Kotak Mahindra Bank Limited
Q3FY23 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day, and welcome to the Kotak Mahindra Bank Q3FY23 Earnings Conference Call. As a reminder, all participants' lines will be in the listen only mode. There will be an opportunity for you to ask questions, after the presentation concludes. Should you need assistance, during the conference call, please signal an operator by dialing star and then zero, on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Uday Kotak, MD and CEO, Kotak Mahindra Bank. Thank you and over to you, Mr. Kotak.

Uday Kotak: Good evening, friends. Wish you all a very Happy New Year and 2023 as we get off to the start of, what looks like a very interesting year. And it's always challenging at the start of the year to predict what the year will be, especially after what we have seen over the last two or three years. Therefore, let's keep our fingers crossed and assume that we have no negative surprises of the scale and size, which we have seen over the last few years, and let's work our way forward as we manage the opportunities as well as risks.

So in that context, the big question in my mind is something which I will discuss, I've touched upon briefly in the last conference call, which was, where I mentioned that are we in what is effectively looking like Cinderella times and will the clock strike midnight some point of time.

The question I have in my mind after quarter ended December as we get into January is whether we are in Cinderella times or we are in Goldilocks times. And it is something which, when I look at quarter-after-quarter, the way the financial sector seems to be going in India in particular, it is looking amazingly good. And let us assume that there is a fair probability of both Cinderella and Goldilocks also continuing for a while. So we need to watch this very closely as we go into 2023 and beyond.

Specifically, with reference to Kotak, I will just point out a few points on strategy. One, as we can see, something which we've talked about that we have taken a call that we are going for growth, and we will continue with the strategy for growth as we get into the calendar 2023 and beyond. So therefore the fundamental objective of growth while managing risk is at the core of a strategy which Kotak is looking forward to. Second, we have, in the last few quarters made significant investments of what I think are investments for the future.

And we see that continuing for the next couple of quarters at least as we continue down the path of investing to build a much stronger future and foundation of Kotak in terms of people and technology, including on the mix of people we have with a much better ratio of mix between expertise in specific areas, including technology and customer orientation as distinct from only disproportionate focus on financial sector domain.

Therefore, this mix is very crucial from a strategy point of view when I think about the future of financial services. Third, I discussed earlier in the last quarter about the mix of assets and have mentioned about moving the mix of assets to mid-teens on the unsecured retail side. As you see from quarter-to-quarter, our unsecured retail now is at about 9.3% versus the last quarter as a percentage of our total assets. And we see over the next four to five quarters us getting closer to mid-teens mix of unsecured retail loans. And I would like to believe that sometime by the fourth quarter of FY24, we should be getting closer to that number.

And finally, I think one of the most important items on our agenda is focus on granular deposit and liability franchise. I think that's the core of our bank. And that is something which we have got a significant amount of focus on, which is to build this granular franchise. Therefore, even as some of the more chunky money has moved, our focus on granular franchise continues and we will do it with even more vigour as we go into the future, including taking the tough calls which we need to build some of the segments, customer segments even stronger than historically, particularly the salaried customer segment, where on a relative basis, we have some more work to do.

Therefore, it's an area of focus, granular growth, much more focus at individual sizes, more holistic proposition for the salaried customer as we go forward and really make the change to the overall deposit and liability franchise of the bank.

So these are the broad strategic points. And in addition to that, I must also cover the point on our group and for the bank on a consolidated basis. As you will see in the third quarter results, the consolidated profit after tax of the bank is, split into 70% bank stand-alone and 30% out of all our other group subsidiaries.

Therefore, the contribution to the consolidated profits of our group subsidiaries continues to be in the range of 30% to a third of our total profits when I look at it on a consolidated basis. We think about us as one financial institution across the spectrum and we'll continue to keep that core culture of a unified holistic financial institution working to build an even stronger positioning in the broader financial sector.

And in that context, I mention, which I think later on my colleague will cover, on a very significant focus in one of the areas which we have not mentioned earlier and which I would like to state as one of our growth agendas is the alternate asset business, which is run out of one of our subsidiaries as one of the areas of growth where we've added significant amount of assets under management, and we continue to strive for that even higher. And we see that alternate asset business crossing more than $5 billion in the next quarter or two as assets under management, making us probably one of the largest Indian alternate asset managers for the future. And in all these alternate asset pools, we are committed to putting around 15% of the firm's capital, of the group's capital alongside because we want to make sure that there is alignment of interest of return of our capital along with our Limited Partners.

So this is another significant focus on this growth area. And I must highlight here that in this alternate asset space, we are not very much present in the growth equity segment, but all other segments, which are credit, infra, we're just in the process of closing out a data center fund and a whole range of activities as we think about Kotak at the next level. With that, I'll now hand over to my colleague, Jaimin Bhatt, to take it forward from here.

Jaimin Bhatt: Thank you, Uday. Let me take you through this quarter numbers, quarter three for FY '23. Let's start with the consolidated numbers. The consolidated post-tax profit, we ended with a number just short of INR 4,000 crore. This is at INR 3,995 crore this quarter, which is against what we did INR 3,403 crore last year. On a quarter-on-quarter basis itself, it's about 11% growth, not annualized.

We've seen growth in our customer assets, and at the consolidated level, we are now at INR 3, 77,000 crore, which is roughly about a 22% growth on a Y-o-Y basis. If I take this quarter's profit, the ROA would be at 2.76% versus what we did 2.6% a year ago. And our ROE at consolidated level on this quarter would be at 15% and for the nine months, it's about 13.5%.

The bank, as Uday mentioned, contributed 70% of the profits for the quarter, bringing in INR 2,792 crore of post-tax profit, which is 31% higher than what we did this quarter last year and 8% on a sequential basis.

