“Axis Bank Fixed Income Investor Conference Call”

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MANAGEMENT: MR. JAIRAM SRIDHARAN- CFO, AXIS BANK
MR. SHASHIKANT RATHI- HEAD TREASURY & MARKET, AXIS BANK
MR. SUAGATA BHATTACHARYA- CHIEF ECONOMIST, AXIS BANK

Moderator: Ladies and gentlemen good day and welcome to the Axis Bank Fixed Income Investor Conference Call to discuss Q4 and annual FY17 Results. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference to Mr. Jairam Sridharan – CFO Axis Bank. Thank you and over to you sir.

Jairam Sridharan: Key Highlights for the quarter's performance.

1. **Strong performance on Retail deposits**: CASA balances grew by 26% YOY and 21% QOQ. Savings Account balances grew by 19% YOY and 7% QOQ, while Current Account balances were up 37% YOY and 49% QOQ. The year-end CASA ratio stood at 51%.
2. **Retail and SME Advances witness healthy recovery**: Sequential loan growth was healthy in Retail & SME reflecting a strong bounce from any impacts of Demonetisation. The Retail loan book grew strongly at 12% QOQ, while SME advances too grew at 14% QOQ. The YOY growth in Retail and SME advances stood at 21% and 10%, respectively. The share of Retail Advances now stands at 45% of total loans. Retail also now forms 46% of the Bank's fee income. The Bank's Card business had another strong quarter with spends growing by 83% YOY.
3. **Slippages continued to be lower than peak levels witnessed earlier in the year:** Gross slippages stood at Rs 48.11 Bn, compared to Rs 45.60 Bn in Q3. Net Slippages were at Rs 20.08 Bn compared to Rs 42.10 Bn in Q3. Provision coverage now stands at 65%. Credit cost for the quarter was 1.73% and for the full year was 2.82%.
4. **Strong sequential growth in Earnings:** Core operating profits for the quarter grew by 27% QOQ and PAT was up 111% QOQ. Profits for the quarter and year have declined by 43% and 55% YOY respectively.
5. **Capital position remains healthy**: At the end of FY17, our Tier I ratio stands at 11.87% compared to 12.51% at the end of FY16.

Let me now discuss the Bank's performance in greater detail.

Starting with the performance of our **<u>Retail Franchise</u>**.

- Savings Account balances at quarter end grew at a 19% YOY and 7% QOQ while Current Account balances witnessed a strong growth of 37% YOY and 49% QOQ. This resulted in an overall CASA growth of 26% YOY and 21% QOQ. Our overall CASA share in deposits stood at 51% at the end of the quarter.
- CASA deposits on a daily average basis for the quarter also grew by 26% YOY, and comprised 45% of total deposits. On a daily average basis, SA deposits grew by 29% and CA deposits grew by 20%.
- There has been a sharp increase in system liquidity post demonetisation. A material part of the super-normal incremental deposits that we gained post demonetisation continues to remain

with the Bank. We have witnessed that nearly 42% and 82% of the incremental savings and current account deposit balances have gone out till end March.

- CASA and Retail Term Deposits continue to form a strong base at 81% of total deposits.
- We continue to make investments in developing an extensive branch network. During the quarter, we opened 93 branches, taking the total number of branch additions during the fiscal 2017 to 400, in line with our plans to open 350-400 new branches. For the next year, we expect to open a similar number of branches as in FY17.

Let me now discuss our **digital and payments platforms.**

- We continue to witness strong traction in adoption of digital channels by customers. Please refer to Slide 20 in the Earnings Presentation.
  - Digital transaction volumes increased by 87% on a YOY basis. It is useful to note on this chart that while transaction volume at branches is normalizing to pre demonetization levels, the same is not happening to ATM transactions. ATM volumes seem, on present evidence, to be moving towards a new, lower normal.
  - Mobile banking spends in Q4 reported a growth of 76% on a YOY basis aided by 54% growth in transaction volumes.
- We continue to maintain strong positioning in the transactions and payments space. If you refer slide 24, you will see that the Bank continued to witness strong growth in our cards businesses. Cards portfolio spends in Q4 increased by 83% YOY to Rs 171.57 Bn. The Bank had 3.3 Mn credit cards in force at the end of the quarter, making it the 4th largest credit card issuer in the country, with a market share of 11%. As at end of the quarter, the Bank also stood as the third largest acquirer of point-of-sale terminals in the country. The Bank has added 130 thousand POS terminals, 33% of the current base in the last 12 months.

