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IDFC's Q3FY10 Results Conference Call
January 27, 2010

Moderator: Ladies and gentlemen, good afternoon and welcome to the IDFC Q3FY10 Results Conference Call. As a reminder, for the duration of this conference call all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference please signal the operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand over the conference over to Mr. Bimal Giri of IDFC. Thank you and over to you.

Bimal Giri: Good afternoon everyone. I welcome you to this conference call organized to discuss our financial results for the first nine months for financial year 2010. I have with me Rajiv Lall and Vikram Limaye. Before we begin I would like to state that some of the statements made in today's discussion may be forward-looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been emailed to all of you. These documents have also been posted on our corporate website. I now invite Rajiv to provide key highlights of our performance for the first nine months of fiscal 2010.

Dr. Rajiv Lall: Thank you Bimal. Hello to all of you. Thanks again for joining us. Let me run you through the highlights of our performance for this quarter, which has for those of who have been following us know, we present on a year-to-year basis because we believe that given the lumpiness of the revenue streams in our business that you get a better perspective on how the company is tracking if you track our performance on a year-to-year comparison basis. So, on our consolidated numbers our operating income is up 32% from Rs. 1,142 Crores in the first nine months of FY 2009 to Rs. 1,508 Crores in the first nine months of FY 2010. The principal contribution to this growth came from net interest income that is related to infrastructure lending, which expanded 30% from Rs. 561 Crores to Rs. 731 Crores nine months to nine months.

The second component of our operating income, which is non-interest income, also showed a very robust growth of 50% rising from Rs. 455 Crores in the first nine months of FY 2009 to Rs. 681 Crores in the first nine months of FY 2010. Within non-interest income the income from asset management has increased 67% from Rs. 125 Crores to Rs. 209 Crores. Income from our investment bank increased 55% from Rs. 85 Crores to Rs. 132 Crores. Loan related and other fees increased 18% from Rs. 90 Crores to Rs. 106 Crores and income from our principal investing activities, profit making from our equity book, grew by 52% from Rs. 154 Crores to Rs. 234 Crores.

Operating expenses also increased 37% up from Rs. 235 Crores in the first nine months of last year to Rs. 320 Crores in the first nine months this year. This was essentially due to increase in business activities - expansion of our footprints in the mutual funds business and some hiring in the investment banking business. On a rolling 12-month basis I think it is important to know that our cost to income has remained flat at 23.5%. Pre-provisioning profits for nine months to nine months increased 31% from Rs. 907 Crores to Rs. 1,188 Crores. Total provisions for various asset classes were Rs. 38 Crores for the first nine months of last year and for the first nine months of this year we are at Rs. 60 Crores. There is a number of things happening underneath this number. We have reversed some provisions, to be precise it was under Rs. 24 Crores, which were made against certain equity investments which we exited during the first quarter, but the increase in the overall provisioning number for cumulative loan loss provisions was on account of formulaic provisions that we make that are linked to our incremental gross disbursements.

Profits before tax therefore increased by 30% from Rs. 869 Crores to Rs. 1,128 Crores - nine months to nine months. And after providing Rs. 294 Crores towards taxes profits after tax increased by a very healthy 32% from Rs. 634 Crores to Rs. 834 Crores for the first nine months for this fiscal.

Lets turn next to the return on assets analysis on a rolling 12 month basis where we compare the 12-month period October 2008 to September 2009 with January 2009 to December 2009. Over this 12-month period the overall net interest income was stable at 3.5% of average assets, but within that NII related to our infrastructure lending activity increased from 2.9% to 3.1%. On an incremental basis our spreads have continued to improve on our infrastructure lending business even last quarter.

Non-interest income contribution to return on assets increased from 2.3% of average total assets to 2.8% and contribution to ROA from our other non-interest income related activities mainly principal investments, asset management, investment banking have all trended up. The net-net of this all is that if you look at our total return on assets after tax they increased from 2.9% to 3.2% over the latest 12 month rolling period.

