FY05 as compared to Q2 FY04, has resulted in a Treasury segmental loss of Rs



3.5 crores. The positives as against those really are the significant growth in the retail lending activities. We are seeing a 20% odd jump on the PBT, and again on the corporate banking side again a significant jump on the PBT levels.

Well, one of our big savings really was, we probably prevented high loss on the treasury side. We brought down our duration's significantly starting from April-May onwards. We currently run a duration of about 0.7-0.8 years.

Specifically talking about assets retail assets, we continue to see significant growth rates on the commercial vehicle side. Personal loan continues to be growing as expected. In home loans, we probably moved slightly more cautiously than what we hoped, but we are still going about it in the right way. We have seen significant growth both on the SME and the corporate side, in particular the SME side, lot of traction and proposals coming up from various industries.

On the yield side, commercial vehicles, one does see, probably some pressure on the yields, hence margins are under pressure, but it probably seems to have stabilized now for the last one or two months.

Delinquencies are reasonably under control and so are losses, and we run reasonably low gross and net NPA levels.

On the liability side, as Uday mentioned, we have had significant traction. We continue with our broad strategy of affluent plus customer segments. We now have a reasonable distribution across the entire country. We practically cover most major cities and we would have covered practically about 20 odd cities by the end of this year across about 40 to 45 odd branches. Last quarter we did mention that we are going further in our strategy by, actually looking at our existing infrastructure of group companies and seeing how we can use their outlets as extension counters also. The twin focus on CASA and fees arising out of investment advisory continues. We are seeing about 50-50 mix in our top line on both these accounts. We are adding about 3,000 odd accounts on a monthly basis across our 20 odd branches now. CASA itself really is growing on the retail side by about Rs 25 to Rs 30 crores every month and on the corporate side by about Rs 10 crores, more in line with the figure of about Rs 40 crores per month, which Uday mentioned about. I will hand it back to Uday now to take you through the other subsidiaries.

Uday: I have got Ajay Sondhi here, and I will request Ajay to talk on the investment bank and the institutional equities...

Ajay: Gentleman, the numbers are with you, but let me just tell you over the last few months we have seen the results of our key strategic initiatives bearing fruit, and two in particular, one, we have been for the last many years the leading player in the primary equity market. And as the leading underwriter and distributor of primary equity to both domestic and foreign investors, we have expanded our business template to also start underwriting and distributing equity on exchanges outside India. In other words GDRs and ADRs, and that business that we conduct through our international subsidiaries, and the



first transaction we did along those lines was \$100 million convertible bond for Mahindra & Mahindra, which was listed in Singapore, that was done in May of this year. And during the last three months, we did two other transactions, one, we acted as a joint book runner and joint global coordinator for the \$30 million GDR of LIC Housing Finance. And second, we were a co-manager in the international syndicate for the ADR transaction of \$890 million of Hutchison Telecom International Limited. We do have a pipeline as well, and as we go along our strategy will continue to focus on being a leading or a dominant player in terms of underwriting and distribution of Indian equity to both domestic and foreign investors including different formats apart from just domestic listings. So, that is one strategic initiative where we have seen results coming in.

The second initiative that we have been working on is to leverage more effectively our synergies with Goldman Sachs, our joint venture partner, and again there has been a fair amount of work along those lines that we have been doing over the last 12 to 18 months, and there are two specific manifestations of that that we have seen in the preceding quarter. One, we have a program with Goldman Sachs where we second number of professional staff to their offices for periods between six months to one year. We started that program earlier this year and we had a second tranche of employees that we sent during the preceding quarter on a long-term secondment to Goldman. And as we continue with that we have much better networking and much better skill sets in our employees through the program. The second benefit we get out of the closer cooperation with Goldman is a much better origination platform especially for cross border mergers and acquisition business, and one of the deals completed during the quarter was where we advised Patni Computer Systems in acquiring Cymbal Corporation of the US which has been the largest cross border acquisition deal done by an Indian IT company to date, and we also find that there is a positive level of activity and business that we are deriving especially on the cross border front. A lot of that is driven by a far closer working relationship with Goldman Sachs.

Apart from that as Uday mentioned, the highlight of the quarter was the milestone setting transaction for National Thermal Power Corporation, which has been in many ways the most successful Indian IPO of all time in our history. The numbers reflect the fact that the trading income from the primary dealership business was not as robust for reasons that we all know.

