FY11 Earnings Call Transcript

May 02, 2011

Moderator: Ladies and gentlemen, good morning and welcome to the IDFC conference call to discuss results for the financial year 2011. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need any 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 Sir.

Bimal Giri: Good morning everyone. I welcome you to this conference call organized to discuss our financial results for financial year 2011. I have with me Rajiv Lall, Vikram Limaye, Sunil Kakar and Sadashiv Rao Before we begin I would like to state that some of the statements made in today's discussions 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 fiscal 2011.

Rajiv Lall: Thank you Bimal and good morning to all of you. Thanks for joining us today. Let me give you some of our numbers in our usual format and we will open it up for Q&A. On a consolidated basis our operating income was up 21% from ₹ 2,107 Crore in FY 2010 to over ₹ 2,550 Crore in FY 2011, within that net interest income increased 47% from little over ₹ 1,117 Crore in FY 2010 to ₹ 1,645 Crore in FY 2011. This was driven by NII from infrastructure lending, which also expanded 47% to about ₹ 1,500 Crore.

The second component of our operating income, which is non-interest income, was down 8% from ₹ 950 Crore last year to ₹ 875 Crore this year and we need to spend a little bit of time on understanding this number, because there is a lot of noise around this number, and I want to clarify. If I just go through it formulaically, of the ₹ 875 Crore in non-interest income, income from principal investments activities was down 27% from ₹ 261 Crore in 2010 to ₹ 191 Crore in FY 2011. Management fees from asset management decreased by 14% from ₹ 290 to ₹ 248 Cores and total revenues from asset management businesses, which includes the carry and capital gains, was down 20% from ₹ 362 in FY10 to ₹ 291 in FY11. Fees from investment banking and broking were up by 9% from ₹ 183 Crore to ₹ 199 Crore and loan related and other fees were up by 35% from ₹ 144 Crore to ₹ 194 Crore. So, basically what I want to draw your attention to is really the tracking on the core business. I think the message that we wanted to re-emphasize through this call is that the core business has actually performed very strongly, so if you strip away principal gains which are on account of investments that we make and capital gains we reap there from; then total non-interest income is actually flat. So the decline that took place on account of the capital market related businesses and the asset management related businesses was pretty much made up by the increase we have seen in non-interest income relating to the balance sheet linked businesses. This is when you strip away principal gains, likewise the impact on PAT is also very, very significant, so PAT growth year-on-year on a consolidated basis is up 21%, but if you were to strip away capital gains from principal investments both last year and this year then PAT is up 40%, so that really is a very, very important way of examining the results in this particular cycle.

Let me now turn to the expense line, we have done a very disciplined job on overall operating expenses, which are actually down by about 3% from ₹ 549 Crore to ₹ 533 Crore over 12-month period and commensurately our cost to income ratio is also down quite sharply from 26% odd at the end of last year to under 21% at the end of this year. Pre-provisioning profits increased by 29% from ₹ 1,559 Crore in FY10 to ₹ 2,013 Crore in FY11. Total provision for various asset classes increased by 81% from ₹ 130 Crore last year to ₹ 235 Crore this year and this has been driven in part by general provisions on account of the higher disbursements. We have, as you know, a fairly robust provisioning policy, but it has also gone up because we have decided to take some provision against the mark-to-market positions of our listed equity portfolio as well as some dues in treasury.

Profits before tax therefore increased by 25% from ₹ 1,429 Crore last year to ₹ 1,779 Crore this year after providing ₹ 497 Crore towards taxes profit after tax increased by 21% from ₹ 1,062 Crore last year to ₹ 1,282 Cores this year. So, just to again re-emphasize the point that I was articulating earlier, now if from this 21% you strip out principal investments and the corresponding capital gains last year and this year you would find the PAT is actually up 40%. The payout ratio in FY 2011 was 26% of PAT and dividend was ₹ 2 per share. This is up from ₹ 1.50 last year, so it is the third increase in total dividend per share. That is as far as the P&L is concerned.

Now let me take you through the rolling 12-month ROA analysis that we do, so we will compare for the purposes of this conversation the 12-month period from January 2010 to December 2010 and fiscal 2011. NII was stable over these 12-month periods at 3.8% of average assets. NII Infrastructure and NII treasury both were stable at 3.5% and 0.3% respectively, so that is the breakup if you like for the 3.8% NII.

Non-interest income as a share of average assets, not surprisingly, declined from 2.5% to 2%. Contributions to ROA from principal investments, asset management, loans and other fees were at 0.5%, 0.9% and 0.6% respectively for the 12-month period January 2010 to December 2010 and they were down to 0.4%, 0.7% and 0.5% respectively for fiscal 2011. Contribution to ROA from investment banking and broking was stable at 0.5%, which means overall the contribution went up in absolute terms because average assets also went up. Operating expenses and provisions were at 1.6% and 0.5% for the previous 12-month period and are now down to 1.2% and stable at 0.5% for fiscal 2011.