Now some highlights on the balance sheet front. The size of our balance sheet increased by about 4% from Rs. 30,000 Crores as on December 31, 2008 to Rs. 31,207 Crores in December 31, 2009. But this does not really tell you really what is going on in terms of building up the momentum on our loan book. Our loan book actually in the same period grew by 12%. Gross approvals increased by 91% from about Rs. 8,600 Crores in the first nine months of last year to over Rs. 16,500 Crores for the first nine months of this fiscal year. Gross disbursements also increased by 44% from Rs. 5,500 Crores to close to Rs. 8,000 Crores and what this means is that the pipeline is building up very nicely and momentum in the loan book is quite strong so that we can, on a net disbursement basis, expect to see accelerating pace of growth in our loan book in the coming quarters. In terms of the composition of our book Energy and Transportation continues to be the top two sectors that absorb the bulk of our lending activities. Energy now accounts for about 40% and Transportation about 19% respectively of our outstanding disbursements.

On the other issues to report I think there are a couple of things; one is that the mutual fund business continues to expand its footprint quite nicely and is achieving pleasant recognition in the market. Kenneth Andrade who is our Chief Investment Officer for the IDFC Mutual Fund was voted the best fund manager for the year for small and mid cap equities by Business Standard. Yesterday, although it is technically beyond the quarter we were informed that our private equity shop was awarded the best private equity firm of the year by PEI which is a well reputed international magazine and media group that follows the private equity investments in emerging markets in particular. Our investment banking activities have done quite well in Q3 although it is a lumpy business - the Q3 numbers were somewhat lower than the Q2 numbers, but nine months to nine months last year being relatively slow year our investment banking activity has continued to do extremely well. I will warn you that the return on assets of 3.2% is not going to be sustainable for an indefinite time period. The expansion of our ROA has been really the result of a cyclical expansion of spreads in our lending business and a lot of robustness in our non-interest income business especially as it relates for investment banking. As the cycle picks up pace and interest rates begin to rise we can expect at least for a little while our lending spreads to tighten a little bit and the investment banking business as you all know is unpredictable and therefore we do not expect that we can maintain a 3.2% on return on assets although our performance, by no means are we expecting it to be shabby going forward. With those general comments I will stop here and open up the proceedings for question. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin with the question and answer session. Our first question is from the line of Ashish Sharma of Enam AMC. Please go ahead.

Ashish Sharma: My question pertains to the treasury income, Why is there a sharp decline in treasury income for the quarter? And I guess even the treasury assets have gone down substantially, so what is the exact reason behind it?

Vikram Limaye: Couple of comments, one is the yield on treasury assets has gone down. The NII on treasury has gone down on account of two things, one is the treasury book itself has reduced in size and that also has to do with what we see as investment opportunities in the landscape and the yield on those investment opportunities. So as you know given the nature of the yield curve and in order to maintain sufficient liquidity to fund growth the short-term yields have actually gone down quite dramatically and that is reflected in the yields that we are getting on our treasury book, so that is basically why the NII on treasury has gone down. The yield for shorter duration investments is much lower and our overall treasury book size has also reduced.

Dr. **Rajiv Lall**: Traditionally I will just add to what Vikram has said, our treasury book is not a trading book. We maintain a certain size of treasury basically to manage ALM risk, so what that necessarily means is there is part of the paper we hold is quite liquid. So as the yield curve has steepened the cost of holding liquid securities to us has basically increased; and as the growth of our loan book has accelerated we have used the amount that is held in treasury because we felt that we could deploy the same resources for this into more profitable lending. So another way of looking at it is that it is yes, it is true that treasury NII has come down, but treasury NII has come down because the size of the treasury book has come down. If the size of the treasury book had been larger our overall lending NII would have been slower in growth.

Ashish Sharma: And generally what sort of internal yields on treasury should we target? Is there any rule of thumb that you follow or is it basically on the market environment?

Dr. Rajiv Lall: It depends on the market environment. The idea is that if you can as far as possible you can avoid a negative carry on this liquid book that you are carrying, you are doing quite well.