The two NBFCs, Kotak Prime and Kotak Investments clocked in better profit this quarter versus the previous quarter, Prime bringing in INR 225 crore and KMIL bringing in INR 86 crore. Kotak Prime has seen the vehicle book grow to at about 24% on a Y-o-Y basis. Kotak Investments also showed a rise in the advances during this quarter recently. The Microfinance Business Correspondent, which is done through BSS, brought in a post-tax profit of INR 82 crore this quarter as against INR 26 crore a year ago.

The capital market subsidiaries, KMCC and Kotak Securities, again, sequentially bringing in better numbers at INR 269 crore versus the previous quarter. So last year, quarter 3 had a much better capital market run and therefore driving profits. Kotak Securities continuing to have decent market share, 10.1% on the cash market and 5.8% at the overall market share.

The Life Insurance Company bringing in improved performance from INR 247 crore in quarter 3 last year to INR 330 crore this quarter. The mutual fund business bringing in INR 150 crore this quarter, somewhat helped by capital gains which we booked this quarter, which was on similar lines as we had booked in the same period last year.

The capital and reserves, the net worth of the group standing at about INR1, 07,000 crore with capital adequacy at 23.2% and a healthy CET1 ratio at 22.3%. The bank itself having a net worth of INR 80,000 crore thereabouts. The two NBFCs, again, adequately capitalized with 30% capital adequacy ratios and ROA for both of them being in excess of 3%. At the bank level, PAT of INR 2,792 crore for this quarter. The NII growth over the same period last year at 30%. We closed this quarter at INR 5,653 crore, which is compared to even the sequential quarter is 11% higher number.

The advances at the bank crossing the INR 3, 00,000 crore mark, we ended with INR 3, 11,000 crore, which is about 23% higher than what we did one year ago. The credit substitutes, again, showing a sharp growth at 30%-odd for the year. With credit substitutes, our total customer assets now at INR 3, 39,000 crore. The unsecured retail, as Uday talked about, we are now at 9.3% of our advances. And the NIMs have grown from what was 5.17% in the previous quarter to 5.47% in this quarter.

As we talked last quarter, a large part of our book is on floating rates, 69% to be precise, with EBLR comprising 55% of that book. In addition to the floating rate book; of the fixed rate, 9% of that book is something which matures in the next one year. On fees and services, again, we've seen a growth of 23% on a Y-o-Y basis coming both from the distribution and the syndication income side as well as from the general banking fees. The HTM book currently stands at 32% of our total investment book with a modified duration of HFT plus AFS, net of the OIS being at 1.1 year.

As Uday talked about, we have pushed for growth, and which has resulted in higher costs, particularly on the non-employee side. As of 31st December '22, we ended with 39 million customers, which is compared to 30.7 customers a year ago. At the bank level, our operating profit at INR 3,850 crore, about 43% higher than what we did last year. On the same lines as we've done in the previous periods, we have reversed our COVID provisions on the same formula, and we continue to carry about INR 400 crore of credit cost to COVID provisions. Credit cost for this quarter, which is without considering the COVID reversals or restructuring, but including standard provisioning, we ended with 0.27%.

Our GNPA numbers have dropped from INR 6,983 crore a year ago to short of INR 6,000 crore now, with the GNPA percentage standing at 1.9% compared to 2.7% a year ago. With the PCR of close to 78%, our net NPA is at 0.43% versus 0.79% a year ago. Slippages, again, have dropped this quarter at INR 748 crore, of which INR 171 crore did upgrade during the same quarter.

Our fund-based restructured COVID resolution as well as MSME together is about 0.25% of our advances book. Our SMA2, which is for fund-based for borrowers with exposures of INR 5 crore plus is at INR 191 crore with CASA now standing at 53.3%. The capital adequacy of the bank, again, continuing to be healthy with CET1 itself at 20.7%. I'll give it to Manian to take up the customer asset book on the wholesale side, please.

KVS Manian: Thank you, Jaimin. Good evening. I'll take you through the corporate bank and the wholesale businesses. As we usually do, if you look at the corporate banking, SME and the credit substitutes together, our growth is in the early teens if we compare on a Y-o-Y basis. On a Q-o-Q basis, it's 6%, driven somewhat by some DCM assets that are still waiting to be sold out. The growth needs to be also seen in the context of IBPC of INR 945 crore that we have done in this quarter. The competitive pressures on pricing have been significant in the quarter and we did see compressed spreads in the business.

The uptick in credit substitutes in well-rated space continues to be our strategy to combat the irrational pricing in this market, so that we can optimize our PSL costs suitably. Credit costs remain extremely low and the general asset quality is better than any recent years we have seen in the past. Very low SMA0, SMA1, SMA2, very low delinquencies. Also the ECLGS portfolio in the SME book as well as for the entire bank continues to hold very well, and there is no difference that we noticed in the credit quality of the ECLGS book vis-a-vis the rest of the non-ECLGS book.

Our fee income continues to grow well in this space. DCM had a very good quarter. It had some marquee transactions spanning across sectors - CRE, infrastructure, NBFCs, manufacturing. We also had good growth in forex, as well as CMS fees. On the liability side, we continue to see good traction on the non-custody current account business. Custody side of the current account is impacted by the state of the markets. We are in the process of also bringing more focus structurally on the mid-market segment, between SME and Large Corporate segment. Some other areas that we remain focused and are continuing to focus are SME, where you can see faster growth than the rest of the corporate bank at 25% Y-o-Y, structured lending, infrastructure financing, especially of completed assets in roads and renewables and securitization as a product. Some other sectors and segments that amongst many mentioned are, one, of course, in the CRE side, we remain focused on the residential real estate. We see continued traction in the real estate new sales, though, we are seeing some early stages of some moderation in the pace of sales in most markets. And on the commercial real estate side, we continue to remain cautious, primarily driven by pricing than by availability of assets. NBFC sector has seen good growth and the health of this sector appears stable and we have grown in that space slightly faster than the rest of the wholesale bank. And as I said, SME, the credit quality continues to be excellent and our focus on NTB continues there. And our Y-o-Y growth in advances is relatively faster in this segment than the overall wholesale business.