Let me turn to spreads, there has been a fair bit of discussion about spreads. Two points here, the first is that our incremental spreads over the last three quarters have been stable to rising and if you look at our average spreads on outstanding disbursements compared to last year we are down by about 40 basis points. Again, to reiterate a point that I have made in the past, this compression of 40 basis points that we have seen during this sharp escalation of interest rate period, where our cost of funds have been rising, the decline in spread has been smaller than in previous episodes of interest rate tightening, so given that our incremental spreads have been steady to rising unless there is a macroeconomic surprise, we expect for our spreads essentially to have stabilized to improving depending upon what the trajectory of interest rates is over the next 6 to 12 months.

I have talked about the cost to income ratio but let me just repeat that for completeness. Cost to income ratio decreased from 26.2% to 20.9%. Our effective tax rate actually increased from 26.7% to 28%. Leverage as of March 31, 2011 was 4.2 times, and the ROE decreased from 13.7% to 12.9%, these are all over corresponding rolling 12-month periods and that is because obviously we raised a significant amount of capital in the middle of last fiscal year. We can expect ROE's to rise over the next 12 months. That is the ROA analysis of income on the ratios.

Let me to talk now highlights of the balance sheet. Our balance sheet grew by 42% from March 31, 2010 to March 31, 2011 from ₹ 33,500 odd Crore to almost ₹ 48,000 Crore. On the liability side, our outstanding borrowings grew by 37% from ₹ 26,500 odd Crore end of last year to a little over ₹ 36,300 Crore at March 31, 2011. Our gross approvals grew 40% from ₹ 30,000 Crore odd in FY 2010 to almost ₹ 43,000 Crore in FY 2011. Our gross disbursements more than doubled from ₹ 13,000 Crore in FY 2010 to almost ₹ 27,000 Crore in FY 2011. Energy, transportation and telecom have continued to be the top three sectors contributing 46%, 29% and 16% respectively of total exposure and 42%, 25% and 22% respectively of total outstanding disbursements. None of this should come as a surprise to you; it only goes to reiterate the point that I am emphasizing for the third time now that the core business has performed extremely strongly.

Now let us look forward a little bit and I wanted to share some more thoughts that we have with the investment community on what we see as happening in the power sector. The power sector is obviously a very significant exposure for us, since its 46% of our total book. We monitor and evaluate developments in this sector carefully and we will calibrate our growth and exposure to this sector according to our analysis. So we see as does a lot of the market, two key risks in our power sector generally and therefore to our particular portfolio as well and these are off taker risks and fuel risks. The off taker risk, I have spoken about a little bit in previous conversation, just to remind you the poor financial health of SEBs has been on account of increasing cash losses as a percentage of their total revenues and these new losses have been increasing, despite a secular reduction in aggregate technical and commercial losses. The only reason why this could be happening is that the tariff hikes, which translate into the effective collections and effective tariffs for the SEBs have not been commensurate with the increase in the cost of procuring power that SEBs have to fork out and that is why cash losses have been increasing.

So this is the objective reality. What does this mean for IDFC and how do we mitigate this risk? Well, we try and mitigate this risk in two ways. The first is we are as careful as we can be with respect to who the off taker is so if you did an analysis of our portfolio you would find that there is a significant chunk of power generating assets that are exposes to those states such as Gujarat for example that we believe actually have a much better financial performance but that is only so much of that you can do. Ultimately, the most important way in which we mitigate risk in a very disciplined manner making sure that the projects that we support are able to deliver power at a rate that is highly competitive and so as long as the cost of delivery of power that we support through our lending is lower than a certain critical threshold then we are confident that even in a time of potential stress these projects will be higher up in the merit order and therefore their power will get taken up. Their cash flows will not be impaired and therefore debt servicing to us will not be impaired.

Third mitigant obviously, and this I have talked about on numerous occasions, is by making sure that we will lend only to a very carefully selected group of promoters. These are promoters that have strong balance sheet, very strong execution records and are also thinking very intelligently about managing their own risk. So that is with respect to off taker risk.

Let me spend a minute on fuel risk. This is not something that we have talked about in the past but again it is no secret. Everybody knows about this and this is something that we need at various levels to take up. The reality is that there are severe shortages of coal and now possibly also of gas, which means that a lot of projects are at risk of seeing delayed delivery of coal and this will depress certainly the equity returns to the promoters. It will result in delay in cash flows to projects and therefore represents a risk to creditors. So how do we mitigate this risk? This is linked to the previous point I made about the type of promoters that we back. The most effective way to mitigate this risk is by disproportionately supporting projects that have access to some captive resource, whether it is imported or it is domestic but it is captive. If it is imported captive then we have to make sure that the promoter has the ability to drive down the cost of the supply chain going back to the point of origin. So if it is a mine in Australia then the promoter is able to manage the supply all the way from mine to delivery onshore in India in such a way that the cost of fuel and the availability of fuel both are assured and controlled.