Let me just briefly cover our institutional broking business as well, which again is a strategic joint venture with Goldman Sachs and in line with the trend that we have seen for most part of this year that we continue to make progress in respect of both the level of clients that we add to our business as well as gains in terms of trading volumes and market share that we have made, and we have made these gains during the quarter and we continue to have a positive momentum in the business in respect of market share gains on the cash side of the business. On the equity derivatives business, the institutional segment, which is the business that we started only very early this year, we have made very substantial gains in terms of market share and we are now one of the top two institutional brokers on the F&O segment and we continue to make further gains in that business and that grows in a



very robust fashion for us as well, and we have positive momentum in that business as well.

Uday: On the retail broking side, I think business volume have seen a pick up particularly in the month of September, and we averaged daily volumes of Rs.7.5 billion during Q2 FY05. We are also seeing a very significant increase in our online, Kotak Street Online Business where our volume have increased to Rs 620 million from Rs.360 million during this Q2 of last year.

Our portfolio management service (PMS) continues to be the star, and we are now at Rs 13.2 billion of assets under management as compared to Rs 7.8 billion same time last year.

We have recently launched another variant product in our PMS, which till now was primarily focused on the top end customers. We have now started a retail PMS scheme which is for an amount of Rs 1 million for any investor to come into this and which is the separate product by itself, targeted at a different market segment, and we are getting excellent response even for this lower end product and we are actually pretty happy and almost to say that the way the segment has grown for us is more than what we would have bargained for when we started it. But, things are looking pretty good in terms of our positioning and we hope to see our consolidation of positioning in the equities brokerage business.

On Kotak Mahindra Primus, which is the car finance business company, the car finance business is under very significant margin pressure, and we have taken a call that while we will continue to maintain our reasonable market share, we will not chase volume at the cost of value, which is why if you saw the growth in our numbers, we have grown faster in the other asset categories compared to our car business, keeping in mind of course that we have a reasonably large base in the car finance business, and we see this business as something which has to be managed very tightly, and you need to be very detail oriented to make sure that you create value in this business, and that is the way we see it right now.

On asset management, that is the mutual fund business, we are at Rs 55 billion in terms of assets. We have increased our equity AUM to Rs 7.3 billion which is nearly four times what it was last year the same quarter. We are very focused on building equity asset fund management because in the fixed income assets, particularly the bond funds, we have lost AUM, and on the liquid funds the margins are much thinner.

Life insurance, as I mentioned to you, first year premium in Q2 grew 95% as compared to Q2 last year. We have about close to 90,000 policies, and we are moving pretty quickly in terms of scaling up this business and we see probably a greater growth in top line in next two quarters compared to the first half of the year.

And with that I will now hand it over back for Q&A, which any of you would like to ask, thank you.



Moderator: Thank you very much sir. We will now begin the Q&A interactive session. Participants who wish to ask questions please press \*1 on your touchtone enabled telephone keyboard. On pressing \*1, participants will get a chance to present their question on a first-in-line basis. To ask questions please press \*1 now. First in line we have Mr. Aditya Narain from Citi Group.

Aditya Narayan: Yeah hi, Adithya here.

Uday Kotak: Yes Adithya.

Adithya Narayan: Yeah, my question is relating to KMCC where you know you have done a fair number of deals, but one were to strip out the trading income, there does not seem to be too much profit or profit growth, and I was just figuring out whether, you know, isn't that there ought to be a little bit more leverage in terms of a good market which is not really showing up in numbers, you know, like in the current quarter basically, in the current half year you made 2 crores only net stripped off the treasury side, and can one expect this to go up substantially or does one really have to club it with the float fees that tends to come out of localized deals.

Ajay: Adithya, hi it's Ajay. Just to respond to your question, the revenue recognition event, while deals may have been completed or announced in the quarter, the point of revenue recognition may have been either before or after the calendar quarter, but looking at the substance of it the base transaction which was completed in the quarter was NTPC IPO, but the fees for that has not been booked in the quarter that is under review, okay. Similarly, the announcement about the Patni Computer transaction, the fees of that will be booked in the current quarter (Q3 FY05), again. So it is not linear in the sense of that, but in terms of the outlook if I may say, as far as the capital markets are concerned, I do believe that this financial year ending March 2005 would probably be a more robust year for total primary issues than the previous year has been from point of view of the pipeline that we see. There is a big swing factor based on what the government does or does not do with its divestment program, and in respect of the advisory business as well, you know, there is a pipeline, but again as with everything else, it is not predictable as to when some of these deals close, but we do expect it to be a reasonably robust period going ahead.

