



Kotak Mahindra Bank

Q3FY07

Conference Call

January 22, 2007

Readers are advised that the transcript appears in its unedited form. The vendor's transcriber may not be familiar with the names of Kotak Mahindra Bank's conference call participants, Kotak Mahindra Bank or industry-specific terms. In order to post the transcripts quickly following the conference call, we have not corrected misspellings of names or trade terms or made any other changes to the text.

This document contains certain forward-looking statements based on current expectations of Kotak Mahindra management. Actual results may vary significantly from the forward-looking statements contained in this document due to various risks and uncertainties. These risks and uncertainties include the effect of economic and political conditions in India and outside India, volatility in interest rates and in the securities market, new regulations and Government policies that may impact the businesses of Kotak Mahindra Group as well as its ability to implement the strategy. Kotak Mahindra does not undertake to update these statements.

This document does not constitute an offer or recommendation to buy or sell any securities of Kotak Mahindra Bank or any of its subsidiaries and associate companies. This document also does not constitute an offer or recommendation to buy or sell any financial products offered by Kotak Mahindra, including but not limited to units of its mutual fund and life insurance policies.

This document is not an offer of securities for sale in the United States of America. Securities may not be offered or sold in the United States of America unless they are registered or exempt from registration. Any public offering of securities to be made in the United States of America will be made by means of a prospectus that will contain detailed information about the Kotak Mahindra Group and management, as well as financial statements.

All investments in mutual funds and securities are subject to market risks and the NAV of the schemes may go up or down depending upon the factors and forces affecting the securities market. The performance of the sponsor, Kotak Mahindra Bank Limited, has no bearing on the expected performance of Kotak Mahindra Mutual Fund or any schemes thereunder.

Moderator

Good evening ladies and gentlemen. I am Sunil, the moderator for this conference. Welcome to the Kotak Mahindra Bank's conference call. For the duration of the presentation, all participants' line will be in the listen-only mode. I will be standing by for the question and answer session. I would like to handover the proceedings to Mr. Uday Kotak. Thank you and over to you sir.

Uday Kotak

Good afternoon friends. This is Uday Kotak here. I have got my colleagues Mr. Jayaram, Mr. Dipak Gupta, and Mr. Jaimin Bhatt here with me. I would assume that you would have received the details on the earnings as well as the earnings update and I will just take you through some of the highlights of performance of the bank for the quarter ended 31st December on a consolidated basis, as well as highlights on some of the individual businesses.

The consolidated total income is up 82% in Q3FY07 to Rs. 11.9 billion from Rs. 6.5 billion in the same quarter last year. Consolidated PAT is up 107% to Rs. 169.5 crore, that is up from Rs. 81.8 crore last year, and the year to date consolidated PAT is up 74% year-on-year to Rs. 3.67 billion.

Consolidated advances are up 53% year-on-year to Rs. 137.1 bn with retail loans continuing robust growth, and when we define retail, we define retail in the context of retail and commercial, and consolidated net interest margins are continuing at a healthy rate of 5.2%.

We continue with a strong addition of people across the group with bulk of the additions being in the commercial bank and the life insurance company. We are now at 9,600 people i.e. close to 4,000 higher than the same period last year, which was at around 6,000 employees. Just for perspective, when we became a commercial bank in March 2003, the total group strength of employees was about 1,500, so we have had a pretty strong addition to people on a consistent basis over last 3 to 3-1/2 years and this continues as we go forward.

We are now 90 full-fledged bank branches, up from 53 branches last year across 59 towns and cities, and we continue with our guidance of around 110 branches by March 2007.

The Q3FY07 net interest income of the bank standalone is up 88% on a year-on-year basis. The standalone PAT of the bank is up 39% to Rs. 454 million in Q3FY07 versus Rs. 326 million Q3FY06. Capital adequacy is about 11.6% with Tier 1 at about 8.58%.

