“Axis Bank Limited Q1 FY'17 Earnings Conference Call”

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Moderator: Good Evening, Ladies and Gentlemen, and Welcome to the Axis Bank Conference Call to discuss the Q1 FY'17 Earnings. As a reminder, all participant lines will be in the listen-only mode. Please note that this conference is being recorded.

Participation in the conference call is by invitation only. Axis Bank reserves the right to block access to any person to whom an invitation is not sent. Unauthorized dissemination of the contents or the proceedings of the call is strictly prohibited and prior explicit permission and written approval of Axis Bank is imperative.

Axis Bank team is represented by Mr. V. Srinivasan -- Deputy Managing Director; Mr. Jairam Sridharan -- CFO; and Mr. Rajiv Anand -- Executive Director. There will be an opportunity for you to ask question at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" then "0" on your touchtone phone.

On behalf of Axis Bank, I once again welcome all the participants to the Axis Bank conference call. I would now like to hand over the conference to Mr. Jairam Sridharan -- CFO, Axis Bank to begin with the presentation. Over to you, sir!

Jairam Sridharan: Thank you, Malika. Ladies and gentlemen, good evening. I welcome you to our conference call for the presentation on the Bank's performance for the first quarter of the financial year 2017. On this call with me are my colleagues, Mr. V. Srinivasan -- Deputy Managing Director and Mr. Rajiv Anand -- Executive Director (Retail Banking).

At the end of this presentation, we will be glad to respond to your questions. For parts of this call, we expect to refer to slides in our quarterly Earnings Presentation. So you might want to keep the Presentation handy.

Key themes for the quarter's performance; there are five key themes that I like to point out:

#1. Asset Quality Stress:

In previously indicated pockets continues to get crystallized. We have witnessed significantly higher slippages during the quarter, predominantly from the Watch List segment of the corporate portfolio. Fund based outstanding of the Watch List accounts has decreased to ₹20,295 crores. This quarter, we have also disclosed the non-fund based outstanding in our Watch List portfolio, which stands now at ₹2,562 crores.

#2. Business growth remains strong:

Growth momentum is healthy with balance sheet and loan growth at 18% and 21% respectively. CASA balances grew at 18% and comprised 43% of deposits.

#3. Operating Earnings profile has been steady:

Underlying earnings quality remains steady, with operating profit margin at a healthy 3.41% of average assets. Three factors have driven suppressed net profit growth – NPA provisions, the consequent interest reversals, and growth in OPEX because of our stronger branch growth compared to last year.

#4. Strong performance on the retail franchise:

The retail franchise of the Bank had another good quarter -- with saving accounts growth of 18% Y-o-Y and core retail loan growth of 26%. The share of core retail advances excluding FCNRB deposits is now at 40%, up from 38% last year. We are now the 4th largest credit card issuer in the country, with a card market share of 10%.

#5. Strong Capital Position:

We remain well capitalized to pursue growth opportunities, with our Tier-I ratio at 12.38%, up from 12.15% last year.

I shall dwell on these themes in greater detail as we go along.

Let me begin my detailed comments with our perspective on the macro situation as it looks for Indian banking today. There are three points here worth making.

First – Fragile and uneven global recovery. Growth in the U.S. and China slowed during the first quarter of calendar year 2016, but Euro area and Japan growth was better than expected. Uptick in commodity prices helped commodity exporting countries, though the outlook on EM growth remains challenging.

Global financial markets and flows to emerging markets recorded gains during April-May, but turned volatile around the Brexit poll. In this context, ultra-accommodative monetary policies by major global central banks seem likely to continue in the near term.

The second worth making is on the mixed data on domestic growth, with a slight positive bias. The provisional estimate of gross value added for 2015-2016 at 7.2% was marginally lower than the advance estimate, on account of deceleration of services sector activity. However, the monsoon so far has been in line with the IMD’s forecast of an above-normal and well-distributed monsoon, thus providing an optimistic outlook for FY'17 growth, especially in rural growth.

Industrial growth remained muted during April-May due to low investment demand and weak rural consumption. Public investment, especially in roads and railways, has been better, though private investment remained weak.

The third worth making on the macro is around easing liquidity, but stagnant bank credit growth. CPI inflation rose more sharply than expected due to a more-than-seasonal jump in food prices driven by lower supply, while core CPI inflation broadly remained flat. Consequently, policy rates remained unchanged. RBI injected liquidity through variable rate repos and OMO purchases of ₹805 billion during Q1 in pursuance of the revised liquidity management .

Credit growth, however, continues to be tepid, with non-food credit growth declining during the quarter from 10.3% to 9.8%.

With this macro backdrop, let me now discuss the Bank's performance in greater detail:

Starting with asset quality:

In April 2016, the Bank published a Watch List of accounts, which the management assessed to be the key source of stress in the corporate lending book over the next two years. I would like to highlight a few developments on this Watch List this quarter. You might want to refer to Slide number 24 in the Presentation.

Fund Based outstanding of Watch List accounts fell to ₹20,295 crores, driven by slippages into NPA during the quarter.

Non-fund based outstanding was ₹2,562 crores, down from ₹2,626 crores as on 31st March.

Our quarterly review did not reveal any account to upgrade out of the Watch List this quarter.

Total corporate slippages were ₹2,911 crores during the quarter, of which ₹2,680 crores or 92% came from the Watch List portfolio.

We will in future referring to the term "Dissolution Rate" to quantify the proportion of reduction in watch list outstanding as a proportion of original watch list outstanding. For the current quarter the Dissolution Rate stands at 10.3%.

In the quarter, during the periodic rating review of our corporate loan book, some exposures have been downgraded. These downgrades were concentrated around the Watch List portfolio and you can see that data on slide number 25.

Moving on from the Watch List:

Up-gradations and recoveries from NPA in first quarter were at ₹140 crores and write-offs at ₹32 crores. Consequently, the net addition to Gross NPA pool during the quarter was ₹3,466 crores.

