"Axis Bank Q2 FY18 Earnings Conference Call"

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Moderator: Good evening, ladies and gentlemen, and welcome to the Axis Bank conference call to discuss the Q2 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, Chief Financial Officer; and Mr. Rajiv Anand, Executive Director, Retail 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 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. Good evening. I welcome you to our conference call for a presentation on the bank's performance in the second quarter of the financial year 2018. For some parts of this call, we expect to refer to slides in our quarterly investor presentation, so you might want to keep that presentation handy.

Let me start with some highlights of the results. Strong retail franchise continues to gain strength. Strong CASA growth at 24%, retail loans growth at 23%, retail fee growth at 23% as well. The digital space continues to witness strong performance by the bank, Axis Bank is ranked #2 in mobile banking spends as per the latest RBI data. And the acquisition of Freecharge, which was closed earlier this month, will help us augment our digital capabilities even further.

Third highlight is that the loan growth momentum is back. Strong loan growth was led by pickup across all segments. Growth in corporate loans is much higher than witnessed in recent quarters driven by strong growth in working capital loans. And SME loans as well have grown at a much higher pace than they have done in recent times.

Accelerated recognition of NPLs has led to a sizable reduction in the overall stressed assets pool. There were high slippages in the quarter, driven by divergence assessment by RBI in their annual review process. Slippages are driven by corporate loans and have largely come from the low-rated pool of assets. Aside from RBI reclassification, we have also made ₹505 crores of additional provisions in this quarter towards the various lists of IBC accounts, further increasing our provision coverage there.

The capital position remains healthy in spite of the higher provisions in the quarter. The capital adequacy ratio stood at 16.32%, with a Tier 1 of 12.36% and a CET1 of 10.95%. Subsidiaries continue to deliver healthy performance. They are increasingly becoming important component of our position as a full-service universal bank. The first half performance of the subsidiaries remained strong.

Let me discuss the performance now in a little bit more detail. The deposit franchise had another excellent quarter with savings account and current account balances growing by 21% YOY and 28% YOY respectively. The quarter-on-quarter growth in savings accounts and current accounts was at 7% and 11% respectively. Overall CASA balances grew 24% YOY and our CASA ratio stood at 50%. CASA deposits on a daily average basis grew 24% YOY, and by that definition, CASA ratio was 46% of total deposits.

CASA, retail term deposits together form a strong base at 83% of total deposits and are up 224 basis points YOY. Term deposits degrew by 2%, while the wholesale term deposits degrew by 3%. Retail term deposits, excluding FCNRB deposits, grew by 8% in the quarter. Overall deposit growth for the quarter stood at 10% YOY.

The banking system credit growth continues to see gradual improvement from the multi-decade lows that we witnessed in the March quarter. We were close to 7% for the fortnight ended 29th September. Our aggregate loan growth rebounded strongly, and compared to this 7%, we stood at 16% YOY. Loan growth was largely driven by 23% increase in retail and 15% in SME. Corporate loan growth after a long time picked up sharply and was up at 10% YOY in second quarter from 3% in the previous quarter. Working capital loans grew by 36% YOY.

Moving on to the earnings profile. I request you to refer to Slide 13 of the earnings presentation. Net profit grew 36% YOY to ₹432 crores. Net interest income was 3.45% for the quarter, with domestic net interest income at 3.71%.

Slide 14 represents the net interest margin waterfall. Net interest margin for the first half of this fiscal was at 3.53% compared to the last year average of 3.67%. The compression of NIM remains in line with our expectations. We reiterate our NIM guidance of moderation of around 20 basis points on a full year basis compared to last year. Cost of funds during the quarter stood at 5.18% compared to 5.24% in the first quarter and 5.68% in the second quarter last year. Fee income growth was healthy at 12% and constituted 30% of operating revenue. Retail fee continues to be an area of strength with robust growth of 23%, and it now constitutes 48% of total fee income. Trading income for the quarter stood at ₹377 crores.

Operating expenses growth moderated to 13% YOY. The cost to average assets for the bank was at 2.17% for the quarter. We expect OpEx growth to continue to moderate in the second half of this fiscal year. Operating profit for the quarter stood at ₹3,777 crores, down 8% on a YOY basis. Operating profit margin stood at 2.39% compared to 2.95% in the second quarter last year and 2.87% in the first quarter of this financial year. Provisions and contingencies reduced by 13% on a YOY basis. For a more detailed provision breakup, please refer to Slide 17 in the investor presentation. Provision coverage ratio of the bank stood at 60%.

Let me move to performance in key business segments. The strong retail franchise continues to drive our financial performance right now. If you refer to Slide 22 of the earnings presentation, share of retail loans in the overall loan mix stood at 45% at the end of Q2. Retail loan book remains well diversified and nearly all major segments are contributing significantly. Share of home loans in the overall retail book have come down steadily from 54% in financial year '13 and now stands at 43% at the end of the second quarter. The share of personal loans, credit cards, auto loans and small business banking loans have all inched up.

If you flip over to the next slide, you will observe that the growth in the second quarter in retail was led by credit cards, personal loans and auto loans that grew by 51%, 36% and 33% respectively. Our new engines of growth like small business banking and education loans continue to see strong momentum with YOY growth of 79% and 115% respectively. We continue to focus on affordable housing and have made disbursements to more than 32,673 families till August 2017. In personal loans and auto loans, we continue to see traction, driven through acquisition from digital channels and through our branches.

Slide 24 of the presentation highlights the strong growth trend in retail fees over the last few years. It has grown at a CAGR of 19% over the last 4 years despite many unfavorable regulatory changes. At the same time, retail fees have increasingly become more granular and annuity based. The share of fees from cards had been steadily inching up from 26% as of the end of financial year '13 to 39% at the end of the first half of this year. Cards fees grew strongly again this quarter by 36% YOY.

Internal customers continue to be the mainstay of the bank strategy for sourcing retail loans, with 72% of sourcing in the second quarter coming from existing customers, 97% of the bank's credit cards and 78% of the personal loan originations in the quarter came from existing customers of the bank. 50% of the overall sourcing happened through our branches.

Given our strategy to source from our internal customer base, we believe that branches will continue to remain essential for new customer acquisition and hence continue to make investments in developing an extensive branch network. We opened another 100 branches during the quarter; however, the newer branches continue to get smaller in size. Axis Bank also ranks among the top 10 most valuable brands in India in this quarter.

Our leadership position in the transactions and payments space continues. If you refer to Slide 29, you will notice that the bank's market share in digital and new technology products has been much higher than in the traditional payment space. The bank has 3.8 million credit cards in force at the end of the quarter, the fourth largest credit card base in the country with a market share of 11%.

Credit card spends in the second quarter increased by 56% YOY to ₹9,915 crores, and debit card spends grew by 84% YOY to ₹7,564 crores. The bank is also the second largest acquirer of point-of-sale terminals in the country, with an installed base of 4.7 lakh POS terminals.

We also continue to witness strong traction in the adoption of digital channels by customers. If you look at Slide 33 in the earnings presentation, 60% of the bank's active customers are digitally active and 40% of our mobile banking customers prefer to only use the mobile app. Mobile bank logins are more than 4 times that of Internet logins. The total number of debit and credit card transactions at POS and e-commerce continue to grow strongly and are now much higher than all transactions that we witnessed at ATMs. Overall digital transaction volumes increased by 42% on a YOY basis, while ATM and branch transactions continue to trend downwards.

Mobile banking spends in the second quarter reported a growth of 78% on a YOY basis, aided by 29% growth in transaction volumes. Our market position in the mobile banking space by spends improved significantly as we jumped 2 places in the ranking table to get to the second position as per the latest RBI data for the month of July 2017. Axis Bank was also ranked #2 for functionality in Forrester's Mobile Banking Benchmarking for 2017 for all Indian banks.

If you look at slides 35 and 36 of the presentation, these highlight our capabilities and strong positioning in the UPI or Unified Payments Interface space. 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 more than 2.1 million virtual payment addresses being created across the app. The bank has partnered with marquee merchant partners like IRCTC, LIC and Uber to drive the acceptance of payments on the UPI platform. We currently have over 4.5 million registered customer base.

During the quarter, we were one of the 4 banks that have partnered with Google for their digital payments app Tez to facilitate the processing of payments across the UPI-enabled banks. During the quarter, we also implemented our UPI-enabled payment solution for Uber and Ola on their Android apps.