Let us move on now to a discussion on **Advances growth**.

Aggregate loan growth stood at 10% YOY. Loan growth was largely driven by Retail and SME.

- On the Retail and SME side, the impact of Demonetisation on growth has been fading and we witnessed strong sequential pick up in segments where things looked bleak in Q3.
- If you flip to slide 23 of the earnings presentation, you will see that the disbursement growth has rebounded for retail segments like Home Loans and Agri Lending that were impacted materially during the last quarter due to demonetization.
- Retail lending continues to show strong growth, with a YOY growth of 22% this quarter, excluding loans against FCNR-B deposits.
  - Retail lending growth in the quarter has been led by Auto loan, Home loan and Credit Cards.
  - The credit quality of retail loans continues to be steady.
- SME loan growth stood at 10% YOY and 14% QOQ.
- The Corporate Advances portfolio was flat on a YOY basis.

- Overall demand for corporate credit continues to remain tepid. We continue to focus on lending to higher rated corporates. 85% of new sanctions in the corporate book for the fiscal year 2017 were to companies rated A and above. Presently, 66% of outstanding corporate loans are to companies rated A and above.
- Credit growth in the banking system is presently at multi decade lows. We expect credit growth to pick up in FY18, but it is hard to be definitive about levels.

- If you turn to slide 11, you will notice that the Bank's credit growth has been consistently higher than the overall Banking system credit growth. In FY18, we expect the Bank's Advances portfolio to grow around 5% faster than system growth. As has been the case in recent quarters, the Retail advances business is likely to continue to remain the key engine of growth in FY18.

Let me now move on to the next theme – that of **Asset Quality**.

- Gross slippage for the quarter stood at Rs 48.11 Bn, similar to the Rs 45.60 Bn in Q3. Net slippage stood at Rs 20.08 Bn, down from Rs 42.10 Bn in Q3. During the quarter one account with loan outstanding of Rs 16.61 Bn in the cement sector was downgraded and upon successful regularization during the same quarter was subsequently upgraded. Thus our gross slippage and upgradation numbers for the quarter are both influenced by the similar amount. This account was, and continues to be, on the Watch List. In the quarter, we have also made a provision of 25% against the loan outstandings on this account at the end of the quarter.
- Moving on to Slide 27 of the Earnings Presentation, you will see that the Gross NPA ratio of the Bank has decreased to 5.04% at the end of March 2017, from 5.22% as at end of December 2016, while the net NPA ratio has decreased to 2.11% at the end of March 2017 from 2.18% as at end of December 2016.
- The Watch List has reduced to Rs 94.36 Bn, or 2.23% of customer assets in March 2017, from 2.83% in December 2016 and 6.20% at the beginning of the year. Total slippages from the corporate lending book stood at Rs 43.20 Bn for the quarter, of which 83% came from the WL portfolio. At the end of 4 quarters since the Watch List disclosure, 58% of this list has now slipped into NPA.
- Moving on to slippages outside the WL, slide 30 captures the key metrics. Over the fiscal year 2017, 84% of corporate slippages have been from the WL, and 16% from outside. The key sectors that have contributed to non WL corporate slippages during the quarter are Metals, Infrastructure construction and Engineering and Electronics.
- Net slippage (before write-offs) in retail and SME stood at Rs 0.39 Bn and Rs 1.46 Bn respectively.
- Total recovery and upgrades for the Bank stood at Rs 28.04 Bn.
- We have increased the Provision Coverage Ratio on NPAs from 64% to 65% in this quarter.
- Credit cost for the quarter was 1.73%. For the full year FY17, credit cost stood at 2.82%, broadly in line with the revised guidance we offered in Q2.

I would now like to touch upon the new RBI circular dated April 18, 2017 with respect to "Divergence in Asset Classification and Provisioning for NPAs". While all banks are required to offer the detailed Notes in their Financial Statements, we think it would be useful to have some discussion on this important topic in this call as well.