To summarize the risks that we see in the power sector on account of off taker risk and fuel we have a particular strategy of how we mitigate our risks in these. I am happy to elaborate on this through Q&A.

Going forward what does it mean I think that the message for the entire industry, IDFC have been, I would like to believe, much, much ahead of the curve and more disciplined than others who have been in this business for a shorter period of time than us but going forward clearly we will have to exercise even greater discipline than we have in the past in managing our exposures to the energy sector and what that means is that we have to devise a particular strategy based on the mitigants that I have just described to you to be very, very selective in who it is that we lend to and how much it is that we lend in the energy sector. So I can share broad brush, to share more information on our strategy for how we build our book would be to give away secrets to the competition. So I will refrain from doing that, but suffice it to say that we will have to pick our assets very carefully.

Finally let me spend a minute because essentially I have been talking about prospects for asset quality. Let me talk about current NPA situation. Our net NPA was 0.1% and our loan loss coverage ratio as on March 31 was a healthy 1.6%, notwithstanding the risks that I have been talking about we still feel very good about the asset quality of our overall portfolio.

Finally and on an equally important note, I wanted to make an introduction, some of you already know him, but I am delighted to take this opportunity to formally introduce you to our newest colleague who joins us as Group CFO and that is Sunil Kakar. Sunil will oversee finance and accounts, business planning and strategy, investor relation, yes he will become increasingly the face of IDFC when it comes to talking to you all in addition to Bimal and team. He will also be in charge of resource raising. He will also oversee IT and administration. He will be a member of the management committee. Those of you who know him know that he brings with him close to three decades of experience from banking and insurance. Before joining us, he was the CFO - India of Max New York Life and before Max, he was with the Bank of America for close to two decades. Sunil did his degree from XLRI and engineering from IIT, Kanpur.

I think on that note, I can draw my comments to a close and open the session to Q&A. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Mahrukh Adajania from Standard Chartered. Please go ahead.

Mahrukh Adajania: What was your incremental cost of funds in March and where do you see it settle in the first and second quarters and by how much did the lending rates rise in the fourth quarter? Just in the fourth quarter there was some pressure on the loan related fees on a sequential basis. Sir if you could talk through that as well?

Vikram Limaye: On loan related fees I am not sure I understand the question. We do not actually look at this business on a quarterly basis as we have been saying for some time. Loan related fees on average if you look at what they have been as a percentage of assets were and from an ROE perspective also in terms of loan book growth etc., and what the fee growth has been, has very closely tracked what growth we have seen in the overall loan book. So there is nothing unique about Q4 that I would like to highlight or that should cause any kind of concern for anyone. This line item within our non-interest income revenue stream will track what we see in regular loan book growth.

Rajiv Lall: I just like to add one comment to that, which is that we have tried very hard to even out the business across quarte` In fact, last year we tried deliberately not to leave everything to Q4 so we worked very hard in Q1 and Q2 to make sure that the year is more even than it normally is for a lot of our competitors who book a lot of assets in Q4. So the way to re-emphasize the cost point is we look at this business on a twelve-month rolling basis, and on that trend, we do not see any slowing down as such other than what we are guiding and signaling over the twelve months' period for the growth for the overall balance sheet.

Sunil Kakar: On cost of funds specifically, I do not think so we can share numbers, but I can tell you that look we are a AAA rated corporate and the cost of funds are available on Bloomberg so you can have a look at it may be plus, minus five basis points here and there depending on the efficiency of borrowing. So directionally it is being what a AAA rated corporate would borrow at, because we are wholesale funded. We did raise some retail infrastructure bonds but that was marginally related to affect the overall cost of borrowing. In that direction, I would also like to share that we are focusing on developing the diversification of our sources of liabilities that is through some ECB borrowings as we go forward and we do expect as we go forward that with the interest rate cycle and I cannot predict when, but we do see some softening of interest rate cycle towards the second half of the year and therefore the spreads accordingly would tend to increase and this is done on a case-to-case basis. We focus on our credit quality and we ensure that we get appropriate spread for the risk we take.

Rajiv Lall: What I can tell you is that over the last three quarters our incremental spreads notwithstanding whatever trends we have seen in the cost of funds have been stable to rising.

Moderator: Thank you. Our next question is from the line of Suresh Ganapathy from Macquarie. Please go ahead.

Suresh Ganapathy: On the zero coupon bonds, can you quantify what would have been the implied interest expense debited through the reserves this entire year?

Rajiv Lall: We will have to get back to you on that. We do not have the ready calculation with us at this table, but we have not done any zero coupon bonds since we said to you that we will not be doing.

Suresh Ganapathy: Sir, what would be the total quantum of zero coupon bonds, which have been given this accounting treatment.

Rajiv Lall: ₹ 1.500 Crore as of March 31, 2011.

Sunil Kakar: I do want to share something that when we calculate this spread which we have been sharing etc., we do take this take off the zero coupon impact for this spreads which we share which has come down?