Fintech and wallet companies have done tremendously well to attract customers in the short span of their existence. Clearly, fintech companies have something unique to offer in terms of customer proposition. We believe that a combination of this value proposition and the strength of this acquisition engine with the power of lending and deposit products of a bank can create significant value. It is this strategic view that has led us to the acquisition of Freecharge, which was completed a few days ago.

Conventional wisdom in banks has been to start with deposit products as the nucleus around which one creates a franchise. We believe it is equally possible to build a franchise around a powerful and unique payments platform solution, which is what we would hope to do with Freecharge. Freecharge is one of India's leading digital payments companies with a user base of 54 million, gross merchandise value of over ₹7,200 crores and 213 million transactions. The acquisition of Freecharge would help us to augment our digital capabilities significantly. Our customer base would increase by more than 2x and enhance our reach among a new customer segment that is predominantly young. With digital payments as a hook, we can leverage the platform for digital distribution by targeting digitally native mobile-first customers.

Moving to our corporate segment. Our focus in recent years had been on 4 areas: reduce concentration risk, build a higher-rated lending book, increase the share of working capital loans and transaction banking revenues, and prepare for a move towards the deeper bond markets through our DCM franchise. In line with these focus areas, you will notice on slides 43 through 48 that Corporate Credit growth has been led by transaction and working capital-oriented businesses. Working capital loans grew by 36% YOY even as term loans grew by 3%. Incremental sanctions have been to better-rated corporates with 85% of these rated A or better. Presently, 70% of outstanding standard corporate exposure is to companies rated A or better. The bank's exposure to top 20 borrowers as a percentage of Tier 1 capital has been steadily declining and stood at 118% at the end of Q2 as compared to 287% at the end of financial year '11.

On Slide 47, we have shown the status of our power sector portfolio. Out of the total power sector net advances of ₹17,742 crores, 87% of advances are to power generation, of which 78% are coal based. Further, 85% of the power generation projects are currently operational. As of September 30, 2017, we have recognized NPAs of ₹3,300 crores in the power sector with a provision coverage of about 45%.

The bank's debt and capital markets platform continues to be a market leader. The bank's share in the Indian bonds market for the quarter stood at 22% as compared to 18% for the same period last year.

Axis Bank continues to top Bloomberg league tables for corporate bonds for the 10th consecutive year and has been awarded the Investors' Choice for Primary Issues in Corporate Bonds in India by Asset Benchmark Research. Our leadership here positions the bank very well to benefit from the growth in the corporate bonds market.

In the SME segment, the focus has been to drive growth while we ensure quality of the book. Our loan growth here has improved during the quarter end and stood at 15% YOY. The growth was broad-based as the term loans and working capital loans both grew by 18% and 14% respectively. Share of working capital to overall SME loan book currently stands at 78%.

While the implementation of GST has led to some challenges for smaller businesses in the unorganized sector, it provides significant benefits and opportunities for the more organized players. As SME businesses, a large chunk of whom are a part of the informal economy, gradually move into the formal economy, GST will improve information access significantly, which will further help in better risk evaluation and loan pricing. Our focus here remains on quality growth and at present 87% of the outstanding standard exposure in this portfolio is to customers rated SME 3 or better.

Let me now move to asset quality. I'm sure many of you have seen the information that we have presented in our press release and in the presentation on RBI divergence this quarter. Let me now offer you some more color on what forms that divergence. Every year, RBI conducts a risk-based supervision exercise. And for the year that ended financial year '17, the exercise was conducted earlier in Q1, and the results were presented in the form of a report in October, a few days ago. In this report, the RBI has pointed out certain reclassifications in the banks' asset classification and provisioning as of the 31st of March, 2017.

The bank has duly recorded the impact of such reclassifications in the result for the quarter ended 30th September. Some details on these accounts are as follows. A total of 9 accounts were reclassified by RBI. As on 30th June, 2017, these 9 accounts were classified as standard assets across most consortium banks, with only about 6% of the total outstanding of these accounts being classified as NPAs across the sector. As on 30th September 2017, fund-based outstanding of these 9 accounts for us was ₹4,867 crores, all of which now stands as NPA. ₹2,400 crores of this is from accounts that are either a part of the bank's watch list or were restructured as on 30th March. ₹200 crores have already turned NPA in the first quarter. 7 of the 9 accounts pointed out by RBI were rated BB or worse as on 30th June 2017.

From a sectoral perspective, the distribution of the 9 accounts is as follows. There is one large account in the steel sector, which contributes ₹1,128 crores. The power sector has 3 accounts amounting to ₹1,685 crores. There is one account in the IT/ITES sector, which contributes ₹1,143 crores. And the remaining 4 accounts together comprise ₹911 crores. Of these 9 accounts, 8 are consortium accounts. Of these 8, Axis is the lead banker in only one account. On the ninth account, where Axis is the sole banker, that's the one in the IT/ITES segment. We expect a fairly significant part of this account to get repaid in short order after the conclusion of a business sale transaction for which the binding agreement is already in place.

The bank created a total provision of ₹1,618 crores on these 9 accounts during this quarter. We estimate that the divergence-related accounts will consume around 40 basis points of credit cost for the full year. Incorporating this impact and after evaluation of the underlying credit trends of the rest of the book, we are updating our credit cost guidance to 220 to 260 basis points for the full year. We expect to maintain provision coverage ratio in the 60% to 65% range.

If you refer to Slide 51, you will notice that during the quarter the total slippages from the corporate book was ₹8,110 crores of which 73% came from accounts which were rated BB or worse in the previous quarter. 53% of the slippages were from the watch list and various restructuring dispensations. If you look at this trend over the last 6 quarters, you will notice that on average 86% of our corporate slippages have come from the book that is BB or worse.

If you move to the next slide on Slide 52, you will see that as a result of RBI divergence and other movements on NPA recognition, there has been a significant reduction in the stressed pool of assets. Irrespective of the definition you use for what to call the stress pool, this quarter has continued the trend of a secular and continued reduction in the size of the remaining stress pool at the bank.

Further, if you flip over to the next slide, it highlights the overlap among the various stress pools, where you see that the entire watch list is subdued in the BB or below group as is most of the restructuring accounts. The gross NPA ratio of the bank stood at 5.9% at the end of September as compared to 5.03% at the end of June 2017, while the net NPA ratio has increased to 3.12% at the end of September as compared to 2.30% at the end of June. Gross slippage for the quarter was ₹8,936 crores and net slippage was ₹7,888 crores. Net slippage in retail and SME stood at ₹292 crores and ₹219 crores respectively.

Let's move now to Slide 54. As on 30th September 2017, the bank has total loans outstanding of ₹7,041 crores against the 2 lists referred by the RBI for potential IBC action. On the ₹7,041 crores, we have made an incremental provision of ₹505 crores during this quarter, taking the total provisioning towards these accounts to ₹3,886 crores and our provision coverage up to 55%. Credit cost for the quarter stood at 316 basis points. The credit cost for the first half of the financial year has been 256 basis points. This includes 73 basis points on account of RBS and 14 basis points on account of the additional provisioning that we have done for IBC accounts.

The accelerated recognition in this quarter and the continuing reduction in the size of our stressed asset pool improves our confidence in the trajectory of the overall bank credit costs. We continue to expect normalization of bank credit costs by the second half of financial year '19.

Let me move now to capital levels and shareholder returns. Our total capital adequacy ratio, including H1 profits, continues to remain healthy at 16.32% and the Tier 1 capital adequacy ratio of 12.36%. This compares with the Tier 1 ratio of 12.6% at the end of 30th June and 12.03% at the end of 30th September 2016.

Slide 62 of the presentation lays out the impact of various items on our Tier 1 ratio over the first half of this financial year. Seasonal one-off items, which played in the first quarter, consumed 23 basis points; growth consumed 34 basis point of Tier 1; fresh AT1 bonds contributed 70 basis points; and profit contributed 35 basis points making for a net accretion of 49 basis points of capital in the first half. Risk-weighted assets for the bank stood at ₹496,781 crores. Annualized return ratios have seen some moderation due to the onetime impact of higher provisioning related to RBI divergence. ROE and ROA for the first half were at 6.82% and 0.57% respectively.