Vikram Limaye: The other thing that we would like to mention here is that we are obviously looking at this business from a long-term perspective. So we have proactively tried to borrow longer tenure paper whenever it has been available because we believe long term that would serve the franchise extremely well in a hardening rate environment where we are able to borrow long term paper at attractive rates that is what we have tried to do because from a longer term perspective that would have a positive impact on spreads.

Ashish Sharma: Fine. One general observation, I think, earlier in one of the interviews Mr. Lall had said that IDFC Bank is a possibility. I guess it is too premature to ask on that, but what exactly is the prognosis? Is IDFC looking into converting itself in a full-fledged banking institution, what is the roadmap there?

Dr. **Rajiv Lall**: The answer is no. You must be aware that the RBI is talking about creating a new category of NBFCs called infrastructure NBFCs. So we are waiting for the RBI to come up with their description or their criteria for how this new capacity is going to get regulated

Ashish Sharma: Fine. So at this point in time the banking license for acquiring a bank is not the plan?

Dr. Rajiv Lall: No.

Ashish Sharma: Fine. Thanks a lot. If any other question is there I will come back.

Moderator: Thank you, Mr. Sharma. Our next question is from the line of Mr. Manish Choudhary of Citigroup. Please go ahead.

Manish Choudhary: Hi, Rajiv, Vikram. Just wanted to check one thing - in terms of most incremental lending in the project finance space currently, as I understand, it is done on a multi-institutional funding basis. What I wanted to check is if there is any difference between the terms of the covenants that IDFC puts versus other banks in terms of these loans that are happening at this point in time in the market?

Vikram Limaye: The short answer is no. In large part this is part of consortium lending, right, so while we may be lead arrangers for the financing there are necessarily other institutions that kind of get involved in this, so the terms are generally the same. There is not anything different that we do that other institutions are not doing.

Dr. Rajiv Lall: But if we are leading it then we are setting the terms.

Vikram Limaye: The market terms are reasonably well established. So if this is project finance on infra has been going on for a few years, so it is not – I do not think that there is anything materially different in terms that are happening now as opposed to on previous projects.

Dr. Rajiv Lall: But there are a number of transactions that are not consortium that either just one or two lenders, one of which is IDFC in which case, the situation could be quite different. I couldn't from the top of my head tell you, what share of our total loans outstanding are ones in which in consortium has won which are they are not into consortium.

Manish Choudhary: Okay. And some sense in terms of your exposure to energy is still large. How much would be generation and how much would be non-generation?

Vikram Limaye: Large part of the book is generation related, as you know there have not been too many transmission projects that have been handed out. We do have some exposure to distribution, but I would probably say that 90% of our book is generation.

Dr. Rajiv Lall: How much of the generation is captive?

Vikram Limaye: So most of it is generation related, small portion is distribution and very little in transmission. That is also reflective of the environment. You see the landscape is largely in generation.

Manish Choudhary: And finally, if you could give us some sense of in terms of the incremental disbursements or approvals that you have done? How much would be consortium led and how much would be independent of that?

Vikram Limaye: As a percentage I don't have the number handy right now. But I would say that a large part of it would be consortium. But by consortium I mean there are at least a couple other banks involved but it is not a bilateral deal it is just between IDFC and the company.

Manish Choudhary: Okay. Alright. Thanks, so much.

Moderator: Thank you, Mr. Choudhary. Our next question is from the line of P. S. Subramanian of SBI Cap Securities. Please go ahead.

P. S. Subramanian: Good afternoon. My question is actually on loan growth. The banking sector has seen loan growth of close to 12% plus and within that infrastructure it has actually grown much faster. Just wanted to understand why IDFC's balance sheet growth is lagging the industry growth. Is it that the opportunities are not as lucrative in the infrastructure lending space right now?