Rajiv Lall: Not artificially inflated by any jugglery on the zero coupon bonds.

Sunil Kakar: So if I say that the spreads for the full year is 224 we have taken the impact that you know the cost of zero coupons in both numerator and denominator have been adjusted to reflect the true cost out there.

Suresh Ganapathy On the Opex I mean I know you do not look it on a quarterly basis but I think there is some accounting related adjustment which has been done this quarter with respect to jointly controlled entities, three of them which is jointly controlled, so is the expenses down purely because of that account?

Rajiv Lall: No, I think there is an important clarification there, which is that what the rest of you call CSR activities, we call IDFC foundation activities. There were the revenues and the expenses associated with that were previously in our P&L. So, what we have done is to clean this up. We have taken both the revenues and expenses of these activities out of IDFC and put them into a section 25 companies, which is called IDFC foundation. But even if you strip this out, the cost to income ratio is down quite substantially and we can send you, again I do not have the actual calculation. So, with foundation and without foundation, if you get without foundation fiscal 2010 compared to fiscal 2011 the decline in the cost to income ratio is also quite significant and this has been because our overall HR bill. Our HR costs have only increased 3%, 12 months to 12 months and our overall other non-HR operating expenses also have been flat.

Suresh Ganapathy: Some clarity on this provisioning that you have done this quarter specifically for the equity related. I mean is that the mark-to-market rate was actually negative or you actually did some prudential provisioning on it because you thought that the investments are going to be having a permanent impairment how does it work I mean in the sense how you do go about taking a call on these things?

Sunil Kakar: On the equity side we have two books that we carry - one is the current book and one is the long book. Now IDFC has a conservative policy where we take lower of cost or market value. So, even in the current book, where the full book is mark-to-market. If we see any dimunition that are temporary in the current sense, we keep an appropriate amount into provision. In the long book we do use judgment where we assess whether the impairment is absolutely temporary or could be over a medium term and therefore using our judgment we have affected provisions regarding investments in the long book also. The impact on the long book is slightly more 'other than temporary' and that is why we take a provision, which is prudential in nature. So we do not know exactly how it is going to turn out to be, but it is a prudential call to make a provision.

Suresh Ganapathy: But are the RBI regulations not very clear on whether you need to mark the entire equity portfolio to mark-to-market every time every quarter or is it very subjective leaving room for management judgement?

Vikram Limaye: It is quite clear that if you classify an investment as a short-term investment or a current investment as it is called it necessarily needs to be mark-to-market. There is no option on that. If you classify something as a long-term investment then you do not need to provide against it unless you believe there is a permanent impairment in value.

Moderator: Our next question is from the line of Nandita Parker from Karma Capital. Please go ahead.

Nandita Parker: Could you give us a perspective on what you see in terms of traction in new projects whether you see any kind of previous hurdles in environments and land acquisitions actually get resolved and sort of attitude from a government standpoint of getting things done?

Rajiv Lall: What is interesting is that the momentum of credit amount on account of infrastructure does not seem to be showing as of yet, the type of slowdown that one would expect if one were relying entirely on media for sources of information about problems, etc., facing the sector. So actually appetite for investment and project development in the infrastructure space, I would say remain really quite robust. That said there is no doubt that the cost of execution, cost in terms of hiring, the time to execute projects and the time it takes to get approvals and all the irritations and complications that are associated with that, those have escalated. So there are small number of cases in the power sector for example where some plans have been made, equipment has been deployed, construction has started in the expectation, for example, that the promoter would get access to mining rights. In a small number of cases that decision has been indefinitely postponed, so there is a risk that these people are contending with. When you talk to them however they express cautious optimism that once the state election results are in, that a lot of these things will start getting to be unclogged. My own personal observation is that when it comes to environment related issues, it is almost as if things are happening at two tracks, at two levels, there is a broad macro conceptual level, I think the environment ministry is raising important questions about the long term sustainability of the current growth rate. He is asking the question can we grow at 9-10% a year if we are also to be responsible guardians of environment. That is a legitimate question to ask and that question is being asked in the context of the formulation of the 12th plan. Then at a micro level on a deal specific level, it seems to me that there is a greater level of pragmatism in decision making that there was a few months ago, so it is kind of mixed bag right now and to the point I was making in my own remarks, as far as we are concerned, it only validates the view that we have held for some time that for long term sustainable development in this sector from a creditors point of view, you have to engage with people who have the ability, who have staying power and who have patience and who have an approach to business that is able to overcome the growing barriers to entry as we see them. So selected bets made intelligently over a period of time will be safe, but indiscriminate investment in this sector could lead people in to trouble.

Nandita Parker: In terms of either delays and cost overruns and this sort of things what can you do, there is nothing you can do on the asset impairment side?

Rajiv Lall: Remember that most of our assets, our disbursements are linked to achievement of certain milestones, so for example if the fuel is not available, then the disbursement will not happen, that is certainly the case for our power sector.