Last quarter, Axis Bank was included in the FTSE4Good Emerging Markets Index based on the bank's sustainability practices and performance. The bank is also listed on the MSCI India ESG Leaders Index based on the bank's ESG performance.

Moving on to performance of our key subsidiaries. The bank's subsidiaries have started to scale to a level where they are now able to complement to the bank's overall strategy. They are also starting to contribute materially towards creating dependable alternative revenue pools for the bank. Axis Finance, our fast-growing NBFC, complements the bank's strategy by offering financial solutions to retail and corporate customers who have unique financing requirements. The loan book grew by 65% YOY in the first half, revenue grew by 19% YOY to ₹341 crores while PAT grew 32% to ₹101 crores.

Axis Capital, the institutional equities and investment banking franchise of the bank has been the leader in equity and equity-linked deals over the last decade. It reported 5 times increase in the value of deals executed during the quarter to ₹11,021 crores. The revenues in the first half grew by 21% to ₹152 crores, and profit after taxes grew by 39% to ₹68 crores for the same period.

Axis Securities, our broking business, is one of the fastest-growing stock brokerage firms in the country and currently ranks among the top 3 brokerages in India in terms of total client base. The cumulative client base rose 37% in the first half of this fiscal to 1.59 million. Total revenues in the first half grew by 32% to ₹438 crores, led by a 37% increase in broking revenue, while the profit after taxes grew by 44% to ₹26 crores for the same period.

Axis AMC, our mutual fund business continues to perform well. The AMC reported 46% YOY growth in average AUM during the quarter, led by 23% YOY rise in the number of client folios. The revenues for the first half of fiscal '18 grew by 43% YOY, and profit after taxes for H1 grew strongly at 52% YOY.

As I close, allow me to resummarize the key themes for the quarter. The franchise remains strong, robust CASA growth, robust growth in retail loans, fees etc. Loan growth momentum has picked up across all segments, and we expect the full year growth numbers to have an upward bias than we envisaged earlier.

OpEx growth has started to moderate, and we expect the trend to continue for the rest of the year. High corporate slippages driven by increased recognition due to divergence accounts pointed out by RBI, excluding the sizable impact, the financials of the bank on an operating basis remain steady.

The accelerated recognition in the quarter and the significant reduction in the size of our stressed asset pool improves our confidence in the trajectory of the bank's credit costs over the medium term. We expect normalization by the second half of financial year '19.

With that, I come to the end of my comments. I would be glad to take your questions with an apology to all of you for having kept you waiting for a few minutes at the beginning of this call. I am happy 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: In terms of your BB & Below pool that you talked about, where a lot of slippages are coming from, what would be the size of that pool?

Jairam Sridharan: The size of the pool at the end of the period was ₹15,815 crores. You might refer to Slide 52 in the earnings presentation, which shows the trend.

Mahrukh Adajania: Okay. And just in terms of the disclosures that you made in terms of the divergence accounts, so would you be able to share in which of the accounts were you consortium lenders and in which sector?

Jairam Sridharan: There were 8 accounts where we were consortium lenders, but only accounts where we were the lead bankers was at the IT/ITES sector account.

Mahrukh Adajania: Okay. That was the sole and lead?

Jairam Sridharan: No. That is where we were the sole banker. The lead banker, we are in a power account of moderate size. It's probably the fifth largest account on this list.

Mahrukh Adajania: Okay, got it. And the other question I had is that your watch list was always a closed watch list. And a lot of banks had revised their watch list in the first quarter. So do you have any plans to revise it, especially in the power sector? Or do you think that with the divergence now, everything is taken care of?

Jairam Sridharan: No, Mahrukh, We have no intention of coming up with any sort of enhanced watch list. We are putting up disclosures on various ways to look at our portfolio, whether its watch list, various restructuring dispensations or the low-rated pool etc. And we can look at all of these and draw our own conclusions on what the size of the stress pool is.

Mahrukh Adajania: Okay. And I just had one more question, that in terms of these 9 divergent accounts, obviously, you mentioned that only 6% of the value of these accounts is classified as NPLs. So there would be some big names which are standard. And you mentioned about a near-term resolution in only of one of them where you are in the IT space. So in terms of others, do you think a lot of them can be upgraded in the next 6 to 9 months? Was this just a technical reason why RBI asked you to show that slippage?

Varadarajan Srinivasan: Mahrukh, as Jairam said, the inspection cycle for banks happened at different points of time. And clearly, our inspection got over late September, and we got the report early October. We need to wait and watch in terms of what happens across banks. So we got to wait and watch in terms of actions taken by RBI on all these accounts across banks.

Mahrukh Adajania: So my question more was that there could already have been some resolution after the end of the quarter on any such accounts?

Varadarajan Srinivasan: No. One was the monetization. The others were, to some extent, normal consortium accounts where JLFs have taken certain decisions. And we have been in line with the decisions taken by the JLF. And to some extent, we need to see how RBI treats these accounts across banks.

Mahrukh Adajania: Alright. And what would be the whole system exposure to these 8 or 9 accounts?

Varadarajan Srinivasan: Close to ₹40,000 crores.

Moderator: Thank you. We will move to our next question, which is from the line of Veekesh Gandhi from Bank of America. Please go ahead.

Veekesh Gandhi: So your stock of gross NPLs is ₹27,000 crores. Can you give us a split of between corporate and retail, how much is what?

Jairam Sridharan: Yes. Of the ₹27,000 crores, about ₹5,000 crores is retail plus SME and ₹22,000 crores was corporate. Between retail and SME, it's about an even split.

Moderator: Thank you. The next question is from the line of Dhaval Gada from Sundaram Asset Management. Please go ahead.

Dhaval Gada: Just wanted to reconcile the power sector stress. I mean, if I understand correctly, almost 65% of the power exposure is BBB and below. Is that correct? I mean, including the NPAs.

Jairam Sridharan: No, the better way to look at it is rating distribution excluding the NPAs. Because where you care about ratings is where the account hasn't slipped yet already. So if the account is slipped, obviously, it will sit in the D category. So we find it useful to actually exclude all those who have already demonstrated default and look at the rest. And if you look at the rest, just about 30% is rated BB or worse.

Dhaval Gada: Fair point. But the question is, basically like 65% of the pool is sort of at risk. I mean, some is already slipped, some is likely to. Why was this not included in the original watch list is what I was trying to understand?

Jairam Sridharan: See, a lot of the power accounts are indeed part of the watch list. So this is not sort of incremental to that. As you've seen in our watch list sectoral distribution as well, about two-thirds of the watch list comes from power. So a lot of it is indeed there.

Dhaval Gada: Okay. And the second question that I had was, given that the internal capital generation is sort of slow at this point of time, would it be prudent to sort of curtail growth and look at maintaining capital position? I'm just trying to understand at what point do you think capital buffer will be lower? We are at 11% CET1 at this point of time, so.

Jairam Sridharan: Right. We think we have adequate capital right now to pursue the kind of growth opportunities that are there in front of us. Now if we continue to grow at this pace and accretion to capital isn't brisk, then you're right, at some point we will reach a point where this will become a binding constraint. Right now, it is not a binding constraint.

Dhaval Gada: At what point you would look to raise capital?

Jairam Sridharan: See, we've said in the past that at a basic level, we want to be at least 150 basis points above regulatory requirement. On CET1, the regulatory requirement is about 8.8%. So add 150 basis points to that, and that gets you there.

Moderator: Thank you. The next question is from the line of Nilang Mehta from HSBC Asset Management. Please go ahead.

Nilang Mehta: I just wanted to get a sense on the RBI review which happened. So what is the risk of FY '18 review streaming up more surprises like this?

Jairam Sridharan: Nilang, the nature of this is that you will get to know once a year. We just got done with ours like literally 5 days ago. So it's impossible for us at this point of time to speculate on what might happen a year from now.

Nilang Mehta: But would you give us some guiding principles, what does RBI look and where are the general disconnects with auditors and the management's view on these accounts, which leads to such large divergences?

Varadarajan Srinivasan: It's difficult to sort of guide on that because each of these are some account specific sort of observations. And these are not something which you can say is consistent with what happened even in the last year.

Nilang Mehta: So just failing to understand here because you, as a management, have certain views on these accounts. Your auditors have certain view. And RBI has its own recognition policies. And what comes out is something very different. So it would be really helpful to get some guidance on this, otherwise these numbers seem meaningless.