Uday Kotak: And if I were to, sort of, add to Ajay. Aditya, obviously the question we constantly ask ourselves in our internal reviews, the pipeline at this point time is more robust than what we have seen for a long-long time, both on investment banking, that is, IPO, as well as on M&A side. I must also highlight to you that our policy with reference to the international subsidiaries is that we book those incomes with one quarter lag (since their financial year end is on December 31), and some of the international deals which, including the LIC housing finance, which we have done in quarter two of FY05 will be added in the revenue in quarter three of FY05. And particularly now that the investment bank has broadened its horizon to doing international deals on offshore platforms, some of these revenues may actually be captured in our international subsidiaries significantly, and which we report with one quarter lag.



Adithya Narayan: Thanks.

Moderator: Thank you very much sir. Participants who wish to ask questions please press \*1 now.

Moderator: Next in line we have Mr. Sridhar Shivaram from Morgan Stanley.

Sridhar Shivaram: Yeah, good afternoon. My question is again regarding the investment banking revenues. I understand that some of these large deals that are happening these days are at very low investment banking fees, I mean, numbers are really low to be even quoted. So how do you see this market going forward and the competition that is there in the market, and how does it impact the profitability of the business.

Ajay: Shivaram, this is Ajay. First I think your comment is probably specific to government privatization deal mandates, on fees by and large in non government deals we see a trend on total fees that is stable to actually improving in terms of increasing fees or stable. We are not seeing fee pressure on non-government deals. On government privatization deals, fees has been low and will probably conceivably be likely to remain low, and those deals are done selectively based on overall franchise benefits and overall global marketability of those deals, but the bulk of the fees and revenue projections and budgets and what we actually do, a lot of that is based on deals from the non-governmental sector where they are holding up quite well. Does that answer your question?

Sridhar Shivaram: Yeah it does. I have another question on insurance. Can you just give us an update on how the insurance business is doing, we see in some of the ranking tables that, you know, some of the others have moved ahead and Kotak is not even in the top three or four. So just give a background on how the insurance business is shaping up.

Ajay: Sridhar, Ajay again. Just wanted to add on to the fee a bit, the other point I would like to comment on is the fact that, we have also increased our focus on GDR and ADR convertible deals, which is an additional fee pool that we were not tapping earlier because they were non-domestic listings. Now, we are also doing deals in that category, which opens up the potential of another fee pool for us to tap into. I just wanted to make the additional point. to your previous question.

Uday Kotak: Yes. Life Insurance, let me say it this way Sridhar. We see a pick up of our life insurance business very significantly in the second half of this year in terms of top line compared to the first half. Yes, our current ranking I would say would be the region of around 8th in terms of where we stand currently. We are in fact adding more of our resources in building a life insurance business faster. One of that changes which has happened is we have now effective November 1, Gaurang Shah, who used to be in the Bank, handling our entire retail assets group, is now formally the CEO of our life insurance company, effective November 1, and we are giving a very significant thrust to distribution both outside as well captive distribution between bank assurance and our securities network to push the insurance product more aggressively than probably what we have done earlier, and we hope to see the results of this pan out over the next few months and



hopefully over a period of time. Basically across all our businesses, we have quickened the momentum to the growth impetus, and very significant focus on top line is the key mantra for us as I have told you.

Sridhar Shivaram: Okay thank you.

Uday Kotak: And some of the manifestation of the fact that our life insurance and banking costs have remained high is because we want to be in a very significant mode of investing and growing our top line at a faster rates, and that is the balanced call which we have taken literally in the last few months.

Sridhar Shivaram: Thank you.

Moderator: Thank you very much sir. Participants who wish ask questions please press \*1 now. Next we have a follow-up question from Mr. Adithya Narayan of Citi Group.