Vikram Limaye: I would like to just understand some of the data that you described but if you look at our approvals which is a function of what projects are actually achieving financial closure or what projects we are getting involved in, in terms of financing is that as we outline our gross approvals have almost doubled, if you compare the nine months period to the current nine months period. Now when you look at overall bank lending to infrastructure etc., you know we have focused primarily on private sector projects and so we are not doing working capital financing to companies that are in the infrastructure space so we are not lending to public sector entities in a large way. So that part of the landscape that some of the other public sector banks may be involved in - we are not involved in a large way. So there are some differences in terms of the focus of our lending effort versus just generic lending to entities that might qualify as infrastructure entities. So I would say that if you were to look at our approvals as a proxy for the level of activity in infrastructure then that indicates approvals have picked up quite sharply. Disbursements will obviously follow because of the nature of the product is such that disbursements will take two three years after achieving financial closure. So it is spread over a period of time, but we are seeing a pickup in disbursements over the last three four months and I think that will be reflected in the numbers in the next couple of quarters.

P. S. Subramanian: Thanks a lot.

Moderator: Thank you, Mr. Subramanian. Our next question is from the line of Mr. Mudit Painuly of Macquarie Securities. Please go ahead.

Mudit Painuly: My question is on spreads. Your spreads were flat, the 12-month rolling spreads, are you seeing incremental pressure on spreads of banks being slightly aggressive in this phase?

Dr. Rajiv Lall: Not yet. But our overall spreads are flat because the treasuries spreads have come down. If you look at just the infrastructure spread it has gone up.

Mudit Painuly: So infrastructure spreads have gone up and it is purely because of the decline in treasury incomes. Okay thanks.

Moderator: Thank you. Our next question is from the line of Kajal Gandhi of ICICI direct. Please go ahead.

Kajal Gandhi: What is the basic reason for the Q3 jump in the principal investment income?

Vikram Limaye: As we have said several times before we do not look at this business from a quarter-on-quarter basis. So particularly as it relates to principal investments it is not something that we will plan on a quarterly basis, we monetize profits on our investments when we believe it is a right time to do so and so we cannot predict what that will be whether it will be Q1 verses Q4, we are not going to just sell investments in any market or at any valuation. So I will not able to answer that question in terms of a quarter-on-quarter basis. What I can tell you is that where we believe that valuations are attractive and it is appropriate for us to monetize that is what we do.

Kajal Gandhi: Okay, what is the current capital adequacy on the books?

Vikram Limaye: About 20%.

Kajal Gandhi: And what kind of growth we are looking for in the coming years slightly longer term on the loan book?

Dr. Rajiv Lall: 30% plus.

Moderator: Thank you Ms. Gandhi. Our next question is from the line of Siddharth Teli of ICICI Securities. Please go ahead.

Siddharth Teli: Hi Rajiv. One is a housekeeping question. This time around we have seen Rs. 42 crores of provisioning in the current quarter. While I do appreciate that sum of this would have been on account of higher disbursals that you saw during the quarter. Are there any other provisions that happened during the quarter?

Dr. Rajiv Lall There was some provisioning against the equity investment.

Siddharth Teli: Could you quantify this?

Dr. Rajiv Lall: It is a very small number.

Vikram Limaye: Most of our provisions as you know are made based on percentage of gross disbursements that are not asset specific or just building our provision base so that we have an adequate provision given the growth in our asset book. So we provision as a percentage of gross disbursements as we go along and that is classified as provision for contingencies because this is not an asset specific provision. It is not because we see any issues with any particular assets; it is just us trying to build up our provisions, so that they are in line with the buildup in the loan book.

Siddharth Teli: Any sense that you are getting on incremental borrowings now when you going into marketplace like one is you had a CRISIL downgrade and the other is the recent credit policy like you said that your ratings will determine the risk rates on banks books. So could you throw any light on that. Can I have the cost of as the bankers probably mention as the cost of funds there increased or how is it behaving, what is the outlook going forward?

Dr. Rajiv Lall: No, cost of funds has not increased as far as we are concerned, we can tell as a result of the CRISIL downgrade.

Siddharth Teli: You expect it to remain so?

Dr. Rajiv Lall: It is very difficult to say whether it is because of the CRISIL downgrade or perhaps as interest rates rise the cost of funds will rise but there is too much has been going on in the system. The point is that there is been nothing that you can identify as having had a material impact on our cost of funds that has to do with the CRISIL episode. That is the point so beyond that you know the cost of funds would be determined by so many other things.