Jairam Sridharan: You're right, Nilang. I mean it would be helpful for us as well to actually get some guidance on this. And unfortunately, on an account-to-account basis, over the last 2 years we have seen significant movement in terms of the way some of the sort of policy interpretations has worked. And kind of try as the banking sector might, to actually apply those principles on a fairly consistent basis, these last years have been difficult to kind of predict. At an overall level, though, the convergence seems to be happening. The AQR year was the year in which the largest sort of divergence has worked. And the sector as a whole had around ₹3,00,000 crores worth of divergences. Last year, the divergences were much lower. For us, it was just under ₹9,500 crores. This year, for us, it has been about half of that. So clearly, it is converging. It's becoming a smaller and smaller number every year. And hopefully, it will not be there next year.

Varadarajan Srinivasan: Again, one other thing to add, to give you more color than whatever Jairam said in his presentation was that, in none of the 9 accounts the lead bank has declared these as NPA.

Nilang Mehta: Just to understand again more clearly, this RBI would have the same treatment for all the banks or this treatment for these accounts would differ from bank to bank?

Varadarajan Srinivasan: The treatment can differ from bank to bank. We need to wait and watch. As I said, the inspection cycle is not simultaneous across banks. I think it happens sequentially. So you will see it through the rest of the year for the other banks.

Nilang Mehta: Okay. Just one last question on this BB pool accounts, ₹15,000 crores, which you mentioned, it is primarily in the SME space or it is more of the larger MSME ?

Jairam Sridharan: No, these are all large corporate.

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

Kunal Shah: So first thing is BB and below, when you look at it in terms of the RBI's divergence and the watch list, there is another ₹3,300 crores, which largely would be BB and below. So what would have actually triggered it? Because if we look at the movement of BB and below, maybe it has been pretty consistent over last 4-odd quarters. But all of a sudden in this quarter, again ₹3,300 crores. So was it that maybe because of the RBI's divergence, we have become slight conservative and considered few of the accounts in BB as well as NPL? Or was it that the overall sectoral development has not been net positive, which is leading to it?

Jairam Sridharan: No. If you look at the overall number, overall slippages number ex of RBI divergence, on a net slippages basis, it is no different from broadly what we have had over in our last quarter and almost all of it does indeed come from the BB and below population. And that is what you're seeing there.

Kunal Shah: No. So if I look at corporate slippage of ₹8,100 crores and RBI's divergence was ₹4,800 crores. And within this ₹4,800 crores, ₹2,400 crores was already from the watch list and restructured. So I think, maybe if I just look at it ₹8,100 crores of corporate slippage and ₹4,800 crores from RBI's divergence, so balance would largely be from BB and below?

Jairam Sridharan: Yes.

Kunal Shah: But if I look at it on a gross basis, it is slightly higher. So what would have actually triggered that?

Jairam Sridharan: I have nothing specific to offer you. These are account level things that we saw at the power sector. You have started seeing more slippages now than you have seen in the past. And as we have indicated in the past, that will continue through the rest of this year and maybe into the first quarter of the next financial year. And that sectoral development is what will show up here.

Kunal Shah: And any concentration in this BB and below in terms of some lumpy accounts out there as well?

Jairam Sridharan: No, these are fairly granular. I mean, all the lumpy ones would have been part of the watch list. So outside of the watch list, there aren't many lumpy accounts.

Kunal Shah: Okay. And in this RBI's divergence, you have highlighted fund-based. What would be the non-fund based exposure over these 9 odd accounts?

Jairam Sridharan: The total non-fund based exposure on these 9 accounts is roughly ₹900 crores.

Kunal Shah: Okay. And lastly, in terms of this provisioning, you said like 40-odd basis points is what this is leading to. So this is still you are assuming only 25% provided on the RBI's divergence. You are not increasing the coverage out there going forward all through the fiscal.

Jairam Sridharan: So I am assuming two things here. One is that any incremental provisions that need to be done on these accounts because of the aging through the rest of this year, which will get incorporated. Plus, on some of these accounts, we have fairly straightforward recovery plan built in, which should kick in, in the next few weeks and months. And some of that, possibility of kind of at least one of that panning out is baked in. That is what gets you to the 40 basis points.

Kunal Shah: But contingency provisioning utilization is also built in or it is already utilized?

Jairam Sridharan: Contingency provisions have been utilized.

Kunal Shah: This quarter itself?

Jairam Sridharan: Yes.

Kunal Shah: ₹260 odd crores?

Jairam Sridharan: Yes.

Moderator: Thank you. The next question is from the line of Manish Karva from Deutsche Bank. Please go ahead.

Manish Karva: So on this RBI dispensation thing, does RBI tell you to make this account as NPL or it is your choice to make it as an NPL?

Varadarajan Srinivasan: No, they changed the classification.

Manish Karva: Because till last year, RBI just used to give it, because what was mentioned earlier was that you have to classify it as a separate topic in your annual report. You may or may not classify it as an NPL.

Varadarajan Srinivasan: No, it is the same.

Jairam Sridharan: You have to classify it as NPL. Last year as well, same thing was done.

Manish Karva: Okay. And they would also specify what kind of provisions you need to make on this?

Jairam Sridharan: No, they don't specify the provisions, but they say that treat them as NPA effective XYZ date, and that date automatically fixes a provisioning rate.

Manish Karva: Okay. Then the second thing on this is that as a management, you didn't think that these are NPLs. Probably the recovery rates on some of these accounts as a security cover that you may be holding on some of these accounts, should be much higher. And the general assumption should be that you should be able to recover most of these cases as such?

Jairam Sridharan: I think that is a fair assessment on many of these accounts. As we mentioned, the large IT/ITES account that we have, we expect very significant recoveries in a fairly short while with a business sale that has already been finalized. And similarly, we have ideas of recoveries on some of the others. But as Srini was mentioning, before, a lot will depend on what happens to these accounts at the other banks. Because we are small parts of consortium in these accounts, so it depends on what happens and what is asked of the other banks because these accounts are not NPA now. We would be the first lender to actually be making these accounts NPA. So we need to see what happens through rest of the sectors recognition and what that does to the underlying quality of the account.

Manish Karva: But going back what you were saying that, the sector has to recognize it now because RBI tells every bank to recognize it.

Varadarajan Srinivasan: We have to recognize it. If it is part of their risk, they need to do it.

Jairam Sridharan: So that list might not be the same across all banks. So just because we have got a particular name on our list doesn't necessarily mean that the same name will be there on every bank's list.

Manish Karva: But the leader has to have it as an NPL, right or may be?

Jairam Sridharan: One would think so, but we cannot be certain about that, Manish.

Manish Karva: Okay. And would you have a number of what is the slippages from the watch list or it is just a simple subtraction of the reduction in watch list?

Jairam Sridharan: No, the watch list slippages are about ₹2,430 crores.

Manish Karva: Okay. And what are the actual restructured accounts as in like-to-like comparison as we compare from the last quarter?

Jairam Sridharan: Last quarter to this quarter, I mean, total restructured book, just give me one moment. The total restructured book across various dispensation is now 1.6% of our total book. And in total value terms, it's ₹7,390 crores across core restructuring, SDR, S4A, 525, all that stuff put together. And as you can see on the simplified Venn diagram that we now have on slide 53, you will see that the entire watch list and almost all of the restructuring dispensations are encapsulated by the BB and below pool.

Manish Karva: Okay. And lastly, how much was the margin impact due to this? When you mention in your margin tree, the margin loss on this was 4 basis points. Was it only to do with the RBI accounts or it is to do with the whole slippages that happened during this quarter?

Jairam Sridharan: No. That 4 basis points refers to the RBI account.

Manish Karva: Okay. And what would be for the slippages because outside that also that is pretty high. Should be 8 basis points?

Jairam Sridharan: No. But there if you do the kind of YOY comparison, the numbers are actually not meaningfully different and so there you only see 2 basis points.

Moderator: Thank you. The next question is from the line of Anand Laddha from HDFC Mutual Fund. Please go ahead.

Anand Laddha: Same again on this RBI identification of account, just wanted to know what are the conditions when this account will get upgraded? And by what time this account can get upgraded?

Jairam Sridharan: That's a great question.

Varadarajan Srinivasan: We'll have these conversations. As we said, this list came to us just a few days back. We will have these conversations as we go along. And also it depends on how it is treated across banks. So we'll get to know over the course of this quarter.

