"Motilal Oswal Securities Limited – Oriental Bank of Commerce Con-call"

May 12, 2016

Charles: This is Charles from **(inaudible) 2.14** Management. Thanks for your time. I appreciate you are probably in quite a busy period speaking with the investors. I welcome Indian emerging markets. So, I cover financials across emerging markets, and Oriental Bank of Commerce is held and based out of India and emerging market. I have been through your results and I am sure you probably get the same question from each shareholder, but may be if you could just go through the loan book in terms of how far, where you really think we are in the credit cycle for audit companies? The last quarter has kind of marked a peak or if there is still a number of causes or issues to come and why also the bank does not simply kind of push all bad loans out all at once?

Management: The cycle seems to have peaked for bad loans, but because now after the RBI review also which was here being done in all banks in India that was absorbed by us mostly in the previous quarter itself and the stress in some of the sectors like steel and ports and all that has been resulted in huge slippages but there cycles used to be to a peak. Now we look forward to much lesser substantially lesser slippages in the coming quarters from what we have seen in Q3 and Q4. As per your query on pushing all of it out that is presently the system is the sale to ARC, we find that ARCs have their own issues and not much has been happening on that front. Some of the measures taken by government and the discussion on some of the stressed asset funds that we have if that comes through then we will be able to push a lot of it out of our books.

Charles: It is quite about bad lines at the moment. Can you repeat that last bit, what would need to come through?

Management: Government has recently permitted ARCs, Asset Reconstruction Companies to get up to 100% FDI, so if they expect some of their investments will come into the capital of ARC. So if that happens because what we see is that ARCs have not been very active in purchasing the bad assets from the bank with capitalization coming we hope them to be more active in future, also there is a discussion within the government for creating a stressed asset fund type of a thing, if that comes through we are not very sure at this moment, but if that comes through that will again be a big push through for bad assets out of the books of banks in India.

Charles: Can you hear me okay, but this is a very bad line, my end.

Management: We can, little disturbance, but we can hear you.

Charles: There is the whole ARC fund that has been around for a while. I notice, I think you have sold some last quarter but why don’t you think it has taken off quite like the governments originally expected. What has been the issue for these companies?

Management: The portfolio sale last quarter has only been 190 Crores in our books but government expectation, we do not know the detail, but the fact is that they expected ARCs to be more active, but there was a lack of capital it seems and that is why they opened up 100% FDI in ARCs recently. So hopefully that will speed up the process. That is what I said.

Charles: Sir it is a really bad line, I did not catch that last line, you mentioned that you opened up something?

Management: What they have opened up is that now ARCs can get 100% of their capital through FDI. They are able to get their business they expect, then this asset sale thing should pickup.

Charles: How much of your loan book you anticipate that you could sell to these ARCs and is that the only restructured loans which you have sell to the ARCs?

Management: We can sell SMA-II the words they call it stressed assets and NPAs, but I will not be able to give a number because still the process of capitalization of ARCs is not yet very clear to us.

Charles: And on your earlier point on credit costs, Sir you think that I might be misunderstanding but it sounded like you told about credit cost next quarter could be less than 4 and 3Q. Is that correct?

Management: Yes that is what our belief to a very great extent because the bad asset cycles used to be peaking with various measures taking by Government of India for steel sector, power sector and the road sector. These were the three biggest contributors. Once these sectors we are already seeing some improvements, so once it goes through I think that improvement should be quite obvious from the next quarter onwards.

Charles: Because I was reading through some analyst research on the company and I understand you have not reported any NPAs I think the SEBs or electricity board do you not perceive that as a problem going forward. Do you think that the government has managed to fully sort that out?

Management: What has happened is Discom, our debt has come down substantially about 3900 Crores is already converted into government bond which require no provisioning. That has already happened. Now our debt is around 1400 Crores plus some bonds and we already hold part of the provisioning because of the restructured portfolio book where these assets were lying. So going forward we do not see a major hit even if the NPA position has to be recognised we do not see a major provisioning coming to our bank. I had also given yesterday an estimate or the worst-case scenario our provisioning will be 100 Crores throughout the year that is the worse case scenario because we already hold almost that much of provisions in these books.

Charles: Is there any seasonality in the reason why 4Q was so much worse compared to the other quarters before. You said you typically find that it is 4Q in India where you have got the highest NPLs anywhere.

Management: It is not like that. Q3 was equally bad. Our slippages in Q3 and Q4 have been similar because one was that there was emphasis from the regulator on recognizing the weak assets as NPLs and making a provision on that, so that has happened in a big way and this quarter some of the steel assets specially and in shipbuilding and construction we were already weak and we were seeing issue coming in those cases has been recognised as NPL.

