ICICI Bank Limited
Earnings Conference Call – Quarter ended September 30, 2013 (Q2-2014)
October 25, 2013

Please note that the transcript has been edited for the purpose of clarity and accuracy.

Certain statements in this call are forward-looking statements. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from those included in these statements due to a variety of factors. More information about these factors is contained in ICICI Bank's filings with the Securities and Exchange Commission.

All financial and other information in this call, other than financial and other information for specific subsidiaries where specifically mentioned, is on an unconsolidated basis for ICICI Bank Limited only unless specifically stated to be on a consolidated basis for ICICI Bank Limited and its subsidiaries. Please also refer to the statement of unconsolidated, consolidated and segmental results required by Indian regulations that has been filed with the stock exchanges in India where ICICI Bank's equity shares are listed and with the New York Stock Exchange and the US Securities and Exchange Commission, and is available on our website www.icicibank.com.

Moderator: Ladies and gentlemen, good day and welcome to the Q2-2014 Earnings Conference Call of ICICI Bank. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you should need assistance during the conference call please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. N. S. Kannan, Executive Director of ICICI Bank. Thank you and over to you sir.

N. S. Kannan: Good evening and welcome to the conference call on the financial results of ICICI Bank for the quarter ended September 30, 2013, which is the second quarter of the current financial year 2014.

As always, my remarks this evening would revolve around four key themes:

- First: the macro-economic and monetary environment;
- followed by, our performance during the quarter, including performance on our 5Cs strategy;

- then, our consolidated results;
- and finally, the outlook for the full financial year 2014.

Let me start with the first part on the macro economic and monetary environment during the second quarter.

The operating environment in the second quarter was challenging, marked by significant volatility in financial markets, several policy changes and continued weakness in growth. During July-August 2013, concerns on tapering of quantitative easing in the US, as well as India's high current account deficit, resulted in significant capital outflows from India, particularly in the debt segment, resulting in sharp depreciation of the rupee vis-à-vis the US dollar. With a view to managing the volatility in the exchange rate, RBI announced certain measures in mid-July, including an increase in the Marginal Standing Facility rate from 8.25% to 10.25%, limiting bank borrowing under the Liquidity Adjustment Facility or LAF to 0.5% of net demand and time liabilities of banks and increasing the minimum daily cash reserve ratio balance required to be maintained by banks to 99% from 70% earlier. These measures led to a sharp increase in short term market rates by about 200 basis points.

In view of the impact of the above developments on banks' treasury positions, in August 2013, RBI announced certain dispensations including increase in the held-to-maturity, or HTM holding limit for government securities to 24.5% of net demand & time liabilities one-time transfer of government securities from available for sale, or AFS, and held for trading, or HFT categories to HTM category up to the 24.5% limit at July 15, 2013 prices and also amortization of mark-to-market losses on the fixed income AFS & HFT book in equal installments over the remaining part of the year. The Reserve Bank of India also announced open market operations of ₹ 80 billion of long dated securities, in order to ease the pressure on long-term yields.

In September 2013, positive developments such as the deferral of tapering of quantitative easing in the US as well as RBI measures to attract foreign currency inflows, the measures on FCNR deposits and increasing banks' foreign currency borrowing limits, resulted in stability and appreciation in the exchange rate. Consequently, in its mid-quarter monetary policy statement on September 20, 2013, RBI reversed some of its exceptional measures by reducing MSF rate to 9.5% and the minimum daily cash reserve ratio requirement for banks to 95% of the fortnightly requirement. The MSF was further reduced to 9.0% on October 7, 2013. However, with the emergence of upside risks to inflation, in its monetary policy statement, RBI increased the repo rate by 25 basis points to 7.5%. RBI also indicated its intent of normalising monetary policy operations with the repo rate resuming as the effective policy rate.

Overall, financial markets remained volatile during the quarter. The rupee depreciated from ₹ 59.70 per US dollar on June 30, 2013 to a low of ₹ 68.36 per US dollar on August 28, 2013 and thereafter appreciated to ₹ 62.80 per USD by end-September 2013. Similar swings were seen in the equity and bond markets. The Sensex declined by 4% till end-August 2013 before recovering in September 2013. Yields on 10-year government securities reached 9.2% at August 19, 2013 compared to 7.5% at end-June 2013, before subsequently easing to 8.8% by end-September 2013.

Looking at real economic activity, growth continued to remain subdued during the quarter. The index of industrial production (IIP) remained weak recording a growth of 0.6% in August 2013. Growth during April-August 2013 was 0.1% even on a low base of

0.2% increase year-on-year in April-August 2012. At the same time, inflationary concerns re-emerged during Q2 of 2014, with the wholesale price index increasing from 5.2% in June 2013 to 6.5% in September 2013. The increase was largely due to rise in food prices which went up 18% year-on-year in August and September 2013. Retail inflation measured by the consumer price index remained high at 9.8% in September 2013.

Having said this, there were positive developments during the second quarter on the external front. Exports revived, recording an increase of 11.2% during the quarter compared to a decline of 1.6% in Q1 of 2014. Imports declined by 8.6% during the second quarter, primarily due to a decline in gold imports. As a result, India's trade deficit reduced from around 50 billion US$ during Q1 of 2014 to 30 billion US$ during Q2 of 2014, easing concerns on the current account deficit.

With respect to trends in the banking sector, non-food credit growth improved to about 18% by end-September 2013 from 13.9% at June 28, 2013 and 15.4% at September 28, 2012. Some of this growth is likely to have been driven by a shift of borrowing from the non-bank funding market to bank borrowing, following the sharp increase in short term market interest rates during the quarter. Deposit growth continued to remain muted with total deposits recording a growth of around 14% with some marginal improvement towards the end of the quarter. Demand deposit growth increased to about 18% during the quarter before reverting to 11% growth levels.