Provisions and contingencies other than tax for the quarter were ₹2,117 crores against ₹1,122 crores last year. Of this, provisions for loan losses were ₹1,823 crores, provisions for standard assets including un-hedged foreign currency exposures were ₹238 crores, provisions on SDR accounts was ₹71 crores and there was a write back of ₹18 crores on account of investment depreciation.

In the standard assets provision bucket, we have provided the balance requirement of ₹51 crores against one entity in the food sector as per an RBI directive to all banks and exposure to that entity. We hold a total standard asset provision of ₹156 crores against this entity now.

There are also two accelerated pieces of provisioning that we have done in this quarter. As part of AQR, RBI had instructed Banks to set aside an incremental 10% provision against a pool of select assets in a phased manner during fiscal year 2017. This amounts for us works out to. ₹142 crores. Instead of phasing it out over the four quarters, we have provided the entire amount in this quarter.

Similarly, on SDR accounts, where we are required to make a provision of 15% in a phased manner over period of four quarters, we have provided the entire amount of ₹71 crores in this quarter.

Our annualized credit costs for first quarter FY'17 were at 198 basis points. We indicated in our previous earnings call that we expect the slippages to have a bias towards the first-half financial year 2017. That is what you are seeing reflected in this number. For the full year, we continue to expect credit costs to be within our expected range of 125 basis points to 150 basis points.

During the quarter, fresh gross slippages into NPA stood at ₹3,638 crores of which gross corporate slippages stood at ₹2,911 crores. On a net basis net slippage in retail and SME stood at ₹257 crores and ₹306 crores respectively. Q1 is typically a seasonally weak quarter for retail NPLs especially in the retail agriculture segment, and we expect seasonality patterns on non-corporate slippages to continue this year.

Our net restructured book stands at ₹7,363 crores with fresh restructuring of ₹544 crores during the quarter. This was on account of the shifting of the DCCO that is the Date of Commencement of Commercial Operations of two accounts.

We witnessed ₹888 crores of slippages from the restructured book during first quarter.

During the quarter, the Bank has implemented Strategic Debt Restructuring or SDR in two accounts of which one account was already an NPA. The underlying loan amount is ₹252 crores.

The Bank has also implemented the 5/25 scheme for four accounts where the outstanding loan amount was around ₹790 crores.

The cumulative outstanding value of the underlying loan amount for SDRs and 5/25 undertaken by the Bank so far, is around ₹850 crores and ₹3,500 crores respectively.

We have not sold any assets to ARC during the quarter.

Gross NPA for the Bank was at 2.54% as on end June 2016, up from 1.67% in fourth quarter of FY'16 and Net NPA at 1.08% from 0.70% in fourth quarter. Our provision coverage ratio stood at 69%. Our intent is to keep the provision coverage ratio around 70% by the end of the year.

As on 30th June 2016, the aggregate impairment i.e. net NPAs and net restructured assets as a percentage of net customer assets stood at 3.07% vis-à-vis 3.28% as on 30th June 2015.

Let me move on now to the next theme – that of strong growth in our advances portfolio.

Aggregate loan growth remains healthy, at 21% Y-o-Y.

Retail lending continues to grow strongly, with a Y-o-Y growth of 26% this quarter, excluding loans against FCNR-B deposits.

A few details on this growth:

Our retail lending growth continues to be led by home loans, unsecured personal loans and credit cards.

Internal customers continue to be the mainstay of the Bank's strategy for sourcing retail assets. Roughly two thirds of the incremental acquisitions for retail loans continue to be the Bank's existing deposit customers.

97% of the Bank's credit card and 78% personal loan originations in the quarter were from existing customers of the bank.

43% of the overall sourcing happened through our branches.

The credit quality of retail loans continues to be healthy.

During the second quarter and third quarter of financial year 2017 the loans against FCNRB deposits are likely to mature. This will also reduce our liabilities by a similar amount.

Our corporate advances portfolio had a Y-o-Y growth of 21%.

As indicated in our prior calls, we continue to find attractive refinance opportunities for highly rated corporate's. We expected these opportunities to reduce over time but for now, select high quality opportunities continue to present themselves.

82% of new sanctions in the corporate book were to companies rated A and better.

Presently, 64% of outstanding corporate loans are to companies rated A and above.

In fiscal year 2017, we expect the Bank's Credit growth to be around 18 to 20%.

Let us now move on to the Bank's Earnings Profile.

I request you to refer to slide number 15 of the Earnings Presentation.

Operating profit for the quarter was at ₹4,469 crores, a growth of 9% over the first quarter last year.

Operating profit growth remained at a healthy 3.41%. If you look at the chart on the slide, you will find that the past eight quarter average of our operating profit margin has been 3.35% and so our operating profit margin this quarter was a tad above our eight quarter average.

Operating profit margin in Q1 however was lower than the peak margin achieved in Q1 last year.

Slide 15 again shows the impact of various factors contributing to the Y-o-Y change. As you will see here, three factors explain the differentials. First is the higher interest reversals due to increased slippages; the second is the higher operating expenses, and the third is the lower fee income. The higher trading profits in this quarter were net neutral against a one-off item in net interest income seen in quarter one of last year.

NII growth was 11% on the back of healthy interest earning asset growth of 16%.

Net interest margin for the quarter was 3.79%, with Domestic net interest margin at 4.04%. We expect our full year NIM to remain above 3.6%.

Cost of funds during quarter was 5.81% compared to 5.84% in fourth quarter and 6.12% in first quarter last year.

Fees grew by 11% and constituted 24% of operating revenue. Granular fees comprising retail and transaction banking continue to grow at a steady pace. Retail fees had a growth of 19%, transaction banking had a fee growth of 17% and SME segment had a fee growth of 23%. Corporate banking fees were relatively flat with a growth of 2%.

During the quarter, trading income stood at ₹911 crores up 41% Y-o-Y.

Operating expenses in the quarter increased by 23% Y-o-Y. The key driver of this increase is our accelerated investment in recent quarters on our branch network and staff strength.

The cost-to-income ratio of the Bank for the quarter was at 38%. On a full year basis, we expect our cost-to-income ratio to be around 40%.