Charles: Okay. In terms of capital adequacy and I know your tier I is low at the moment, and you are writing off more, it has got to keep on coming down. At what point does the regulator come in and say you have just raise capital straightaway.

Management: Our tier I is quite high from the minimum regulatory provision. So we do not see any issues on that. If you see our total CRAR is 11.76 against regulatory minimum of 9.625% and tier I is 9.10% against a regulatory minimum of 7.62, so against 7.62 we are already at 9.1.

Charles: Surely I know it is only some prudential buffer so most regulators would say to be prudent you need to go I do not know 300 BPS or something above?

Management: The regulatory minimum that we are talking in India RBI has already kept 1% higher than the Basel III norms and we are even higher than that. So I do not see any issues going forward and we did receive subscription from Government of India and from institutions in this year and going forward also Government of India itself has good plans for investment, so I do not see any trouble on this front. In fact we are quite comfortable amongst the several public sector banks also we should be comfortable ones.

Charles: Sir, can you just go and I understand that you have been revaluing some of your loan book. What proportion of your loan book is currently held for sale?

Management: Restructured book you are talking?

Charles: I understand you have been pushing through some revaluation?

Management: Revaluation of fixed assets yes, of immovable property, it is 45% of the incremental value in the revaluation is permitted to be taken as tier I capital. So we have got a benefit of that for about 40 BPS this quarter in the tier I capital. That has improved.

Charles: Was that simply or due to the revaluation of the property?

Management: Properties yes that is the only revaluation of properties, and we did it after a long gap of 6 to 7 years.

Charles: Are you allowed to revalue any of your government bonds for instance? Do you hold any?

Management: Government bonds in AFS are all mark to market. So revaluing them happens on its own. That is not something fixed.

Charles: Do you or all Indian banks do that mark all the government bonds to market?

Management: Government bonds those, which are in AFS, yes mark to market; HTM is only on the purchase price.

Charles: Do all Indian banks do that and has OBC always done that historically?

Management: It is a practice across.

Charles: Has OBC historically say for the last 19 years always mark-to-market government bonds or have they historically also been held for maturity?

Management: Held to maturity is only a portion. I will tell you how much of our investment is held to maturity and what is mark-to-market. I will just give you the details. Hold a minute. Out of our government bonds let me call SLR bonds my AFS is around 21% and rest is HTM. This 20% is mark-to-market.

Charles: Did you expect to keep that ratio about the same going forward?

Management: Normally it will be the same.

Charles: Can you talk me through the new lending that you are doing how is that different from say a couple of years ago? This whole kind of cycle changes the code show or that does banking now?

Management: In the last few years, means after the 2008 issues in the global economy, India was not very impacted and therefore the growth in infra and within infra, power, road sector and steel was growing very fast so the banks lending to these corporates was much higher. Today last one or two years the lending to these sectors is not as high as that and we are again more emphasis to retail and our agriculture and medium and small enterprises. Though still as on date in my book the corporate credit is around 53% and the retail and agriculture MSME is about 46% that is the ratio. So this ratio will change in the favor of the retail MSME every year a few percentage points even going forward we expect it to improve compared to the corporate credit unless capex starts which we expect to happen about three four quarters down the line in a big way. Once that starts then probably again corporate credit will be keeping pace with the growth in the smaller credit.

Charles: Presumably the things that you are going after, most of the banks that we speak to that they kind of attempt to say that they are going after a higher quality loans. Is that why you think the best risk return is in the market at the moment as a bank in the retail kind of space?

Management: Retail basically has seen very little of bad loans and though their return is a bit less on especially the housing loans and personal loans it has come down, so part of the retail, because part is housing loans, there the return is a bit less but virtually it is very good security, very less of capital required because the capital risk weight is less and then the NPLs are very less. So that is the advantage there, but we are having a healthy mix. When we talk of other than direct agriculture and direct housing the other retail loans like personal or vehicle loans and the medium and small industry loan, the risk is spread and the margins are a little higher. So it has to be in our opinion a healthy mix of all of it and that is what it is as far as our branch is concerned. Our retail is today about 12.12% it is 1.5% higher from last year and the total MSME is about 20%, agriculture is about 14% so it is all well spread out into it so good spread and that is why their return is comparatively good.

Charles: Who do you think is your key competition in the kind of tight of retail, or SME loans that you are making?