With this background, I now move to Part 2 on the performance of the Bank during the quarter.

Let me begin with the progress on our 5Cs strategy:

- **First, with respect to Credit growth:** Total advances of the Bank increased by 15.5% on a year-on-year basis from ₹ 2.75 trillion at September 30, 2012 to ₹ 3.18 trillion at September 30, 2013. The growth in the domestic loan portfolio was 14.4% on a year-on-year basis at September 30, 2013. The domestic loan growth was driven by retail loans, with the rate of corporate loan growth declining substantially.

  The retail loan portfolio grew by 19.6% year-on-year at September 30, 2013, compared to 12.6% at June 30, 2013. The organic retail loan portfolio, i.e. excluding bought out portfolios, grew by 27.8% at September 30, 2013 compared to 26.6% at June 30, 2013. We continued to see strong traction in this business, with mortgage and auto loan disbursements increasing year-on-year by 35% and 45% respectively during the quarter. The outstanding mortgage and auto loan portfolios grew by 23% and 27% respectively on a year-on-year basis at September 30, 2013. Commercial business loans declined by 16% on a year-on-year basis at September 30, 2013, reflecting both a slowdown in this segment as well as run down of the bought out portfolio in this segment. The unsecured credit card and personal loan portfolio at ₹ 54.45 billion at September 30, 2013 continued to remain a small portion, about 1.7%, of the overall loan book though the growth rate is high due to the low base.

  We have calibrated growth in the domestic corporate portfolio to 11.0% year-on-year at September 30, 2013, given the operating environment.

  Net advances of the overseas branches increased by 18.9% on a year-on-year basis in rupee terms, primarily due to the movement in the exchange rate. In dollar terms the net advances of the overseas branches remained stable on a sequential and year-on-year basis at September 30, 2013.

- **Moving on to the second C on CASA deposits:** Reflecting our strong retail franchise, we saw an addition of ₹ 46.82 billion to our savings deposits in the second quarter. Current account deposits also increased by ₹ 33.91 billion during the second quarter. As a result, we maintained our period end CASA ratio at 43.3% at September 30, 2013, similar to the level at June 30, 2013. The average CASA ratio for the Bank improved from 39% in Q1-2014 to 40.3% in Q2-2014.

- **On the third C on Costs:** For the second quarter, operating costs, including DMA expenses, were higher by 4.5% on a year-on-year basis. The Bank's cost-to-income ratio declined to 37.3% in the second quarter of fiscal 2014, compared to 39.4% in the first quarter of fiscal 2014. The moderation in operating expenses was primarily due to a year-on-year decline in variable employee expenses, such as the positive impact of the movement of government securities yields on retiral benefits.

- **Let me move on to the fourth C on Credit quality:** During the second quarter, the Bank saw gross NPA additions of ₹ 11.45 billion, primarily driven by slippages in the SME and mid-sized corporate loan portfolios. Deletions in the second quarter were ₹ 5.66 billion. The Bank has also written-off ₹ 5.58 billion of NPAs. The net NPA ratio was 73 basis points at September 30, 2013 compared to 69 basis points at June 30, 2013.

  During the quarter, the Bank restructured ₹ 10.76 billion of loans. After taking into account deletions and the required specific provisioning, the net restructured loans for the Bank increased to ₹ 68.26 billion at September 30, 2013 compared to ₹ 59.15 billion at June 30, 2013.

Provisions for Q2 of 2014 were at ₹ 6.25 billion as compared to ₹ 5.08 billion in Q2 of 2013 and ₹ 5.93 billion in Q1 of 2014. As a result, credit costs as a percentage of average advances were at 81 basis points on an annualised basis for Q2 of 2014. The provisioning coverage ratio on non-performing loans continues to remain healthy at 73.1% at September 30, 2013.

- **Now to the fifth C on Customer centricity:** The Bank continues to focus on enhancing its customer service capability and leveraging on its increased branch network to cater to its customer base.

  During the quarter, the Bank added 157 branches and 196 ATMs to its network. With this, the Bank has a branch network of 3,507 branches and 11,098 ATMs at September 30, 2013. The Bank also continues to strengthen its technology channels for increasing customer convenience. During the quarter, the Bank launched 'Pockets by ICICI Bank', a first-of-its kind app on Facebook, which offers the Bank's customers the convenience of banking while they are on Facebook. 'Pockets by ICICI Bank' offers a variety of unique features such as 'split 'n' share' which allows customers to split and track group expenses and share that with friends on Facebook and 'Pay a friend' which allows customers to transfer funds to their friends without knowing their bank account details. 'Pockets by ICICI Bank' has been developed with robust security features.

  The Bank's Facebook page continues to be appreciated by customers with about 2.5 million fans. ICICI Bank continues to have the largest fan base on Facebook among the Indian banks.

Having talked about the progress on 5Cs, let me move on to the key financial performance highlights for the quarter.

1. Net interest income increased by 20% year-on-year from ₹ 33.71 billion in Q2 of 2013 to ₹ 40.44 billion in Q2 of 2014. The net interest margin increased from 3% in Q2 of 2013 and 3.27% in Q1-2014 to 3.31% in Q2-2014. On a sequential basis, the international margins increased from 1.60% in Q1-2014 to 1.80% in Q2-2014 on account of higher yields on incremental lending and a reduction in cost of funds. The domestic NIM was stable at 3.65% in Q2-2014 compared to 3.63% for Q1-2014, reflecting the Bank's relatively lower reliance on wholesale funding as well as the 25 basis points increase in base rate.