As part of the Risk Based Supervision exercise for 2016 which concluded in Q3 FY17, the RBI pointed out certain modifications in the Banks' asset classification and provisioning as on March 31, 2016. The total reclassification in respect of additions to Gross NPAs as assessed by RBI was Rs. 94.78 Bn.

Of the said above:

- Rs. 52.60 Bn was recognized as NPAs in Q1 and Q2 of FY 2016-17, prior to the Risk Based Supervision exercise.
- Rs. 18.11 Bn was recognized as NPA in Q3 of FY 2016-17.
- The balance amount of Rs. 24.07 Bn remained standard as on 31st March 2017 as the irregularity in those accounts has been fully regularized.
- The financial impacts of the reclassification are thus fully incorporated in the Bank's accounts before this quarter.
- It is also important to point out that of the total amount pointed out as reclassifications; Rs. 79.90 Bn was part of the Watch List disclosed by the Bank in April 2016, well before RBS 2016.

Based on the level of recognition during FY17 and our outlook on the corporate lending portfolio, we believe that on slippage and credit costs, the worst of this credit cycle is largely behind us. However, we recognize multiple uncertainties that still remain with regard to resolution mechanisms for stressed loans. We also realize that Q4 is a seasonally strong quarter on recoveries, and the strength might not be directly imputable to the next full year. Taking these into account, we expect our credit costs to be in the range of 175-225 basis points for FY18. The credit cost range factors in different economic scenarios and their consequent impact on stressed sectors, and on the NPL resolution and recovery cycle. We believe a range better captures the possible scenarios that may play out during the year. As the year progresses and as we have more visibility on the macro developments, we will update this range as well as attempt to make it narrower.

To round up our discussion on Asset Quality, here are some more metrics:

- During the quarter, the Bank implemented Strategic Debt Restructuring (SDR) in 5 standard accounts. The underlying loan amount is Rs 12.93 Bn. We have created provisions of 15% on this entire loan pool. The Bank has implemented 5/25 and S4A in one and two accounts, respectively during the quarter.
- The cumulative outstanding value of the underlying standard loan amount for SDR stand 5/25 undertaken by the Bank so far, is around Rs 21.73 Bn and Rs 23.29 Bn respectively.
- During the quarter, the Bank sold assets with a gross outstanding of Rs 23.54 Bn and a net book value of Rs 18.28 Bn to ARCs (asset reconstruction companies) against sale consideration of Rs 16.86 Bn (cash Rs 2.66 Bn and security receipts Rs14.20 Bn).
- Outstanding value of security receipts stood at Rs 15.25 Bn.

- During the quarter, slippages from the restructured book stood at Rs 9.42 Bn.
- To get a sense of the overlaps among different restructuring dispensations, I request you to have a look at the Venn diagram on slide 27. As this diagram indicates there is an overlap of more than 50% across different categories with our disclosed WL.

I would also like to inform you all that the Bank's Board is in the process of formulating a policy for making provisions for standard assets at rates higher than the regulatory minimum, based on evaluation of risk and stress in various sectors as indicated by RBI. Slide 34 provides a snapshot of the Bank's Top ten industry concentration. Telecom sector has moved out of top 10 and its fund and non-fund based outstandings stood at Rs 39.82 Bn and Rs 91.26 Bn respectively. In anticipation of the new standard asset provisioning requirements starting Q1, we have added Rs 1 Bn into our contingent provisions pool this quarter. The total outstanding of Contingent Provisions now stands at Rs 2.60 bn.