Growth in deposits excluding IPO collections, is about 75% to Rs. 97 billion, up from Rs. 55 billion the same period last year and total number of deposit accounts is over 297,000 as on 31st December 2006 as against 139,000 accounts as on 31st December 2005, which means our number of deposit accounts have more than doubled.

The bank has emerged a winner in Euromoney Private Banking poll in 16 categories including the best local private bank.

Kotak Securities has clocked an average daily volume for Q3FY07 of Rs. 40 billion against Rs. 25 billion in the same quarter last year and my colleague will take you through this part. In terms of market share for the quarter, we are up to 9.7% and on a YTD basis about 9%.

Total assets managed and advised by the group are now up to Rs. 227 billion, which was Rs. 126 billion same period last year. Kotak Investment Bank was awarded the best domestic investment bank and the best equity house in the Asset AAA Country awards. Kotak Mahindra Prime was awarded the Voice of customers 2006 best auto finance company in India by Frost & Sullivan.

Then the next item is on account of adoption of the revised accounting standard, AS15. The impact for the quarter for the group in terms of P&L hit is Rs. 73.3 million and Rs. 32.9 million for the bank.

The last item which here I would focus more on is that RBI has come out with a series of guidelines on distressed asset accounting for banks. This is with reference to one of our important businesses which has been growing and as you are aware, is acquisition of distressed assets portfolio which we acquire from other banks and NBFCs. On such distressed assets portfolio we have made an additional provision of Rs. 284.5 million in the consolidated financials in this quarter, and the provision at the bank standalone is Rs. 203.2 million. This is with reference to earlier RBI guidelines and norms which allowed recognition of distressed assets differently from what they have been changed to from time to time. The recognition of such assets as NPA when additional provisions there on which in accordance with RBI norms for such asset requires the recognition of profits, NPAs and provisioning on individual asset basis as opposed to portfolio basis, and this as a matter of clarification, the RBI norms for ARCs (Asset Reconstruction Companies) for similar assets do not require such provisioning, and such recognition of NPAs therefore based on the distressed asset portfolio which we have bought in recent times require to be classified as distressed assets for a bank and not for an ARC. This has led to a significant provisioning in our books against these assets, which we have taken through our P&L for this quarter and has resulted in consolidated net NPA rising to 2.3%. Consolidated net NPA excluding these distressed assets continues to be at a healthy rate of about 0.22%. This impact of this accounting change or this accounting norm has had a negative impact on our P&L on the net basis consolidated at Rs. 256 million for the quarter on consolidated basis and Rs. 174 million for the bank standalone.

With that we will move to the next item which is the consolidated financial break up category wise in terms of streams of revenue. The financing activity has grown at 61%. Fee income has grown at about 40%. Life insurance premium income has grown at about 97%, and treasury and investment income has grown at about 104%. Overall growth in revenues is about 66% on a consolidated basis. Our Q3FY07 profit before tax, if we exclude the two items, which we continue down the investment path which is our branch banking retail liabilities and life insurance,

is about Rs. 2,645 million and our profit before tax after these items is Rs. 2,401 million and EPS is Rs. 5.16 for this quarter versus Rs. 2.6 for the same period last quarter.

Consolidated financial breakup of assets in terms of advances, commercial vehicles has grown at 25% year-on-year, Auto loan at 15%, personal loans at 86%, home loans at 102%, corporate banking which also includes small and medium enterprises has grown at about 102%, and the rest is about 81%. So, overall growth in consolidated advances is 53%, and the overall number including treasury and other assets is a little higher. Keep in mind we had a higher SLR provisioning end of December linked to some IPO floats which had come because of the RBI norms on that and therefore there is some excess which was there on end of December which need not be there in January.

In terms of consolidated analytical ratios and financials, networth is about Rs. 30.88 billion, book value about Rs. 95, net interest margin as I mentioned 5.2%, net NPAs excluding stressed assets which as I have just explained to you is 0.22%, and return on average networth and keep in mind that we have added networth in April through the GDR issue is about just below 16% at 15.9%, and if we took out the returns before retail liability and life insurance on a pre tax basis, the return on average networth is 26.6%.