2. Total non-interest income increased by 6.0% from ₹ 20.43 billion in Q2-2013 to ₹ 21.66 billion in Q2-2014.

    - We have seen an improvement in fee income growth from about 3% for the full financial year 2013 and 8.9% in the previous quarter to 16.7% on a year-on-year basis in the second quarter. The improvement in fee income growth was primarily driven by growth in the retail banking fees, commercial banking fees and forex & derivative income. The Bank's retail fees, including remittances, contribute about 55% of its overall fees.

    - Other income was ₹ 2.51 billion in Q2-2014, compared to ₹ 1.62 billion in Q2-2013 and ₹ 2.88 billion in Q1-2014.

    - During the second quarter, treasury recorded a loss of ₹ 0.79 billion compared to a profit of ₹ 1.73 billion in

Q2-2013 and a profit of ₹ 4.03 billion in the first quarter. As you are aware, the quarter saw significant volatility in market rates following the policy measures announced on curbing volatility in the exchange rate. The Bank has fully recognised the mark-to-market provisions of ₹ 2.79 billion on its investment portfolio, and has not availed of the option permitted by RBI of recognising it over three quarters. Had the Bank amortised the same over three quarters, the treasury income for the second quarter would have been higher by ₹ 1.86 billion. During Q2-2014, the Bank also transferred SLR securities with face value of ₹ 23.11 billion from AFS and HFT category to HTM category and has recognised a loss of ₹ 0.10 billion resulting from the said transfer on account of the movement of yields till July 15, 2013. If the transfer had not been effected, the treasury income during the second quarter would have been lower by ₹ 0.71 billion. Going forward, the treasury performance would depend on market developments, including the impact of policy measures.

3. I have already spoken about the trends in operating expenses and provisions while speaking about the 5Cs strategy.

4. The Bank's operating profit, excluding treasury, increased by 31.3% from ₹ 30.22 billion in Q2-2013 to ₹ 39.67 billion in Q2-2014.

5. The Bank's standalone profit before tax increased by 21.5% from ₹ 26.86 billion in Q2-2013 to ₹ 32.63 billion in Q2-2014.

6. The Bank's standalone profit after tax increased by 20.2% from ₹ 19.56 billion in Q2-2013 to ₹ 23.52 billion in Q2-2014.

This translates into an annualised return on average assets of 1.70% for Q2-2014, compared to 1.54% for Q2-2013.

7. The Bank's capital adequacy as per Reserve Bank of India's guidelines on Basel III norms continues to remain strong at 16.50% overall CAR and 11.33% Tier I ratio at September 30, 2013, giving us the ability to grow our business further. In line with applicable guidelines, the Basel III capital ratios reported by the Bank for the quarter ended September 30, 2013 do not include the profits for the half year ended September 30, 2013. Including the profits for H1-2014, the capital adequacy ratio for the Bank as per Basel III norms would have been 17.21% and the Tier I ratio would have been 12.04%.

I now move on to the consolidated results.

The profit after tax for the life insurance company in Q2-2014 was ₹ 3.87 billion as compared to ₹ 3.96 billion in Q2-2013. This level of net profits reflects an annualised return of about 30% on the Bank's invested capital. The year-on-year decrease in profits was due to a decline in renewal premiums coupled with higher new business strain in Q2-2014 compared to Q2-2013. The decline in total premium was mainly on account of de-growth in renewal premium given the slowdown in business growth following September 2010. However, the company has seen healthy growth in new business premiums on a year-on-year basis. The new business annualized premium equivalent for ICICI Life was ₹ 9.54 billion in Q2-2014 compared to ₹ 7.81 billion in Q2-2013. The new business margin for Q2-2014 was 14.1%. During the quarter, the company has made changes to its products with the intent of smoothening the transition to the new product regime. Accordingly, this led to higher sales of ULIP products, which have relatively lower margins, with the proportion of ULIPs in the business mix increasing to about 60% levels in Q2-2014 compared to about 53% levels previously. The retail weighted received premium for ICICI Life increased by 10.9% on a year-on-year basis during April-September 2013. While the IRDA numbers for the industry are not available, we understand that the company has retained its market leadership among the private players.

The profit after tax for the general insurance company in Q2-2014 was ₹ 1.56 billion as compared to ₹ 1.01 billion in Q2-2013 and ₹ 2.03 billion in Q1-2014. The profits were lower on a sequential basis, primarily on account of lower investment income following the volatility in markets during the quarter. The company maintained its leadership position in the private sector with overall market share of 9.5% during April–August 2013.

Let me move on to the performance of our overseas banking subsidiaries. As per IFRS financials, ICICI Bank Canada's profit after tax for Q2-2014 was 12.9 million Canadian Dollars as compared to 12.2 million CAD for Q2-2013. Total assets for ICICI Bank Canada were 5.27 billion CAD at September 30, 2013 compared to 5.23 billion CAD at June 30, 2013. ICICI Bank Canada will continue to work towards further optimisation of capital and selective portfolio growth in order to improve its profitability and return ratios. The capital adequacy ratio was healthy at 31.2% at September 30, 2013 compared to 31.0% at June 30, 2013.

ICICI Bank UK's total assets were 4.21 billion US$ at September 30, 2013 compared to 3.75 billion US$ at June 30, 2013. ICICI Bank UK is focusing selective lending opportunities to highly rated entities, including trade & transaction banking products and shorter term loans to multinational corporations and subsidiaries of Indian companies in UK and Europe. The profit after tax for ICICI Bank UK for Q2-2014 was 6.1 million US$ compared to 4.3 million US$ in Q2-2013. The capital adequacy ratio was 26.1% at September 30, 2013 compared to 26.6% at June 30, 2013.