Adithya Narayan: Yeah hi, Adithya here, this question of mine is really focused on the funding side given that you still are a reasonably wholesale based funder, you know, what has been the kind of move in terms of your funding cost and how do you see it playing out as far as some of your asset categories are concerned?

Dipak: Adithya, there are really two parts to it, one is obviously the wholesale funding cost would move, have moved up in the region of around 25 to 50 basis points on an incremental basis. The good news for us is that the increased cost on the wholesale side is getting balanced by the fact that our CASA growth as well as the IPO float side is also growing pretty well. So for us if I take the incremental cost of the wholesale funding which will be about, say, take an average of about 50 basis point, it is getting balanced albeit by a small number, which is the CASA number, which is growing. So all in all we believe that this mix and a faster growth in CASA, which is what very significant focus has been given in the last two to three months and step up is being done there. We believe that over the next few months we see an evening out to a marginal increase in our cost of money that is the total impact on the wholesale is say 50 basis points, of which the net impact to us is more in the region of around 25 odd basis points, and this goes back to the fundamental philosophy of going in for the banking model. We see that as the funding cost side grows, obviously the asset side has grown faster than the liability side, which is the reality because the asset business is the business we have been more entrenched in, but we see that the liability side is also growing up particularly through CASA. If you look at our retail liabilities and retail CASA as a percentage of our retail liabilities, we are continuing to maintain it at around 30%, which for a bank less than one and half years in business is a pretty decent ratio.

Adithya Narayan: Okay just one follow-up on this, you know, since there is obviously a biggest thrust on the CASA side, how is it going to show up in terms of the operating cost or the liability cost on the branch network, can one expect a bit of an acceleration there.



Dipak: Yes, in a short run, yes, because what is happening is that we are basically quickening the pace of our branches which you will see probably in Q3 FY05 and Q4 FY05 and having said that, the good news is that we are making very good progress on actually getting CASA, and I think our entire branch model which in the early stage was getting settled down, is finally settling down and we are getting our act together, and that is why I think we are getting our numbers. We are getting our customers. We are getting larger AUM per customer than what we had bargained for in our business model, and in fact that is going to help us over a period of time, and all in all I think we are finally getting the act together, which is giving us the confidence to go faster on the roll out.

Adithya Narayan: Okay, if I can just add on one more, you know, in terms of the branch strategy last time you had said that couple of branches will be remodeled from, you know, our existing businesses. Broadly how many of those are there in the current numbers, and out of the 75 odd that you are targeting how many would be upgraded or refitted branches?.

Dipak: Let me put it this way Adithya - our original thinking was to go for more like 25 to 30 cities. We are increasing that to a number which is more like 40+ cities, and the reason for that is our initial success in some of the smaller cities where we have opened branches, for example, our experience in Ludhiana or say something like Jaipur is extremely good, and the speed at which those branches are actually rolling out the products and actually getting customers is significantly faster than what we had bargained for, and therefore it is actually making us feel better about going from 25 to 30 to more like 40 plus cities, because of the impact the first branch in a city is actually making in terms of returns, and this is the reason for the change. Therefore if you add 10 more cities that itself will give us somewhere 10 to 15 branches depending on whether it is one or more. Plus, the fact that we go little more deep in some of the metros compared to what we have planned, and this is the reason why we believe that things are moving faster and we also, compared to the first branch, we opened the first in end of March 2003, the break even period also looks like it is going to be shorter for the newer branches. We are getting experience. We have got a set of people, it is easier for us to move people around than what we could do when we started, and therefore we see the newer branches probably breaking even faster compared to what we had bargained, and older branches now beginning to kick in and some of them have actually moved past break even point already.

Adithya Narayan: Thanks.

Moderator: Thank you very much sir. Participants who wish ask questions please press \*1 now. At this moment there are no further questions from participants.

Uday Kotak: I would just say one other point which I wanted to highlight and that is effective October 1 we have restructured our wealth management division. It is now a full-fledged division within the bank. Earlier we had a part of it sitting in the bank and then there was the Kotak Securities PCS force. Everything is restructured and it is a single division now, going out there with a team of nearly 80 relationship managers, out there in the market place to build our customer franchisee across 8 cities. Thank you.



Moderator: Thank you very much sir.

Uday Kotak: Thank you friends.

Moderator: Ladies and gentlemen, thank you for choosing CyberBazaar's conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.

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