“Axis Bank Q1 FY18 Earnings Conference Call”

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MANAGEMENT: **MR. V. SRINIVASAN - DEPUTY MANAGING DIRECTOR, AXIS BANK**
MR. JAIRAM SRIDHARAN – GROUP EXECUTIVE & CHIEF FINANCIAL OFFICER, AXIS BANK
MR. RAJIV ANAND - EXECUTIVE DIRECTOR - RETAIL BANKING, AXIS BANK
MR. SIDHARTH RATH - GROUP EXECUTIVE - CORPORATE AND TRANSACTION BANKING, AXIS BANK

Moderator: Good day, ladies and gentlemen and welcome to the Axis Bank Conference Call to discuss the Q1 FY2018 results. 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 – Group Executive & Chief Financial Officer, Mr. Rajiv Anand - Executive Director, Retail Banking and Mr. Sidharth Rath - Group Executive, Corporate and Transaction Banking. There will be an opportunity for you to ask questions 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's conference call. I would now like to hand the conference over to Mr. Jairam Sridharan to begin with the presentation. Thank you and over to you, sir.

Jairam Sridharan: Thank you, Margaret. Thank you, ladies and gentlemen, very good evening to you all. I welcome you to Axis Bank conference call for a presentation on our performance in the first quarter of the financial year 2018. At the end of this presentation, we will be glad to respond to your questions. For some parts of the call, we do expect to refer to slides in our quarterly earnings presentation. So it might be useful to keep that presentation handy.

Let me start with a major highlight of this quarter's performance. First, our turnaround is gathering strength. The turnaround in financial performance that started last quarter has gained some more momentum this quarter. Annualized credit cost for the quarter came in well within our guided range. We remain confident of it reverting to long term average levels by FY19. Growth in corporate advances is starting to recover, driven largely by strong growth in working capital loans. Fee income growth has rebounded as well back to mid teens. The balance sheet remains strong with high provision coverage at 65%. Annualized ROE is now back in double digits.

The second highlight has been the strong retail franchise which continues to deliver. CASA growth was sharp at 25%. Retail advances continued growth in the 20s. Retail fees grew strongly. Our strength in the digital and in the payment space continued with significant market share across products, and multiple new innovations in the market. And third highlight of the quarter has been that our subsidiaries have started delivering and are scaling up strongly. Subsidiaries have started contributing significantly and are an increasingly important component of our position as a full service universal bank.

Let me now discuss the Bank's performance in greater detail. The deposit franchise had another strong quarter, with Savings Account and Current Account balances growing by 22% YoY and 30% YoY respectively. The overall CASA balances grew 25% YoY and our CASA share in deposit stood at 49% at the end of the quarter. CASA deposits on a daily average basis for the quarter grew 24% YoY and comprise 45% of the total deposits. On a daily average basis, SA and CA deposit grew 22% YoY and 29% YoY respectively. The QoQ growth in SA and CA deposits on daily average basis stood at 1% and 7% respectively. CASA and Retail Term deposits continue to form a strong base and stood at 83% of total deposit, up by 156 basis points over the March quarter. During the last quarter, the Bank raised Rs. 8,500 crores through issuance of tier I and tier II bonds. Consequently, the need for term deposit based funding was limited. Term deposits de-grew by 1% YoY and the wholesale term deposit base declined 7% YoY whereas the retail term deposit, once you exclude FCNRB deposits grew by 12% YoY. The overall deposit growth for the quarter stood at 10% YoY.

Banking system credit growth in the first quarter saw marginal improvement to around 6% levels from their multi-decade lows witnessed in the March quarter. Aggregate loan growth improved during the quarter and stood at 12% YoY up from 10% that we had in March. Loan growth was largely driven by a 22% rise in retail and a 10% rise in SME. Whereas the corporate advances, which grew overall by 3% had working capital advances growing by 23%.

Moving on now to the Bank's earnings profile, I request you to refer to slide #9 of the earnings presentation. Net profit improved sequentially by 7% to Rs. 1,306 crores. Net interest income for the quarter rose by 2% YoY with NIMs impacting the NII growth from a stronger trajectory. NIM for the quarter ended at 3.63% with domestic NIMs at 3.85%. The next slide #10 represents the sequential NIM waterfall. NIM for the quarter was 3.63% and was lower by 4 basis points compared to the FY17 NIM of 3.67%. You might recall that we had guided for a full year NIM compression of around 20 basis points. The modest compression of 4 basis points that we have seen is in line with what our expectations were for the full year.

Cost of funds during the quarter stood at 5.24% compared to 5.42% in the fourth quarter and 5.81% in the first quarter last year. Fee income grew strongly by 16% YoY and now constitutes 26% of our operating revenue. Retail fee continued to be an area of strength with a robust growth of 32% and it contributed 48% of the total fee income. Fees from cards and from distribution of investment products were up by 39% YoY and 50% YoY respectively. Corporate banking fees in the quarter declined by 14% YoY. The interest rate trends during the quarter did provide some opportunity for treasury gains and the treasury gains thus stood at Rs. 824 crores. Operating expenses in the quarter increased by 19% YoY. The cost to assets of the Bank was at 2.20% for the quarter. We do expect operating expenses growth to moderate towards the second half of the fiscal in line with our full year guidance on operating expense growth.

Operating profit for the quarter stood at Rs. 4,291 crores declining by 4% on a YoY basis. Operating profit margin stood at 2.87% compared to 3.41% in the first quarter last year.

Provisions and contingencies increased marginally by 11% YoY. For a detailed breakup of the provisions, kindly refer to slide 46 in the earnings presentation. This quarter the Bank has also put in place a policy for making provisions for standard assets at rates higher than the regulatory minimum based on an evaluation of risk and stress in certain sectors as per the RBI circular dated 18th April 2017. Accordingly, we have made enhanced standard asset provisioning of 1% on four sectors. These four sectors are Power, Infrastructure Construction, Iron and Steel and Telecommunication services. Against these sectors, an additional provision of Rs. 184 crores has been made during this quarter. The Bank's provision coverage continues to stand at 65%.