Provisions and contingencies increased by 89% Y-on-Y due to the higher slippages witnessed during the quarter. Our provision coverage ratio stood at 69%. The significant jump in provisions resulted in profit after-taxes declining by 21% on a Y-o-Y basis.

The annualized RoA and RoE for the quarter stood at 1.19% and 12.04% respectively.

The fourth theme is the continuing build-out of our retail franchise.

Please refer to Slide #18 in the Earnings Presentation. The digital journey of the Bank continues to progress steadily. Our market share in mobile transactions is now 13%, significantly higher than our market share in overall deposits. Mobile banking spends in first quarter reported a growth of 159% on a Y-o-Y basis.

In terms of number of transactions, digital channels are outpacing every other channel by a wide margin. Electronic channels, i.e. Digital and ATM, now contribute 88% of all customer-induced transactions in our retail base.

While we grow digital channels at rapid pace, we continue to invest significantly in broadening our physical network footprint. During the quarter, we opened 102 domestic branches. We expect to continue our increased pace of branch openings through the year, and plan to open 350 new branches to 400 new branches.

Savings account balances at quarter end grew at a strong 18% Y-on-Y. Current Account balances also had a healthy performance with a growth of 18%, thus driving an overall CASA growth of 18% year-on-year. Our overall CASA share in deposits was 43% at the end of the quarter, around 67 basis points higher than Q1 of last year. CASA deposits on a daily average basis for the year grew by 17% and comprised 40% of total deposits. On a daily average basis, SA deposits grew by 17% and CA deposits grew by 16%. CASA and Retail Term Deposits together continue to form a strong base at 80% of total deposits.

Product penetration into our strong SA base continues to be a major source of our growth. Big data analytics led targeting of the known retail customer for selling of unsecured lending, cards or other payment products continues to be core to our franchise building in retail space.

The Bank had 26 lakh credit cards in force at the end of the quarter, making it the 4th largest card issuer in the country. The credit cards portfolio saw a substantial increase in spends by 54%, to ₹6,308 crores from ₹4,104 crores for first quarter last year.

During the quarter Axis Bank introduced a dedicated innovation lab, called “Thought Factory” at Bangalore to ideate for breakthrough solutions for the banking sector. Thought Factory will house an “Accelerator” to collaborate closely with high potential startup ecosystem players. It has also launched a “Hack for Hire” program for spotting talent from across the country through Hackathons and bringing them on board as full time employees at Thought Factory.

The fifth and final theme relates to our comfortable capital levels and delivery of healthy return ratios for our shareholders.

As of 30th June, 2016, our total capital adequacy ratio including the first quarter profits is 15.67% with a Tier-I capital adequacy of 12.38%. This compares with a Tier-I ratio of 12.15% as of the first quarter FY'16.

The annualized return on equity and return on assets were at 12.04% and 1.19% respectively. As the impact from higher slippages recedes and benefits of higher investments in branches and employees kick in, we expect these ratios to normalize.

Moving on from these major themes, I would like to highlight a couple of other metrics that you might find useful in understanding the Bank's performance.

SME loan growth stood at 13%. We have seen some pick up in pace here, and now expect SME growth to be better than financial year 2016. The domestic credit deposit ratio of the Bank was at 84% at the end of the quarter.

During the quarter the Bank listed Asia's first internationally listed certified green bond of USD$ 500 million on the London Stock Exchange. This is the first green bond for the Bank within its overall USD$ 5 billion Medium Term Note program. The Bank has additionally listed its entire MTN program in London. The proceeds of the bond will be invested in green energy, transportation and infrastructure projects. Risk weighted assets for the Bank stood at ₹4,21,273 crores and grew by 17% on a Y-on-Y basis.

As I close, allow me to re-summarize the key themes of the quarter:

#1. Asset quality:

Stress realization is continuing and will likely have a bias towards first-half of FY'17. Operating environment remains challenging but not deteriorating from past levels. Our credit cost guidance for financial year 2017 remains unchanged.

#2. Business Growth:

Growth momentum is healthy with loan growth at 21% and CASA growth at 18%.

#3. Earnings growth impacted by asset quality and OPEX growth:

Underlying earnings quality remains healthy.

#4. Strong performance on the retail franchise: The retail franchise of the Bank had another good quarter – with saving accounts growth of 18% year-on-year and core retail loan growth of 26%.

#5. Strong capital position:

We remain well capitalized to pursue growth opportunities, with our Tier-I ratio continuing to grow and now reaching to 12.38% in spite of some of these other challenges.

With this, I come to the end of my comments. And at this point we would be glad to take your questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Mahrukh from IDFC. Please go ahead.

Mahrukh Adajania: I just had a few questions. Firstly, on the Watch List, the top 10 sectors that you have broken down, that now would relate to ₹200 billion, right?

Jairam Sridharan: That is right, Mahrukh.

Mahrukh Adajania: Okay. And the services sector seems to be outside the top 10, would that coincide with the slippages, is that a correct way to look at it?

Jairam Sridharan: Broadly right.

Mahrukh Adajania: Okay. And would there have been 25% to 30% of your slippages, would they have come from the non-top 10 sectors?

Jairam Sridharan: Yes, that is probably right. Though I do not have the exact numbers with me, but that is probably right.

Mahrukh Adajania: Okay. And you said that you maintain that 1H, there will be a front ending of slippages. So, can we assume that 1Q was the worst or how do we look at slippages from here on, because your credit cost guidance remains 150 bps for the year.

Jairam Sridharan: Sure. So, there are two elements to this question. One is the overall slippages, which is sort of at the Bank level, where you have got of course in 1H, so the seasonally high elements of retail and SME as well. And just from a seasonality adjustment perspective, for those parts of the businesses, Q2, Q3 and Q4 tend to get progressively a little bit better. So that you should, one currently expects that to broadly hold. Now as far as the Watch List is concerned, we did articulate that there is going to be a little bit of a bias towards the first half. You have seen a meaningful part of that in Q1. As we look forward into Q2, you can look at our overall guidance number, and if we expect to have a full year credit cost still within our range; the math will broadly indicate that things will moderate at a particular pace from here.

Moderator: Thank you. Next question is from the line of Rakesh Kumar from Elara Capital. Please go ahead.