Sadashiv Rao: Basically, the first thing is land acquisition, so without the basic land requirement no disbursements are made. If it is a power project, then it is based on coal, without coal linkage no disbursements are made, so we have conditions to ensure that our loan is safe, however there could be still certain delays in project completion and that is typically built in terms of contingencies in the project cost and sufficient moratorium for loan repayment.

Nandita Parker: On the power sector you mentioned the state of the SEBs, is there also in your mind a lot depending on the state elections in terms of you are going to see tariff increases after?

Rajiv Lall: Not clear, but I think to the point that was I made earlier is that we do see a certain pattern that when it comes closer to elections, discipline as you can expect becomes weaker and once you have passed the elections, then discipline is exercised in intelligent and in unintelligent ways, so unintelligent exercise of discipline is when SEB says we will stop supplying power and therefore reduce our losses. intelligent exercise of discipline is when the state electricity regulator says okay, now we will raise that.

Nandita Parker: So maybe that the controller general needs to take a look at this as well right?

Rajiv Lall: He is, as a matter of fact, actually work is being done at the level of the CAG and by the ex-CAG Mr. Shunglu that report is also imminent but this is a long fuse and this will take a long time before we see any resolution or deterioration. Again to make a point I have made before this is no different from long term deterioration in the fiscal position of government and therefore it becomes a much broader call on the macroeconomics of this country whether or not the current situation is sustainable.

Moderator: Our next question is from the line of Kalpesh Mehta from Motilal Oswal Securities Ltd; please go ahead.

Kalpesh Mehta: Just wanted to check since last nine quarters our cost to income ratio on a rolling 12-month basis was at around 24-25% and in this quarter we are at around 21%, so is this a new reality that we are working on going forward as well or you will see some increase in cost to income ratio henceforth.

Rajiv Lall: This is a new reality.

Kalpesh Mehta: In terms of your adjustment to reserve, apart from zero-coupon bond, are there any adjustments done via reserves?

Sunil Kakar: The cost of raising the infra bonds, this is all as per allowed under the Act whatever we spend for advertising and the retail infra bonds, which we raise, a certain amount goes to the securities premium account.

Kalpesh Mehta: Those were hardly ₹ 9 to 10 Crore looking at your notes to accounts. The zero-coupon bonds were at around ₹ 1,500 Crore, so at max the cost could have been around ₹ 130-140 Crore.

Sunil Kakar: Probably a little lower. That is there but as I said that when I calculate the cost of borrowings, since the interest expense is not there on the numerator I have excluded in the denominator the quantum of zero-coupon bond, so that the cost of borrowings reflect the interest bearing liabilities only.

Moderator: Our next question is from the line of Amit Premchandani from UTI Mutual funds; please go ahead.

Amit Premchandani: You made a comment that you expect the interest rate to go down in second half, to be a much more benign scenario, while your duration of liabilities has actually quite increased as compared to assets, just wanted to understand there is some mismatch in what you said and what you have done.

Sunil Kakar: That is going forward, the duration of liabilities is not significantly different, our duration is remember on an interest rate basis it is different from my maturity basis, even if I am borrowing five year money or a ten year money, my interest resets are of much lower tenure, so my duration of the assets and liabilities are not different, it is 2.1 versus 2.3, so that is the only amount of gap we have.

Amit Premchandani: On the liabilities front?

Sunil Kakar: Asset is 2.1 and liability is 2.3.

Amit Premchandani: But in your presentation it is 2.07 as compared to 2.74.

Sunil Kakar: 2.7 is not the effective duration, the total quantum of liabilities is lower out there, so when you adjust the quantum side of it and 2.07 was 2.1 is what I said.

Rajiv Lall Just to elaborate on that this lengthening of the duration of liabilities has happened on the last quarter, we do not expect interest rates to decline for, four to five months, so by that time we will have to restructure our balance sheet to play that bet if you would like but right now the risks are to the upside rather than downside.

Amit Premchandani: On the transfer of some of expense in revenue item in the IDFC foundation, just wanted to know on a net basis does it impact PAT numbers at all.

Rajiv Lall: No hardly because there would be a ₹ 2 Crore decline. If we included the foundation of PAT it would have been ₹ 2 to 3 Crore higher.

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

Manish Shukla: You said that your incremental spreads over the last two to three quarters are either stable or improving, now Bloomberg data shows that between June 2010 and March 2011 AAA borrowing cost for one year and three year have gone up by anything between 200 and 250 basis points, so is it fair to assume that you have already implemented that kind of lending rate increases on your book?

Rajiv Lall: Yes, it follows that we must have done that.

Manish Shukla: Is it one of the reasons impacting your disbursements because fourth quarter was lower than third quarter and the fourth quarter is the least on all the four quarters of the year in terms of disbursements?