Profit after tax, company wise, Kotak Mahindra Bank Rs.454 million, Kotak Mahindra Prime Rs 108 mn, Kotak Mahindra Capital which is the Investment Bank Rs189 mn, Kotak Securities Rs 804 mn, International subsidiaries, and this is again a very significant jump, Jayaram will touch base on this ,essentially arising out of performance fees and some of it arising out of performance fees on asset management have kicked in and that has helped. Life insurance continues to be growing pretty fast and coming to the fact that we continue to invest in Insurance business, the loss for the quarter stood at Rs. 175 mn versus a loss of Rs 120 mn for the same quarter last year. You will find the second last item which is minority interest and other adjustments is positive, last year the same quarter was a negative because at that point of time Goldman Sachs still held 25% of our investment bank, securities and the international businesses, so that share was getting reduced earlier and now after buying back, the group's ownership of that is 100%. So that is positive in terms of the accounting treatment.

With that I will now request my colleague Dipak Gupta to take you through the bank standalone. Dipak over to you.

Dipak Gupta

Thank you. Bank standalone as Uday mentioned, in Q3FY07, we have a profit after tax figure of about Rs. Rs 45.4 crore as compared to Rs. 32.6 crore last year same quarter. If you look at the break up of this Rs. 45.4 odd crore across the key business segments, on the lending side you have Rs. 19.1 crore for this quarter as

compared to Rs. 26.5 crore last year, but remember this Rs 19.1 crore has a net negative impact of about Rs. 17 odd crore arising out of the additional provisioning on the stressed assets, so if you double that back then the actual core lending on the retail asset side has grown significantly.

Again corporate banking has seen significant growth from about Rs. 10 crore of PBT last year to about Rs. 42.5 crore this year and the growth is really on all counts, on fee income, on float income, transactional income, lending, as well as on the derivative side.

Retail liability continues to be in investment mode. The figure which you see is net of all our incomes arising out of the current accounts, savings accounts, the transactional income, and the distribution fees. Treasury again is significantly better than last year, again essentially last quarter we had reasonable movement on the treasury bill side which gave us significant income, so net-net Rs. 45.5 crore as compared to Rs. 32.5 odd crore on a YoY basis.

Advances, Uday took you through most of the advances, commercial vehicle has been growing moderately at about 25% odd. The key growth really is on the personal loan and home loan business, close to about 100% over there, as well as on the corporate banking side. The corporate banking growth includes the growth on big corporates as well as SME. In SME we have seen significant growth over the last 1 year. Overall, for the assets on the standalone basis, the growth is about 78% odd.

Back to bank standalone deposits, what you see is a very healthy growth in CASA in absolute terms. In percentage terms though CASA has been more or less close to the 18% or 19% figure, last year it was about 15%, but there was one period in March of last year where it touched around 19% odd, but it is more or less around the same level in percentage terms, the absolute amounts had grown significantly, while the CASA growth has to catch up with the significant growth on the asset size of the balance sheet also.

Last quarter, as Uday mentioned, we also took a significant provisioning hit on account of increase in provisioning on the standard assets which need to be 1% by March as well as a hit on account of AS15 in the bank standalone.

If you look at NIMs, they continue to be healthy, on a consolidated basis, NIMs are around the same level as last year, about 5.2% as compared to 5.3%. On a standalone basis also NIMs are reasonably healthy. NIMs are about 4.5% on bank standalone basis.

Moving onto Kotak Mahindra Prime, that is the car finance business. The profit after tax for the quarter is around Rs. 11 crore as compared to Rs. 8.5 crore last year, but again like in the bank standalone Rs. 11 crore odd is net of about Rs. 8 crore odd of provisioning impact arising out of stressed assets, otherwise KMP is

growing reasonably well now. It was awarded the best auto finance company in India by a survey conducted independently by Frost & Sullivan. I will hand it over to Jayaram to carry forward on Kotak Mahindra Capital Company (KMCC).