Let me now discuss our performance in key business segments starting with Retail. The retailization of the Bank continues to drive our financial performance right now. If you refer to slide #16 of the earnings presentation, the share of Retail Advances in the overall loan mix has been growing steadily over the last few years and stood at 46% at the end of Q1. At the same time, the Retail loan book has continued to become more diversified over time with nearly all major segments contributing now materially. The share of home loans in overall Retail book has steadily come down from 54% in FY13 to 44% at the end of Q1FY18 with the share of personal loans, credit cards, auto loans and small business banking continuing to inch up.

It is worth mentioning here that superior growth in retail loan product distribution over the years has been achieved by deepening business relationships within existing branches coupled with an expansion in newer geographies where the Bank already has seasoned branches. This strategy was augmented by deep data analytics capabilities used to identify, market to and underwrite to the most appropriate pockets of our customer base.

If you flip over to the next slide, you will observe that the growth in Q1 was led by credit cards, auto and personal loans which grew by 55%, 32% and 28% respectively. Our new engines of growth like microfinance, small business banking and education loans continue to see strong growth momentum with YoY growth of 16%, 87% and 146% respectively. We continue to focus on affordable housing and has handed over keys now to more than 32,000 families of affordable homes till date. In personal loans and auto loans, we continue to see traction driven by acquisition from digital channel and branches. Internal customers continue to be the main stay of the bank's strategy for sourcing retail assets. 73% of sourcing in the first quarter was from existing customers. 97% of our credit card business and 79% of personal loans originations in the quarter were from existing customers of the Bank. 45% of the overall sourcing happened through our branches.

Given our internal sourcing strategy, we believe that branches continue to remain essential for customer acquisition and hence we continue to make investments in developing an extensive branch network. We opened 81 branches during this quarter; however, the newer branches continue to get smaller in size.

Our leadership position in the transactions and payment space also continues. If you refer to slide #20 in the earnings presentation, you will notice that the Bank's market share in digital and new technology products have been much higher than in the traditional payment space. The Bank now has 3.5 million credit cards in force making us the fourth largest credit card issuer in the country with a market share of 11%. Cards portfolio spends in the first quarter increased by 74% YoY to our life high of Rs. 17,478 crores. The bank is the second largest acquirer of point of sales terminals in the country with an installed base of 4.6 lakhs POS terminals. Big data analytics led targeting of known internal customer base for cross selling of cards and other premium products continues to be core to our strategy in the space. We also continue to witness strong traction in the adoption of digital channel by customers. Please refer to slide #21 in the presentation. 58% of the Bank's active customers are digitally active. 40% of mobile banking customers prefer to use only the mobile app for banking with us. Mobile banking logins are now more than 4 times that of internet based logins.

On slide #22, we would like to draw your attention to a very important trend we have recently been witnessing. The total number of debit and credit card transactions at POS terminals and E-Commerce channels are now consistently higher than the total transactions witnessed on ATMs. This phenomenon started in the third quarter with some of the changes in the macro economy and has since held on to those new normals. Overall, digital transaction volumes increased by 64% on a YoY basis while ATM and branch transactions continue to trend downwards at the expense of these new technology led payments. Mobile banking spends in the first quarter reported a growth of 70% on a YoY basis aided by 29% growth in transaction volumes.

If you flip over to the next slide, it highlights some of the unique payment solutions introduced by the Bank recently for customers and merchants. We were among the first 4 banks to go live on NPCI's UPI ecosystem with the launch of Axis Pay, our UPI app that has seen tremendous response with over 3 million downloads. The Bank has also partnered with marquee merchant partners like IRCTC, LIC, PVR, Uber etc. to drive the acceptance of payments from the UPI platform. The initiative taken by the Bank in developing instantaneous, intelligent and interconnected payment solutions have helped us to partner with transportation firms and offer them unique solutions from the payment area. The Bank launched India's first EMV contactless transit card in partnership with Bangalore Metropolitan Transport Corporation (BMTC) and separately with Kochi Metro Rail Corporation to offer hassle free transit and retail payment solutions to customers. We were also the first bank to launch NPCI integrated interoperable RFID tag for providing Electronic Toll Collection Services for customers across the country.

Digital Technology is also aiding the Bank to garner more Current Account business as customers now prefer banks more and more with a strong digital edge. We have also launched our digital invoice discounting platform for MSMEs called Invoicemart. We were one of the 3 entities allowed by RBI to set up Trade Receivables Discounting System or TReDS, an electronic platform for facilitating cash flows for MSMEs. This platform became operational in this quarter and will further provide impetus for SME customers and for our overall strategy in the SME and MSME space.

In the Corporate segment, our focus in recent years has been on 4 areas; reduced concentration risk, build a higher rated lending book, increase the share of working capital loans and transaction banking revenues and finally prepare for a move towards the deeper bond markets through our DCM franchise. In line with these 4 focus areas, you will notice on slides 25 to 27 these following details. Number one, the Bank's exposure to top 20 borrowers as a percentage of our tier 1 capital has been steadily declining. At the end of Q1, it stood at 106% as compared to 287% at the end of FY11. Number two, incremental sanctions have been to better rated corporate with 93% of these rated A and above. Presently 68% of outstanding standard corporate loans are to companies rated A or better. Number three, corporate credit growth has been led by transaction and working capital oriented businesses. Our working capital loans grew by 23% YoY, even as term loans de-grew by 2%. And number four, the Bank's Debt and Capital Markets platform continues to be a market leader.

Our top position in the leader board here over the last 10 years positions us very well to benefit from the growth in the corporate bonds market. During the first half of calendar year 2017, the Bank further improved its market share to 23% from 20% in the same period last year. We continue to top Bloomberg League tables for corporate bonds for the 10th consecutive year and have been recently awarded the Best DCM House in India and the Best Investment Bank in India by Finance Asia Country Awards for Achievement 2017.