Management: It is only every bank in India today except one or two they are concentrating on the same pattern, so the competition is there and it is going to be there with the small banks coming up in the next one year. They might start small, but going forward they may create in our opinion they may enhance the market size rather than cut into anybody's share.

Charles: Are you referring to the kind of 11 licenses, which were added?

Management: Yes, because presently most of the existing banks they are already doing the same lending. All the universal banks are doing it. So competition is already quite high and the bank has to go through very robust processes to keep increasing its book.

Charles: Yes. For Mudra loans are you also doing both and to what extent of those kind of something that you have to do versus a natural opportunity?

Management: We have done around 1300 Crores of Mudra loans, not a very big number, but then we were very clear from the ones that the due diligence will be as it is in any other loan and government has appreciated that and allowed us to do the due diligence as we have done for including the CIBIL check and all those things, credit check of the customers as we do for other similar small loans. So we do not see it as any threat on the credit quality of the bank and we see them going forward to increase bit by bit every year.

Charles: Also the PMJDY for financial inclusion?

Management: PMJDY is basically a deposit account. It is the savings account and the overdraft linked to it is still quite low and that is not expected to be a big number because the maximum OD is only Rs.5000 so that is not a very big number. It is a miniscule number, but deposits that come, the low cost deposits there is quite a substantial number. So that is helping us in our low cost deposit collection.

Charles: There are a number of banks that would have historically kind of lent to the steel sector, construction, and all these sectors, which who is now lending to them exactly? Is it government subsidies?

Management: Presently, we are not seeing capex coming into steel sector, so the steel sector where capex is not coming so the lending is not happening because the industry was stressed and there is no capex. Only when the health improves then only we expect the capex to come in and the requirement of lending coming. As far as power is concerned, there is lot of emphasis on renewable. There things are coming up nicely and the other power sector, the demand is quite muted because new stations have not come, we have generated enough capacity those are plant load factor as it increases probably going forward a few quarters back we think of people planning of new investments. Presently we are not seeing much of a new investment in these sectors other than renewables.

Charles: Just to understand that there has been some recent change to the bankruptcy law in India?

Management: That's very good,(audio break). The act is put to help banks, but the act has been passed by the Parliament yesterday and we hope that all the due setting up of infrastructure and all that you require will happen in the next two to three quarters.

Charles: You are right. That is fast.

Management: Because that is what the government's intent is to look at the passing off the act. There are several acts, which take very long to pass. This act went unanimously through both houses of Parliament very fast. So the intent seems to be to go fast and we hope that by next year means after March 2017 the implementation on the ground will be seen, but it is a very good move in a very good direction.

Charles: If it does really get done in the next 12 months do you think that it may be more attractive for you to kind of make default or sell them on the ARCs?

Management: That will have to be seen as to how we look at the long-term position of that account. See every account, every unit has a different feature on its if whether accounts where we think resolutions can happen even if today they are not able to pay, if things are improving we will either like to sell to ARC or go by any recovery or bankruptcy code processes. Bankruptcy code will come into play only in those accounts where we decide to go for recovery and even for ARCs it will help in a big going forward.

Charles: Is there any particular ARC that you work with or that you will work within the future?

Management: In our case, the public sector banks will go for open bidding process with ARC. So it is not a particular ARC with which we work.

Charles: And typically on the liabilities, which you sell to the ARC, what kind of haircut do you think you would have to take when selling?

Management: It will all depends on what type of asset it is. So far we have not taken big hits on the ARC asset sales because what has happened is that the assets that we have sold are backed by substantial securities. So we have not seen much of hit on the ARC sale so far. Going forward we will have to see how much and it is all-dependent on individual accounts and even not in a sector. So we cannot predict any of the haircut percentages on these.

Charles: Sir, I understand that there is a list of 150 accounts where they had to be standardized provisioning for across the banks in India?

Management: You are talking about the asset quality reviewed done by RBI. See in our case, the provisioning that was to be made and the accounts that were to be recognised is spread up to March 31. We took almost 80% in the first quarter itself. So Q4 we had left out of only about 160 Crores to be recognised as bad loans and whatever provisioning has been required up to March has been done.

Charles: I think they mentioned Punjab Food can that sort of provisioning would be made as a part? I mean is that a legitimate example because of something that will need to be kind of reported.

Management: Yes it has been reported correctly. We were asked to make provisions for our outstanding on Punjab Food credits 50% provisioning by March and 50% in Q1 of next year may be June quarter. So we have made 50% but that is not a very big sum for us. It is around 75 Crores, but what we are looking forward is what discussions we are having with the Punjab Government also it seems that they are also intending to resolve part of the issues very fast. So if the resolution happens that much of the provisioning will go down in June, but even if it does not happen the worst case scenario provisioning is 75 Crores for us in June. That is what is left out.