Jayaram

Thanks. KMCC had a reasonably good quarter in terms of what has been happening there. KMCC was awarded the best domestic investment bank and the best equity house in the Assets AAA Country award. Couple of marquee deals which we have talked about; one of them is the Great Eastern Shipping Company Ltd where we acted as the exclusive advisor for the demerger of its offshore division, and the other one where we acted as financial advisors to Mahindra & Mahindra in the acquisition of a German Company.

In terms of domestic equity offerings Kotak Investment Banking successfully completed domestic equity offerings of Lanco Infratech and Sobha Developers. Sobha was over subscribed by 125 times, which is one of the highest over subscription in recent times. KMCC also acted as a global coordinator and joint book runner for the QIP of Marico Limited.

Kotak Securities has had an extremely good quarter and the numbers speak for themselves. Profit after tax for this quarter of about Rs. 80 crore as against Rs. 49 crore in the similar period last year. In terms of average daily volumes, Kotak Securities clocked average daily volumes of about Rs. 40 billion during Q3FY07 and this is against the figure of Rs 25 billion during the similar period of FY06. The average daily volumes for FY06 were about 24.4 billion.

In terms of market share, currently we are running at a market share of 9.7% of the total average daily market volume during Q3FY07 and 9% during year to date FY07. This is as against the previous year's number of about 8.5% YTD, so clearly a significant improvement in the market share as well.

In terms of the AUM in the portfolio management service, currently standing at about Rs. 21.3 billion, this is a little lower than what we had at the same period last year which was about Rs.24.3 billion and that is essentially because of redemption of some closed ended schemes which we were running in the PMS and that number was about Rs. 6.8 billion. We are currently in the process of launching a couple of closed ended schemes again and hence the numbers will climb back.

In terms of the Kotak Institutional Equities, we have achieved a steady growth in revenues, and clearly building, on both, marketing and client relationship across the world. Currently, our network in Kotak Securities is 815 offices across 284 cities and town, and we service over 292,000 secondary market customers.

Kotak Mahindra Asset Management company, again had a good quarter and the total AUM as on December 31st 2006 was Rs. 126.9 billion, the same number as in

December 31st 2005 was Rs. 74 billion, and that is a significant increase in assets under management. Even more important equity AUMs have also significantly increased from Rs 20.2 billion in the previous year to a current number of about Rs 26.4 billion.

Asset Management company again has expanded in terms of coverage, we currently have about 53 branches, and we service over 460,000 investors. We recently had an NFO of structured product called the Kotak Dynamic Asset Allocation, which garnered about Rs. 670 crore. I will hand it back Uday for life insurance.

Uday Kotak

Life insurance continues to grow, premium income has grown by 76%. We think the business is beginning to get serious traction, we see excellent future for this as we look at the future. Our network of 65 branches is up from 44 branches. We have 248,000 individual policies on the book and in addition to that group policies as well. So all in all we feel very good from a long-term point of view about our overall business.

Coming back to just few points, if you see what is happening, the two areas where we are investing very seriously is our branch network growth in the bank and in our life insurance business, and we believe that we will continue to do that because it is creating the long-term franchise and potential earnings and despite the fact that they put some pressure on the current P&L. In addition to that the other area which I would like to touch upon is that we are continuing to be reasonably active in the distressed asset market where we already have a reasonable size portfolio. We believe that this portfolio is very valuable as we look at the future and we do believe that amongst the banks and institutions in India we continue to have a very significant presence in this business, which we expect to grow even further.

With that we hand it back to all of you for any questions you may have.

Moderator

Thank you very much sir. We will now begin the Q&A interactive session. Participants who wish to ask questions, please press *1 now. Participants who wish to ask questions please press *1 now. The first question comes from the line of Mr. Kunal Shah of Edelweiss.