Rakesh Kumar: Just firstly one question, what could be the total slippage number for the full year from the Watch List and out of The Watch List quantum wise like if you can…

Jairam Sridharan: See, we have not guided on slippage numbers this year, what we have said is from the watch list roughly 60% we expect to slip into NPAs over a two-year period with a little bit of bias towards first half FY'2017. Apart from that, we have not offered specific slippage guidance this year. What we have said is our credit cost guidance is 125 basis points to 150 basis points for the financial year.

Rakesh Kumar: And secondly, the interest reversal of 0.07% that would be from the corporate book and majorly from the watch list book?

Jairam Sridharan: That is right. And I will I also reiterate that 0.07% is incremental. So, the last year in the first quarter; also there would have been some interest reversals. This year there was some more interest reversals. So the incremental is what that 7 basis points represents; not the absolute value.

Rakesh Kumar: Okay. And just third last question. How do you see the composition of slippage from the Watch List interest reversals impacting full year margins vis-à-vis previous year?

Jairam Sridharan: See, we had guided at the beginning of the year that we expect our net interest margin to be upwards of 3.6%. You have seen that in the first quarter, our net interest margin was 3.79%. We continue to hold our original guidance on the margin. We continue to expect margins to remain above 3.6%, how much above 3.6%, time will tell depending on how the Watch List resolution goes, but also more importantly; how the cost of fund moves and our pricing power changes in the market in the coming three quarters.

Moderator: Thank you. Next question is from the line of Adarsh from Nomura. Please go ahead.

Adarsh Parasrampuria: Couple of questions. Firstly, when I see the ratings breakdown of the Watch List, it was like 50-50 AA and then 50 AAA and it has almost become sorry, BBB, and that has got downgraded quite a bit, so just wanted to understand this kind of sudden movement.

Jairam Sridharan: Yes, thanks for the question Adarsh. See, last quarter, when we showed you the Watch List, we showed you the ratings distribution as of the rating that existed in that quarter. We do have a periodic rating review exercise, which happens at least once a year. And in this quarter, being the beginning of the year that ratings review did happen as you can imagine, a lot of the accounts that were on the Watch List, which were rated better BBB or better we realized that the situation in which their last rating was offered has materially changed and hence they ended up getting downgraded. So, what you see now is a reflection of a reality that was already incorporated in our Watch List creation. This is not new information; this is just us reflecting that new information in the ratings as part of our regular rating review exercise.

Adarsh Parasrampuria: Okay, I get that. The second thing is, your credit cost guidance, right, 125 bps to 150 bps, I believe that does not include any general provisioning, right? It is specific provisioning?

Jairam Sridharan: No, it does not.

Adarsh Parasrampuria: And the other thing is, what is the denominator there, because I guess is it advances because you have a large bond book, so is that customer assets or advances or …

Jairam Sridharan: It is net customer asset.

Adarsh Parasrampuria: Net customer asset, which would include the bonds, is it?

Jairam Sridharan: Yes, it will include our investment book as well.

Adarsh Parasrampuria: And the last question is, you had a ₹9 billion treasury gain. Just wanted to check what is the split between the G-sec and the corporate book?

Management: Primarily G-sec.

Adarsh Parasrampuria: Primarily G-sec, is it, okay? No, because I just saw that the corporate bond book is down, so I thought may have booked some gains from there, so…

Management: Sure, we have booked material gains in the corporate book also but if you look at the ₹9 billion amount which you are talking of, at least three-fourths of that would have been from the G-sec book.

Moderator: The next question is from the line of Parag Jeriwalal from Religare Capital. Please go ahead.

Parag Jeriwalal: Sir, in last time when you have given the Watch List you have said that out of the restructuring SDR outstanding book 72% is in the Watch List. So, can you just give a same breakup for this quarter as well?

Jairam Sridharan: I do not have that readily, Parag. What you have seen this quarter is I talked earlier in my opening remarks about slippages that happened from the restructuring side into NPA and a lot of that was or almost all of that was from the Watch List. So, that goes away from the Watch List and that goes away from the restructuring side as well.

Parag Jeriwalal: And on SDR, when you said one was already NPA and other was outside NPL so, does the one which was outside NPL is already under Watch List or no?

Jairam Sridharan: SDR account, was that on the Watch List? Yes, I think, yes, it was.

Parag Jeriwalal: And there is debit entry I mean there is an addition to the watch list as well in your presentation when you have given the ₹315 is when added. So what is that entry?

Jairam Sridharan: So there are two things that, there are two parts that you will see before the NPA bar. The first bar is the devolvement of non-fund based, so there is some non-fund based limits that clients might have had, as their situation evolves, some of that might devolve into fund based and because this waterfall is of the fund-based outstanding to the extent the devolvement happens, you are going to see that increase the outstanding. So, that is the first part and the second part models what we call movement in balances which is basically the net movement in balances between whatever interests got accrued, whatever repayments got made and any new disbursements that might have happened on account on committed sanction.

Parag Jeriwalal: Yeah. So, this ₹315 is independent of ₹2,562 crores which is the non-fund base you are showing

Jairam Sridharan: Correct, yeah, correct, because this has become fund based now.

Parag Jeriwalal: And one last question, what is the sense in terms of, if you look at your last quarters between, as you said that, retail and SMEs are kind of bulky in terms of slippages in the first quarter. So what generally is the ratio of first quarter compared to the next three quarters if you compare for 2015-2016, FY2016 and FY2015?

Jairam Sridharan: See, typically the seasonality tends to be much stronger in retail and somewhat milder in SME; and if you see retail, what tends to happen is the first quarter particularly for agri, etc., you tend to see the peak and by the second quarter and third quarter you will see those numbers reduce somewhat meaningfully and let us say, reduce by kind of 20%-ish. But two and three quarter will roughly be the same. And fourth quarter is when you will see the real drop in NPLs that tends to be the shape of the slippage addition in retail. SME would largely follow that, but with a much milder slope at each level.

Moderator: Thank you. Next question is from the line of Vishal Goyal from UBS Securities. Please go ahead.