Rajiv Lall: Not clear that is what it is. Fourth quarter actually, as I said, we have been trying to manage our overall growth in more leveled way across all four quarters, but to go back to a comment I made a little while earlier that I am actually surprised about the strength of credit demand for infrastructure still notwithstanding the fact that asset yields have trended up, I think more broadly macro wise and this is presumably what the RBI may also be seeing is that the transmission mechanism has not translated enough in terms of actual delivered cost of borrowing to corporates or whoever is borrowing out there, so the cost of funding has gone up, cost of deposits at the margin for banks have gone up but the asset yields have not gone up enough and therefore you have not seen a material slowdown in entry growth of credit off take overall and so maybe that is the next leg in the adjustment and the transmission mechanism that as asset yields trend up further then you will begin to see a slowdown in credit off take and demand, so it is in expectation of that evolution that we have been guiding at least our stakeholder to expect a slower rate of growth of balance sheet over the next 12 months.

Manish Shukla: Could you give us the split between provisions for the loan book and provisions for investment out of the total provisions?

Rajiv Lall: We do not have a policy for desegregating loans in the public domain, but we shall evaluate that. I do not want to make ad hoc decision, my colleague may have stuck to this policy for a reason, and if we change the policy we shall post it on the website.

Manish Shukla: You said you split your book as long book and current book. Can you share that split proportion?

Sadashiv Rao: That is available in the balance sheet.

Moderator: The next question is from the line of Jatinder Agrawal from RBS. Please go ahead.

Jatinder Agrawal: On power sector basically you have two types of participants on the lenders side, one segment is where and who do not have exposure to power private producers and on the other side mostly which is public sector banks they have exposures to state electricity boards. Both have their own pros and cons and if you sit in front of each, everyone tries to justify their exposure that they have. How do you read that, because you do not have exposure to SEBs, so what are your thoughts as to how will that come out?

Rajiv Lall: Well as you said, both have their pros and cons to the extent that you have sovereigns lending to sovereigns in a very cynical sense, asset quality does not matter. It only begins to matter when problems become hugely acute at which point again if the past is any guide to the future you will expect some kind of bail out to happen. When it comes to the lending to the private sector and it is not the case that the PSU Banks have not been lending to the private sector. PSU banks have a huge exposure to private power. I think the need for creditor discipline is much greater. So you cannot just do name lending, you cannot lend on the basis that eventually the sovereign will bail you out, you really have to understand the sector and you have to understand the risks before you start putting money to work and so broadly my response to you would be that the problem is that moral hazard can infect the behavior of various participants in this sector in a way that is problematic for all of us and that is the reality of the situation. Within that reality what it means is that discipline and restraint become that much more important and of value. So I think going forward you will certainly see that IDFC's energy exposure will not be growing quite at the same pace as we have seen it grow in the past and within that exposure you will see some meaningful recalibration of what we actually financed going forward.

Jatinder Agrawal: For the zero coupon bonds can we have the amount, which was outstanding as of March 2010?

Rajiv Lall: ₹ 2,100 Crore.

Jatinder Agrawal: So it has come down to 15 billion is it?

Rajiv Lall: ₹ 1,500 Crore yes.

Jatinder Agrawal: How does it go forward in FY'12 does it runoff further? Can you give an approximate?

Sunil Kakar: Two years by the end of the impact of zero coupons is going to come down significantly in FY'12 and by 13 it will disappear.

Rajiv Lall: So over the next 24 months, in the next 12 months it will come down very sharply and in the subsequent 12 months it will be gone.

Jatinder Agrawal: Lastly sir can we get of the main subsidiaries two data points, revenue and profitability of the individual subsidiaries, the main ones, can we get the revenue and the profit line?

Rajiv Lall: That is available in the annual accounts, we are happy to share that with you, we will post that on the website actually.

Moderator: Next question is from the line of Nischint Chawathe from Kotak Securities. Please go ahead.

Nischint Chawathe: Couple of quarters back you had expressed concerns on the momentum on the pace of growth in the road sector, how do you see things moving up now on this sector?

Rajiv Lall: Actually there have been quite a lot of improvements in the road sectors, which you do not see yet, manifest itself in terms of loan growth or disbursement growth rather because it takes a bit of a lead time, but there have been a meaningful improvements at the level of ministry and NHAI, results that bidding for road project under the PTC Group for the national highway has picked up quite smartly and we have been getting our share of those transactions. So we expect for that to be actually one on the bright spots for the next 12 months.

Nischint Chawathe: Possibly the fastest growing or the largest contributor for next year, can we say?

Rajiv Lall: Certainly a larger contributor than it has been in the past.

Nischint Chawathe: What we understand is that RBI is looking in having a comprehensive review of a set of regulations for NBFC and I guess you know you also I guess working as an industry representative with RBI. Can you just explain us to what the thought process is and what are we really looking forward to?

Rajiv Lall: I do not know whether the terms of reference for the NBFC committee are in the public domain, I can basically do no better than share with you what those terms of reference are. The idea is basically to advise the RBI on the regulatory infrastructure for NBFC, meaning what should be the nature of regulation that applies to NBFCs of what size, I do not want to get in the details, but one of the fundamental issues that we are deliberating on is what is an NBFC, versus what is not an NBFC, if something is classified as an NBFC, then at what point and under what regime would the regulation apply. That is one set of issues that the committee has focused on.