I'll now hand over to Shanti for taking you through the rest of the assets.

Shanti Ekambaram: Thank you very much, Manian. And I will take you through the highlights of the commercial banking business, which showed very strong growth this quarter.

I'll start with commercial vehicles. The commercial vehicle industry continued its growth momentum with YTD December growth at 46% Y-o-Y and Q3 at 17%. Interestingly, all three quarters have seen similar unit sales for the industry, and we expect Q4 to be marginally better.

Overall, operator economics are working fine with freight demand remaining good and improvement in the availability of return load. Within commercial vehicles, the passenger, the bus segment has shown a very strong growth coming out of COVID across segments of employee, school, and travel. Collection efficiency continues to be stable and back to pre-pandemic levels. Kotak has grown the business strongly during this period and the disbursements continued to grow at almost double the pace of the industry, and this has helped us shore up market share in this segment. We will continue to build our book and market share focused on risk-adjusted return and deepening our distribution across geographies.

Construction Equipment, the industry has seen a strong and consistent growth during the year. In fact, in Q3, we saw a recovery of demand for road equipment, and also after an elongated rainy season, we saw that the asset utilization has improved. Collections have been stable. We continue to grow faster than the industry in this segment on our disbursements and have improved our market share. We will continue to grow the market share in this segment.

Tractor Finance, the tractor industry grew at 10.5% Y-o-Y, similar to H1. Better crop yields and firm commodity prices ensured good cash flow in the hands of the farmers. There has also been a pickup in the commercial deployment and collection efficiencies have improved and are better than the pre-COVID levels. We continue to grow our disbursements strongly across both new and used tractor financing and have grown faster than the industry in all the 3 quarters. Given the good monsoon and robust cash flows, the outlook for the industry continues to be good, and we remain focused on this segment and continue to lead.

Our Microfinance business continued its strong momentum growth in Q3. We've grown 100% plus Y-o-Y. We are happy to announce that our retail microfinance business crossed the 1 million customer mark during this quarter. Collection efficiencies in this segment are holding up very well, and which shows the ability of the customers to honor their repayments. We see good credit demand in the rural economy, and our MFI business is well poised to leverage this for the coming quarter. We have expanded our presence into 3 new states, Gujarat, Rajasthan, and UP apart from where we are, which is Karnataka, Bihar, TN, MP and Maharashtra. There is a large unserved market that requires access to formal credit, and we will focus to continue our growth with the same risk-adjusted returns that we see.

Agri SME, as Manian talked about, I think the credit in the SME segment is seeing a pickup and that also is shown in the agri traders and the processors. Farmers were holding on to the produce anticipating higher price realization. They have shown growth in Q3 and are likely to see this growth continue into Q4.

The cash flow cycle as well as limit utilization is comfortable. And our credit costs have been reducing due to recovery of delinquencies. We continue to grow at a healthy pace in this business. Overall commercial bank showed strong growth this quarter and will continue into the next quarter.

I now request Virat to take you through the highlights of the consumer banking business.

Virat Diwanji: Thanks, Shanti. I'll take you through the quarter 3 numbers for consumer bank. I'll start with consumer assets. We continue to gain market share in quite a few product lines. As you are aware, we are on the path of improving our positioning in the credit card and personal loan business. Our unsecured portfolio in consumer bank is moving at a faster clip, and we have grown at about 75% Y-o-Y and 12% on Q-o-Q basis.

Our mortgage lending business continues to grow well at 29% on a Y-o-Y basis, and we see a good traction both in home loans and loan against property segments. Also this book is holding very well on all parameters of collections in spite of increase in the EMIs linked to repo rate hikes.

On credit card, we had yet another good quarter. Our market shares have been steadily growing, both on spend and cards in force. We are strengthening our cobrand product suite further and are going live with Indian Oil for fuel-centric products. In our endeavor of driving customer experience through mobile-first approach, we went live with 3 key services on mobile banking in STP mode for our credit card customers. They were credit line increase, credit card replacement and card upgrades. We have seen a strong positive jump in consumption of the services post digitization. Our overall credit card advances grew by over 85% on a Y-o-Y basis.

We have scaled up our customer acquisition in both traditional and data-led digital space for personal loan. Significant proportion of personal loans continue to be sourced digitally. Our focus has also been on digitally service our loan customers post acquisition, and that has shown a significant amount of traction in Q3 of FY23.

Moving on to the business banking assets. Bank continues to focus on growing business banking franchise, both on assets and liabilities with manufacturing sector gaining momentum and services sector opening up, we find growth across all customer segments and locations. We continue to register healthy credit growth in this segment with focus on superior risk-adjusted returns.

Our strategy of adopting 360 degree digital-first approach for our business customers is yielding positive results. We have witnessed a very good traction on adoption of various digital offerings like Digi OD, Merchant One Account, FYN for trade customers, including digitally signed agreements for our customers.

We now move on to the liabilities. In absolute terms, the overall incremental deposit growth in Q3 vis-à-vis Q2 saw a marked improvement over previous quarter with major contributions coming from TD. The factors that impacted the SA growth in the earlier quarter continued, which was essentially movement of SA by HNI, that is balances over INR 10 lakhs to more lucrative investment options in Q3. The second thing which came up or which impacted the SA growth was non-replenishment of government money in some government department accounts.