Vishal Goyal: So, two questions. One is on the Watch List and I think we discussed about I think 60% probability of default on this Watch List, correct?

Jairam Sridharan: Over an eight-quarter period, yes.

Vishal Goyal: Over an eight-quarter period. Now that your own ratings have gone down for almost half of the book from BBB to below or whatever like BBB. So, do you think that probability of default should increase from here?

Jairam Sridharan: No, Vishal, the ratings downgrade is a lagging indicator, it is not a leading indicator in this case. We did the Watch List review before we did the rating review had we done things the other way around we would have seen this outcome before we even created the Watch List. So, this is not new information that incrementally changes anything in terms of what we believe about the Watch List. And one other element, the previous caller had asked, what percentage of the restructured and SDR outstanding is on the Watch List versus not? I now have the data in front of me. The restructured and SDR outstanding on the Watch List now is 61% and not on the Watch List say 39%.

Vishal Goyal: The other question actually is on the non-fund based, it has actually declined I think around what ₹60 crores roughly while the devolvement of NFB actually is 315. So, the NFB should have become funded, correct?

Jairam Sridharan: Yes.

Vishal Goyal: And so, the decline should have been more, so what would have happened?

Jairam Sridharan: Basically think about it in three stages, there is a non-fund based limit, then there is a non-fund based outstanding, and then the non-fund based outstanding becomes fund based outstanding. So the non-fund based limit would have a chance of getting converted into non-fund based outstanding which is the number that you see the ₹2,562 crores number is non-fund based outstanding, right. So some new limit would have gotten converted into outstandings as well, within the non-fund based base, it will be a small number, that is why the delta is not very big.

Vishal Goyal: Okay. And I believe the non-fund based limits would not be like much higher than the outstanding?

Jairam Sridharan: And there is going to be depending on a case-to-case basis there is going to be a whole lot of ability to actually freeze limits on an account-to-account basis and that is why we decided to show the non-fund based outstanding as a metric here as opposed to limit because limits are very difficult to just add up across different accounts given the flexibility we have on freezing or unfreezing.

Moderator: Thank you. Next question is from the line of Nilanjan Karfa from Jefferies. Please go ahead.

Jefferies: Hi, Jairam, very related question to the earlier one. The 315 is not a devolvement, right? Is that a wrong usage, what I mean is, it is probably a conversion of what you call as limit, but it is like undrawn sanctions getting converted, right?

Jairam Sridharan: No, that is a different thing. So there are two steps here and the first step is what Vishal was asking about; but you are asking about the second step. In the first step, a non-fund based limit gets used and it becomes non-fund based outstanding. Otherwise, it is just unused limit, right. It becomes an outstanding when it actually gets used; but then that gets converted into fund based and that is what we are calling devolvement, I mean you might have a different word or you could call it conversion or something else. But we are calling it devolvement, is when the non-fund based outstanding gets converted into a fund based outstanding.

Nilanjan Karfa: Okay. But because what I think is if there is a customer who has come to you would provide a limit and that basically can be converted any time. So, that is like an undrawn sanction. So the terminology might be different.

V. Srinivasan: I think there is a difference. When there is a limit, as Jairam initially said, there is an ability on our part to ensure that the limit is frozen and you need not use it. But if actually you have a limit which is actually utilized opened at LC when the LC comes up for payment then that LC becomes a fund based outstanding, what was non-fund based becomes a fund based outstanding, which is an actually utilized non-fund based limit.

Nilanjan Karfa: Right. But if I go back to how you calculate the credit conversion, so are these limits or whatever these are which can get converted, are these revocable by the bank or you cannot because that will then determine the risk exposure to these guys?

V. Srinivasan: There would clearly be conditions under which it can be utilized. There would be some flexibility on our part on unutilized limit to be frozen.

Nilanjan Karfa: Would you be able to clarify on that and what portions you would still expect some of these to get converted; because if I remember in the previous quarter, we did talk about many of the projects which are under execution still. So is this where all of this is coming from?

V. Srinivasan: I think the impact on projects would be on first disbursement, initially you would start with non-fund based limits, but as it would go towards implementation and commencement of production the emphasis will be more on disbursement rather than non-fund based limits.

Nilanjan Karfa: Right. And sir, just to continue with this, when we talk about non-fund based outstanding, are we also including exposures related to the derivatives in this?

V. Srinivasan: No, this is LCs, bank guarantees.

Moderator: The next question is from the line of Nitin Agarwal from Antique Stock. Please go ahead.

Nitin Agarwal: Sir, does the devolvement of NFB largely belong to the power sector?

Jairam Sridharan: No, actually. There are actually a few different accounts here and there and they are all relatively small ones.

Nitin Agarwal: Okay. And because I see like the slippages from Watch List has largely happened from, say, sectors like cement, mining, etc., while exposure under watch list in power and metal segment taken together has increased. So does this imply that overall slippages that we will have from this Watch List over the two-year period could be higher?

V. Srinivasan: That is a denominator issue, I think you are looking at the percentages…

Jairam Sridharan: I think he is calculating the rupee value based on the distribution.

Nitin Agarwal: Yeah, by the distribution, I calculated the values

Jairam Sridharan: No, that is fine. See, the thing is, as you can see in the waterfall chart, the numbers in terms of either devolvement or movement in balances are all relatively small compared to the numbers of the Watch List themselves, they are extremely small percentages very-very low single-digit. So at that level of precision, one can hardly tell how accounts and account balances are actually going to move but this level of movement in accounts and this level of conversion from non-fund based to fund based is well within the limit of our assumption that we have made when we talked about the 60%.

Nitin Agarwal: Okay. And the second question that I have is like on the Bancassurance fees, how do you see that moving post the merger of Max with HDFC Life?

Rajiv Anand: So from what I understand, the whole process is expected to take anything between six months to one year. So during that period we will continue to sell Max Life insurance. They have helped us build a good business over the last five years or so. And as things stand currently we will continue to work with the merged entity as well.

Moderator: Thank you. Next question is from the line of Alpesh Mehta from Motilal Oswal. Please go ahead.

