



IDFC Limited

Q1 FY14 Earnings Conference Call Transcript July 30, 2013

Moderator Ladies and gentlemen, good day and welcome to the IDFC Limited's Q1 FY14 Earnings Conference Call. As a reminder for the duration of this conference all participant 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. Should you need assistance during this conference please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Bimal Giri of IDFC limited. Thank you and over to you sir.

Bimal Giri I welcome you to this conference call organized to discuss our financial results for Q1 14. I have with me Mr. Vikram Limaye, Mr. Sunil Kakar and Mr. 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 related to our financial performance have been emailed to all of you. These documents have also been posted on our corporate website. I know invite Sunil to provide key highlights of our performance for Q1 FY 14.

Sunil Kakar Thank you Bimal. On the macro side let us start there; you know the recent action by RBI is something which is keeping us very watchful. The longevity of the recent steps taken by RBI to protect the rupee will be a key consideration for all whole sale funded financiers. The urgency to bring the current account deficit, inflation and currency within the comfort zone seems visible and these metrics will be closely monitored over the coming months. Specifically, in the infra sector, the CCI clearances for coal and oil & gas projects; the market linked gas pricing policy; periodic increases in petrol and diesel prices; 100% FDI in telecom and steps to pass on burden of higher fuel prices in power to consumers are some of the positive steps being taken. However, in balance, it would appear that FY 14 will continue to be a challenging year and that private sector Capex revival could take some time.

Now I will take you through the numbers and then we can get on to the Q&A.

Our balance sheet has increased by 10% from INR 65,017 crores as of June 30th, 2012 to INR 71,655 crores as of June 30th, 2013. Our gross loan book increased by 13% from INR 50,892 crore to INR 57,600 crore as on June 30th. On the liabilities side, our outstanding borrowings increased by 8% from around INR 50,000 crores to INR. 54,000 crores as of June 30th, 2013.



In Q1 FY 14 the gross approvals were only INR 2833 crores and gross disbursement were INR 3,211 crores. Energy, transportation and tele-communication continue to be the top 3 sectors contributing 40%, 25%, 22% respectively of total outstanding disbursements.

Moving on to P&L – on a consolidated basis our operating income increased by 32% from INR 772 crores in Q1 FY13 to INR 1021 crores in Q1 FY14. NII increased by 11% whereas NII from loans increased by 14% from INR 555 crores in Q1 FY13 to INR 631 crores in Q1 FY14.

The second component of our operating income which is non-interest income increased significantly by 127% from INR 146 crores in Q1 FY13 to INR 331 crores in Q1 FY14 primarily driven by treasury trading gains. Net of principal gains, the non-interest income increased by 86% from INR 144 crores in Q1 FY13 to INR 268 crores in Q1 FY14. Our fixed income revenues, driven by treasury trading gains, increased by 10x to INR 139 crores in Q1 FY14 from INR 12 crores for the same period last year. However, the loan book related fees came down by 61% from INR 59 crores in Q1 FY13 to INR 23 crores in Q1 FY14. The total provisions for various asset classes, if you look at it purely from the P&L perspective, actually came down from INR 103 crores last year to INR 59 crores. However, if we were to analyze it, last year within the INR 103 crores there was a INR 60 crores provision for our investment in Deccan Chronicle which obviously was not there this year. If we were to focus only on loan provisions, the loan related provisions in Q1 FY14 was INR 85 crores as against INR 39 crores in Q1 FY13.

Our total loan loss provisions stands at a healthy at 1.9% of our loan book. We have been saying in the past also that it is our endeavor to keep growing our cumulative provisions so as to take care of the adverse environment.

Details on some key ratios on a rolling 12 twelve month basis for the period July '12 to June '13 compared to FY13. On an average our spread decreased slightly from 246 to 238 which was mainly due to lower NII income in treasury which was more than off-set by the trading gains. However, NIMs were stable at 4.1% and loan spreads at 2.89%. Our focus on cost has ensured that the cost to income ratio further decreased from 15.1% to 14.7% and ROE increased from 14% to 14.9%. ROA moved up marginally from 2.8% to 2.9% and the closing leverage was at 5x.

Quarterly EPS fully diluted increased from INR 2.50 per share in Q1 FY13 to INR 3.66 per share in Q1 FY14. Our existing policies and conservative approach resulted in our aggregate provisions for various asset classes being at INR 1473 crores as on June 30th 2013. Of this INR 1,072 crores is towards loans and about INR 400 odd crores for investment and others. As of June 30th 2013 our asset quality continues to be good with gross NPL's at only 32 basis points and net NPL's at 20 basis points.

Now to some other developments.

You would be aware that IDFC has submitted its application for a new banking license to RBI. Other than that IDFC was the first Indian financial institution to sign up for the 'Equator principles' which is a credit risk management frame work for determining, assessing and managing environmental and social risk in project finance transactions. IDFC also won the top green IT enterprise award and the legal team of IDFC has won the General Counsel's Gold Award for best Asian and South Pacific legal department for 2013.

Thank you and we shall now open the session for Q&A.



Moderator

Thank you very much sir. We will now begin the question and answer session.

We have the 1st question from the line of Jatin Mamtani from Barclays , please go ahead.

Jatin Mamtani

One was on the bank application. Basically my understanding is that different players who applied for the license would have probably made different commitments to the RBI as part of the application and offered a value proposition. I am sure you probably cannot divulge all the details but could you may be share with us some broad contours of what your application would consist of in terms of a value proposition that you would offer as a new bank?