Let me now talk about the overall consolidated profits.

The consolidated profits for Q2-2014 increased by 12.9% to ₹ 26.98 billion compared to ₹ 23.90 billion in Q2-2013. The consolidated profit growth was lower on account of the impact of market volatility primarily on the Bank's primary dealership subsidiary. The annualized consolidated return on average equity was 14.6% for Q2-2014.

Let me now come to our outlook for the full year FY2014. Given that half the year has elapsed, we thought it appropriate to take stock of actual trends vis-à-vis our expectations & targets at the beginning of the year.

Looking at the environment: while the turbulence in financial markets that we saw in July-August has substantially abated, overall the economic outlook is more challenging than envisaged at the beginning of the year. Full year GDP growth is likely to be lower as compared to expectations of a pickup, and the anticipated easing of monetary policy and consequent reduction in market rates has been impacted by inflationary concerns.

Coming to ICICI Bank:

- On the loan growth front, retail loan growth trends are robust and we have achieved 20% year-on-year loan growth at the end of the first half, which was our full year target. We have calibrated corporate loan growth substantially, reflecting the environment and our cautious approach to incremental lending. We expect sustainable credit growth for the banking system to be around 15%, and would target to grow 2-3% higher than that level. Growth would continue to be driven by retail at around 22-23%. Growth in the loan portfolio of overseas branches will continue to be calibrated to conditions in the funding markets.

- Trends on the deposit side have been strong, and we would target an increased average CASA ratio of 39-40% as against 38-39% estimated earlier.
- Trends in margins have also been better than our original expectations, aided by better margins in the overseas branches book and stability in domestic margins given the retail deposit franchise. Against our initial target of 10 bps improvement in full year NIM over the 3.11% level in FY2013, we believe we can target around 20 bps expansion in NIM on a full year basis.
- Fee income growth trends have also been better than our original expectations, with growth for the first half at 12.8%. We would target fee growth of around 14-15% for the year.
- Treasury income has been volatile reflecting market conditions, contrary to the general initial expectation of profit opportunities in treasury from declining yields. However, based on current market conditions, we expect to recoup a significant part of the mark-to-market provisions taken in Q2.
- Other non-interest income trends have been strong, aided by continuing dividend streams from subsidiaries. We expect this trend to sustain.
- The trend in cost-to-income ratio has been positive, with the ratio at 38.4% in the first half. We would continue to target to contain the ratio at a level below 40%.
- Thus, we expect to improve on the core trends seen in the first half in operating profit, and subject to market conditions, improve the treasury performance relative to the second quarter.
- Given the economic scenario I mentioned earlier and issues of profitability challenges, longer working capital cycles and liquidity constraints faced by companies, corporate asset

quality continues to be impacted across the system, particularly among medium and smaller companies. We had estimated provisions as a percentage of average loans of about 75-80 bps for the year. The first half experience has been about 82 bps.

During the first half, we have had gross additions to NPLs of about ₹ 23 billion. We currently expect a similar trend in the second half.

With respect to restructured assets, we have seen gross additions to restructured loans of about ₹ 20 billion and also currently have loans aggregating about ₹ 20 billion referred to CDR. Given the environment, the CDR pipeline is expected to increase, and we would also see some restructurings outside CDR, resulting in a higher amount of restructuring in the second half.

While given the operating environment the provisioning costs for the year may be higher than our initial estimates, we do not expect them to exceed 90 to 100 basis points of average loans.

In summary, we are seeing strong core operating trends: loan growth driven by retail, healthy deposit growth, improving fee income growth and sustained cost efficiency. These healthy core operating trends would give us the ability to absorb the higher level of provisioning arising out of the credit cycle. Our growth continues to be supported by a capital position that is well above regulatory norms.

Before I end, I am happy to say that as you would have seen in the press release, Rakesh Jha has been designated as Chief Financial Officer. I am sure all of you know him well and will join me in wishing him all the best. Rakesh has been the Deputy CFO since 2007 and has played a critical role in finance, planning & strategy for much longer. He is well qualified and deserving of this position. Rakesh will continue to report to me, and I will also continue with my other existing responsibilities for risk management, corporate communications & branding, markets and commercial banking, and day to day oversight of the compliance and internal audit functions which report to the CEO and Audit Committee.

With these opening comments, my team and I will be happy to take your questions.

Mahrukh Adajania: Just wanted to clarify a few things; firstly, you said that the restructuring pipeline was ₹ 20 billion, is that correct?

N. S. Kannan: Yes, currently we have loans aggregating about ₹ 20 billion to companies referred to CDR.

Mahrukh Adajania: What is the amount for gross NPL slippages during the second quarter?

N. S. Kannan: ₹ 11.45 billion

Mahrukh Adajania: Ok. You mentioned that lower employee expenses are largely due to retirement benefits. Is there some other aspect as well?

N. S. Kannan: Largely, the decrease in expenses is because of the revaluation of retirement benefits due to the movement in yield on government securities. Although the increase in yields has resulted in a treasury loss, but correspondingly, there also has been a benefit on valuation of retirement liabilities. As I mentioned earlier, we are confident of keeping the cost to income ratio below 40% on a full year basis.

Mahrukh Adajania: Would the lower cost to income ratio be on account of strength in operating income?

N. S. Kannan: It would be primarily on account of strength in operating income. Also, there is not much pressure on costs. If you look at the attrition rates, the employee cost increase expectations or any other operating expenses, including the rental for premises, generally the cost pressures are not much. Further, we always believe that there is some scope for cost control. Given these factors, we are quite confident of keeping it below 40%.