Alpesh Mehta: First question is related to your fee income. It has been slowing down over the last four quarters to five quarters. So what is the outlook on that front now?

Jairam Sridharan: Right. So fee income in general, if you look at where the income has grown versus not grown, you will find that fee has grown in the areas which are more granular such as transaction banking, retail lending, card businesses, and retail liabilities, etc., and SME advances, the growth has been actually relatively strong. The areas where the growth has been modest is particularly on large corporate lending related processing fees rate which historically has been a fairly large element of our fee contribution. But where the growth over the last few quarters has been tepid and that continues in this quarter as well with a 2% year-on-year growth in the first quarter. As we have mentioned in the past, in terms of the direction that our business is taking in large corporate lending, we are moving towards better rated corporate’s and as we do that our ability to extract fees from some of these transactions continues to remain very much limited. So while we would be happy to see more fee income in this particular case given the business choice that we have made we are perfectly happy with the situation where that particular fee income component is not increasing nearly as much as some of the other components.

Alpesh Mehta: Okay. And there is some re-classification in this quarter, business banking fees have been classified as a transaction banking and some part of the Treasury has moved there. What is this re-classification exactly?

Jairam Sridharan: Yeah, there are some internal re-classification that we have done in terms of which businesses actually work better together and need to be seen together because they are given as a single bucket of solutions to our clients. This fundamentally does not change any of the story of what is happening underneath and that was incorporated in the comments that I made earlier where we are seeing growth versus no growth in fee income.

Alpesh Mehta: And just last two questions. First is related to your branch expansion and the employee head count. We have seen some increased activity on that front. So, do you see this traction continuing in the coming quarters or it has just been up-fronted as of now?

Rajiv Anand: So as Jairam said in his opening remarks, we opened approximately 315 branches last year. We expect to open somewhere between 350 branches to 400 branches this year, of which 102 branches have been opened in the first quarter. So it is fair to say that we will open about 100 branches every quarter. As far as people are concerned, there are two parts to that. Obviously, we need to staff the new branches that we have opened; but we have also added to our acquisition team, what we call BDEs, and we have seen a significant addition to that. So therefore, as far as people is concerned the additions are sort of more or less done so, from hereon we will add net additions meaning net of attrition, etc., will be minimal.

Alpesh Mehta: Okay. And lastly about the S4A guidelines, any take on that? And do you expect any of the Watch List account being upgraded in the coming quarters because of the S4A guidelines? And what kind of upgrades and the recoveries are you guys factoring in for FY'17, just a range that would also be useful?

V. Srinivasan: As far as S4A is concerned, provisional discussions are on with a few companies. None of it is finalized. So we need to see as it goes along, how many of this will convert into actual S4A transactions because their guidelines to some extent have a lot of restriction and we will have to wait and watch it. I do not expect too many transactions to happen on the S4A front. As far as recoveries are concerned, I think we should hopefully do better than last year.

Jairam Sridharan: Yes. We have baked in a slightly better recovery environment than last year and this year we have not provided specific guidance on recovery numbers. However, what I will say is that we are not baking in very significant improvement in recoveries and if happens, that will be a pleasant upside.

Alpesh Mehta: Okay. So the current credit cost guidance does not include any upside because of the S4A per se. Is that the fair assumption to make?

V. Srinivasan: See, I think you got to assume whatever happens whether resolution in whatever form will ultimately go into the credit cost. So if we do S4A and on account of it, there is some amount of provisioning to be done that will be form the part of credit cost. If there are some accounts which remains standard on account of S4A that will also be part of the credit cost.

Alpesh Mehta: And the pool of contingency provision remains the same, we have not utilized anything in this quarter or did we?

Jairam Sridharan: Yes, we have not utilized anything. So, yes, it remains the same.

Moderator: The next question is from the line of Sarvesh Gupta from Trivantage Capital. Please go ahead.

Sarvesh Gupta: This was related to the last question, which was asked. I think you spoke about ₹180 crores in up-gradation and recovery for this quarter, right plus there was no recovery from the Watch List. So if you can add a bit of color on the recovery environment because some of the other corporate lenders had guided for a higher portion of recovery from the stressed books?

Jairam Sridharan: Yeah, we are aware of the higher number that some others have spoken about while we are seeing some signs that the environment might be a little bit better this year compared to years past, we do not believe yet that there is enough improvement in the environment or enough change in the operating condition of a lot of the borrowers for us to bake in or for us to be very optimistic about some of the recovery numbers. So to be perfectly honest, some of the recovery numbers I have seen floating around I am a little bit skeptical about and I am not really sure that that level of recovery is indeed going to happen in this year.

Sarvesh Gupta: Understood. Sir, my second question was on your margins. Now, 54% of the retail book is LAP and housing loans where we see that there is a lot of pressure on the yields across the board. And secondly, on the corporate book, you are focusing more and more towards higher-rated corporate's, where again yields can be potentially lower. So in this context, how do you see yields panning out? And don't you see a compression in the margins potentially happening because of this focus?

Jairam Sridharan: See as far as the business yields are concerned, you got to look at trends rather than the current level. So in retail lending, for example, when you speak about what is the level of home loans plus LAP, you got to actually track that against what the overall composition is changing like over time. On a quarter-on-quarter basis, we continue to see yields increase on the retail lending portfolio, not decrease on that because of the changing business mix between all the different businesses that exist. So on the retail side we are seeing our yields go up. On the corporate side as we migrate upwards towards better risk clients, our yields might not go up as much; but on an overall basis the guidance that we gave earlier on and in our fourth quarter call where we talked about a net interest margin remaining upwards of 3.6% that incorporates all those dynamic within this.

Sarvesh Gupta: So on the retail side, are you seeing a shift away from housing plus LAP?

Jairam Sridharan: We put up both these numbers every quarter, so you can track it. So, yes, our greatest kind of growth engine right now continue to be personal loans, credit cards, auto loans businesses and some of these other businesses and not necessarily LAP and home loan.

Moderator: Thank you. Next question is from the line of M. B. Mahesh from Kotak Securities. Please go ahead.