Charles: Got it right. Overall, when I look at the estimates the expectation that growth NPAs will increase this year, but net NPAs could come down marginally. Is that a fair view do you think?

Management: It will depend on the resolution process, what I can say the expectation is that the slippages will go down substantially. First step the slippages from good to bad loans will go down substantially, now whether the level remains the same or reduces will depend on the resolution for which the government and the regulator has taken a lot of steps including the various processes being followed for resolution in steel sector or stalled projects in road sector and also we expect some of the accounts to get upgraded because of that and plus the stringent provisioning requirements that are there as the provisioning goes up, the net NPA position should continue to improve much faster, that is for sure to happen.

Charles: Given you are comfortable with your capital position, what do you think it is reasonable to expect in terms of loan growth this year and do you also have a target for deposit growth this year?

Management: We expect loan book growth of between 10 to 12% and the deposit growth is also expected to be on the same level because we are shifting to retail deposits, very retail, well spread deposits where the growth has been very good and reducing our dependence on the larger deposits, so with that we will share the larger deposit to the extent not required and so we expect loan book as well as deposit book growth of anywhere between 10 to 12%.

Charles: On the deposit book it sounds like a lot of the other banks are obviously trying to build their CASA ratio and go off the retail deposits and lot of them have used quite clever technology to do that, how do you think your competitor is going to walk, why would a customer go to you rather than say an HDFC Bank?

Management: The alternate delivery channels that are being used, I do not know if you have our presentation made yesterday, our alternate delivery book, alternate delivery channels already have about 55% of our transactions, only 45% happen in our brick and mortar branches and going forward we expect this a lot of products have been launched recently and several more or coming through including a revamp of our entire mobile banking and mobile wallet business, our net banking has already improved substantially from last year, already the brick and mortar branches handling only 45%. Going forward it will be a little more or less, yes compared to private banks we still have larger transaction in branch banking because of our rural reach and that interior and rural banking the quantum of branch banking will be higher than the alternate channels but in other places we are pushing the alternate channels quite successfully, so we are very competitive in that space.

Charles: Is there any bank in particular that you see as your competition given your kind of target market in the retail space?

Management: Not only retail. As I told you we are not targeting only retail. We are targeting retail, agriculture and MSME sector, the smaller industries all put together and competition is across, all private banks are trying to do that, all public sector banks are trying to do that, so competition has been there and competition will remain there. We do not see any competition stifling us out because we have been working on it and with improvement of our channels we expect our growth, which is not a very huge growth of 10 to 12 to be achieved.

Charles: Are you giving any guidance in the medium term you hope to have as a provision coverage and kind of how your cost, I know there are one or two one offs sizing last quarter but how your cost save in the coming year would go?

Management: We have not given any guidance on it, but for sure the cost to income has gone up this year because of some of the specific issues in this year, we expect it to return back to how we were, maybe substantial reduction but number guessing would not be right to say at the present and provision coverage, yes last two quarters the slippages have been very high, so the coverage has come down and we expect to come back to the coverage as the slippages go less as you rightly pointed and I said that provisioning will continue to happen and as the slippages keep going down the net NPA will come down because of the asset coverage going up.

Charles: Your overall credit cost will have to increase this year simply because you are provisioning more?

Management: This year means 2015-2016, it went up just because of the higher slippages but going forward we expect it to come down.

Charles: Why did you say it went up?

Management: This year it is higher, the credit cost because of the slippages that have happened in a big way, but which slippages to bad loans coming down this cost will also come down certainly.

Charles: I appreciate that it is a hard number to give but what do you think is a more normalized credit cost for the bank, a lot of your slippages now are legacy issues?

Management: I would not like to do a guess on that right now because a lot of measures are being taken by the government and the regulator and any figure can make a substantial change hopefully for the better.

Charles: For the management of the company, I think there was an CEO, was not there last, has that changed?

Management: I joined the beginning of the year on January 1, 2015 and I have a term going beyond this one year, so we do not see major changes, we have an executive director who is new but we will have one more executive director going forward but that will only keep adding to the value.

Charles: I understand one of the issues that some people have with Indian public sector banks is that the better management tend to kind of get moved on and that not as well compensated as say some of the private banks, is there kind of any movement to try and change that so that kind of management stays longer at the bank that they are in and kind of better compensated and in line with shareholders?