Anand Laddha: Okay. And also the last question you answered, the impact on the margin is just 4 bps, which means that most of these accounts are paying you interest?

Jairam Sridharan: All of them.

Anand Laddha: Okay. And do you still believe that in the coming quarters, these account will continue to service interest or they will stop servicing interest?

Varadarajan Srinivasan: Well, I think some of these accounts surely would be paying interest.

Anand Laddha: Okay. But it means say, some account will be paying interest, some account may not be paying, so there could be some margin impact even next quarter also?

Varadarajan Srinivasan: I would think at least 60% of these accounts would pay interest.

Jairam Sridharan: But just to be clear from a pure accounting perspective, as on a cash basis, the money that come in will be recognized. Accrual of interest will be not be done while the accounts remain in NPA status.

Anand Laddha: Okay. And is it fair to say, 65% of that would be paying cash and 35% will be based on accrual? So 35% you won't be recognizing?

Jairam Sridharan: Let's see.

Varadarajan Srinivasan: I think it's too early. I mean, we'll have to see what happens across banks.

Anand Laddha: And if you can give some color now, what's the outlook on slippages for the second half of FY18?

Jairam Sridharan: Sure. So you saw that our first half slippages were 256 basis points annualized. And our guidance for the full year is 220 to 260 basis points. So that should give you a sort of fair sense of where we are expecting them to go. So basically, a trajectory of the kind we were looking at in Q4 and Q1 should broadly come back with a little bit higher recovery than upgrades. That is broadly what one would expect.

Anand Laddha: Got it. And when you say the normalization of provision costs should happen in second half FY 19, what is meant by normalization? Will we be going to a long-term averages of provision cost or it is below that?

Jairam Sridharan: No. At this point of time, we're looking at long-term averages.

Anand Laddha: Okay. And if you can give some color like what's the outstanding SR we are holding? And is there any provision we made on that this quarter?

Jairam Sridharan: The outstanding pool of SR is about ₹3,000 crores.

Anand Laddha: Okay. And did we make any provision on this SR, this quarter?

Varadarajan Srinivasan: No.

Jairam Sridharan: Whatever is required by mark-to-market movements and that's about it.

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

Nilanjan Karfa: Just wanted to check, have you disclosed the character of this BB and below in terms of sector compositions, etc?

Jairam Sridharan: We have not disclosed. But that's a good idea, maybe we'll do it in the next quarter.

Nilanjan Karfa: Why don't you do it right now? You know, it will be very useful for us?

Jairam Sridharan: Okay. Let me try and pull something up. Let's carry on with the conversation. And if I get it during the course of our conversation we will put that out.

Moderator: Thank you. The next question is from the line of Manish Shukla from Citigroup. Please go ahead.

Manish Shukla: On IBC accounts, you made a provision of about ₹500 crores this quarter. Do you still need to make something over the course of next 2 quarters?

Jairam Sridharan: Yes. We need to make a little bit more on these and we'll need to see how the second list pans out. So that's a bit of an imponderable. The second list has time till middle of December before we realize whether it's actually going to hit IBC or not. And then we will need to look at the provision numbers required there. But we are now at 55% coverage across the 2 lists put together. One of the reasons why we made ₹500 crores of extra provisions was to make sure that we don't have any big leftovers for the coming 2 quarters. Let's see how the quarters pan out.

Manish Shukla: And in your assessment of credit costs, have you assumed that some of these IBC assets might actually be liquidated or there would be an upside risk to provisions?

Jairam Sridharan: What we are working on right now is that on a weighted average basis, if you look at the full pool of accounts that are going to go through the bankruptcy process, some of them you might have meaningful recoveries, some of them might end up going to liquidation, and you might not have much recoveries at all. On a weighted average basis, on the full pool, we are expecting a haircut of around 60%, which is what we're building towards from a provision coverage perspective.

Varadarajan Srinivasan: Again, out of the 12 accounts as well as the second list, considering the time period specified in the IBC process, it's quite unlikely that anything would go into liquidation before end of this period.

Manish Shukla: Yes, so that will spill over into next year?

Varadarajan Srinivasan: Yes.

Manish Shukla: Okay. And one last question. There was some decent uptick in corporate growth this quarter. Is there any one-off there? Or you believe that can directionally sustain corporate loan growth?

Varadarajan Srinivasan: It should be sustainable.

Moderator: Thank you. The next question is from the line of Aseem Pant from HSBC. Please go ahead.

Aseem Pant: Just a couple of questions. One is that, the other ₹911 crores, could you tell me which sectors they belong to?

Jairam Sridharan: The other 4 accounts. Each of them is in a different sector. Something in basic material. There is a sugar account.

Varadarajan Srinivasan: I think, it doesn't make sense. It's scattered across sectors and size is also not too material.

Aseem Pant: Okay. And with regards to that ₹4,800 crores in these 9 accounts, what would the corresponding NFB exposure be to these accounts?

Jairam Sridharan: ₹900 crores.

Moderator: Thank you. The next question is from the line of Sri Karthik from Investec. Please go ahead.

Sri Karthik: I have a question regarding the new disclosure. So the BB and below exposure that you sort of now presented, you have been giving this disclosures for a while now. Any particular reason why you sort of specially mentioned that in the asset quality disclosures?

Jairam Sridharan: Yes, Sri Karthik. What has been happening is, over the last few quarters, as we saw the contribution of our Watch List and some of the restructuring accounts towards the overall slippages has come off. And we have been getting a lot of questions saying, if slippages aren't coming from the Watch List pool, how we, as investors, should try and bound the problem in our heads in terms of where indeed are the slippages coming from and, is there a measure that you can offer. And we looked at our data internally, tried to cut it many different ways to see what is the best indicator, and we found that something which is already in the public domain is a great indicator of where the slippages are coming from, which is the pool that is BB and below. And as you can see in the chart that we have presented on slide 51, that over the last 6 quarters, 86% of corporate slippages have indeed come from that pool. That was BB and below the prior quarter and hence we thought that it would be useful context to lay out there.

Sri Karthik: And in that context, Jairam, on slide 44, you have indicated that BB and below is about 11% of the corporate exposure that equates to about ₹20,000 crores. Where is this divergence coming from?

Jairam Sridharan: So this is the non-funded stuff. The slide 44 is exposure and slide 51 is funded outstanding. Towards earlier question that was asked. Nilanjan asked the question on the sectoral split of BB and below. The top 5 sectors contribute two thirds, about 66%. The largest sector is power, which has about one third of BB and below. Infra construction has 11%. Iron and steel has 11%. Roads have 8% and mining and mining products has 5% of the BB and below pool of ₹15,800 odd crores.

Moderator: Thank you. We'll move to the next question, which is from the line of Bhavik Dave from Reliance Mutual Fund. Please go ahead.

Bhavik Dave: Sir, I just wanted to check with you that the number that you mentioned for the systemic exposure for these 9 accounts or the 8 accounts that were consortium of is around ₹40,000 crores, is it right?

Jairam Sridharan: That is true.

Bhavik Dave: So we technically have a 9% to 10% market share in these ₹40,000 crores, which is almost double of our normal market share in the loans? Is this the right way to look at it?

Jairam Sridharan: Yes.

Bhavik Dave: Okay. And sir, on your power exposure, out of the ₹20,000-odd crores that we have, so ₹4,000 crores is part of the watch list. ₹3,300 crores is part of NPA. Is the remaining ₹12,500 odd crores, was that like completely from part of your BB and below? Like most of it will be there?

Jairam Sridharan: No. You can see on Slide 47 that we have put out a snapshot of the power sector overall. The sector has about ₹17,500 crores as exposure, which is non-NPA. And if you look at that ₹17,500 crores, about 30% is BB or worse. Another 30% is BBB.

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

Rahul Jain: Jairam, so, again, on this divergence accounts. So this ₹5,500 crores, was it a gross divergence or a net divergence number?

Jairam Sridharan: Gross.

Rahul Jain: And when were these loans originated?

Varadarajan Srinivasan: Long time ago. They are not recent.

Rahul Jain: So these would be like, going back to 2011 and '12, which you've been talking about.

Jairam Sridharan: Yes.

Rahul Jain: Okay. And these are not really identified, already happened 6, 9 months back or so.