Moving on to the SME segment, our focus here has been to ensure quality of the book we take on board. Our SME advances growth stood at 10% YoY. This segment continues to be a significant driver of our priority sector lending. We believe that the recent implementation of GST could be a short-term challenge, but provides significant benefits and opportunities for the SME sector in the medium to long term. The longer term benefits are high as SME businesses, a large chunk of which are a part of the informal economy, are expected to see gradual movement into the formal economy. GST will improve transparency significantly and will further help better risk evaluation and loan pricing. We saw some decline in draw downs during the end of the quarter and demand from customer side was muted as businesses were still dealing with registration and implementation of GST. We believe small businesses are still working out how GST will impact them; however, large parts of the organized sector has fully adopted GST already and in general demand for loan should see an upward trend in the medium term. There could also be an increased working capital requirement as tax payments will need to be made every month before the return is filed. Our focus here remains on quality and at present 85% of outstanding standard advances are rated SME3 or better.

Let me now move on to asset quality. Gross slippage for the quarter stood at Rs. 3,519 crores compared to Rs. 4,811 crores in the fourth quarter. Net slippages stood at Rs. 3,213 crores. Gross NPA ratio of the Bank stood at 5.03% at the end of June compared to 5.04% at the end of March. The net NPA ratio has increased to 2.3% at the end of June compared to 2.11% at the end of March. Our watchlist has further reduced to Rs. 7,941 crores or 1.81% of customer assets as compared to Rs. 9,436 crores or 2.23% of customer assets in March. Gross slippages from the corporate lending book stood at Rs. 2,317 crores for this quarter. Net slippages before write-offs in retail and SME stood at Rs. 758 crores and Rs. 228 crores respectively.

Recoveries and upgrades for the Bank for this quarter stood at Rs. 306 crores. Our annualized credit cost for this quarter was at 1.95%, clearly lower than the peak levels witnessed last year and well within our credit cost guidance range of 175 to 225 basis points shared at the start of the financial year. You will notice that our watch list remains dominated now by the power sector. Expected slippages from this sector and this part of the watch list are fully baked in our estimates. We remain confident of ending the year within our credit cost guidance of 175-225 basis points.

Let me now touch upon the capital levels and shareholder returns. Total capital adequacy including Q1 profits continues to remain healthy at 16.63% with a tier 1 capital adequacy ratio of 12.60%. This compared to the tier 1 ratio of 11.87% at the end of 31st March and 12.38% as of 30th June 2016. During the quarter, we raised Rs. 8,500 crores through issuance of tier 1 and tier 2 bonds, of which tier 1 was Rs. 3,500 crores and tier 2 was Rs. 5,000 crores.

Slide #37 in our earnings presentation lays out the impact of various items on our Tier I ratio over the last quarter. Seasonal one-off items consumed 28 basis points of capital, growth consumed 1 basis point of tier I. Fresh tier I bonds raised contributed 72 basis points and profits contributed 30 basis points making for a net accretion of 73 basis points of capital for the quarter. Risk weighted assets for the bank stood at Rs. 483,889 crores. Annualized return ratios saw some sequential recovery with ROE and ROA for the first quarter standing at 10.21% and 0.87%, respectively. As the impact from higher slippages recedes and benefits of higher investments in branches and employees kick in, we expect these ratios to continue to improve further.

Moving on to the performance of our key subsidiaries. The Bank's subsidiaries have started to scale to a level where they are now able complements to the Bank's overall strategy. They are also starting to contribute materially towards creating dependable, alternative revenue pool for the Bank. Axis Finance, our fast growing NBFC complements the bank's strategy by offering financial solution to retail and corporate customers who have unique financing requirements. It has grown its overall book size at a CAGR of 57% while income is up 7 times in the last 3 fiscal years. The PAT growth has grown at a CAGR of 71% over the same period. Axis Capital, our institutional equities and investment banking franchise, has been the leader in equity and equity linked deals over the last decade. It has been the no. 1 banker in equity capital markets having executed equity deals worth Rs. 992 billion since April 2015 and continues to perform well. Its earnings have averaged above Rs. 100 crores in the last 3 fiscal years. Axis Securities is one of the fastest growing stock brokerage firms in India and currently ranked among the top 3 brokerages in India in terms of total client base. The retail broking business has grown its customer base and earnings at a CAGR of 46% and 63% respectively over the last 3 fiscal years. Axis AMC, our mutual fund business was set up in the year 2009 and has seen rapid growth in average assets under management. Axis MF has grown average AUM by around 4 times in the last 3 fiscal year and continues to gain market share with 2.28 million folios currently. The AMC reported 56% YoY growth in average AUM during the quarter.

As I close, allow me to resummerize the key themes from this quarter. Our performance turnaround continues to gather strength. Credit costs are expected to be within guided range and reverts to long term average level by FY19. We continue to hold healthy provision coverage levels at around 65%. ROEs are now back in double digits. Our retail franchise remains strong with robust CASA, robust retail advances growth and strong fee growth as well. With this, I come to the end of my comments and will be glad to take your questions now.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Mahrukh Adajania from IDFC Securities. Please go ahead.

Mahrukh Adajania: What was the total corporate slippage for the quarter?

Jairam Sridharan: Rs. 2,317 crores.

Mahrukh Adajania: And in terms of slippage outside the watch list, was that across sectors or lumpy?

Jairam Sridharan: The slippages outside of the watch list continue to be in the same sector that we have spoken about before. The top 3 sectors were Iron and Steel, Infrastructure Construction and Power in that order.

Mahrukh Adajania: Okay and your non-corporate slippage therefore would have also jumped this quarter?

Jairam Sridharan: Yes, it has Mahrukh, particularly driven by retail slippages on the agri front. So we are seeing some increase in agri slippages. Agri does tend to have a seasonal high in Q1 anyway and on top of that, some of the recent developments in the form of farm waivers etc. has contributed to the issue and we have seen some enhanced slippages there.

Mahrukh Adajania: Okay. And this corporate slippage outside the watch list, do you think its one-off or how do you look at it?

Jairam Sridharan: See, the way I look at it is that in terms of the overall slippage levels, we do expect a certain level of slippage to have come from outside of the watch list and it is well baked in, in our original guidance to you of where credit costs are going to end up. On a quarter-on-quarter basis, the volatility between watch list and non-watch list is going to continue given some of the lumpiness here. So I would not actually concentrate too much on the percentage split especially now that the watch list itself is a relatively small number, but as I said the sectors of stress continue to remain the same that we have talked about before, Iron and Steel, Infra Construction, Power etc.