However, traction on granular retail savings account, both on acquisition and deepening has improved in quarter three, which denotes the core strength of the savings franchise at the bank. In Q3, the trend of our customers opting to use our platform in paying GST, customs duty, and income tax was very encouraging. This trend over coming quarters is likely to give a positive boost on CASA balances. We have gone live with launch of end-to-end digital journey for all types of savings accounts in this quarter. This, again, is expected to give positive boost to customer acquisition.

During this quarter, we launched a completely revamped product offering for our corporate salary customers, which puts us at par among the best offerings in the industry. This will help us to penetrate within the existing relationships and facilitate acquiring newer corporate relationships.

Continuing with our focus on granular build-up of low cost and stable deposit, our current account acquisition in nine months period on a YTD basis has witnessed a healthy growth of 25%, leading to a book growth of about 11% on a Y-o-Y basis. The traction on Merchant One Account launched in quarter two saw encouraging adoption by customers. We believe this will help us in attracting new customers while positively impacting the balances of existing customers going forward.

As we aligned the rates on term deposits to market rate, we were successful in locking the outflows from the savings deposits for a longer duration term deposit. Term deposits growth trajectory change showed the growth of about 32% on a Y-o-Y basis as on December 22.

With that, I'll pass on to Dipak for digital.

Dipak Gupta: Thanks, Virat. On the tech side, you'll see a lot of work this quarter on the digital side, and Virat has outlined a lot of them essentially on the retail, consumer side, both liability side as well as the asset side, reasonable amount of work on the merchant side, again, some of them, which Virat talked about, and also on the business banking side. Developments have been in the area of payments, basically a lot of customer journeys, a lot of journeys have become DIY now or are in the process of becoming DIY.

A reasonable amount of digital work on cross-selling, API Banking, and a lot of similar other initiatives. Some of these are outlined in the slides that are sent out to you. Again, an increasing number of efforts really on controlling payments and payment-related businesses. All of these developments will fall in place over the next couple of quarters. However, one of the aspects I'd like to highlight is the significant effort all of us are putting and the investments Milind and his tech team are really making at the back end.

And these are really very interesting aggressive investments, which we are making in building a capacity and the back end, improving significantly our overall resiliency of systems, improving our latency, increasing our cyber trust on the digital side, and interestingly, ensuring that we increase our engineering capability in-house. And all of these hopefully will fall in place over the next couple of quarters and you will see the benefits of these as we go forward. With that, I'd hand it over to Jaideep, to take you through Kotak Securities.

Jaideep Hansraj: Thanks, Dipak. Hello, friends. This is on Kotak Securities. We continue to go through challenging times in the equity space with continuous drop in average volume on the cash market. At the same point of time, significant increases happening in the options market. The total income for Kotak Securities for the three months ending December '22 is at INR 646 crore. This compares with INR 656 crore for the same period last year and INR 631 crore for the previous quarter.

The profit before tax is INR 319 crore versus INR 359 crore for the same period last year and INR 298 crore for the previous quarter ending 30th September. The PAT closed at INR 241 crore for 31/12/22 versus INR 270 crore for 31/12/21 and INR 224 crore for the previous quarter.

The overall market share, which includes F&O has seen a strong jump to 5.8% versus 3.0% as what Jaimin mentioned earlier as well. There has been a marginal drop in the cash market share in this quarter. With this, I'll hand over to Nilesh for the AMC.

Nilesh Shah: Thanks, Jaideep. Good evening, friends. Let me take you through our asset management business. Our equity average AUM grew 13% to INR 1.59 trillion. However, our debt AUM de-grew by 12% to INR 1.24 trillion. This resulted in total AUM remaining almost flat at INR 2.89 trillion.

Our active equity AUM market share grew to 6.4%. SIP inflows for December '22 grew 19% year-on-year to INR 8.2 billion. Our retail AUM stands at 55% of total AUM spread over 4.7 million unique investors. Our profit after-tax was almost flat at INR 150 crore for December '22.

Our total assets under management across mutual funds, portfolio management fee, offshore insurance and alternate assets grew 5% year-on-year to INR 4.05 trillion, led by 61% growth in alternate assets. I will hand it over to Dipak Gupta.

Dipak Gupta: So just to carry forward from that point where Nilesh left off. Normally, Nilesh is very bullish on the AUM increase on the mutual fund side, but this time, he is practically flat and we have very significant increase if you see on the alternate asset side. And Uday touched upon this in the early part of his message. We've seen very significant interest and increasing interest on the alternate space.

In this quarter, we basically got the big jump that you see on the commitment side, is on the infra side as well as the real estate side. But looking forward one sees very significant interest also on our strategic assets side and you will see investments from leading traditional LPs on that side also. And like Uday mentioned, we expect to hit the INR 40,000 crore odd assets under management or commitments shortly. And from the firm's point of view, again, what Uday touched upon, we hope to be keeping a reasonable investment in this business, and our own commitments should be around the 15% range in each of these investments.

Moving on to Kotak Prime, the markets have improved. Actually, December was a pretty good month. We've seen the return of discounts at the lower end in the marketplace. January is sort of tepid, but hopefully, expect it to pick up. Again, something which we mentioned in the last time, we've seen very significant shift in the marketplace for first time, buyers going straight to the Level two cars rather than entry level cars and that trend seems to be continuing.

Overall, industry should end somewhere between 3.8-3.9 million this year. However, next year growth at this point of time looks like being less than 10%. Overall from KMP's point of view, the quarter-on-quarter profits are more or less stable. If you recall last year, we had a lot of profits coming from the Volkswagen acquisition that we did, the Ford acquisition that we did, some of those are tapering off, but we expect to maintain some of these profitabilities as we build the two-wheeler and the LAP portfolio out of KMP.