Mahrukh Adajania: Just one last question on your fee income. There has been a strong revival. Is there any lumpiness, for example any huge forex income, which may not repeat next quarter?

N. S. Kannan: There is no lumpiness. We do believe that our strategy of granularising has helped as there has been growth across segments like transaction-based commercial banking, forex and retail banking fees.

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

Vishal Goyal: Can you give some colour on the fresh NPL formation in terms of whether there have been retail additions and within the wholesale segment which industries are the additions coming from?

N. S. Kannan: On the retail segment, there are no concerns and we continue to see very robust asset quality. On the SME and corporate side, given the operating environment, there has been stress. There is no particular sectoral distribution. Typically, there have been issues in sales growth, gearing issues or extension of working capital cycle in the cases where we are seeing slippages or restructurings. I think it depends on a particular company's position and the sales growth rather than being specific to any particular industry segment.

Vishal Goyal: Can you say the same for even restructuring or that will be different?

N. S. Kannan: As I mentioned, in the current pipeline of CDR cases, our share is ₹ 20 billion and given the environment, the CDR pipeline is expected to increase. Further, we would also see some restructurings outside the CDR resulting in a higher amount of restructurings in the second half of the year compared to first half.

Vishal Goyal: All this is coming from infra, metals or some other sector?

N. S. Kannan: It is largely the mid-corporate segment where we are seeing restructurings and again there have been no industry specific issues. We are very careful about restructuring loans and our past experience from restructuring has been good.

Vishal Goyal: Can you give the number for new savings bank accounts opened in the quarter?

Rakesh Jha: We do not separately disclose that on a quarterly basis.

Vishal Goyal: Ok. On the retiral benefits, will it remain volatile given the bond yields?

Rakesh Jha: The valuation of retiral benefits is a function of the yields because the present obligation is dependent on the residual payment period and the discount rate. So it will indeed be a volatile number. Generally, in a quarter the interest rate movement is not as sharp as it was during this quarter. Given the sharp interest rate movement this quarter the impact on retiral benefits was on the higher side.

N. S. Kannan: Some volatility in that line item will be there. Hence, I talked about the first half number for the operating expenses growth which is the more appropriate number. I would again reiterate that we are confident of keeping the cost-to-income ratio below 40%.

Vishal Goyal: It is the valuation of the liabilities which led to such a sharp decline in expenses. So would you expect a similar experience, for example, if the yield remains at 8.5%?

Rakesh Jha: We do a quarterly valuation of the liability. So if the yield remains at the same level as it was on September 30 then there should no incremental impact.

Vishal Goyal: So, if the yields remain at the current levels, you go back to the normal run rate employee cost?

N. S. Kannan: Yes, that is why if you look at H1-2014 as a whole it gets somewhat smoothened out.

Moderator: Thank you. The next question is from the line of Jignesh Shial from IDBI Capital. Please go ahead.

Jignesh Shial: Just wanted to check, have we sold any portfolios to ARCs during this quarter?

Rakesh Jha: We have sold some of our NPLs to ARC. If you look at the number of outstanding security receipts given in the presentation, there has been increase of about ₹ 560 million during the quarter.

Jignesh Shial Are those recoveries or the amount that you sold?

N. S. Kannan: That will be the addition to the security receipts portfolio.

Jignesh Shial: Ok. Have we bought any loan portfolios during the quarter?

Rakesh Jha: From a priority sector lending perspective we do buy on a quarterly basis. But most of the purchases are in the form of PTCs which form part of the investment portfolio.

Jignesh Shial: Ok. What would be the quantum of our wholesale deposits currently?

N. S. Kannan: It will be just under 30% of the total domestic deposits.

Jignesh Shial: Just reconfirming, our gross additions to NPLs during the quarter had been ₹11.45 billion, right?

N. S. Kannan: Yes

Jignesh Shial: And the write-offs have been ₹ 5.58 billion?

N. S. Kannan: That is correct.

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

Manish Karwa: Just wanted to take your outlook on the overseas margins. Do you think this trend can sustain for some time?

N. S. Kannan: 1.8% is the highest level of overseas we have achieved. Further increase from here looks difficult, but we would work towards sustaining the overseas margins in the 1.7%-1.8% range.

Manish Karwa: What is the reason for the increase to 1.8%? Is it because of better spreads on the lending side?

N. S. Kannan: Yes, it is partly on account of better spreads. In addition, we continued the deployment of excess liquidity during the quarter. There are lower competitive pressures on the asset side and the funding costs have also come down. So it is a combination of all the three factors.

Manish Karwa: On your UK subsidiary, your total assets have gone up sharply on a sequential basis. Is it a one-off thing or are you seeing more business there?

Rakesh Jha: There has been a marginal increase in the size of the loan book. The deposit base has increased sequentially. Going forward we do expect some loan growth as the liquidity would get deployed in the second half of the year.

Manish Karwa: Lastly on your PD business, the loss is largely because of the way interest rates have moved. Have all the losses been taken through the P&L or is there any deferment of loss?

N. S. Kannan: On PD business, there was no option of deferral available to them. This option was given only to banks.

Manish Karwa: So, everything has been accounted for as of 30th September?

N. S. Kannan: That is correct.

Moderator: Thank you. The next question is from Sachin Shah of Emkay. Please go ahead.

Sachin Shah: Your have exposure to companies having extremely high leverage. Does that really worry you with the current environment? Going forward do you see that the environment will get tougher resulting in higher slippages?