Mahrukh Adajania: And was there any fresh SDR done during the quarter?

Jairam Sridharan: No SDR. There was one S4A done during the quarter, but no SDR.

Mahrukh Adajania: And how much was that?

Jairam Sridharan: The S4A was Rs 338 crores.

Mahrukh Adajania: Perfect. And security receipts?

Jairam Sridharan: No additions this quarter.

Mahrukh Adajania: So same as last quarter, Rs. 29.5 billion.

Jairam Sridharan: Yes.

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

Kunal Shah: In terms of agri NPLs, when we look at the end of FY17 it was at 3.2%. So where does it stand now at the end of Q1 FY18?

Jairam Sridharan: I do not think we have shared sectoral level GNPA ratios. But let us just say that agri have had a material jump up in their slippages in this quarter and it has been well above what to expect from a seasonality perspective.

Kunal Shah: Okay. Secondly in terms of these 12 accounts, everything was there in NPL and there is no impact either on the provisioning or on the NPL side, as was highlighted earlier in the press release?

Jairam Sridharan: No major changes there. There was some minor incremental provisioning. But the way the RBI circular on provisioning guidance on this works is that we are supposed to start any incremental provision required in the second quarter and we are expected to spread it out between the second and the fourth quarter through that period. So you will see that starting to happen from the next quarter.

Kunal Shah: Okay. And any quantification of that?

Jairam Sridharan: We have not shared the specific number there, but that number is also incorporated and included in our credit cost guidance for the full year.

Kunal Shah: And lastly in terms of overall CD ratio is up for to almost like 97 odd percent. So what is the overall growth outlook I think on the corporate side we are nearly saying 3% growth and when we look at the other private players, in fact there the corporate growth is slightly strong. So now what is the outlook on the corporate side and even on the deposits when we look at the term deposits, I think in fact there has been no growth YoY. So what is the reason?

V. Srinivasan: See, as far as corporate credit growth is concerned, I think you saw what we said on the call, that term loans have de-grown and there has been increase in working capital loan. That would continue and as we go further down the year, we expect corporate growth to be closer to the double digit range. As far as the balance sheet on the liability side is concerned, again we mentioned that because of borrowings in terms of tier I and tier II, the need for deposit is lower. So therefore the wholesale deposits have come down, de-grown YoY and that is what is reflected. So if you look at whether it is tier II or tier I, these instruments take care of funding requirements as far as the balance sheet is concerned. Therefore, need for wholesale deposits is lower.

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

Adarsh Parasrampuria: Couple of questions. You had a lot of write-offs in this quarter. Just wanted to understand the nature of these. Are these just technical in nature or you believe that you will not recover anything out of it?

Jairam Sridharan: Hi Adarsh. All of these are technical write-offs from tax optimization perspective.

Adarsh Parasrampuria: Secondly in terms of Power, if you can just walk through what is your NPA restructured book and watch list total, and why is there no migration to NPAs from watch list? It has been relative stable number on Power Watch List for some time and one would have expected that you will start seeing the migration soon, so?

Jairam Sridharan: Sure. At a high level, the Power accounts on the Watch List are lumpy. So there are a few accounts and there are large accounts which when they slip, you will see a big material movement in the watch list composition in those times. We are not going to be evenly spread through the rest of this year. So that is just the nature of that they are in different stages of either restructuring or coming up with some other resolution mechanism. So I would not expect smoothness in that and just be prepared for some lumpy movements here and there. Srini, anything you would like to add on?

V. Srinivasan: Yes. Basically I think one of the accounts is in SDR. There is a process going on as Jairam was saying towards the later part of the year. Depending on resolution, we will see how and what happens as far as one of the large accounts is concerned. The other accounts I think they are operational and they are generating cash flows to some extent, but there are some glitches in terms of which needs to be taken care of and process is on. Second what Jairam was saying that you would see some bulky, lumpy sort of changes happen as and when it happens but looks like it is in the later part of the year.

Adarsh Parasrampuria: And just picking the Power, wanted to understand whether outside of whatever you have quantified because things have moved relatively very slow in the sector, would you think there is more stress lying outside of what you quantified and two, is the loss given default in Power increasing a little bit than what you would expect it, say a year back or so?

Jairam Sridharan: On your first question Adarsh, yes, there is a little bit of stress in the Power sector outside of Watch List as well, or to put it differently if we were to draw out the Watch List today, we will probably put a couple of more Power accounts in there than what we did five quarters ago. Overall, our Power portfolio is above Rs. 20,000 crores and of that, about Rs. 5,500 crores or thereabout is in the watch list. So clearly that is the most stressed part of the watch list number. Apart from that, there might be a little bit more in terms of stress, but whatever we expect outside of the watch list in the Power sector, that is already baked in our estimates of credit cost that we shared with you at the beginning of the year. So while it is true that there is some stress in the Power sector outside of the watch list, it is fully captured in our credit cost estimates.

Adarsh Parasrampuria: And anything on loss given default on Power?

V. Srinivasan: You are right to say that longer the sector continues to stay in this shape, to some extent, there would be more pain. But considering some of the accounts we have, I do not think it is materially shifting, but logically what you are saying is true.

Adarsh Parasrampuria: And last question from my side, you keep highlighting that in various sectors there will be some sectors outside watch list but well baked into your credit cost guidance for this year. I am just trying to understand that the credit cost number applies to one particular year and when you give a stress book estimate that is the static pool, right? So do you think large part of whatever sits out is something that you would think will get recognized this year? I am just trying to understand credit cost impact from outside watch list next year, so?

Jairam Sridharan: Sure. So Adarsh, what we are saying in effect is that there will be some swap set between what is in the watch list and what is outside in terms of how slippage actually works. So you will see some part of the watch list survive through this year or some parts of the watch list which have already slipped get recoveries back and upgrade it through next year and on the other hand, you will see some pockets which are outside the watch list slipped. So there will be that swap set is essentially what you are seeing reflected in the credit cost guidance.