The next one is on Life Insurance. Life insurance, again, we seem to be now back to pre-COVID levels. Claims are more respectable back to, like I said, pre-COVID levels. Overall, private sector industry individual business growth has been healthy at about 15%-odd. We have grown slightly better at about 17%-plus.

The group business has grown reasonably well this time and our own growth is close to about 23%-plus in that area. The revised or the normalized death claims at pre-COVID levels are reflected in the PAT. The PAT is back to a healthy respectable number. And Jaimin mentioned that we are up from about INR 270 crore last quarter to INR 330 crore this quarter. And our solvency in all of this remains healthy at 2.88%.

With that, I hand over back to Jaimin to summarize.

Jaimin Bhatt: Thanks, Dipak. We would be open to taking questions from – in the queue.

Moderator: First question is from the line of Kunal Shah from ICICI Securities.

Kunal Shah: Congratulations for a great set of numbers. So firstly, in terms of opex, if you can just call out, particularly on the overhead side, some sharp rise which has been there. And where are we in terms of our journey of investments because cost to income even on such a high base of margins, improved fee income trajectory that's still continuing at 50%-odd. So, and maybe where are we in terms of that this year?

Jaimin Bhatt: Kunal, if I might just take some of them which happened. We've talked about the fact that we are in an investment phase and we will continue with this. So this period has certainly seen some of the spends higher on the promotional activities in the festive season. We're also continuing to see the higher costs on the IT and related activities. The cost of growth is both on the asset side and the liability side, asset side with respect to acquiring the customers and the payouts to the BSS as well as on the liability side, which is when we aggregate the accounts. So it's been there and as we've mentioned that the investment phase will continue for some time and possibly this year and somewhat going into the next year also.

Kunal Shah: And credit cost would, credit card would further add on because there also we are seeing a significant traction out there and costs attached to it would be relatively on the higher side?

Jaimin Bhatt: Yes. So, as Virat mentioned, yes, we have focused on the credit card business, and yes, we do intend to push that further.

Kunal Shah: And secondly, in terms of the repricing of loans, so where we are seeing in terms of margins, that's clearly a reflection of the EBLR and MCLR. But are we largely done with the repricing part of it or still there is a benefit which is yet to reflect?

Jaimin Bhatt: Kunal, it's like this. The continued rise in the repo rate, as you mentioned, 55% of our book is EBLR-linked and all of that is repo-linked. As we've seen the rise in repos coming in from April this year, you've seen the quickness with which you pass that to the borrowers is faster than what you're seeing in the rise of cost of funds, and that is continuing. You've seen the last rise in repo happened in December, which part of that benefit you've seen in this period, but some of that will go into the current quarter. So as long as this pickup of the repo continues to happen, you will see some growth happening. Of course, there is another 14%- 15% of the book on the MCLR, which also gets repriced.

So as long as that continues, we are going to see some pickup happening, maybe not as sharp, but the growth of the margins will possibly be in that direction. Of course, over a point of time, once the repo stops, you'll see some of that coming off.

Kunal Shah: So if the repo is to stay here, then then only the MCLR benefit is something, which will be reflected in repo...

Jaimin Bhatt: That's right.

Moderator: The next question is from the line of Hardik Shah from Goldman Sachs.

Rahul: Yes. This is Rahul here. Wish you all a very congratulations on a good set of numbers and then also Happy New Year. Just two, three questions. One is the level of margins that we have, it's unquestionably strong, and of course, the loan book mix is also changing.

How do we plan to spend, spend, there is, of course, the opex has been high, but when we see the branch expansion and the strategy from some of the largest bank is to also ramp up distribution network. How should we think about that given that you've got a lot of capacity now on the income side to kind of keep beefing up the ground level presence?

Jaimin Bhatt: Sure. Maybe I'll just request Virat to take up the branch expansion and related question.

Virat Diwanji: Yes. Look, we continue with a journey of our measured expansion on the branch network. However, we also take the cognizance of the fact that the digitally done transactions are significantly going up. So, while the branch presence is necessary, but the transactions are moving up, and hence, we will have to take a measured step in expanding. And in line with that, we will do, we are planning to do about 150 odd branches in the next financial year.

Rahul: So where are we in terms of our digital investments? I mean, we have been investing a fair bit in the last, I think two years now. How much more is yet to be done? And how expensive it is to kind of keep bumping money to digital?

Dipak Gupta: Digital is an ongoing one, Rahul, but what happens with digital is, you have to keep upgrading the back-end also, yes, because capacity planning and resilience planning with increased digital becomes extremely important and you have to actually put in that investment upfront. Yes, you look at a simple thing like UPI itself, volumes in the last one year are practically 2.5x.

Now that volume increase capacity while you will increase your front-end, yeah, has to be matched with equal investment at the back-end. So that investment will keep happening, yes, and then you don't have an option over there. In addition to that, on the tech side, the other digital investments really will be as we acquire larger and larger base of customers and a lot of these customers are really mass retail customers, it is extremely important to keep them engaged, yeah. So things like cross-sell, engagement, again, require very significant digital investment.

So, some of these already are on a path, yes. For example, like I mentioned DIY, increasingly both on the asset side as well as the liability side, and actually even on the SME side for that matter, will become DIY, that is significant investments. The journey has started. These will just keep going up and up as we move forward.

And countering this really, Kunal asked about expenses on the other end, while tech costs go up and give you efficiency in delivery, manpower costs, hopefully, will come down progressively, yes, because you gain efficiency replacing or compensating the manpower cost with tech cost really. So, you have significantly better productivity arising out of that.

Rahul: Fair enough. Thanks, Dipak. Just an extension is when do we start seeing the operating leverage kicking in at the back of these investments, have been made, you have been making?

Dipak Gupta: I think it will start by next fiscal, yes. A lot of our journeys are just about falling in place, give it about 1 or 2 quarters of settling down, and you will see the benefit of that coming from next fiscal really.