Jairam Sridharan: Or in any of the prior years. No.

Rahul Jain: Okay. Got it. Again, just wanted to clarify some numbers on Slide 52, where you've given BB and below pool. So that total pool is about ₹15,800 crores, right? And you're saying, of that ₹10,000-odd crores is from watch list and restructuring dispensation. And on the following slide, the total restructuring dispensation is about ₹7,400 crores. The differential would be from outside the watch list, this 4,000 odd crores?

Jairam Sridharan: Yes. So if you look at the Venn diagram carefully on the left...

Rahul Jain: Yes. Because that Venn diagram says ₹1,600 crores. That's the reason why I wanted to double-check my understanding.

Jairam Sridharan: That ₹1,600 crores that part of the restructured dispensation, which is not BB and below.

Rahul Jain: Yes. So essentially, what I'm talking about is the second part of the Slide 52 has ₹10,000 crores as WL plus restructuring dispensation, whereas of that watch list is ₹6,000 crores?

Jairam Sridharan: No. The way I would frame this is, if you look at the Venn diagram, there are 3 levels there: ₹2,697 crores, ₹3,355 crores and ₹2,407 crores. If you add those 3 things, that is the part of BB and below, which is either watch list or restructuring.

Rahul Jain: Okay. I'll do the calculation maybe later and then take it offline. The other question I wanted to that I will quickly check is, would you be able to share the rating profile of the corporate bond book as of this quarter, especially the below-investment-grade book?

Jairam Sridharan: So there is a chart on Slide 69.

Rahul Jain: 69?

Jairam Sridharan: Yes where we show the corporate bond book and the rating profile there.

Rahul Jain: Alright. Sorry, my miss. Just a last question on this power sector exposure which you've talked about. So the NPAs are ₹3,300 crores, Watch List is ₹3,874 crores. That totals up to ₹7,100 crores. And this is on the base of ₹17,700 crores of power exposure. Now that's like more than 50...

Jairam Sridharan: Rahul, ₹17,700 crores doesn't include NPA. ₹17,700 crores is only the standard book.

Rahul Jain: Yes. Alright. So you're basically saying I should also not be including ₹3,300 crores in my calculation?

Jairam Sridharan: Correct.

Moderator: Thank you. We are moving to the next participant from the line of M. B. Mahesh from Kotak Securities. Please go ahead.

M.B. Mahesh: Just couple of questions again on that BB part. Does Slide #52 and 44 talk to each other?

Jairam Sridharan: You're talking about reconciliation between 52 and 44, right?

M.B. Mahesh: Yes. Because there is a decline there. Here there is an increase.

Jairam Sridharan: No. So basically, Slide 44 is on a total exposure basis, and excludes financial institution group. So financial institution lines or so either FIs or sovereign rated institutions and there's certain exposure level. That's how 44 is defined. 52 is most directly relevant from a stress asset assessment perspective. It has fund based outstanding of accounts with NPAs excluded. That's what is actually shown on Slide 52.

M.B. Mahesh: Okay. Just trying to reconcile again. What does it mean? So if 10% has gone to 11% and here on page 52, there is a reduction, so what have you done? So have you seen any reduction in fund-related exposures?

Jairam Sridharan: No. I'll need to reconcile, but the numbers will certainly add up very clearly. In absolute terms, the BB outstanding has fallen by about ₹3,500 odd crores in this quarter, largely driven by the slippages that have happened from that pool in this quarter net off any upper upgradations or any downgrades that might have happened from BBB to BB in this quarter.

M.B. Mahesh: Which comes to the second part, actually. So if you opened this quarter with ₹19,460 crores, and you say that 73% of ₹8,100 crores has slipped in the current quarter.

Jairam Sridharan: Correct.

M.B. Mahesh: Then you have essentially seen roughly about 2,300 crores of fresh downgrades?

Jairam Sridharan: Downgrade, correct.

M.B. Mahesh: Which is actually higher than last quarter, which you reported about ₹1,500 crores.

Jairam Sridharan: So it has been a little bit volatile. If you look at the last 5 or 6 quarters, the average sort of downgrade amount has roughly been in that ₹1,500 crores to ₹2,300 crores kind of range. It bounced around a little bit. It's not been steady. At this point of time, we are not yet at a place, where we can unequivocally say that downgrades have fallen to 0 or have become very small. They are still kind of pretty steady at around ₹1,500 crores, ₹2,000 crores kind of range.

M.B. Mahesh: Just kind of correcting here. Why did you move these RBI divergence accounts from standard accounts straightaway to NPA? You would have put them in the Watch List, BB sometime in the past and then downgrade it.

Jairam Sridharan: No. Of course, no. RBI accounts, we just came to know now. So if the accounts are already in BB and below, kind of well and good. But 2 of the large accounts in the RBI list were paying perfectly on time, so they were actually not in the BB and below pool. And they are actually the big part of why BB and below contribution is not closer to 90%. And those 2 accounts were not rated BB and below at the end of last quarter. And they will directly go to D now.

M.B. Mahesh: Okay. And question to Srini. What has been your opinion on the progress of NCLT cases? Would you expect them to be completed by March 2018?

Varadarajan Srinivasan: Yes. I think the expressions of interest for a lot of these cases have come from; there's been a decent number. And so hopefully, by November end, the first bid should come through.

M.B. Mahesh: Of the 12 cases, where do you think is the first resolution likely to come? And do you expect any kind of litigation to come in where you feel that the promoter entity bid is likely to be higher and bankers will have an issue around how to settle the issue?

Varadarajan Srinivasan: Not really. I think the bankers are putting in place a framework in terms of evaluation of bids which we will try and make sure that it's consistent across the assets. And I think as long as the bankers are aligned on that, the NCLT process is irreversible. And therefore, whether it is a promoter bid or someone else's bid, I think the evaluation will be done on that basis.

M.B. Mahesh: Sorry just kind of asking this question again. If a promoters bid is substantially higher than the nearest bid, the promoters bid will always have to be accepted?

Varadarajan Srinivasan: Not really. I think it depends on what sort of bid it is. Whether it's cash, how much is cash, how much is held in terms of what sort of payment mechanisms are there. I think the lenders evaluate how exactly the offer is. And not necessarily just on NPV.

Moderator: Thank you. The next question is from the line of Amit Ganatra from Invesco. Please go ahead.

Amit Ganatra: Your power sector exposure, I had a question. So 15% basically, which is under construction. How would that be rated entirely? Would that be BB and below? Or what will be the rating profile of that, please?

Jairam Sridharan: It will be skewed towards BB and below, but I don't think entirely it will be there.

Amit Ganatra: The other thing is that in power sector exposure, so suppose if an account is typically right now. So that would mean that it is servicing interest or, I mean, what does it imply? The difference basically between BBB and an A kind of an asset in a power sector? Because otherwise the income would be in a utility kind of mode, right?

Varadarajan Srinivasan: Yes. As long as the asset is standard, its interest is being serviced.

Jairam Sridharan: In order to determine borrower rating and the facility rating, it's not just about behavior of the account. It's not as if, if an account is paying, it will have an AAA rating, and if it's not, it will have a BB rating. The underlying financials, the overall leverage levels, a whole lot of factors will actually go into the rating, apart from the pure payment itself. Every account which is not NPA is servicing. Otherwise, it would have become NPA.

Amit Ganatra: I'm just trying to understand in power sector, ideally, then the stress should ideally, now incrementally be limited to 15% of assets, which are still under construction for which their fate is not known as of now. But assets which are operational, once they are settled into whatever rating they are. But if they are standard, then basically, it tells that they are at least servicing the interest portion, right? And how to read this operational...

Varadarajan Srinivasan: Not really, right. It's not that the entire capacity may have power purchase agreements (PPA). Some of them maybe on merchant. So those sort of things would be driver of ratings in terms of what the outlook in terms of revenues, and what's the debt outstanding as far as the project is concerned, and therefore, rating will be driven by a lot of these considerations.

Amit Ganatra: Okay. So it is the rating distribution which is more important from a stress perspective rather than an asset being operational or nonoperational. That's what you're saying?

Jairam Sridharan: Yes.

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

Samir Shah: This is Samir here. Thanks for the disclosure on the BB number. How does this tie up with our SMA 2?

Jairam Sridharan: It's closely related, but it's not exactly the same.