The second set of issues that the committee is focused on is to look at the question of potentially unregulated NBFCs, so there are number of entities in the marketplace that may be conducting financial services activities of some volume, but are not registered as NBFCs. So the question is - are there any entities of this nature that are significant? Are they presently regulated as they should be regulated and in what manner should they be regulated and one of the issues that keep cropping up at this particular context is the notion of regulatory arbitrage. So is the current regulatory infrastructure such that allows entities to conduct activities in a manner that is less regulated or unregulated relative to others, if that is the case then from a systemic risk point of view, which is really the overarching concern of this committee as it advises the RBI what needs to be done and what does not need to be done. Final thing is that the explicit brief for all of us is to look at all of these things from a pro business point of view, so the idea is not to shutdown businesses or make life difficult for individual players, the idea is to make the whole architecture simpler, more pro business but in a manner that draws the line underneath some types of systemic risk that may evolve in the future.

Nischint Chawathe: Is there some kind of big change in the way RBI was looking at the sector or these companies in the past does that really mean that it will be substantial change in the contribution of these guys in the entire financial system?

Rajiv Lall: I do not think so. I think it is more what will eventually come under this will probably be in the nature of refinement and will not be a fundamental change.

Moderator: Our next question is from the line of Manish Choudhary from Citigroup. Please go ahead.

Manish Choudhary: Basically just wanted to check with you on the spreads, if you compare the overall spread that you have mentioned in the presentation versus FY'10 they have declined some 2.7 to 2.2 whereas on the ROA tree the infrastructure spreads have actually gone up from 3.3 to 3.5. So there is a little bit of discrepancy I understand part of that is because of the capital?

Rajiv Lall: There is no discrepancy. There is spread and then there is net interest income as the share of the average assets, which is what you see in the ROA tree. In the ROA tree that number will go up because of the capital effect.

Manish Choudhary: The difference actually seems to be relatively large for the capital, because it is about 70 basis points if you add the two. That is why I wanted to check.

Management: It is the fact that we are running a capital adequacy ratio of 24%, so the amount of capital that is in the NII line, there is no interest expense coming through and also as we have been speaking and that happened in the second half so that is why you will see the impact in the second half. If you are looking for net interest margin kind of number, that number actually went up. Spread reflects had I borrowed everything in debt and we are not borrowing everything in debt, my funding of the loan asset is a mixture of debt and equity and because we borrowed more in equity actually that is how we are funding.

Manish Choudhary: This is basically only on account of the capital that this different.

Rajiv Lall: Absolutely.

Manish Choudhary: In terms of your spreads basically you have been saying that you are expecting spreads to stay stable or the increase from here going forward is that correct?

Rajiv Lall: That depends on what governor decides to do tomorrow. I think market consensus is 25 basis point, if it does more than that then it is difficult to predict how the market will actually react, but we will go back to the comment I was making a little while ago that at least my judgment about where interest rates are headed is to do with what the RBI is seeing and what the RBI is seeing no material deceleration in credit growth entry at this point and it has seen the inflation numbers actually pick up over the last quarter, so they will need to take action. It all depends on how drastic that action needs to be. If they over correct in order to in their judgment to moderate inflationary pressure, then our story about improvement in spreads will be delayed by a quarter, but if the trend of the interest rate hikes stops at this particular policy meeting or in the next policy meeting then I think we are because market anticipate these things and the anticipations have been correct then we will be on track for much better environment for us in the second half of this fiscal year.

Moderator: The next question is from the line of Ganesh Jayaraman from Spark Capital. Please go ahead.

Ganesh Jayaraman: Could you just tell me what proportion of your top line or your interest income came from the zero coupon bonds as I know you told me you have eliminated the discrepancy in your ROA calculation, but what proportion of your income will come from such bonds?

Rajiv Lall: Income from these bonds?

Ganesh Jayaraman: It does not have any expenditure related to it in the P&L, so I am just trying to see what proportion of your income could have come without any cost?

Rajiv Lall: So, I will give you a sense of it, our total borrowing for this year is ₹ 37,000 Crore. Of that ₹ 1,500 Crore is zero coupons, so that will be the proportion.

Ganesh Jayaraman: What I am trying to understand is it invested in equity of certain things, or does it come with interest income or is it invested in your loan assets. I am just trying to get a sense of that.

Rajiv Lall: It is actually the amount at that time was calibrated to be roughly equivalent to the amount that we have invested in the subsidiary companies that we have acquired.

Ganesh Jayaraman: What proportion of that could have gone?

Rajiv Lall: Those are not earning anything in the sense that the loan would earn and to the extent that a good chunk of that has actually has gone into the asset management company, where all these amounts are deducted entirely from our capital that is ₹ 800 Crore and asset management company has not made any profits.