Kunal Shah

Hello sir, congratulations on a great set of numbers.

Uday Kotak

Thank you.

Kunal Shah

Sir, I just wanted to know on the Kotak Securities side, what was your average daily volume on I mean Kotak Securities online trading?

Uday Kotak

You know Kunal, we have historically followed a process, which is giving the total numbers, and I believe we are amongst the few people who give the turnover volumes amongst listed companies every quarter and we have been giving total numbers across different segments of the market place and that is the policy we would like to continue for the moment.

Kunal Shah

Okay, sir, and on your advances side, the others component is there, so that is around about like Rs 27 billion or so.

Uday Kotak

Yeah.

Kunal Shah

So I mean that is growing at a much higher pace like more than 75% plus, so can you just throw some light to what exactly are those others advances which are growing at such a high pace?

Uday Kotak

Yeah, I will request my CFO, Mr. Jaimin Bhatt to take you through some of those breakups.

Jaimin Bhatt

Yeah Kunal. If you look at those numbers out of the Rs 27 billion, bigger items would be about Rs. Rs 4.8 billion stressed asset related business, Rs 3.5 billion would be business banking group which we have in the bank, about Rs 5 billion would be agri related advances, Rs 3.5 would be sub Prime lending, yeah, and there will be some other things which we do in the subsidiaries related to capital market and other areas.

Kunal Shah

Okay, thanks a lot sir.

Moderator

Thank you very much sir. The next question comes from the line of Mr. David from DLH Capital.

David

Congratulations on a great quarter, two questions, first is do you have a sense for when the insurance operation may become profitable, and secondly you mind if I take from your comments about the distressed asset portfolio and the reserves against that portfolio may not be needed over a period of time if you manage it well.

Uday Kotak

Okay, on the life insurance business, we think the growth is continuing to be pretty good and we do not see us becoming profitable in a hurry which is I mean it does not look like we are going to be profitable over the next 12 months, and beyond that it really depends on the business dynamics, but we see value being created in medium term from the point of view of the business itself, and we continue to invest in that, but we do not see us getting profitable in the next 12 months as we look at the situation right now, and beyond that how much and what shape it takes is difficult to say, therefore please do not assume the remarks means that we will be going to be profitable after 12 months, but we probably will watch the situation as we go into the future.

The second point is with reference to the distressed asset portfolio; our view is that we have a requirement of the regulator which we have to follow. We believe the inherent dynamics of the business are positive, and if the regulator requires us to make a reserving or a provisioning we do it and obviously we cannot and should not be questioning that. But we are very very confident that this business is value creator for our shareholders and therefore fundamentally we are not concerned with this provisioning which we believe is more driven by what our regulator requires us and that is how we look at it.

David

Thank you.

Moderator

Thank you very much sir. The next question comes from the line of Mr. Aditya Narayan of Citigroup.

Aditya Narayan

Yeah, hi, I had a couple of questions. One on the margin side, can you give some sense in terms of how yields have moved, how costs have moved, particularly in the context that as far as your asset mix is concerned you know it has veered a little bit more towards mortgages and towards corporate loans, so you know where is the margin sustaining on that front. Second is just a technical one in terms of you know the big fees that have come through on the international businesses, where those had come from. Thirdly, on the broking business itself, you know there is an expansion in volume, but seemingly there has been an expansion in the yields per se, so is there a mix issue there or something else that you know we could be made aware of. And quickly the last one in terms of the stressed asset book, any sense of what is the size of it in your books as recorded.

Uday Kotak

Okay, Dipak you want to address this.

Dipak

I will take the margin one. If you look at it they are more or less similar to last year, these are not so much different from last year, I think up to now it has been possible for us to pass on increases to customers, I don't know whether we can carry it much forward, but just now we have given a lag of 1 to 3 months it has been possible and hence more or less maintaining overall mix, while there is a significant mix change on home loans and corporate you will see personal loans also have grown significantly plus some of the other businesses which come under others also have grown and some of these are reasonably high yield. Home loan again and corporate again are all floating rate, so high yield. On the other questions, I will hand it over to Jayaram really to answer that.