Samir Shah: But would that be around this level?

Jairam Sridharan: Roughly, yes.

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

Siddharth Gandhi: Jairam, you mentioned that most of these loans, which were identified by RBI during the divergence were granted prior to 2012, is that right?

Jairam Sridharan: No. What I meant was that well, the way I interpreted the question that was asked was, were these accounts recent in the sense that hadn't RBI seen these accounts in the past. And our answer was no. There's no recency here. These accounts have all been around for a while. I don't think all of these accounts are 2012 and prior. At least I can remember 1 or 2 accounts which are later than that.

Siddharth Gandhi: Okay. And what would be the rating of these accounts when they were initially sanctioned? And what would be the tenure?

Varadarajan Srinivasan: Each one was different. I say it like you have a 3-year loan, and you got a long-term project. So it's going to be different across each of the 9 accounts.

Siddharth Gandhi: So out of the 9, were majority of them above investment grade or A plus and better?.

Jairam Sridharan: Not at the point of the inspection.

Siddharth Gandhi: Were they highly rated accounts?

Varadarajan Srinivasan: I think there were a couple as we said that will be BBB and above accounts.

Moderator: Thank you. We'll move to our next question, which is from the line of Krishnan ASV from SBICAP Securities. Please go ahead.

Krishnan ASV: I just wanted to understand the sanctity of the ratings. Is there something that Axis bank is seeing as a pattern here in terms of your own internal rating? Is there a lesson here in terms of how you monitor the ratings of the various corporate borrowers with the new portfolio? That's part one. Number two, I recognize that you haven't been able to read any patterns and how the RBI has observed divergences in FY '16 and in FY '17, but what's the key lesson for Axis bank from this?

Jairam Sridharan: Alright. Great question. See, on the first one, kind of what have you learned from a rating perspective itself. At the very least, what are back-testing themes to indicate is that ratings do capture migration to NPA. So whatever process we have internally, the frequency with which accounts are getting upgraded and downgraded on a regular basis, that regularity or that frequency does seem to be working in the sense that a quarter after quarter the slippages are in large bulk, indeed coming from the lower-rated pools. So we've got something good going on there, and we got to continue that and try and make sure that the most recent information about accounts continues to get incorporated in rating. As far as RBI sort of divergences are concerned, as I pointed out before, divergences at the sectoral level were extremely high in financial year '16 as we saw in AQR. In financial year '17, divergences came down materially. For Axis bank, divergence was higher in FY '17, but are of the order of ₹9,500 crores. This year, it is about half that amount. It has come down more in the sort of ₹5,000 crores kind of range. It is not something one's happy about. But directionally, it looks like the key issues that the regulator might have had in terms of the way the industry was thinking about interpretation of key parameters are getting addressed and there is a greater and greater convergence. We are constantly in conversation with RBI about how to get more on the same page, and we will continue to do that.

Krishnan ASV: So just on the divergence bit, I mean, you mentioned earlier during the call that a lot of other banks, including the lead banks in most of these assets, where the RBI has observed a divergence now on your book have been classified as standard assets. Do you, as a bank, get to monitor what other banks are doing with these very assets? So will you be ever able to take it up with the RBI, saying that the lead bank in this particular account has not classified this as NPA, but you have asked me to classify. I mean, do you have that latitude at all?

Varadarajan Srinivasan: We would have that conversation once we know what happens in the other banks...

Krishnan ASV: And you're saying that the CRILC (Central Repository of Information on Large Credits) allows you that kind of data?

Jairam Sridharan: Yes.

Varadarajan Srinivasan: Yes, but as a consortium we will know. We have consortium meetings regularly. And through the consortium meetings you would know.

Moderator: Thank you. The next question is from the line of Manish Agarwal from PhillipCapital. Please go ahead.

Manish Agarwal: Just one question. What will be our total telecom exposure? Number one. And out of our total telecom exposure, do some part gets featured in the stress pool which is disclosed by you?

Jairam Sridharan: Telecom is not part of our top 10 industry segments. It is just around 1% of our overall exposure. And no, nothing material from telecom in the stress pool. The total fund-based exposure for telecom we have is ₹2,500 crores.

Moderator: Thank you. The next question is from the line of Nilang Mehta from HSBC. Please go ahead.

Nilang Mehta: Just wanted a sense on Axis Finance. The book there has grown 5 times in the last 4.5 years. What kind of loan exposure these have there? And what's the plan going ahead for that entity?

Varadarajan Srinivasan: Yes. Clearly, we do things like a deal financing and lending in shares. So those activities have seen quite a bit of an uptick over the course of this year. And that has largely contributed to the book growth.

Jairam Sridharan: And as we look at the future, there are products which one would struggle to do from within the bank context. Think of certain parts of retail lending, which are either high in OpEx or high in terms of operationally, how we look at those businesses. Some of those will continue to get build out in the NBFC.

Nilang Mehta: And that will be a new segment you'll be starting or it is already started?

Jairam Sridharan: No. We have very small piece of many of those in the NBFC right now. All of those need to be grown. And we are still kind of recruiting talent, beefing the team up, et cetera. We have significant plans for doing some of that business development there.

Moderator: Thank you. The next question is from the line of the Dhiraj Desai from EvalueServe. Please go ahead.

Dhiraj Desai: I have a couple of questions on the power sector exposure. So in terms of the operational projects, would you have any projects where no PPAs have been signed? And second question would be, in terms of the coal power plants, what percentage of these plants would not have a PPA signed?

Jairam Sridharan: Yes. We will have some accounts which won't have PPA signed. Most of those would show up in the BB and below category anyway.

Dhiraj Desai: Would this be already recognized as NPA? Or this would still be and what size it might be?

Jairam Sridharan: A small proportion might be. The rest of them will probably show up in the BB and below category.

Dhiraj Desai: And for the coal power plant, what proportion would not be having the PPA signed?

Varadarajan Srinivasan: We don't have the data as of now. I don't think we have disclosed it. But it's not a question of which plant, right? Some of them have partial PPAs.

Dhiraj Desai: Correct. So, I mean, just a sense on the exposure, which does not have...

Varadarajan Srinivasan: As Jairam is saying, I think just be guided by the rating profile. I think that will factor in all these metrics.

Moderator: Thank you. The next question is from the line of Cyrus Dadabhoy from Anand Rathi. Please go ahead.

Cyrus Dadabhoy: One is, I just want to understand the rating breakdown of your incremental corporate lending, and even on the SME book, are these broadly commensurate or correlate with your internal ratings? Are they widely divergent with your internal ratings?

Jairam Sridharan: These are the internal ratings.

Cyrus Dadabhoy: No. I'm saying, the rating breakdown of your incremental corporate lending that you're doing, right, both large corporate, mid-corporate SMEs also. So do these largely correlate with your internal ratings? Or are they pretty divergent?

Jairam Sridharan: But these are the internal ratings as well. Even the incremental sanction, the data that we shown you.

Cyrus Dadabhoy: How do they correlate?

Jairam Sridharan: Very heavily. There will be small offsets, but the correlation will be extremely high. In SME, the situation might be a little bit different, where external ratings might not be available for a lot of the cases.

Cyrus Dadabhoy: And your credit cost guidance of 220 to 260 basis points includes NPL aging on future potential fresh slippages?

Jairam Sridharan: Yes.

Cyrus Dadabhoy: Okay. And one final question, I think I missed it. So out of your total fresh slippages of ₹8,936 crores, ₹2,430 crores are from the Watch List?

Jairam Sridharan: Yes.

Cyrus Dadabhoy: So that's 27%. And 73% is thus outside the Watch List.

Jairam Sridharan: Yes.

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

Rakesh Kumar: So firstly, on the debit card spend, if we see the number from Q3 onwards, it is kind of trending down. And if we see the credit card, it has been trending upward continuously, so like are you taking this into cognizance? This kind of divergence which is happening?

Jairam Sridharan: Yes. See the debit card number spend grew up pretty dramatically during the demonetization quarter, which is the third quarter of the last financial year. So you saw a very steep increase in debit card spends in that quarter. And credit card, there has been a more secular trend growth that has been happening over time. Post-demonetization, some of the debit new first-time debit card users have gone back to cash, but many of them have stayed, which is what you see in that, the ambient level of debit card usage now is significantly higher than what it was pre-demon, but it's not as high as what it was in the demon quarter.