Ganesh Jayaraman: I take your point, but out of the ₹ 1,500 Crore how much will be into equity and how much will be into loans or into your CDR bond?

Rajiv Lall: All of it will be invested in subsidiary companies.

Ganesh Jayaraman: So, there will not be any income from that bond from your zero coupon bonds also in your P&L. Is that a fair conclusion?

Rajiv Lall: There will be no income to the extent till we get some dividend from IDFC securities. Right now it is very small.

Ganesh Jayaraman: Just dividends from it. My second question is on the diversity of your liability profile, could you tell me how the split between PSU banks, ECBs and retail was a year back and how it is now on and how we expect this to be say year or two down the line?

Sunil Kakar: ECB and retail never existed a year back, so to that extent it is zero and whatever we have raised ₹ 1,450 Crore in retail is the first time this year and ECB or foreign currency borrowings is very small 2%- 3% of my total liability, so this whole business of ECB and foreign currency liabilities, is not going to impact sources of borrowing more than 5% - 6%, so that it is on the margin, but what is more important is you start diversifying, you bring in foreign players into the country and then make this whole thing in a larger play, the infrastructure play is then sold or we get attracted on the debt side from the foreign investors also, the rest is a combination of PSU banks and bonds we keep issuing and that is not going to change materially in the next year or two.

Vikram Limaye: But that the share what I can tell you is the share of borrowings from bank has come down, share of borrowing from insurance sector and other sectors has gone up and to the extent that we do turn to ECB in the future, I do not think on this year or next year, but this year for the next 12 months we do not expect our ECB borrowing to have a material impact on reducing the cost to our funding but there will be an important source of long-term diversification.

Ganesh Jayaraman: I see about ₹ 2,500 Crore increase on loan book vis-à-vis December, but ₹ 2,500 Crore equivalent drop in your non-equity investment book, is it a classification change or can I say that it is funds are more from lower yielding asset to more higher yielding assets?

Sunil Kakar: From lower yielding to higher yielding.

Moderator: The next question is from the line of P. S. Subramaniam from Sundaram Mutual Fund. Please go ahead.

P. S. Subramaniam: On this question of spreads, past few quarters you have been saying that competition from some of the banks with high CASA has been pretty high in terms of some undercutting etc. happening could you share some light on how recent developments have been here as to how the pricing environment and competition is spreading out and its likely impact on the spreads?

Rajiv Lall: In fact we have been arguing that the competition from CASA managing banks has not been as fierce as it was in the previous cycle. Therefore because their average cost per funds not withstanding their huge CASA basis has been going up and therefore there have been more disciplined in how they have been passing at least some share of their increasing cost to funds in the form of asset yields. Maybe not enough as much as we should be doing but they have been passing on more than they have been in the past. So my sense is that over the next quarter or two banks will have to become even more disciplined about how they track their asset yields, so I would expect assets yields from the banks to actually go up, especially when interest rates keep going up and liquidity begins to tighten again or the indirect cost of financing for them starts to tighten again and unless they want to, as some of you have started projecting a decline in their margin they want to protect their margins and they will have to live with a lower loan growth, protected margins and therefore better spreads for us. That would be my guess, but we will see what happens.

P. S. Subramaniam: Another question on your effective tax rate during the quarter, it has gone up to 30% despite share of your infrastructure related revenues going up and I believe that has a lower tax rate than some of your non-infrastructure kind of businesses like brokerage and asset management?

Rajiv Lall: The interest income to capital gain, so income of capital gain was down from last year that is why the effective tax has gone down.

P. S. Subramaniam: But on quarter-on-quarter basis also I think there is a big difference, the capital gains amount is more or less similar for both the quarters?

Rajiv Lall: The overall share of the interest income would have gone up?

Sunil Kakar: There are two parts in that story about capital gains, one is the quantum of capital gains and one is the type of assets, which you sell. If it is not a listed entity and the STT not paid then even the capital gain taxes can hit you badly, so if you dig deeper it is purely because of the capital gains story.

P. S. Subramaniam: I know the infra lending also I believe you have lower tax is that you have to pay full tax on that? You have section 36 (1) exemption, I guess?

Sunil Kakar: Yes. That is some portion goes out there. Going forward way what will happen on this is based on the new DTC when it comes through we will address, but currently yes.

Moderator: Thank you. Ladies and gentlemen that was the last question and I would not like to hand this over to Dr. Rajiv Lall for closing comments.

Rajiv Lall: Thank you very much for your patience. It has been an interesting year. To summarize it has been the year of the balance sheet and core business. One final time, please look at our returns and principal gains both from last year and this year then examine the performance that we have delivered over the last 12 months and I hope you will also conclude at that end we are pretty sorted. Look forward to interacting with you again next quarter. As always in the meanwhile if you have any question please email or call the investor relations team. Thank you.

Moderator: Thank you. On behalf of IDFC that concludes this conference call. Thank you all for joining us. You may disconnect the lines. Thank you.