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

Vishal Goyal: I think one question is if you were to adopt IFRS, as of today or as of 30th June, how would your tier I look like?

Jairam Sridharan: See, we still need to see what the final guidelines on IFRS are. So it will be too premature for me to share any specifics. Let us see, for the June numbers which we are supposed to prepare under Ind-AS guideline, RBI guidelines on how to calculate has still not come out. So we are waiting for that. But my sort of broad guess is, it is going to be material but it is not huge. So I do not have specific guidance or anything like that, but somewhere around 50 basis points kind of range.

Vishal Goyal: Just going back to this watch list thing, you have been saying this even in previous calls that there would be some slippages that will come outside of watch list and that there are some accounts in Power which are stressed. But why don't just put that in the watch list so that it is the list which everybody can kind of capture and track because when you say it is outside of watch list like again, we have lost kind of tracking of what is the pool of stressed cases?

Jairam Sridharan: Vishal, as time goes on and the watch list becomes smaller and smaller part of the full book, today it is 1.8% of customer asset and it continues to come down this quarter you saw Rs. 1,500 crores reduction in the Watch List size. As you continue to see the Watch List be a fairly small part, this whole sort of exercise to look at slippages from within Watch List and outside Watch List starts to lose a little bit of relevance. When you have a small Watch List and it is chunky, there will be quarters in which it will form a big part of your slippages and there will be quarters in which it does not. What one should focus at this point is, the overall kind of slippage expectation and correspondingly given a PCR level, the credit cost guidance and that is what we have tried to share. On an overall level, credit cost guidance for this year is at 175 to 225 basis points, which after a first quarter performance at 195 basis points, we continue to feel very good about delivering well within that range.

Moderator: Thank you. The next question is from the line of Manish Oswal from Nirmal Bang. Please go ahead.

Manish Oswal: My question was on the operating expenses growth during this quarter, given the growth, especially the overall loan book growth, the 19% growth in the operating expenses seem to be on higher side. So any comment on that?

Jairam Sridharan: Yes. It is a bit on the higher side and you continue to see us sort of bring that down over the quarter. We have said that in our guidance for the full year that OPEX growth in this year will be in the low to mid teen and we continue to feel confident about ending there as the year progresses. In the first quarter, we were fully aware of and fully expected the kind of growth rate that you have seen here. Of the 19%, 3% points came from a specific regulatory situation where you might recall that bonus entitlements of certain categories of employees was increased last year with effect from this quarter. That is fully baked in, in our original start of the year guidance at mid teens level. So we feel good about bringing this percentage growth down, as the year progresses.

Manish Oswal: Okay. And second question on the pre-provision profit, basically in this quarter we have Rs. 4,291 crores of operating profit and we had guided that 20-basis point reduction in the net interest margin. With the kind of Opex growth we have guided, that means the full year profitability at an operating level will remain under pressure this year?

Jairam Sridharan: Yes, I think you can do the math with all the specific guidance that we have given and yes, you are not very far off.

Manish Oswal: Thank you so much.

Jairam Sridharan: Thank you. Just to clarify a point I made a little bit earlier on the bonus entitlement, that is for contracted employees and not for employees on actual bank rolls.

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

Rakesh Kumar: Sir just one question firstly, like we are seeing lot of delinquency happening from the Watch List, but other than the Watch List, we have seen delinquencies in non corporate sector like in the case of other banks. So while this Watch List of Rs. 7,900 crores still will take time to get over with, then delinquency from the other sectors should also be there actually and you know like what is happening in the banking industry. So taking all that put together, what could be the total delinquency rate we are looking at for this year on a whole?

Jairam Sridharan: As I mentioned before, all this dynamics of what is happening within the Watch List, what is happening with some of the sectors outside of the Watch List, what is happening in the regulatory environment in the form of top 12 accounts etc. all of that is baked in, in our credit cost estimate of 175 to 225 basis points for the full year.

Rakesh Kumar: And what would be the gross slippage number like?

Jairam Sridharan: We have not guided on a specific slippage number.

Rakesh Kumar: Okay. So would we maintain the PCR?

Jairam Sridharan: Yes. We expect to maintain PCR around 65%.

Rakesh Kumar: Although it actually came down this quarter from the Q4, so we are expecting to maintain at this level?

Jairam Sridharan: On a gross of write-off basis, the PCR did not actually come off in this quarter. We did some technical write-offs this year and we expect to do some more during the course of the year as well for tax optimization reasons. But gross of those write-offs, the PCR has been steady and will continue to remain steady.

Moderator: Thank you. The 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 is on the margin movement, can you just explain how is the movement on a quarterly basis as well because the compression on the yield on loans appears to be reasonably high?

Jairam Sridharan: So Mahesh, this quarter you will notice that in our waterfall that we have been sharing in the last few quarters, we actually changed the starting point to a full year, NIM of last year, and we did that because every quarter we found ourselves kind of explaining, kind of details around specific choices and events that happen last quarter. Like this time for example, the big delta comes from the fact that last quarter we had a write-back of interest reversals. If you remember our conference call last quarter, we had mentioned that there was some interest reversals we did in the Q2 and Q3 of FY17, which we reversed out and backed out in Q3 because of which Q3 then looked very high. So to keep away from these sort of minutiae of every quarter things moving here and there through the course of the rest of this year, my intention is to actually use the last full year NIM as the starting point and that is where we have offered our guidance for this year as well. So when compared to last full year NIM, we said, we could see NIM compression of up to 20 basis points. We have seen 4 basis points of that in the first quarter.

M.B. Mahesh: The second is a sub-question on this. Are you seeing a fair amount of spread compression on the incremental loans that you are writing as well? Let us ignore the impact of derecognition that is coming through the P&L because you are going through a fairly large increase in the rating upgrade of your portfolio.