Management: Compensation in public sector in general in India is less than the equivalent counterpart of the private sector, that gap I do not think would be covered, but yes there is a talk of the compensation being made much better. Hopefully, some results will come in a few quarters and then probably the gap will come down a bit. As on today, the gap between what the private sector player get for the same rank, same quantity of business also is much higher but then in the public mindset also, in the employee mindset that has not been a very big issue because service security has been the balancing factor, so I do not see any negativity coming because of that but we do foresee a compensation improvement in public sector in general and public sector banks in particular in the days to come.

Charles: Can you go through just the non-interest income for the bank; that seems to be doing fairly well, what is driving that growth?

Management: Non-interest income basically would be, what has happened is during this year the growth in the bad debts written off also has not been very good because overall economic cycle was poor and credit related income which comes from opening of non-fund based business as the entire corporate credit worthiness was not very good, but as it is improving or stabilizing that book is also expected to give us better profits including the reduction in interest rate that has been happening the treasury also should give a better result in the days to come, at least in the financial three four quarters as the interest rates are expected to come down the treasury income also should be better.

Charles: For other investors in the company clearly a lot of them have sold down, have they told you kind of what clearly the bank is going through a cycle at the moment, is there anything in particular that you think investors in general under appreciate about the business or kind of quite do not understand that you think is important to communicate for investors?

Management: We have not gone in to those discussions with any of the investors. We just explained our position and that is it. That sort of discussion on pricing and all does not happen.

Charles: You mentioned earlier that you may have another nonexec on the board for the kind of shareholders that you have, is that important do you find?

Management: I do not think that is very important in the bank, those are processes that happen almost every two, three years.

Charles: On your net interest margin, what do you think is reasonable expectation for this year and then overtime also?

Management: Our net interest margin for the full year was 2.66 and for Q4 it was 2.65, so we are seeing quite a stable net interest margin and we expect that margins will be between 2.65 and 2.70 going forward also, quite stable.

Charles: It seems some of the other banks have kind of notably high net interest margin, is that simply kind of the product, the loan mix or is that something kind of company specific which has met that OBC has had a lower net interest margin?

Management: Net interest margin is a result of several of the things including the type of loan book that you have, type of sectors you are lending in to, cost liabilities that you are carrying all of it is a mix but our yields have been very good compared to the banking space especially the public sector banks. But our costs have been a little higher. But that is what we have been working at for the last one year and we expect it to keep coming down and that is why NIMS last year we improved from, if you see the full year from 2.61 to 2.66 about 5 basis points and we expect it to be between 2.65 to go up to maybe 2.70 in this financial year. We are not one of the best on this but then we are somewhere a little over the middle also. We are not one of the worst. There are banks with all types of NIMS in India.

Charles: Taking 5-year view, how do you imaging ideally what is your kind of base case scenario for what the bank will look in five years time difference since you mentioned a greater focus on SME and retail a greater focus on kind of CASA deposit, is there anything else that the bank is changing?

Management: The greater focus on these also is till the capex cycle in the corporate world revises because as it happens the mid corporates are very attractive in India so that also will come in to focus in a year or so but what we are revising in the bank to retain its competitiveness is there is already a project going on for an entire revamp of the organizational structure and the process flow of decision making in the bank. We hope that we will be much more nimble and faster as that gets implemented in this financial year itself, so we are preparing the banks for even stiffer competition in the days to come and therefore we do not expect competition to hit us on our growth path.

Charles: Is there a consultancy that has come in and helped you to kind of do a reorganization plan?

Management: It was more internal. We had team of very good young officers who have been inducted in the last few years and seniors put together who have been working for quite some time but once we were nearing the finalization stage we did take a consultancy also, a good consultancy which will now take it forward along with our team.

Charles: Is it a consultancy, which I would know like, an international name or local consultancy?

Management: It is an international name, it is BCG but further details I will not be able to give right now.

Charles: When do you think you will start executing on your reorganization plan?

Management: It will be very soon, as I said from Q2 itself of this year.

Charles: I appreciate it is probably quite broad but can you give any examples of what you think is the low-hanging fruit in terms of being an easy way?

Management: Probably you will have to wait for one more quarter for us to explain it more.

Charles: You think there will be quite a significant change of the process in the system, if I am correct.

Management: Yes.

Charles: Yes that will give investors some confidence maybe, that is all my questions, is there anything you want to kind of communicate to investors?

Management: I think that is all. You have covered a lot.

Charles: Great. Thanks for your time. It is very much appreciated.

Management: Thank you.