M. B. Mahesh: Just a couple of questions. One, again, the moment of that Watch List, do we take it that there has been no additions after an analysis on the portfolio again or should we take it as a static pool of what was given in the previous quarter? The second question is around, if I have to move away from the Watch List is there anything else outside the Watch List because how is the portfolio in the rest of the book, how is that done? You see incrementally stress changing for the positive side or negative side? And the third question is to Rajiv, this stronger growth that we have seen in the auto loans, if you could just comment on that in that particular portfolio?

Jairam Sridharan: On the Watch List, our intention with the Watch List is to keep that list to be a static list, a close list in terms of new additions. So we created the Watch List at the end of the fourth quarter financial year 2016 and that is the list that we are going to track for you and disclose to you every quarter in terms of how that particular list of clients is progressing. Our intent is not to add new clients to the Watch List in every quarter and hence our focus on these things that we are calling the dissolution rate, where our intent is that the Watch List should through one means or another be dissolved over time. And what we want to demonstrate to you is the pace at which that dissolution is taking place, and that is what you are seeing in terms of the Watch List dissolution in this quarter. Now to your second question of, are we seeing any sources of stress outside of the Watch List or anything that is bothering us, the short answer to that question in the corporate portfolio is - not really. The environment over the last few months has if anything turns mildly for the better so, no, we are not seeing any new sources of stress that we are incrementally worried about. And Rajiv, on the third question?

Rajiv Anand: It has been strong growth but remember that is coming off a relatively low base. We have done a couple of things here, one is, we have created some innovative products for our branches to be able to sell and we are seeing some good traction from a cross-sell perspective. And second is I think the relationships that we have been able to build and the technology that we have been able to build with key dealers is helping us grow business.

M. B. Mahesh: Any split on the book, how does it look between new, used, CVC, cars, how should we see that number?

Jairam Sridharan: So, CVC is not included in our automobiles book, it shown separately; between new and used on an incremental basis, used is about 10% of the origination. On a full book basis, used will be in mid-single digits of the auto loans book.

Moderator: Next question is from the line of Hiren Dasani from Goldman Sachs. Please go ahead.

Hiren Dasani: I just wanted your thoughts on the non-employee OPEX which is up about 25% this quarter, is there any one-offs, I mean are we investing in some areas which is leading to the higher bump up here?

Jairam Sridharan: There are a couple of things going on there. As we open up new branches that we have done over the last three quarters, our branch openings, etc., have gone up. That clearly shows up in terms of our rentals and our lease cost, electricity, lighting, that line item tends to grow meaningfully, which is something that you will see in this quarter as an important element. There are a couple of other elements as well which are related to specific business transactions that were done in this financial year for which the cost of acquisition has been booked now however, the benefits will actually commence in the forthcoming quarters so, that is also resulting in some of the non-staff OPEX increase.

Hiren Dasani: So 25% still looks to be quite high for this size of the balance sheet, so that is why I was slightly curious?

Jairam Sridharan: So, there is one more element that I should draw your attention to. When you are talking about growth here, you are talking about year-on-year growth on the OPEX line item. Here, you have got to look at the base in the first quarter of financial year 2016 which had a couple of elements, which made it artificially lower than the other quarters and those adjustments actually once you make, the overall percentage growth for the OPEX numbers is just under 20% and the non-staff part is also under 20%. And those one-offs will continue to be there for two more quarters and then they will go from the denominator; but till that time this percentage will look optically a little bit higher. So, what I would encourage you to focus on is the cost-to-income ratio as well and see in which direction that is heading and we had guided at the beginning of the year that our cost-to-income ratio for the full year would be about 40%. In this quarter, our cost-to-income ratio has been 38%. So on that metric, we feel comfortable with where we are.

Hiren Dasani: Sure. And just one clarification on the earlier discussion about the non-fund based getting into the Watch List into the fund based. So if I understand correctly when you sanction a non-fund based limit, so let us say, you open an LC and at the end of the LC period, if it is supposed to be converted into a loan, which is supposed to be given by the Bank, then that is a normal transaction. But if the customer does not pay up and then LC becomes the non-funded to funded then within three months it has to be classified as an NPL, right? Is that the correct understanding?

V. Srinivasan: Yeah, I think basically that is a call the bank needs to take in terms of if it is a project what the company is and clearly their ability to sanction a loan to retire an LC is always there.

Hiren Dasani: So, I am saying it would have been pre-sanctioned loan only.

V. Srinivasan: It can be pre-sanctioned or it can be sanctioned by another bank. When the LC comes up for payment it can be disbursed by the same bank depending on the need. If the bank feels sufficiently comfortable to disburse a loan to retire an LC, it can do so.

Moderator: The next question is from the line of Roshan Chutkey from ICICI Prudential Asset Management Company. Please go ahead.

Roshan Chutkey: Firstly, what percentage of our customers have taken a credit card or a PL loan from us?

Jairam Sridharan: Of our existing savings account base, either a credit card or a personal loan the penetration rate so to say will be in the very low-teens. And we believe there is a lot of upside there and we could see that proportion continue to grow till the mid-20's.

Roshan Chutkey: Sure. And I have seen the corporate book has increased by about 20%-odd, should not that necessarily translate to corporate fee income growth as well?

Jairam Sridharan: Yeah, I mean, not really. If your incremental growth is up to a much better rated corporate where you might be sanctioning new facilities, you might be actually growing your book but it is going to be hard for you to extract processing fee at the same level from these clients as you could from certain other client categories. So as long as our focus from our segment perspective is on better rated corporate entities, the ability to significantly drive corporate processing fee line item is going to be limited.

Roshan Chutkey: So what percentage of this corporate banking fee growth would be to higher rated corporate clients?

Jairam Sridharan: See, we have disclosed that 82% of incremental sanctions were to clients rated A or better.

Roshan Chutkey: And could you please quantify the interest income reversal for the quarter?

Jairam Sridharan: We do not usually disclose individual line item on interest income reversal, what I would say as one of our waterfall charts on the deck clearly lays out is that the higher slippages in this quarter have resulted in incrementally higher interest reversals this quarter compared to the same quarter last year to the extent of 7 basis points.