Jairam Sridharan: It is a bit dependent on the product mix, Mahesh. So there are some product lines in which this is absolutely true. So some of the best credit corporate loan and the home loan sectors we are certainly seeing margin compression in the new business that we are booking. However, some other businesses, particularly on the retail side and certainly all the fixed rate businesses we are not seeing margin compression. So things like personal loans and credit card, auto loans and all of these businesses we are seeing no margin compression. Also please remember that as a strategy, as we have been articulating over the last multiple quarters, we are migrating towards better rated clients and as we move towards a better rated clients, you will also see some natural impact on the gross yields but we think that is well worth it in terms of the overall return on the risk weighted assets that these segments offer.

M.B. Mahesh: Sure. Thanks. Second question is to Mr. Srinivasan. Just wanted to understand, you made a 1% provision of about Rs. 180 crores for those 4 sectors. One, the power exposure is itself about Rs. 20,000 crores. So 1% on that itself is about Rs. 200 crore. Second, given a fact that you already have such a large NPAs and which is sitting in the Watch List, why does one percent adequately compensate for a risk which is there in that sector?

V. Srinivasan: So clearly if you look at this Rs. 184 crores we are talking about, this is the incremental provision. The 40 basis points on all standard assets is already there. The incremental provision of 60 basis points over and above that is what this Rs. 184 crores is.

M.B. Mahesh: But Rs. 20,000 crores x 60 basis points, even just taking the power portfolio itself takes a large share of this Rs. 184 crores. Just trying to understand why does 1% itself in the first place make a difference because it is too small a number.

V. Srinivasan: Clearly there would be cases, quite a few of them especially in the power sector which are either SDR or any of the other dispensations, where provision requirement is already much above 1%. So to that extent clearly the calculation is not wrong I can assure you. So you have 40 basis points of standard asset provision. You got provisions in certain cases where SDR or otherwise where you have provisions which are much above 1%. And on the residual you are providing another 60 basis points. And that I think is totally in sync with what RBI to some extent prescribed across sectors. When they look at a sector sometimes they talk of increased provisions in all assets regarding the sectors, because even if it is an AAA asset you are going to be providing 1% as far as the sector is concerned. I am not talking of power; I am talking of all the 4 sectors. You are having assets of much higher credit quality, on which you are providing 1%. So overall it evens out in terms of the overall standard asset provisions.

M.B. Mahesh: Thanks. Finally one question is on the SME loans, it has been very sluggish on that front. Any broad thought process around it given the fact that appears to be the next big opportunity in the space right now?

V. Srinivasan: I think it was good till end of May. I think in June all of us know GST was happening. There was lot of activity in terms of de-stocking. People were doing a lot of stuff which were not necessarily something which you would have expected in a normal course of business. Hopefully that should settle down over the course of this quarter. So we saw some level of activity coming off and against that asset levels fall off during June, which hopefully we believe will recover over the rest of the year.

M.B. Mahesh: Thanks. One question, in the Basel disclosures you have reported NPAs in the Banking and Financial portfolio?

V. Srinivasan: No. There is one asset which is the holding company asset on an Iron and Steel company. I think that was showing up as financial because sometimes holding company show off like that but it is not a financial company.

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

Nilanjan Karfa: Just looking at this core tier I consumption, it is pretty sharp. It is about 25 basis points sequentially and then you are saying, obviously we are doing a lot of catch up provisioning and let us assume the IFRS or Ind-AS is implemented, we will definitely need to raise capital pretty quick.

Jairam Sridharan: Nilanjan, our common equity tier 1 has actually increased in this quarter. We have accreted 2 basis points of common equity tier 1. So I think there is something off with the math there. So CET 1 was 11.13% at the end of March and it is now 11.15%. So we have 2 basis point accretion.

Nilanjan Karfa: Okay. I am looking at the Pillar 3 disclosure. It is 10.88% unless there is a printing mistake.

Jairam Sridharan: No. That is for a consolidated level.

Nilanjan Karfa: No, consolidated is 10.96%. Standalone is 10.88%. That is what I am looking at.

Jairam Sridharan: That is without profit for the quarter. And even that has increased sequentially.

Nilanjan Karfa: Does not seem so, because the tier 1 reported just under it is 12.33% which is what is being reported in the press release as well.

Jairam Sridharan: So CET 1, the number 10.88% that you are talking about, last quarter was 10.63%.

Nilanjan Karfa: Last quarter, it was 11.13%.

Jairam Sridharan: No. You are confusing two numbers here. The 11.13% was with profit last quarter. Without profit was 10.63%. That 10.63% has gone to 10.88% as at end of June quarter. When you go with the with-profit numbers the comparison is 11.13% going to 11.15%. Both measures there has been accretion of common equity tier 1 during this quarter.

Nilanjan Karfa: Okay. But that does not change the question because we are running pretty low on capital given fully phased in Basel-III implementation, right? So assuming we will probably get some kind of a hedge which let us say whether it is 50 or 70 basis points, how do you want to approach this capital raise given that there is still risk on the balance sheet in terms of higher provisions? What is the path you need to approach? Do you want to see a cleanup first and then go and hit the market, is that the broad thought process?

Jairam Sridharan: I think at a broad level it is clear that from our current position standpoint, we are adequately capitalized for the rest of this year but probably not adequately capitalized for two full years. So in that sense there got to be some sort an equity event. Now the timing of that depends on our confidence about having actually shown the full turnaround in its strength and having the kind of profit engine running as well as having some visibility into the advances growth coming back, both of which are happening now. So we feel that directionally what you are saying is accurate that kind of raising the common equity at some point would be an appropriate thing for the Bank to do and it is also accurate for you to suggest that the Bank's numbers and performance turnaround should become abundantly clear as we approach investors.

Nilanjan Karfa: Okay great. And in fact quickly delve on the SME and retail, while you have highlighted that agri was probably a little elevated. But if you exclude that, last year I think on an average the gross slippages within the retail SME was between what Rs 600 to 700 crores on a quarterly basis. Is that still the broader run rate that we saw excluding that agri slippage?

Jairam Sridharan: Yes. That is true. But also remember that as I mentioned multiple times in this call in the past that Q1 tends to be a seasonal high in the retail businesses or the smaller ticket businesses from a slippage perspective. Q1 tends to be the high, Q2 and Q3 tends to be roughly similar and medium and Q4 actually tends to be the low. That is the seasonality curve of slippages in retail. So you are seeing a couple of things happening in small ticket loans. You are seeing the agri situation which is at elevated levels and then you are seeing the seasonality which is embedded. Apart from that there is no secular story there.