N. S. Kannan: First of all, it will be incorrect to say that our exposure is only to overleveraged corporates. We are a broader corporate bank and will have exposure across the corporate sector of the Indian economy. Secondly, the issue of corporate leverage has been talked for about 18 months now and we continue to monitor the portfolio closely. We have indeed seen the impact of the environment in terms of incremental additions to restructured loans. However, our past experience of slippages from restructured into NPLs has been quite comforting. Yes, the environment is tough and corporates with higher leverage will have an impact, but we do believe that given our ability to select projects and corporates at the first instance in terms of giving loans and subsequent monitoring should hold us in good stead across the cycle. The numbers I have said in terms of the provisions, restructuring or NPL slippages reflect the work we have done around this and if the economy revives, things can only get much better from here.

Sachin Shah: But if the economy remains where it is for another few quarters, because of your legacy book, do you see things getting worse or we are bottoming out as far as the asset quality pressure is concerned?

N. S. Kannan: In this kind of environment, it is indeed very difficult to predict too much into the future, but if you look at the numbers for the second quarter, our operating performance has been better than what we expected at the beginning of the year. We have been able to increase the outlook on the NIM expansion from 10 basis points to 20 basis points. The cost-income ratio is now expected to reduce below 40%. Fee income growth which we earlier expected to be just about double-digit, is now expected to be about 14%-15%. The better core operating performance than what was expected at the beginning of the year will help us in terms of managing the increase in provisions. We are quite cognizant of it and we are quite comfortable about the outlook for the year as a whole.

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

Suruchi Jain: My first question is about the Insurance business. You mentioned that the profits were lower on account of lower renewal premiums. Could you give us some sense of what is the breakup of renewal clients versus new clients? And could you also comment on the fact that your premiums have actually risen but the profits have fallen?

Anindya Banerjee: First of all, on a year-on-year basis, the profit is ₹ 3.87 billion in Q2-2014 compared to ₹ 3.96 billion in Q2-2013. So the year-on-year decrease is not material. Secondly, the way the industry has evolved post the changes in ULIP guidelines in September 2010, there was a fairly extended period of de-growth. The de-growth has resulted in a lower book that can come up for renewal. The lower level of renewal premiums today reflects the lower new business done in 2010-11 and 2011-12. At the same time, we continue to maintain some cost base to run the new business. On your second question on the growing premiums but the decreasing profits, that is something that does happen to some extent in the insurance business because costs are expensed upfront. So whenever you have robust growth in new business premiums you do see what is called new business strain.

Suruchi Jain: Just a quick follow-up on that before I ask my second question. Was there a lower renewal for all industry participants? What do you see as a five-year growth horizon for your insurance business?

Anindya Banerjee: I would say, to varying degrees the lower renewals have been seen as across the industry. Some companies may be doing better and some may be doing worse and part of it is also dependent on the recency of the book because, as you know, the policies can be surrendered after a certain minimum period. So as more of your book becomes eligible for surrender, the possibility of renewals being lower increases. On your second question on the five-year growth horizon, given the under-penetration of insurance in India, whether you look at it in terms of premium per capita, sum assured per capita or the number of people who have taken out insurance, we believe that the sustainable growth rate for this business should be around 15%.

Suruchi Jain: Moving to my next question, it is just a follow-up from what Mahrukh asked earlier. I understand you have the largest branch network among the private sector banks in the country but at an operational level, apart from the one-time changes in pension or liabilities, what are you doing to bring down your costs, because the way I look at it, the costs are pretty high compared to a lot of other banks?

Anindya Banerjee: I am not sure how one would say that the costs are high compared to other banks. I think both on a cost-to-income basis and on a cost-to-asset basis we would be among the most efficient Indian banks. We have been operating between 38% and 43% cost-to-income ratio on a sustained basis for the last several quarters. As Kannan mentioned, while we are not really seeing any cost pressures on the fixed wage costs, we also continue to control and optimise other forms of costs like travel expenses and other line items. At the same time, we continue also to invest in our franchise.

Moderator: Thank you. The next question is from Umang Shah of CIMB. Please go ahead.

Jatinder: This is Jatinder. Just one question on your cost of funds. Can we have a broad sense how they have behaved year-on-year or sequentially and if you could break that into domestic and overseas?

N. S. Kannan: Sequentially, cost of funds has come down to 6.13% for Q2-2014.

Jatinder: What was the cost of funds for the previous quarter?

Rakesh Jha: It was about 6.3%.

Jatinder: Can we get some broad sense of domestic and overseas cost of funds?

Rakesh Jha: Actually the numbers are different, but the trend line is broadly similar. The domestic cost of funds has come down by about 13 basis points during the quarter and overseas has come down by about 15 basis points. For Q2-2014, domestic cost of funds is 6.8% and overseas cost of funds is 3.1%.

Jatinder: Ok. Can we have some more granular mix of the term deposits? What is leading to the decrease in cost of funds other than CASA on the domestic side?

Rakesh Jha: Between Q1 and Q2 the average CASA ratio has improved which is the primary reason for decrease in deposit costs.

Jatinder: Can we have the term deposit mix into retail and wholesale?

Rakesh Jha: About 60% of the term deposits are retail and 40% are wholesale.

Moderator: Thank you. The next question is from the line of Ashwani Agarwal of BOB Pioneer Mutual Fund. Please go ahead.

Ashwani Agarwal: Just a broader question, in last three years you have lent around about ₹ 1.1 trillion to the corporate sector, and out of that round about 40% constitutes the infra, construction, metals and mining. Can you tell me how much would be term loans and how much would be the working capital loans?

Rakesh Jha: We do not readily have that available with us now.

Ashwani Agarwal: Ok. How many projects would be coming on-stream in the next two years?