Rahul: Got it. Can I get the employee count as of end December?

Dipak Gupta: That we will have to ask Jaimin.

Jaimin Bhatt: We would be at about, in the bank about 78,000-79,000 at the Group, maybe just around the 1 lakh mark.

Rahul: Got it. Just 1 more question on the savings deposit side. So, of course, we understand that the TD rates keep rising and there is some cannibalization of deposits will happen from savings to terms. So at what stage can we start bearing the fruits of higher savings rate etc and the efforts that you've been taking and expanding capacity and reaching out to more customers or we will have to really wait for rate cycle to kind of turn and then start getting the benefit on savings deposits?

Dipak Gupta: I think both, yes. It has to be a combination of both, really. You will see savings move into term increasingly. But you see, as new customers come in, you will see granular movement on the lower level SA deposits. So you see what happens is in the beginning, the HNI category moves out on to the term side, yes.

Rahul: Yes.

Dipak Gupta: There is a lot of inertia at the lower end. But for the lower end to grow keeping pace with your funding requirements takes time. And that happens both through your ETBs i.e. your existing customers and your NTBs. So as NTB builds up through digital and physical channels, you will see that granular movement up progressively. We'll just have to give it time for catching up really.

Rahul: Fair enough. Just one last question if I can squeeze in on the home loan side. On a sequential basis, so while the YoY still remains strong, sequentially it has kind of moderated somewhat, still pretty healthy. And also tying in with what Manian talked about earlier, some early signs of moderation we've seen in mortgages. So shall we sort of start thinking about sequential growth in mortgages starting to come off or is there any other factor here maybe LAP growth slowing down, etc? So how should we think about the mortgage fees growing going forward?

Virat Diwanji: Look, at this stage, we have not seen any moderation on the demand side. There are huge rate pressures in that sense. But for the right customer, I think we are open and we are still committed to make sure that the quality mortgage businesses grow. So, and with the portfolio performing extremely well, it gives us the confidence to at least continue with our journey on growing this mortgages business.

Rahul: Fair enough.

Jaimin Bhatt: Rahul, before you go, just one correction. The headcount in the bank is about 73,000.

Rahul: Okay. Jaimin, what was it last quarter also? Sorry.

Jaimin Bhatt: I didn't get you.

Dipak Gupta: I think it was 71,000.

Jaimin Bhatt: Yes, we were at about 71,000.

Moderator: The next question is from the line of Abhishek M from HSBC.

Abhishek Murarka: Yes. So I think last quarter, the quarter before last, you had called out a normalized NIM of around 4.3%. What do you think your normalized NIM would be now?

Jaimin Bhatt: Look, NIM is actually at the end of the day a consequence of what we are, what the mix as well as what we get on the yields on the assets and whatnot. So we have always been a higher NIM number compared to what happens in the industry and have been going in the range of 4.5% plus. In the current year, the NIM has continued to grow on the basis of the factor, which we talked about. So as we speak, currently, we closed this quarter at 5.47%. As I mentioned, there is some room to even go up further before it starts moderating. So it will all depend upon how the things play out with respect to the movement in the rates as well as the movement in the mix of our asset book.

Abhishek Murarka: Sure. I appreciate that. The broader reason for asking the question is that, if that is to be a slightly steeper compression in NIM as the repo hikes stop and as the cost of funds catch up, then what levers do you have to really deliver a higher EPS growth in FY24?

Jaimin Bhatt: So, there are two things there. One is, we are seeing the change of the mix of our advances. We have seen the unsecured retail grow faster, plus a lot of the expenses and others which we talked about, including what Dipak explained, there is a lot of front-ending of the cost. And that cost as we get the benefits of that, some of those journeys finish, and some of those benefits, we would start seeing from the next fiscal.

Abhishek Murarka: Sure. Okay. The second question is on the cards portfolio. Can you share what would be the approximate revolve rates and what kind of ROAs are you looking at in the cards portfolio?

Jaimin Bhatt: Request Virat to take that.

Virat Diwanji: Look from the pre-COVID period, the revolve has significantly come down, but today, it is back to about 30%- 32% in that range. The thing is the EMI portion on that has grown over the period of time and the rise in the revolve is not that high.

Abhishek Murarka: What would the revolve had been pre-COVID?

Virat Diwanji: Early 40s.

Abhishek Murarka: Sure. And the ROA outlook there, just as, maybe the steady state ROA that you expect to make?

Dipak Gupta: I don't think we would talk about ROA at individual business levels. So I think see, we plan it across the group.

Abhishek Murarka: Okay, okay, no worries. And finally, in your SA portfolio, how do you define bulk and what percentage of it would be bulk?

Dipak Gupta: Well, we do not define the bulk separately as such, but typically about INR 50 lakhs normally, it tends to be regarded as bulk. It's basically more HNI type of customers who keep money with you in SA is generally regarded as bulk broadly and that's the category, which we've seen move out on to TDs or on to mutual funds really.

Moderator: Mr. Abhishek, may we request that you return to the question queue for follow-up questions. We'll take the next question from the line of Mahrukh Adajania from Nuvama.

Mahrukh Adajania: Yes. Congratulations. Actually my question is kind of a repeat question on margin. So, obviously, your margin performance has been awesome, but how to hold that?

So obviously, fourth quarter is good because if there is one more policy rate hike, we are good, but how do you hold that in FY24 because most people think policy rate hikes have peaked?

And also if you see your cost of funds on balance sheet averages and that may not be the benchmark for you, its daily moving averages. But on balance sheet averages, in the second quarter, there was a 40 basis points QoQ rise, now, of course, its 20 basis points. So why was there such a sharp rise in second quarter compared to the third quarter?