Moving on to the Bank's **Earnings Profile**,

- I request you to refer to Slide 15 of the earnings presentation.
- Core operating profits and net profit have both improved sequentially.
- NII for the quarter increased by 4% YOY and 9% QOQ.
- NIM for the quarter was 3.83%, with Domestic NIM at 4.11%.
- Slide 16 represents the sequential NIM waterfall. The NIM improved by 40 basis points on a QOQ basis to 3.83%. The sequential improvement in NIM was primarily influenced by a one-off favourable impact of write back in prior period interest reversals of around 13 basis points which is included in the interest reversal component. Further lower amount of interest reversals on a sequential basis and normal decline in cost of funds helped in the sequential improvement in margins.
- For FY17, the NIM saw a compression of 23 bps and stood at 3.67%. In FY18, we expect further compression of around 20 bps amidst high liquidity, lower credit demand and downward re-pricing of existing floating rate loans.
- Slide 17 represents the compositions of the lending book by rate type, and how it has been changing over recent quarters since the beginning of the MCLR era. For the fiscal 2017, MCLR and base rates have seen reduction of 125 bps and 25 bps, respectively.
- Cost of funds during Q4 was 5.42% compared to 5.51% in Q3 FY17, and 5.84% in Q4 last year.
- Fee income grew by 8% YOY and constituted 31% of operating revenue. Retail fees continue to be an area of strength, with a growth of 17%. Card fees were up by 30% YOY. Corporate Banking fees in the quarter declined by 11% YOY.
- The interest rate environment during the fiscal 2017 had been conducive to significant gains in the trading portfolio of the Bank. During the quarter, trading income stood at Rs 4.28 Bn up 350% YOY.
- Operating expenses in the quarter increased by 18% YOY. The Cost to Assets of the Bank was at 2.27% for the quarter and 2.03% for the financial year. At 2.03% cost to assets, we remain one of the more cost efficient large banking franchises in the country. For the next fiscal, we expect operating expense growth to moderate from FY17 levels of 20%. We expect growth to fall to mid-teens.

- Operating profit for the quarter stood at Rs 43.75 Bn, declining by 1% on YOY basis. Operating profit for FY17 grew by 9% to Rs 175.85 Bn. Operating profit margin stood at 3.01%, compared to 3.43% in Q4 last year and 3.10% in Q3FY17.
- Provisions and contingencies increased by 121% YOY due to the elevated slippages and increase in Provision Coverage Ratio undertaken during the quarter. The Bank shored up PCR from 64% to 65% QOQ.
- PAT for the quarter and FY17 declined by 43% YOY and 55% respectively.

Finally, let us touch on our **<u>Capital Levels</u>**.

- Our total Capital Adequacy Ratio continues to remain healthy at 14.95% with a Tier I CAR of 11.87%. This compares with a Tier 1 ratio of 12.99% at the end of Q3 FY17 and 12.51% as of 31st March 2016.
- Slide 6 in the presentation lays out the impact of various items on our Tier 1 ratio this year. Growth consumed 170bps of Tier 1, the new guideline consumed 11bps, additional capital raised contributed 68 bps, profit contributed 48 bps and the gross accretion to reserves was 1 bps, making for a net consumption of 64 bps of capital for the year.
- A strong and healthy capital base is essential for robust balance sheet and to continue above market growth. We will undertake appropriate steps to maintain strong capital levels.
- Risk Weighted Assets for the Bank stood at Rs 4,723.13 Bn and grew by 17% on a YOY basis.
- ROE and ROA for FY17 were at 7.22% and 0.65% respectively. As the impact from higher slippages recedes and benefits of higher investments in branches and employees kick in, we expect these ratios to improve.
- The Board of Directors have recommended dividend of Rs 5 per share, which is similar to the dividend per share recommended last year. The recommended dividend is in line with the past track record of dividend history of the Bank.

Finally, I would also like to highlight some of the achievements of our key subsidiaries.

- <u>Axis Finance</u> – The NBFC reported 56% YOY growth in average loans to Rs 43.58 Bn and 49% YOY growth in PAT to Rs 1.65 Bn for FY17.
- <u>Axis AMC</u> - The AMC reported 47% YoY growth in average AUM during FY17 with 26% growth in total number of folios. The AMC was able to grow faster than the industry and its PAT grew 80% YOY to Rs 0.57 Bn in FY17.
- <u>Axis Securities</u> - The Retail broking reported 41% growth in active client base and 84% YOY growth in total volumes for FY17. The subsidiary's PAT for FY17 grew by 44% YOY to Rs 0.52 Bn
- <u>Axis Capital</u> - The Institutional Equities and Investment Banking franchise continues to perform well and reported PAT of Rs 1.13 Bn for FY17.