Roshan Chutkey: And are you seeing any asset quality concerns on the LAP book?

Jairam Sridharan: No, not at this point.

Roshan Chutkey: Sure. In the auto loan book split, you mentioned that CVC is shown somewhere else in the book.

Jairam Sridharan: Yes, it is in the others section if I am not mistaken, there is this sliver called others.

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

Rahul Jain: Just one question on your cost of funds. For the last three quarters, it has been around the same levels of 5.8% (+/-2) basis points to (+/-3) basis points and when we know that the card rates have been cut by more than 100 basis point over the last 12 months to 15 months or maybe more, when do we start seeing a decent shift in this particular line item?

Jairam Sridharan: See, at this point, a lot is going to depend on our ability to originate enough deposits at much lower rate than what we have right now. If you have seen the deposit rate themselves, the deposit rates have not moved very significantly in the last few months and that what is being reflected in the cost of funds number that you see. As that ability increases and as we see a greater part of the market slowly move towards lower rates on the deposits side everybody's ability to pass that on is going to increase. So, we are seeing some movement we are seeing a couple of basis points of movement every other month or so. If you are asking me is there any sort of immediate event that is going to materially increase the pace at which that is happening, we do not see anything right on the cards at this moment. Srini, is there anything you would add?

V. Srinivasan: The only thing is that, if you look at Q4 last year, rates were actually quite high and the liquidity improvement has happened since the April policy and that is when deposit rates have started coming off. So if you look at the January to March quarter, cost of deposits were higher than the previous quarter and it started coming down around from April. So you would see some benefit over the course of this year.

Rahul Jain: Okay. And what would be the average duration of the deposit book? In which bucket would the Bank see a majority of deposits maturing?

V. Srinivasan: It is around one year.

Rahul Jain: It is around one year?

V. Srinivasan: Yeah, retail deposits especially.

Rahul Jain: Fair enough. Just one last question on the loans against property though, Y-o-Y growth now seems to be settling in the range of 24% to 25% I mean, which is what it was in this quarter. So is this going to be the new normal or we might see some acceleration or deceleration from these levels as we get into the second-half?

Rajiv Anand: We are broadly comfortable at the current levels. I do not see this number accelerating materially from here.

Rahul Jain: Okay. And majority of this continue to remain from our own existing clients which is 40% - 45% is what I remember?

Jairam Sridharan: No, it is higher than that.

Moderator: The next question is from the line of Shree Shankar from Prabhudas Lilladher. Please go ahead.

Shree Shankar: A couple of questions. Given the cost of funds, can you please give us a cost of deposits as well as the yield on advances?

Jairam Sridharan: The cost of deposits in the quarter were 5.82%.

Shree Shankar: And yield on advances?

Jairam Sridharan: Yield on advances, we have not historically shared. We have historically shared the average yield on assets.

Shree Shankar: Okay. See, probably because of the slippages PCR has been coming down. So what is the level at which by you probably finish any target for FY'17 what level?

Jairam Sridharan: We will end FY'17 at around 70%.

Shree Shankar: At around 70%. And would you share your SMA-2 outstanding data?

Jairam Sridharan: We have not shared it in the past. In light of the overall challenging environment, we are still finding a lot of volatility in the SMA-2 numbers. So every quarter, things are up and down a lot. At this stage, we believe that sharing SMA-2 data is not helpful because the noise in that information is still too high.

Shree Shankar: Okay. One last question. See, you got your PL and CC, credit cards, et cetera, are you seeing any kind of slippages or stress in those personal loans or unsecured credit?

Jairam Sridharan: It is broadly in line with our expectations for an unsecured product.

Shree Shankar: Could you please quantify that that is a very general statement?

Jairam Sridharan: 90 plus days past due rates for the unsecured segment are in the very low-single digits. So, it is a pretty much sort of at historical lows. Now we see something fairly similar. In both personal loans and credit cards we are pricing in for a meaningfully higher level of risk than where we are at right now. Looking at where we are, looking at the trends of those metrics, we do not see any significant reason for us to be worried about the trend of credit risk.

Moderator: Thank you. We take the next question from the line of Anurag Mantri from Jefferies. Please go ahead.

Anurag Mantri: Just a couple of questions. In Slide #15, you have mentioned your operating profit margin trend. What is the denominator for that metric?

Jairam Sridharan: Average assets in the quarter.

Anurag Mantri: Average assets in the quarter, okay. Secondly, regarding your non-Watch List slippages, I think that is around ₹1,000 crores this quarter, any guidance for that or any sense of whether this number is too small, too large, how will it hold on through the remainder of the year?

Jairam Sridharan: No, this is pretty much on the lines of what we expected. As I mentioned before, retail and SME tend to have higher Q1 seasonally, so they form a meaningful part of that. The non-Watch List slippages of the corporate book, we have quantified for you anyway. So you have a good sense of that. So overall, we are fairly comfortable with the slippage levels outside of the Watch List.

Moderator: Thank you. We will be taking the last question from the line of Kitav Shah from SBI CAP Securities. Please go ahead.

Kitav Shah: Sir, just wanted to check your statement on SME loan is picking up pace. So that is a bit counterintuitive so, wanted some sense there.

V. Srinivasan: Why is it counterintuitive?

Kitav Shah: Sir, in the sense that we are still not seeing a strong recovery in the corporate sector linked to that…

V. Srinivasan: I think, there is opportunity to grow the SME business and last year, the business grew at sub-10%. Clearly, our aspiration is to grow it much faster. I think the comment which we have made was to say that this business is now growing faster than the industry and there is enough opportunity to grow this business, at least 15% to 20%.

Moderator: Thank you. Ladies and Gentlemen, I would now hand the conference over to Mr. Jairam Sridharan for his closing comments.

Jairam Sridharan: Thank you ladies and gentlemen, for taking the time late this evening on to listen to our commentary. We would be happy to continue to remain in touch with you. Thanks for your interest in the Bank and have a good evening.

Moderator: Thank you very much, members of the management. Ladies and gentlemen, on behalf of Axis Bank that concludes this conference call. Thank you for joining us and you may now disconnect your lines.