Jaimin Bhatt: See, I wouldn't have the second quarter and third quarter right now. I'll I can get back to you. But on the margins, yes, what you've mentioned is that we do expect some pickup right now. And going forward, yes, if things it may start sinking but there as we talked about, there are other things, which we're working on there.

Dipak Gupta: So Mahrukh, like Jaimin mentioned in the past, one is the product mix will change, yes, as the unsecured piece moves up, inches up, we will see an uptick arising out of that really. Second is, if you see, we were at a CASA of closer to late 50s two, three quarters back. That has come down in the short run. One, hopefully, we'll see CASA inching up back again, that should give you cost of fund advantage. And the combination of these should see us, not necessarily at these healthy levels, but at reasonably good levels of NIM going forward.

Mahrukh Adajania: Okay, got it. And my next question...

Dipak Gupta: And then ultimately, Mahrukh, go by the ROAs really and don't really get carried away by the NIMs really.

Mahrukh Adajania: Got it. And my other question is that what would be your best guesstimate for sector growth in sector loan growth and even deposit growth in FY24, because it kind of all boils down to that, right? So at the end of the day, individual bank growth is a derivative of sector growth, of course, there are market share gains as well, but..

Dipak Gupta: Sector meaning what? You're talking of product mix or...

Mahrukh Adajania: No. The total loan growth for the sector, which is currently running at 15%.

Dipak Gupta: We'll have to request Nilesh to comment upon.

Uday Kotak: He also wears the economics advisor hat, so.

Nilesh Shah: So we believe credit growth should moderate in FY24 over FY23 is the base expense. But again, the components will keep on changing, and a lot will depend upon budget as to what kind of push is given on infrastructure allocation.

Moderator: Ms. Adajania, may we request that you return to the question queue for follow-up questions. The next question is from the line of Saurabh from JPMorgan.

Saurabh: Sir, just two questions. One is on this provisioning. So your net slippage is negative this quarter, but you've continued to draw down on your COVID buffer, whereas some of your peer group, they are adding contingency. So how you're thinking about your credit cost? And do you think this 1% gross slippage rate is sustainable?

The second is, can you shed some light on the alternate business? So how much of that 15% have you invested right now? And that investment, I'm guessing will happen via the bank, right? And what will be the economics of this? Thank you.

Jaimin Bhatt: So let me take the slippage. The slippage has actually been positive. So if you're looking at sequentially, yes, we've dropped from about INR 980 odd crore to about INR 740-odd crore. But yes, you have a slippage, which is coming down. Recoveries and upgrades have been there during that period. So net-net, that results in a negative number. And we are quite okay with that, in the sense that we've seen this happening now for, I think the third quarter or the fourth quarter in a row where upgrades and recoveries have been higher than the slippage itself. We do believe that we have absolutely adequate coverage on our NPAs. We're currently at a coverage ratio of 78%.

On the COVID, we have followed a standard process with respect to a formula of how we are providing that and what we are writing that back. So the write-back is a pretty small number, but it's based on the same numbers, which plays the same process, which we've been doing over the last few quarters.

So that's broadly where it is. On the alternate, these are all committed numbers, not necessarily invested, but the investments will come across the group, it's not just the bank.

Saurabh: And what will be the fee that you get on this alternate business?

Jaimin Bhatt: I'm sorry. I missed.

Dipak Gupta: What, they depend on the fund, and vary from fund-to-fund. It's a combination of fixed fee, carry and distribution of carry. Yes.

Dipak Gupta: It varies. Typically, it's around the 1% range. Part of your income, the other bigger income is out of our own investment, which like Uday mentioned, we tend to be around the 15% range and then see significantly out of carry rate.

Saurabh: So of the total INR 6,000 crore you plan to invest, INR 40,000 crore, 15%, how much has got invested till now?

Dipak Gupta: Roughly about 40% is invested just now.

Moderator: The next question is from the line of Nitin Aggarwal from Motilal Oswal.

Nitin Aggarwal: So two questions like, one is, we are going full throttle in all the unsecured segments and our perception of Kotak has been a bank, which has always been conservative in underwriting and growth. So what's giving us confidence to avoid any incidents, because the guidance of around reaching the mid-teens, again implies like similar 80%- 90% growth next year as well in all the unsecured segments?

And second question is – I will read out the second question also around the CASA mix, we have a sharp decline from the peak, and of course, there is decline - the trend we are seeing across other banks as well. So how do you look fat this equation of CASA decline and the SA rates that we're offering?

Dipak Gupta: So I'll take the first one, Nitin, We were down to practically less than 7% unsecured retail. In our case, unsecured retail includes MFI. So that under 7% has gone to 9%, and like Uday mentioned, we expect to inch up towards the mid-teens. I think that's a reasonably cautious exposure to this area. I think a couple of reasons where the confidence comes from, I think A, if you look at the amount of data available now on customers and 90% of what we do on the unsecured side is essentially our customers, okay, existing liability franchise customers, the amount of data available is significantly higher.

B, The analytics capability is significantly enhanced, and we've invested a lot over the last two years and I'll probably have Paul talk about that. And C, you know all of these customers have been through two years of COVID, and hence, the comfort of lending back again to them is that much higher. Paul, do you want to talk about some of the assets?

Paul Parambi: See, over the last while...

Dipak Gupta: Paul is the Head of Risk. Paul is our CRO, yes.

Paul Parambi: So while in the initial periods of COVID, we hadn't really grown our retail book, we were conservative. But what we had been doing over this period of time is really invest significantly in our capabilities on assessing risk and identifying segments, which makes sense to actually lend to.

And so it's a combination of things. One is that we've built our capabilities significantly over this period of time. And two, is, of course, that we were starting from a low base. I think it's a combination of these two, which is taking us forward and we are very watchful as we grow. It's not that we're not looking at how it's growing. And so we are comfortable at this point of time.