Moderator: Thank you. Our next question is from the line of Smitha Hari of Spark Capital. Please go ahead.

Smitha Hari: Can you let me know what will your proportion of your borrowings, will be due in the next 12 months it, is possible to disclose that? I understand it includes all of the short term and what proportion of the long term?

Vikram Limaye: If you look at the borrowing profile it is about 15% short-term and 85% long-term, so you can assume that short-terms is defined as less than 12 months. So that is what will basically need be refinanced.

Moderator: Thank you Ms. Hari. Our next question is the followup from the line of Mr. P. S. Subramanian of SBI Capital Securities. Please go ahead.

P. S. Subramanian: Could you please share the gross and net NPL details for the quarter?

Vikram Limaye: There is no change in the non-performing assets number for the last two three quarters.

P. S. Subramanian: So this higher provisioning is only on the standard assets?

Vikram Limaye: That is correct.

Moderator: Thank you Mr. Subramanian. Our next question is from the line of Nanditha Parker of Karma Capital. Please go ahead.

Nanditha Parker: This new category of NBFCs, what would be the impact for you would that changes the risk weighting, etc.?

Dr. Rajiv Lall: The theory is that it should improve our provisioning but we do not know yet. We just have to wait for the RBI to actually articulate what they mean. But the intention is to make it easier for NBFCs to fund themselves. That is the broad intent for that.

Nanditha Parker: And how soon do you expect something on this?

Dr. Rajiv Lall: I am told it is not that far away, it should be within next month or so.

Nanditha Parker: And in addition since we met at the conference, which was I guess in November, have you seen a great deal of progress in the infrastructure projects in terms of the government working to remove some of the hurdles, blockages, in terms of all the issues we discussed – Land acquisition, so on and so forth all the developmental issues. Have you seen much progress there?

Dr. Rajiv Lall: There is some perceptible progress on roads. The number of bids that have taken place in the road sector has accelerated quite sharply. So as the minister had promised at that point of time at the conference that in the road sector otherwise no perceptible change that I can report to you.

Nanditha Parker: And so your acceleration in the loan book that you are expecting you are just taking it as sort of in terms of the normal course that things should pickup or do you see a whole lot of visibility for 20% plus?

Dr. Rajiv Lall: You will recall that from various sources we believe that there is about 25,000-45,000 megawatts of private generating capacity that is going to come on stream over the next four years and of this two-thirds of it has already or is about to get to financial closure and one-third of it we expect it could happen in the coming months. There is very large volumes of financing that is required against this. So a very large part what you are seeing in our loan book is just a reflection of the size of that pie and our aggression to get a larger size and larger share of that pie.

Nanditha Parker: Within Power what about in alternate energy anything that you there?

Dr. Rajiv Lall: Yes, there is actually a quite of lot of activity in alternative energy, which we actually expect to pickup because of the generation based incentives that the government has announced. We have seen a fair bit of activity in wind and in solar, and I think, as people are going to get more comfortable with the cost of technology coming down overtime and has financiers get more comfortable with that you will see greater financing activity in solar as well, but that I think will take 24-36 months to unfold.

Nanditha Parker: Both wind and solar?

Dr. Rajiv Lall: Yes. Both wind and solar.

Nanditha Parker: And what kind of size do you think we can get in terms of megawatt over a period, is it like a 1,000 megawatts, the 10,000-megawatts?

Dr. Rajiv Lall: I do not think it is 10,000, but it is not 1,000 either. I could not tell you of the top of my head what it is - we can ask our internal people, they are not on hand right now for what our projected numbers are for expansion in solar and wind capacity. But we can send you an email and let you know.

Nanditha Parker: Sure, great, but this is basically roads and power. You are not seeing anything else happening in?

Dr. Rajiv Lall: We are seeing growth in telecom, there is some of that. There are some activities we are able to see in ports, but by and large it is in roads and power.

Moderator: Thank you Ms. Parker. Our next question comes from the line of Ravi Mehta of Indsec Securities. Please go ahead.