Nilanjan Karfa: Right. And sorry, a last question. When I look at the Watch List, it seems the commonality between 5:25 and Watch List is actually gone up on a sequential basis. What kind of movement did we see between all these buckets and the Watch List?

Jairam Sridharan: That is a really complicated question.

Nilanjan Karfa: No, it moved from Rs. 2,329 crores to Rs. 2,504 crores and I think we said we added about Rs. 289 crores.

Jairam Sridharan: There was a separate 5:25 of an account which was in Watch List.

Nilanjan Karfa: It seems to have gone up.

Jairam Sridharan: There was one account in the Watch List of Rs. 289 crores on which the 5:25 was done. At separate instance there is one account of Rs. 338 crores on which we did an S4A in this quarter. All of those numbers are there in that sort of Venn diagram that we have.

Moderator: Thank you. The next question is from the line of Pankaj Agarwal from Ambit Capital. Please go ahead.

Pankaj Agarwal: My question was on your margins. So how much of this margin compression you would attribute to incremental lower margins and how much is to your asset sensitive balance sheet? How would you break it down? Reason I am asking is that, is it purely because rates are going down and your margins are compressing or you are seeing pricing on incremental margins?

Jairam Sridharan: See, incremental margin contribution is going to be very limited, Pankaj, because if you just see the incremental growth during the quarter that number is not actually very high or not enough to move the needle on portfolio level NIM. So it is more the rate environment story and the basic MCLR migration story.

Pankaj Agarwal: But I think that as you know that interest rates are going down, could you have done something to protect your margin? Or is it like you just got off guard on the rate cycle?

Jairam Sridharan: See, I think in a variable rate book, particularly when a regime change in variable rate is happening, some of the stuff is bound to happen. But it is not something that it has caught us unaware by any means. Like we had guided at the beginning of the year as well, that these dynamics are indeed going to work out and we have guided to a specific range in terms of what the outcome levels were going to be and we are seeing things within that range. Over time, if you have a larger fixed rate book or kind of more stability develops in the interest rate environment, these things will stabilize. Or when the rates moves in the opposite direction, you will see the margin expansion at exactly the same sort of beta and the margin expansion will happen just as quickly as the compression is happening all the way down. So that is an underlying business model issue and it is not something that is sort of particularly surprising to us.

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

Rahul Jain: On your slide 45, you have given a breakdown of your corporate bond book and the movements of the last few quarters and I guess this quarter our corporate portfolio bond book has increased about 7%, what I observed in this slide is between March 17 to June, the BBB and below rated corporates who have increased were 7%. So is incremental bond buying that we are doing is in that segment or this is just a normal rating movement during the quarter?

Jairam Sridharan: This is a rating movement.

Rahul Jain: But that 7% seems little significant during the quarter, so were there bunch of accounts or there was only one account which perhaps caused this?

Jairam Sridharan: This is one significant account here. This is one significant account which had a downgrade and that is what reflected here.

Rahul Jain: Okay. And second thing is, in your tier 1 movement you had this one-off or seasonal impact. Would it account for the increased RW on unrated exposures which was supposed to kick in from June?

Jairam Sridharan: The unrated exposure guideline has not kicked-in in June, and we have got a guidance to pause it. We will see when it comes back into effect. So we will keep you informed about that.

V Srinivasan: Just to clarify, that is not a pause for us, but a pause to everyone.

Rahul Jain: Okay, so when would it be implemented?

V Srinivasan: We will have to wait and watch.

Jairam Sridharan: We will have to wait for what the regulator decides.

Rahul Jain: And would you mind sharing what kind of impact it will have for our tier 1?

V Srinivasan: Basically what the guideline meant that every exposure which you have in your offshore non rupee asset, it means you have a lot of unrated exposure typically which are unrated. And therefore even if you have large PSU exposure which may be AAA, but lot of them don't get rated. Putting a 150% of risk weight was something which we believe was not reasonable. So the RBI has clarified that this will be on pause for now and there were stated cases where we should be putting 100% risk weight which is for a very small set of exposure.

Rahul Jain: Okay. The other question was pertaining to credit cost range that is given out. Now 50 basis point is a range but given that now more and more cases are getting referred to NCLT and if some of these cases are in the power sector and if the resolution does not happen, this clearly could have implication for our range. Now it may not happen in FY18, but it could happen in FY19. So are you kind of baking in that also, some of those scenarios or not really?

Jairam Sridharan: So when we came out, Rahul, with the guidance that talked about at the last call, we simulated multiple scenarios both in terms of PD as well as in terms of LGD and the kinds of scenario we are talking about in terms of how much of power sector will slip now or some of the other sectors what would be the loss-given default, what recovery should we assume in this year, what should we assume in terms of advances growth? All those scenarios have been simulated and the plus or minus 25 basis point range that we shared fully captured a lot of that stuff. With the first quarter out of the way we continue to feel fairly confident about or ability to stay in that range and as the year progresses, you might see us kind of make some adjustment to that range and kind of either narrow it or move it directionally depending on how our experience pans out. As of now we have decided not to adjust it or revise it downwards.

V. Srinivasan: Yes. I just want to clarify when we say adjustment, we are not looking to revise it upwards.

Rahul Jain: It could be a downwards but not upwards is a fair understanding, right?

V. Srinivasan: Yes.

Rahul Jain: Just one last thing. How much of contingent provisions do we hold as of now?

Jairam Sridharan: We have Rs. 260 crores of contingent provisions that we did not use anything in this quarter. And a large part of the contingent provisions are set out towards power assets**.** And one other thing, in my first answer to Rahul that I forgot to mention is that on slide 45 where we are talking about the corporate bonds portfolio, I want to reiterate that this time what we have shown here is the portfolios led only on standard investments. So the nonperforming investments have been taken out of this. Just in case people didn't notice.

Rahul Jain: No. I saw that asterisk which is why kind of I got curious. Thank you.