Nitin Aggarwal: Right. And the second question around CASA mix and the rates, the SA rates?

Jaimin Bhatt: Yes. So if you look at the CASA rates which we offer today, I think across the board, we are about 50 basis points higher than what most of the peers are offering. So we keep evaluating that, but right now, we are at 50 bps higher. And you talked about the percentage drop. Yes, even after that we, at 53% CASA, I would think we have among the highest CASA ratios in the industry and the drop comes on ground, so the fact that there was a time during the early part of COVID and sometime thereafter, where we had kind of reduced our rates on term deposits, as a result, the term deposit growth had slowed down and the CASA has continued and which is where the equation went to about 60% plus of CASA.

As we started now growing the term deposit, the denominator effect is coming into play and that's brought it down to 53%, which is where, again, as I said, we are possibly the highest in the industry still.

Moderator: The next question is from the line of Prakhar Agarwal from Elara Capital.

Prakhar Agarwal: Yes. Just two data packing questions. What was the LCR during this quarter?

Jaimin Bhatt: LCR consolidated, we were at 121.4%...

Paul Parambi: Yes, 121.4% was the LCR.

Prakhar Agarwal: Second bit is, so you sold around INR 945 crore of IBPC. Would that have any impact on margins? And if yes, what would be the impact, if you could quantify or explain the rational?

Jaimin Bhatt: We haven't quantified it, but the impact, if at all, would be pretty marginal, because that continues to be the earning asset in any case.

Prakhar Agarwal: And just, last thing, so supposedly if I were to just make an assumption that there'll be no further repo-rate hike, when do you see this cost probably rising more than probably we have been seeing continuing impact of lending rate rise. So, if at all, if I want to make an assumption that further here on there'll be no rise in repo-rate, when do you see this margins peaking out for us? Maybe a quarter, or two quarter, what is your assessment based on the cost that is coming up over the next two, three quarters?

Jaimin Bhatt: They also depend on the mix of the asset book, how much is fixed floating, how much is repo-linked, again, the mix of the asset side with respect to what is say, home loans versus unsecured. So it all depends on that. So it will spread over depending on all equations spread over one or two quarters.

Moderator: The next question is from the line of Mihir from ENAM Holdings.

Mihir: I just had a technical question like why does Kotak does not increase the FII limit to say 74%? Because I believe the limit is capped to, say, around 55%. So if it's increased, and I believe the MSCI rate can actually increase almost double from here. So can you just like guide on this?

Jaimin Bhatt: Look, Mihir, at 55% current, if I have to remember, current numbers will be around 42%, 43%, thereabouts around that number. So the 55% has never been a hindrance to anybody wanting to come and invest in us. The red flag or whatever the flag raises at 3%, yes, we've never seen anywhere near that. So we'll evaluate as it grows. Right now, we're quite comfortable where we are.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. Uday Kotak for closing comments.

Uday Kotak: Thank you very much. And I just wanted to end based on all the discussions here, a little bit of back to strategy. In October 2020, after the first six months of COVID, we as senior leadership of the bank decided that this is an opportunity for us to work towards transformation in terms of how we thought about the future, particularly on technology and some of the other spends, including on growth outlook, as we looked at the world beyond COVID.

And we've followed this strategy from 2020 October-December quarter to roughly now a little more than two years as we get into 2023. And the important part of this strategy has been to front-load a very significant amount of investment into what we want to do. And this front-loading, obviously, leads to higher operating cost in the short run. And in the short run, we do effectively burn our boats at both the ends, higher front-end cost on the one hand, and at the same time, the technology cost plus the people cost, combined hitting us at the same time.

Over time, as technology starts taking over a lot of the digital and STP, and DIY journeys, it starts giving us greater operating efficiency in terms of our operations. We see that coming in at some point of time in the next fiscal year. Now, whether it's the second quarter, first quarter, third quarter, we are watching it very closely. But the decision to front-load the operating cost was a very conscious decision to change the trajectory of our mindsets, both on technology, consumer, and a significantly more positive growth mindset, including as Paul mentioned on investment, in risk analytics and other areas to change the trajectory and direction of our future.

So you will see, and of course, we have been fortunate with the fact that the interest rate cycle has, in the last nine-months, been extremely positive from the point of view of a banking company, which has given us a pretty good margin growth, which has coincided at the same time when we were front-loading the cost. We see going forward as costs get better and as margins get to more normalization, assuming that we are closer to the end of the interest rate cycle. And my advice is don't take it for granted. Inflation can be sticky.

I'm saying, the base case is that it moderates or it sort of peaks out, but that's not 100% or a very 90% plus probability. There is a scenario where inflation comes back or remains sticky, and rears itself sometime in quarter two or three next year. Therefore, that is another scenario you have to be ready for or we have to be ready for. But assuming the base case plays out, we do see the fact that we have front-loaded cost at a time when we are getting much higher returns on our interest earnings has actually, and this is, we did not design such a high increase in margins. This happened at a time when there has been, by design, a high increase in cost.

And the key, if I had to look at a continuing Goldilocks outcome for Kotak, it would be stabilization of interest rates at overall higher levels, which continue to give us reasonable margins. Our mix change, our technology investments start beginning to pay off, including DIYs, STPs and others, and moderation in ongoing operating expenses as we continue our growth down the asset path, and hopefully, even on the deposit side with a lot of the high-end money going away from our savings accounts, we come to a position where granular growth starts taking over the so called decline.

So this is a Goldilocks outcome. But we got to see how it plays out. And in this world, post 2020, you always got to keep one thing in mind, never say never that nothing can happen. So on that note, let's bring this conference and this meeting to an end. Thank you very much.

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