As I close, allow me to re-summarize the key themes of the quarter and outlook for next fiscal year:

1. **Asset Quality**: Slippages and credit costs have come off the peak, PCR is healthy at 65%. We expect FY18 credit costs to be 175-225 basis points, with steady PCR.
2. **Earnings**: Have recovered sequentially post lows of Q2 which witnessed peak slippages and credit costs. In FY18, we expect a further margin compression of around 20 bps.
3. **Advances Growth:** Loan growth continues to be driven by Retail with SME witnessing a recovery post Demonetisation. We expect credit growth for FY2018 to continue to be led by Retail. We expect to grow around 5% faster than the Banking system.
4. **Retail Franchise**: CASA growth has been strong and Loan growth remains healthy, digital payments and transaction trends have witnessed strong growth.
5. **Capital position**: Our Capital Adequacy Ratio currently remains healthy and we will undertake appropriate steps to maintain it.

With this, I come to the end of my comments and would now invite my friend Suagata Bhattacharya to tell you a little bit about how we are seeing the macro-economic environment.

Suagata Bhattacharya: Thank you Jairam. Good afternoon and good evening ladies and gentlemen. As Jairam mentioned passing FY17 had been a difficult year despite a normal monsoon with the series of global and domestic shocks and surprises. 2016 as you would know was a turning point in the global economy with the shift from deflation to a commodities prices recovery partially resulting from signs of durable tightening of capacity in China. Many central banks have also changed their stance on continued easing with the Reserve Bank of India probably being one of the first. Despite good rains, India’s economic activity remains muted with a slow down even before the impact of demonetization. Even this muted growth was largely due to consumption led demand; investment more or less remaining flat. Bank credit growth fell to multi-decade lows both due to lower demand as well as increasing disintermediation with higher issuances of commercial paper and corporate bonds with persisting surplus system liquidity.

Going forward into FY18 we expect the overall macros in India will continue to remain strong particularly if the rains are good and especially well-distributed. However, as Jairam also mentioned operating conditions are likely to remain challenging, growth will recover only gradually with private sector CAPEX still impeded by excess capacity and low risk appetite. Diffusion by trade of improved global growth to emerging markets will be modest. In India the imminent transition to the GST (goods and services tax regime) is also likely to introduce significant friction. Public sector capital expenditure and government spending on investment is likely to increase with multiple initiatives at the central and states but opportunity for bank’s credit, particularly corporate credit, are not likely to increase to any significant extent. Fiscal credit growth will rise a little bit beyond FY17 levels but not much, probably roundabout 8% to 9% YoY. While we expect inflation to remain moderate, particularly food inflation if the rains are good, and will likely undershoot RBI’s projections for the most part of the year, the balance of probability remains for a long pause in the policy repo rate from the RBI. We expect continuing reduction in bank deposits through cash withdrawals. I will deliberately refrain at this point from a currency view and will await some dissipation of global political uncertainty. That's all from me, thank you very much.

Jairam Sridharan: Those were the comments from the Axis Bank Management team. We are happy to take your questions now.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. We take the first question from the line of Matthew Hughart from JP Morgan. Please go ahead.

Matthew Hughart: I just wanted to ask about the trend in risk weighted assets and it looks like RWA rates increased faster than total assets? I guess this is maybe because of the SME portfolio but if you could just shed a little bit of light on that trend.

Jairam Sridharan: The observation is absolutely accurate, the RWA percentage as a percentage of assets has indeed deteriorated in the fourth quarter and there are two main reasons why RWA percentages has actually changed- both of them to do with business mix one on the lending side and one on the liability side. On one side of the balance sheet we have a little bit of an increase this quarter in off balance sheet items and those off balance sheet items, while they have been very PE accretive, carry a higher risk weight and that’s actually increased RWA percentages temporarily in this quarter. The second element is in terms of mix on the investment side. Our G-sec portfolio has come down a little bit during the quarter and therefore the weighted average RWA of the investment portfolio has gone up. Some of these are seasonal and how the fourth quarter normally tends to work and some of these we need to improve on as well.

Mathew: And the off-balance sheet items, I think you indicated as temporary, is that a seasonal trend?

Jairam Sridharan: I think you will see a reversion back towards what we had in the past in the coming quarter.

Moderator: That was the last question. I now hand the floor over to Mr. Jairam Sridharan for his closing comments.

Jairam Sridharan: Thank you everyone for taking the time to attend our call. I hope you have a wonderful day ahead. Thank you very much.

Moderator: Thank you. Ladies and gentlemen on behalf of Axis Bank Limited we conclude today’s conference. Thank you for joining, you may now disconnect your lines.