Jairam Sridharan: Alright. Thanks.

Moderator: Thank you. The next question is from the line of Kaitav Shah from SBICAP Securities. Please go ahead.

Kaitav Shah: Sir your retail fees have been pretty strong. Just wanted some sense where it is heading for this year and next year?

Jairam Sridharan: So retail fee strength, yes, we have had some very strong performance in this quarter. Rajiv, do you want to share some details?

Rajiv Anand: Yes, most lines have done well. Card spends have been strong both on debit cards as well as credit cards, and so the growth on fee has been very robust this quarter.

Jairam Sridharan: We continue to feel good about our ability to generate strong fee growth through the rest of this year.

Moderator: Thank you. The next question is from the line of Anirban Sarkar from Motilal Oswal Securities. Please go ahead.

Anirban Sarkar: Yes. Thank you for the opportunity sir. I just wanted to know if you have given the data point of SME and retail slippages separately?

Jairam Sridharan: Yes, we have shared net slippages in SME and retail. I think the slippage on a net basis in retail was Rs. 758 crores and in SME it was Rs. 228 crores.

Anirban Sarkar: So this is on a net basis?

Jairam Sridharan: On a net basis. We have not shared gross level.

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

Nitin Agarwal: Sir, a question on the divergence that we had at the end of the last fiscal. So how much of that divergence have we addressed in the current quarter and what is our plans on that?

Jairam Sridharan: Nitin, all the divergence of last year was fully addressed in the last year itself. There is nothing left over to address in this year.

Nitin Agarwal: So of the divergence of Rs. 9,000 crores, I remember approximately 2,500 crores that was there. So that has already been taken under gross NPL, is it?

Jairam Sridharan: No. The divergence that was fully incorporated and even at the end of the divergence process Rs 2,500 crores odd, that amount got regularized post being classified as NPA. But the divergence as a process is over and that part is fully been incorporated in the numbers in the past year.

Nitin Agarwal: Okay. And secondly a small clarification on margins. We are guiding for a 20-basis point potential NIM compression over full year or over the 4 quarters on which 4 basis point is already paid out?

Jairam Sridharan: Full year. 3.67% was the full year last year and we said about 20 basis points compression and of that 20 basis points you have seen 4 in this quarter with the numbers turning up at 3.63%.

Moderator: Thank you. The next question is from the line of Jayant Kharote from JM Financial. Please go ahead.

Sameer: Hi. This is Sameer here. Just quickly what areas are you seeing the strong working capital demand on the corporate side?

V Srinivasan: It is across sector. I think we have been growing the pipeline in terms of working capital loans. We have had incremental sanction over the last couple of years. Clearly our composition of working capital sanctions has increased and that is surely bearing fruit right now.

Sameer: Okay. So no specific sectors there you would name. Secondly, what proportion of the power book is renewable?

Jairam Sridharan: It is under 15%.

Sameer: And all of it is standard I believe?

Jairam Sridharan: Yes. All of it is standard right now.

Moderator: Thank you. The next question is from the line of Siddharth Gandhi from Singhania Investment. Please go ahead.

Siddharth Gandhi: Just wanted to check, this standard asset provisioning that you have made of Rs. 184 crores, under what line does it show in your P&L and second you said you have made this across the 4 sectors. The top 3 are the same in your, what has been in the Watch List and the other is telecom. Now is that only on the funded advances or does it also include the investment also?

Jairam Sridharan: It's only on the funded advances, investment continue to be on a mark-to-market basis and on the first part of your question, standard asset provisioning just shows up in the provision and contingency line in the P&L. So if you look in our presentation on slide 46, in the table at the bottom, the second line which says standard assets, that shows the movement on a quarter-on-quarter basis.

Siddharth Gandhi: There is going to be a write-back in the quarter, is it?

Jairam Sridharan: No. Actually this is on a net basis, there has been a write-back this quarter. But that is because there was some write-back from some other standard assets which actually turned into NPAs and on which we had a lot of standard asset provisioning we got converted to NPA provisioning and net of that, the net amount ends up looking negative. But in reality there is a Rs. 184 crores positive and there are some negative items which show up as NPA provisions.

Moderator: Thank you. The next question is from the line of Pratik G from Drone Capital. Please go ahead.

Pratik G: I had one question. We got your credit cost range that you said, but is the credit cost peaking this year or how do you see credit cost for the next 2-3 years? It should actually eventually start falling off, right?

Jairam Sridharan: Credit cost peak was last year, Pratik, and we expect this year to be meaningfully below last year and we expect to get to long term normal levels in the next year.

Pratik G: And by which year you expect to get normal ROEs that you used to deliver in the better times that is about 18%-20%.

Jairam Sridharan: Let us see. I think our credit cost normalizes next year and as growth comes back sometime over the next couple of years, one should get close to kind of more normalized levels of ROE.

Pratik G: Sir, did I hear you correctly saying that the credit cost for FY19 will be meaningfully lower than FY18, right?

Jairam Sridharan: Yes.

Moderator: Thank you. The next question is a follow up from the line of Mahrukh Adajania from IDFC Securities. Please go ahead.

Mahrukh Adajania: There are a lot of concerns on SDR slipping in the next 2-3 quarters. So your thoughts on that?

V. Srinivasan: There are some assets which clearly come up for, by the time period the resolution is getting over possibly towards the later part of the year. There is activity happening in terms of the resolution. We need to see. We need to wait and watch. But that is true, I think some of the SDRs done over the last year, time period runs out towards later part of this year.

Jairam Sridharan: And just as a reminder Mahrukh, I am sure you have seen this but our total SDR is Rs 2,029 crores of which Rs 1,213 crores is on the Watch List and Rs 816 crores is not.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to handover the conference call to Mr. Jairam Sridharan for his closing comments.

Jairam Sridharan: Thank you Margaret. Thank you everybody for your interest in discussing the result of the Bank in the first quarter. I hope you all have a wonderful evening. Thank you very much.

Moderator: Thank you. On behalf of Axis Bank that concludes the conference call. Thank you for joining us and you may now disconnect your lines.