Rakesh Kumar: But what about the credit card spend, which has been growing quite fast, apart from the credit card in force?

Jairam Sridharan: Yes. So I mean, we are seeing both increase in card numbers as well as increase in acceptance of cards as a payment instrument by customers. Both of which are showing up in the spend growth, which is why we saw about ₹10,000 crores of spend in this quarter from credit cards.

Rakesh Kumar: Secondly, we have given the guidance on the provision coverage number of around 60% to 65%, but that is including the technical write off numbers. So if we exclude the technical write-off number, what will be the PCR?

Jairam Sridharan: Yes. See the way we tend to think about it, and we have mentioned this in the past as well is, when you look at provision coverage, our philosophy is, provision coverage ratio should be guided by what you expect the loss given default to be. And loss given default expectation is an average of all accounts, some of which you will have very high recoveries, and hence, very low LGD. And some accounts in which you would have 100% LGD, that is you will not recover anything. A weighted average of all of this gives you your portfolio level LGD expectation, which as we have indicated in the past for us historically has been around 55%. In this cycle, we expect around 60%. But by the same token, when you calculate PCR, you should again include all accounts in which you have made 100% provision and a lot of other accounts in which you have made smaller provision. And weight average all of that and see what that weighted average number is, which is why we tend to include all the 100% provisioned and written-off accounts. The write off we do is for tax management purposes. To make sure that the tax treatment is aligned with the way the P&L treatment is going. That has got nothing to do with the LGD expectation. And hence, all those accounts, where we are making 100% provision, we believe should be included in the PCR calculation.

Rakesh Kumar: Just a last question on the cost of term deposit. How it is trending from Q1 to Q2? Is this like there is an upward movement?

Jairam Sridharan: No, there is not.

Rakesh Kumar: On the average quarterly balance, it seems that cost of term deposit has gone up.

Jairam Sridharan: The cost of term deposit has declined by 19 basis points Q-o-Q.

Moderator: Thank you. The next question is from the line of Aditya Jain from CLSA. Please go ahead.

Prakhar Sharma: This is Prakhar. Just a couple of questions on the BB and below-rated numbers that you've given. Very straightforward. One, can you quantify the amount of nonfund exposure to this?

Second, just a ballpark on, when you had done the Watch List discussion, you had given a ballpark range of how much could slip, so could you give us some sense of just a ballpark number of what you think can slip out of this number?

Jairam Sridharan: I don't know. Certainly, not the latter one. That's not going to work. So let us see as the quarters come on, how much the slippages look like. As we have shown on the chart on slide 51, most of the slippages are indeed coming from there, but I don't want to at this point of time make estimations on how much of BB might slip. Remember that the BB pool is a dynamic pool as opposed to Watch List, which was a closed pool. So there will be upgrades and downgrades of accounts that happen here, and so that will keep changing things. In terms of the first question that you asked, in terms of how much is the non-fund based outstanding of the BB and below pool, that is about ₹4,000 crores.

Prakhar Sharma: Okay. Is it possible, if you have the number handy, like last one year or so, you've given this chart of how the stock has moved at the end of each quarter. Is it possible to give us preconceived vision of how much of stock has slipped in the last 4 quarters? And what was the other residual action on that, like recovery upgrade? Like is it possible to get some sense on...?

Jairam Sridharan: Certainly. Not handy, but we're doing a lot of that work. We will consider on an ongoing basis what other disclosures might be helpful to the investment community and continue to make it.

Prakhar Sharma: And last thing on construction part, generally BBB is regarded as investment grade. And anything below that is regarded below investment grade. You've drawn the line at BB. Is there a concept, that we see…?

Jairam Sridharan: No. We are talking about BB and below. So BB is included.

Prakhar Sharma: Sure. I got it.

Moderator: Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani: RBI had this regulatory directive, which was kind of put in abeyance of rating the overseas book pool. Is it still in abeyance or you accounted to them?

Jairam Sridharan: No, it is still kept on hold.

Amit Premchandani: And what would be the impact if it was implemented?

Varadarajan Srinivasan: The question was, it was related to unrated exposures, not on overseas.

Amit Premchandani: Yes. So how much of that overseas is unrated in that sense? And how much can be the impact if you are required to implement?

Varadarajan Srinivasan: I think, we have not disclosed that yet, but all overseas exposures in terms of loans typically are not rated.

Amit Premchandani: Okay. And I think what is the time line in terms of capital raising given that your CET1 has fallen below 11%?

Jairam Sridharan: Yes. So as I mentioned in the answer to one of the prior calls, our philosophy has been that let's first see whether capital is a binding constraint. Let's make sure that we have adequate capital to look at growth opportunities that are in front of us, which we believe we have. Then there's a question of how low are you comfortable going from a capital perspective, and historically, we have said we want to go no lower than 150 basis points over the regulatory minimum, which in our case works to about 10.3%, 10.4%. So that's sort of broadly where we are. So we will continue to see what the growth opportunities are and how they are turning up, to make our decision on how we want to think about capital.

Amit Premchandani: And sir, finally, on the non-fund exposure to telecom, what would be the number? You gave the fund-based exposure, what would be the non-fund exposure?

Jairam Sridharan: Non-fund exposure. I mean, in telecom, we do have a larger number in non-fund exposure. Give me 1 minute, while we pull that number up. Non-fund base is about ₹8,000 crores. Just to be clear. I want to be precise here. Most of our exposure in telecom on both the sides is fairly short term, and it is to the top 3 players in the sector.

Amit Premchandani: So even the non-fund would be mostly in AAA or AA kind of mostly, right?

Jairam Sridharan: The top 3 names.

Moderator: Thank you. We'll take one last question from the line of Seshadri Sen from JPMorgan. Please go ahead.

Seshadri Sen: I have a couple of queries. One is on, where does this leave you in terms of IFRS transition? Because can we look at the BB pool that you've disclosed as broadly what would conform to stage 3 under IFRS 9 and that would be the broad transition impact we would look at if IFRS is implemented at the end of this financial year?

Jairam Sridharan: Seshadri, I think you mean stage 2. Stage 3 is where default event has already happened. So stage 3 is equivalent to NPA or restructuring. So any account, which is either already turned NPA or is in any kind of restructuring dispensation, will qualify as stage 3. A lot of other accounts, where there is weakness in the account, but the account has not actually had a default event, but there has been a significant increase in credit risk since the origination of the account that will show up as stage 2. And yes, it will have significant correlation with that account being low rated.

Seshadri Sen: And what about Watch List, would it be stage 3?

Jairam Sridharan: Stage 2. Because the default event hasn't yet happened.

Seshadri Sen: Okay. So broadly, this would be, whatever, wherever, so restructured Watch List, all forms of restructured, they would all be stage 2?

Jairam Sridharan: No. Restructuring is a stage 3 event. Restructuring and NPA are the two stage 3 events. So that basically is deemed as event of default.

Seshadri Sen: Okay. So that's broadly how we should think about the IFRS transition at this stage. So you seem to have a broad perspective on that. Secondly, the new draft guidelines that the RBI put out on benchmarking to external rates. If it is implemented as it is, then how would that impact your margin?

Varadarajan Srinivasan: Here we're going to take a call. First, let them decide what sort of benchmark they are going to use, clearly, the funding or wherever any of this benchmark is nonexistent as of now. And clearly, there will be more volatility in terms of margins. I don't think that you will have because none of these benchmark rates would move exactly in sync with what the deposit rates are.

Jairam Sridharan: So what we are looking at is not a secular compression, but more volatility in margin.

Seshadri Sen: Okay. And the sort of sunset clause on the base rate, how would that impact you over the next, say, 3 or 4 quarters?

Jairam Sridharan: See, there is no sunset clause, Seshadri, but in general, as you have been seeing and as we have been disclosing every quarter, the base rate part of our pool continues to shrink. We expect that by the time the year ends, we will only have about 10% of our outstanding loans in under base rate, which is practically the same as unsetting it.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Jairam Sridharan for closing comments.

Jairam Sridharan: Thank you very much, Margaret. Thanks, everyone for your patience in sitting through this call and apologies again, for starting a little bit late. I hope we were able to address all your questions and do get back to us if there is anything else that we can help you with. And I wish everyone a very happy Diwali. Thank you, and good night.

Moderator: Thank you. On behalf of Axis Bank, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.