Jayaram

On the international fees, as part of our offshore asset management business, we had a couple of schemes which were in the nature of profit sharing schemes. One of those we actually closed in the last month and hence the spike that you see in profits arises out of the profit sharing portion of that scheme.

Uday Kotak

Aditya, on more general point, let me tell you that overall in the securities business so far the margins have held up pretty well and look good, and if you recollect probably across different calls we have been also mentioning that a reasonable chunk of our asset management businesses also had an element of performance fees linked to AUM and growth including the public market asset management, I am not even talking about real estate and/or private equity which so far haven't

really kicked in at all. Asset management side itself is now beginning to see the unfolding of some of those, performance fees also beginning to kick in and we do not see that as one off, we see them as long as all of you collectively and all of we collectively believe that the markets are in good shape, those performance fees we believe are more currently looking like pretty good consistent outcomes of all the money's we manage, and that is actually also beginning to help us in our overall revenue mix.

Aditya, have I answered all your questions, have I missed anything?

Aditya Narayan

Just two things, one on the last thing in terms of the yield, this things actually gone up both on a QoQ basis and on YoY basis, specifically on the QoQ basis, so has there been an improvement in the mix, have you been able to charge something up?

Uday Kotak

I think Aditya, we have actually found that our brokerage business traction is continuing pretty strongly and we don't think our margins so far have been under pressure. We have been able to get what we believed we can, and the fact the we are doing such a significant percentage of the market volume is beginning to actually help us vis-à-vis customers, both on the institutional side and the retail side and we are seeing some benefits of scale and significant market share enabling us to actually do better on the yields. The other point which I mentioned to you with reference to the margins also keep in mind that Kotak Securities run some of the portfolio management scheme on which performance fees have also kicked in with reference to some of those portfolio in terms of asset management, so that is also benefiting Kotak Securities as well. Overall, I think that business is looking to be in good shape.

Aditya Narayan

Just one last one really on the distressed asset, would you be able to quantify the amount that sits on your books; A, and B; we have not seen anything on the revenue line for a year now on this, you know any thoughts on that.

Uday Kotak

Again two parts to it. In some of the earlier portfolios which we bought up to March 2005, we were accounting for those and have been continuing to account for those on a portfolio basis, but till we recover the full portfolio we are not able to book profits on that and obviously sooner or rather than later we see that beginning to get profitable and benefits of that beginning to kick in over the next few quarters. Second is on the portfolios post March 2005, normally what happens

is lot of the portfolios are bought in towards the third or the fourth quarter, most of it is in the fourth quarter, and it takes about 12 to 18 months before you start beginning to see the gains of this portfolio and we think you know it is just amazing that the level of some of these portfolio is compared to what we have bought I mean obviously they are getting more expensive when we look at the future, but the stock which we own is now at original value and it is about Rs. 3,500 crore to Rs. 4,000 crore size of the portfolio we own at face value, which obviously we paid a percentage of that, and it is looking pretty good into the future or now it is tough for me to quantify how the benefits will come but we see those benefits flowing significantly in the next 12 to 24 months.

Aditya Narayan

Okay, thanks, I am not pushing it a bit, just on the branches you know this target of 100 to 110 that you had for 2 years now, now that March is here are you giving some indication in terms of how rapidly you intend to expand thereafter?

Uday Kotak

Aditya, when we do the next quarter we will give you the number for March 2008 in terms of what our target is.

Aditya Narayan

Okay, thanks so much.

Moderator

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

Uday Kotak

Okay, I suppose in that case thank you very much and look forward to being in touch with you again at the end of the next quarter, and wish all of you a wonderful New Year and a great 2007. Thank you.