Ravi Mehta: What portion of your loan books is on fixed rates and what is on floating?

Vikram Limaye: I would say close to 99% would be floating.

Ravi Mehta: And what on the borrowing side like the same proportion?

Vikram Limaye: We are duration matched right. So from that perspective, depending on what is going on the asset side, our liability side is more or less tracking that.

Moderator: We have a question from the line of Sanjay Parekh of ICICI Prudential. Please go ahead.

Sanjay Parekh: You know a few quarters back you had stated that while the disbursement, this was not two three quarters back but last years I suppose, with the disbursements were good but the repayment was causing the overall loan growth to be lower, but this also the disbursements are good but is the repayment causing the loan growth to be lower?

Dr. Rajiv Lall: It has to do with the maturity profile of the assets. Today the average maturity profile of our assets is about 4.8 to 5 years, so that is quite okay for the type of business that we do. We have not seen any marked shortening of that profile.

Sanjay Parekh: And the second one is on the telecom side. Are we lending more to the tower companies or the new service providers?

Dr. Rajiv Lall: Tower companies.

Moderator: Thank you Mr. Parekh. Our next question is from the line of Shrey Loonker of Reliance Mutual Fund. Please go ahead.

Shrey Loonker: I just wanted to get a sense from you what do you foresee just to give more impetus to infrastructure financing I think there has been lot of noise on that? What kind of policy moves and what kind of new initiatives do you see more possible or more probable from the stable of the government or RBI?

Dr. Rajiv Lall: From the stable of government I think any initiatives to improve the clearance process, environmental clearance process should increase or improve the momentum of growth. There are some discussions with the Ministry Of Environment that they will look at coal mining in terms of zones. So rather than looking at it on an approval specific basis they want to have certain framework in place for a class of approvals relating to certain geography. So all those kinds of initiatives if they are implemented till they are implemented and they improve the supply of coal moving forward that will be achieved, boost to activity in the power sectors environment in my sense. As far as RBI is concerned and infrastructure financing there is the initiative that are ongoing which we discussed earlier in all opportunities infra NBFC initiative. If this initiative is carried to its logical conclusion I think it will be quite helpful and make our challenge that much easier to handle.

Shrey Loonker: Sure, but do you see some pension norms being changed or do you see that this time around the government actually doing some more bit on developing the debt markets. Do you see some really concrete moves being made by the government?

Dr. Rajiv Lall: Really concrete is too strong a term but concrete moves, yes.

Shrey Loonker: Just another basic question over the last three quarters to four quarters whatever incremental loans that would have got disbursed, what will be the rate structure that it would have been disbursed on?

Dr. Rajiv Lall: Incremental spreads are really quite robust and they range anywhere from 250 basis points to 350 basis points.

Shrey Loonker: Yes, which is fair, but more from a perspective that are they more at three years or are they more at one year reset?

Dr. Rajiv Lall: So there is a whole range. I think that it was obviously a bit of a tussle at this point because people are expecting rates to rise. So some borrowers want to lock in their rates today, depending upon your interest rate due but we are basically playing different buckets depending upon what product we are providing to what client. Our endeavor is to ensure that no matter which part of the yield curve we are playing in that we are able to protect our spreads and so far, which we been able to do that I do not know how long we will be able to do that when you look forward in the next couple of quarters.

Shrey Loonker: Okay great thanks.

Moderator: Thank you Mr. Loonker. Ladies and gentlemen that was the last question and now I hand the conference over to Dr. Rajiv Lall for closing comments. Please go ahead Sir.

Dr. Rajiv Lall: Thank you for your questions and your continued support. I expect to interact with you again next quarter. In the interim as always if you have questions please address them preferably by email to our Investor Relations team, in particular Bimal Giri and we will do our best to get back to you. Thank you.

Moderator: Thank you Dr. Lall. Thank you gentlemen of the management. Ladies and gentlemen on behalf of IDFC that concludes this conference call. Thank you for joining us on the Chorus Call Conferencing Service and you may now disconnect your lines.