Anindya Banerjee: Our main project under implementation exposure is in the power sector. Most of that is expected to be operational over the next two years.

Ashwani Agarwal: Do you see any problems coming in those sectors because according to me, power and construction are the main areas which can face problems in the next two years?

Anindya Banerjee: If you look at construction, I think the problem is already evident. We have seen companies in the EPC business getting into CDR because their top line is challenged and they also have liquidity issues on account of delay in payments, particularly from the public sector entities. As far as power is concerned, of our total power exposure of about 6.3%, half is to operating companies and the balance half is to projects under implementation. In the projects under the implementation we do not have any of the gas-based plants or the UMPPs. So we have mainly thermal exposure. We do not see too much of a challenge in that sector. In any case these are 10 to 12 year loans funding 25 year assets. So there would be sufficient tail in the cash flows to take care of repayment elongations, if any. We do not see ourselves taking any significant economic loss on these projects.

Ashwani Agarwal : What about the metals sector because even in metals, you have substantial exposure. Total exposure to iron, steel, metals and metal products is about ₹ 64,000 crores.

Anindya Banerjee: Exposure to the sectors you mentioned is about 7% of our total exposure. In the iron and steel sector our exposure is mainly to the larger players. We have not seen any NPL or restructuring issues in those exposures and we do not anticipate any either.

Ashwani Agarwal: Coming back to power, of the ₹ 10,000 crore exposure which is in the thermal category and is non-operating, how many of them would be having backward linkages?

Anindya Banerjee: At the time of financing, about 40% to 50% of the exposures would have been financed based on captive mines and the balance would have largely been based on linkages. Given the way the sector has evolved since these loans were approved, the mix may have changed. However, based on our sensitivity analysis and breakeven PLF we do not see that as a big issue.

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

Rakesh Kumar: With respect to employee expenses, H1-2013 to H1-2014, there hardly any change. So what is your estimate on the increase in the employee expenses?

Rakesh Jha: As Kannan mentioned, if you take the first half numbers in aggregate, that would give you an appropriate sense of going forward the numbers. The number of Q2-2014 was somewhat lower than the trend line because of the impact of movement in yields on retirement benefits.

Rakesh Kumar: Number of employees increased by around 2.3% in FY2012 and 6.5% in FY2013. Employee cost increase was around 25% in FY2013 and 11% in FY2012. How many employees would we add during the year and what is the expected increase in the employee expenses for the full year.

Rakesh Jha: We would have annual increase in salaries of about 8%-10% and number of employees would increase by 10%-12% during the year. Of course, the increase in number of employees will happen through the year and the full impact on the salaries would be seen over the year. Further, we have the impact of the retirals which is going to be a function of interest rates, and then the other variable expenses are there.

Rakesh Kumar: Ok. The capital adequacy ratio on Basel II is 17.63%, which has come down from 18.35%. If you compare the same number on Basel III, that has not fallen so much. What is the reason?

Anindya Banerjee: Under Basel II, the CAR has decreased by about 72 basis points from 18.35% at June 2013 to 17.63% at September 2013 and under Basel III, CAR has decreased by about 54 basis points from 17.04% at June 2013 to 16.50% at September 2013. That kind of a difference may come because the methodology of computation is different between the Basel II and Basel III.

Moderator: Thank you. The next question is from Sapna Naik of Bajaj Finserv. Please go ahead.

Sapna Naik: What was the benefit in employee expenses you received this quarter due to the change in yields?

Anindya Banerjee: We have talked about the employee expenses being lower on a year-on-year basis in detail. The primary reason for that is change in value of retiral benefits due to the movement in yields during the quarter.

Rakesh Jha: The valuation of retrial benefits is based on an actuarial report where number of variables are considered. It would be very difficult to point out what is the movement because of the interest rates.

Sapna Naik: I want to clarify one thing. You have shifted ₹ 2,311 crore from AFS category to HTM category on which you have recorded a loss of ₹ 10 crores. If that portfolio was not shifted, the treasury income would have been lower by how much?

N. S. Kannan: About ₹ 70 crores. Further, bulk of that would have got recouped in the current quarter.

Moderator: Thank you. The next question is from Nitin Kumar of Quant Capital. Please go ahead.

Nitin Kumar: How was the margin trajectory in the domestic business between the retail and the corporate verticals? Did one segment do much better over the other?

Rakesh Jha: Not really.

Nitin Kumar: So you were able to pass on the costs equally?

Rakesh Jha: We have done the increase in base rate which is applicable both on the corporate side and on the retail side. On the retail side, the impact is mainly on the mortgage book.

N. S. Kannan: Overall, average cost of funds did not increase during the quarter.

Nitin Kumar: Secondly, the overseas borrowings have grown during this quarter. What extent have you utilised the swap window for FCNR deposits and foreign currency borrowings?

N. S. Kannan: Overseas borrowing growth is not material in dollar terms. The growth in rupee numbers is primarily because of the exchange rate.

Nitin Kumar: Ok and with respect to the FCNR and foreign currency borrowing?

Rakesh Jha: We are looking at raising both the FCNR(B) deposits as well as on the Tier-1 limit for the borrowings. Some of those numbers will reflect more in the December quarter.

Nitin Kumar: Lastly, the growth in the personal loans has been quite sharp this quarter. So, what is the outlook there?

N. S. Kannan: That is because of the base effect. The outlook continues to be that the growth percentages maybe high but overall basis it will be around 2% of the loan book. Percentage growth can be high because of the very low base as we had practically shut that segment in the past. We have increasingly started doing personal loans mainly for our existing customers.

Moderator: Thank you. Our next question is from Saikiran Pulavarthi of Espirito Santo. Please go ahead.

Saikiran Pulavarthi: Just a bookkeeping question, what is the dividend income this quarter and in the corresponding quarter last year?

N. S. Kannan: Total other income was ₹ 251 crores in Q2-2014, ₹ 288 crores in Q1-2014 and ₹ 162 crores in Q2-2013. Dividends would be the primary contributor to other income.

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

Nilanjan Karfa: Understandably the environment is challenging and you are focused on FY2014. Would you give some guidance for FY2015 as well?

N. S. Kannan: It is too early nearly, Nilanjan, to talk about that. I would rather confine it to this year and then take it as it comes. From our perspective, the franchise is going strong and the operating metrics are doing well. We think that as and when the environment revives, we should be in a better position to take advantage of the situation. The general sense we get talking to people is that things may be bottoming out and things should be better in FY2015 but one has to calibrate it depending on what happens in the general economic scenario.

Nilanjan Karfa: You have increased your credit cost guidance to 90 to 100 basis points this year from 75 to 80 basis points. Is that right?

N. S. Kannan: We said that we do not expect it to exceed 90 to 100 basis points. We are seeing some upward movement in that number because for the first half is about 82 basis points and there is continued addition to NPLs and restructured assets. Further, as you know the restructuring provision requirements have been increased by RBI. Hence, directionally there is an upward pressure on that number. We have a goal of not exceeding 90 to 100 basis points but the good news is that on almost all of the other metrics we are predicting something which is better than what we had predicted at the beginning of the year which should provide a decent amount of cushion against some increase in credit costs.

Nilanjan Karfa: On the international book, what is the ALM structure on an interest rate basis that has given this kind of yield improvement?

Rakesh Jha: On interest rate basis, we maintain the assets and liabilities both on a floating rate basis linked to LIBOR. Even if we raise fixed rate bonds or other borrowings which are longer than one-year maturity we swap that into LIBOR-linked funding. So there is not much interest rate mismatch.

Nilanjan Karfa: Because if you look at the US treasuries between 6 month to 1 year, the movement has been pretty negligible. The movement has certainly come in the two to three-year maturities and hence this question. I understand you mentioned earlier that you had excess liquidity, but was the improvement just because of the excess liquidity getting deployed?

Rakesh Jha: The improvement in overseas margins that we have seen in the last three quarters is more because of the excess liquidity getting deployed. Last year in the September-December quarter we were at a peak in terms of the liquidity mainly on account of a large bond repayment in October 2012. We also have a benefit that the overall international balance sheet has not grown in dollar terms which gives the ability to optimise costs.

Nilanjan Karfa: Any guidance on the ROEs of the overseas subsidiaries which are in low single digits? What is the target plan for those subsidiaries for this year and next year?

Rakesh Jha: We have said that in the medium term the first target is to get to a double digit ROE. But given the excess capital which is still there, especially in Canada where the total capital adequacy continues to be more than 30%, it will take us two to three years to get to double digit ROE. We would also look at some more capital getting repatriated from Canada during this period.

Moderator: Thank you. The next question is from M. B. Mahesh of Kotak Securities. Please go ahead.

M. B. Mahesh: My first question is on the cost of deposits again. You indicated initially that the cost of deposits has decreased on a Q-o-Q basis. If interest rates were to remain at current levels, do you see cost of deposits increasing? And correspondingly, given the fact that you have seen a fairly large repricing already on the advances side, would that lead to a downward pressure on margins? Secondly, as your loan book is increasingly shifting towards higher share of retail, is there a fair chance that incrementally you will start seeing pressure on the margins?

Rakesh Jha: In terms of cost of deposit, because we have been doing fairly well on the CASA front and our reliance on wholesale deposits is limited, we are not really expecting to see the cost of fund increase substantially in the third quarter. There may be some impact because of the higher deposit cost in the month of August. However, things have cooled down and the rates have come off quite a bit since then. From a planning perspective, when the rates were high, we kept away from the market or tried to borrow on the shorter end which will not really impact the cost through the second half. We are confident that, overall, on a margin basis we should be able to broadly sustain at a level similar to Q2.

M. B. Mahesh: Is it a fair assumption to make that today the corporate margins are probably lot higher than the average domestic margin?

Rakesh Jha: Not really. For example, if you look at the mortgage yields which are still from the past book and are relatively high yield. So overall the corporate book will have somewhat higher yield but the difference would not be substantial.

M. B. Mahesh: Is it possible for you to also say what is the outstanding in the mortgage book and not the entire housing loan portfolio?

Rakesh Jha: Now we actually include the builder loans in the corporate portfolio, so the portfolio that we give in the retail is indeed the mortgage book.

M. B. Mahesh: But there would be difference between the new housing loans which you give and also the loans against mortgage?

Anindya Banerjee: We use housing and mortgage interchangeably. What you are asking is what is loan against property (LAP), which is included in the housing loan portfolio. The size of LAP portfolio will be between about 15%-20% of the mortgage loan book.

M. B. Mahesh: Ok. There has been a drop in the general insurance business profitability. Any specific reasons attributed to it?

N. S. Kannan: The investment income for the company has decreased sequentially, but on a year-on-year basis profits have grown by about 55%.

Moderator: Thank you. Participants that was the last question. I would now like to hand the floor back to Mr. N. S. Kannan for closing comments. Over to you, sir.

N. S. Kannan: Thank you everyone for joining the call. My team and I will be available to take any further questions offline. Thank you once again.

Moderator: Thank you sir. Ladies and gentlemen, on behalf of ICICI Bank that concludes this conference call. Thank you for joining us.