Vikram Limaye

I think as you rightly said we are not able to get into details of what our business plan is for the bank. I think suffice to say that given our starting position, which is a fairly strong position, you know we have fairly large balance sheet and we are exceedingly well capitalized. We are very profitable and in terms of our governance standards and experience in terms of credits and under writing standards, our track record on asset quality and how we have managed through cycles etc. it should certainly give great deal of comfort based on our track record that from a systemic risk perspective we are a sizeable, credible entity that could certainly develop a high quality bank over the long term. So I think it is important for people who understand that at the end of the day from an RBI perspective they want to make sure that quality credible entities enter the banking system because they are obviously concerned about not only financial inclusion and certain other objectives that they might have but they also want to make sure that systemic risk is manageable and quality of people and entities entering banking is of the highest order. So I think we obviously have no promoter, we are well diversified, some of the concerns that people have had surrounding other entities that may be entering banking may not necessarily apply to IDFC. We have strong relationships on the corporate side and you know we believe that banking will not only enable us to service our existing client base a lot better. So by no means are we saying that we will not be involved in infra-structure financing if we become a bank. In fact we were saying that we will capitalize on our strength which is infra-structure financing and we will build on that and diversify into other areas gradually over time in a disciplined way; the way we have focused on growing the infra-structure financing business in a disciplined way, we will do the same as it relates to the banking landscape and our growth in banking. So that is one aspect of it. The other aspect of it is obviously the financial inclusion objectives of the Reserve Bank of India and I think on that front as well, given that as would be the case with many other entrants, we would be new entrant into the banking land scape. We do believe that there is an opportunity for new entrants to think about financial inclusion in a different way. So to try and look at it as an opportunity as supposed to regulatory obligation and we will obviously have to take advantage of the fact that the eco system the way it exists today is very different from what existed 10-15 years ago when the current incumbents got into banking and they have to be creative ways of using technology and using all the other infrastructure and the regulatory developments that have happened over the last 10 years to be able to get into some of the areas surrounding agri and financial inclusion etc., in a different way from what the existing banks have done . So I think we are trying to obviously make sure that we not only capitalize on our strength but also try and achieve objectives surrounding financial inclusion and other things which are obviously of national importance and important to the RBI. We took infrastructure financing very seriously when we entered infrastructure financing. There was not a lot of infrastructure financing going on and we have delivered on a mandate to become one of the leaders in infrastructure financing and we believe we can do the same as we get into banking.



Jatin Mamtani

My 2nd question was around the AMC business actually: so if I look at the AMFI numbers for AUM you know there has been a 20% growth in the industry AUM but for you it's been very handsome at 40% plus YoY. Just wanted to understand the drivers for your gaining market share over the last year?

Vikram Limaye

Yes I think again the asset management business has done exceedingly well and continuous to do well. I think there are a couple of points that I would like to make. We have obviously had the highest growth in AUM in the first quarter amongst any of the top ten asset management companies and our market share also has gone up quite significantly from where we were in Q4 FY13 to where we are in Q1FY14. It is gone up by from about 4% to 4.6% which is a significant share. A lot of the growth has been in the bond funds as you would expect and that has 2 things: 1) is the fact that the performance of the bond funds obviously has been exceedingly good and 2) we have actually managed our portfolio quite well in terms of the calls that we had on the rate cycle and how we have adjusted our duration in the bond funds etc., so relatively speaking our bond funds despite all the turmoil in the markets have done exceedingly well relative to competition. We have also managed to raise an NFO on the equity side where again the response was much better than what we had expected. So overall our asset management business has done quite well not only in terms of market share, growth in AUM but also from a margin perspective.

Moderator

Thank you. The next question is from the line of Vikesh Gandhi from Bank of America, please go ahead.

Vikesh Gandhi

I understand that your NPL's are very small on the base but is there any color you can give about the QoQ rise that we have seen on that? Secondly if you can give some idea on you know if you have any restructured book at present, how much of that would be restructured of the loans and secondly what is your outlook on restructuring pipeline/visibility?

Vikram Limaye

So you know as you have mentioned while the NPA's have increased from last quarter the increase is very small because our net non-performing assets is still 0.2% and there was a small increase in one particular asset that has become a non-performing asset. We cannot obviously get into specific names but it is a small number.

As we have guided in the past few quarters, these NPA levels are not sustainable. We have been saying that for some time given the risk that exists in the environment and the uncertainty surrounding infrastructure, we cannot be immune to all these risks and uncertainties. There will be some assets that could become NPAs over time. We have been saying that 0.2% NPA levels are not sustainable and we have in fact been saying that this could rise to anywhere between 1 to 1.5% over the next 12 to 18 months. So we continue to maintain that stand. We are obviously doing our very best to make sure that asset quality remains pristine as it has always been the case with our balance sheet. But from a conservative perspective I think it is reasonable to assume that NPA levels will only go up over the next 12 to 18 months. If some of the uncertainties we are talking about surrounding power and gas and all these other things were to be magically resolved and we were to see tangible progress on the ground that would obviously change the situation quite materially. But we do not see that happening in the near term and to your point surrounding restructuring etc., I think the biggest portion of assets in our portfolio that is subject to restructuring would be surrounding gas based assets. We have again been saying that for the last couple of quarters. We have maintained that trend. You have the entire details of our energy exposure and what our exposure is to gas based assets on the website. It is safe to assume that gas based assets will need restructuring. These we believe as we have again said



before are by no means unviable projects. They are perfectly viable projects, they will be performing at levels that we expect them to perform once the raw-material is made available. Now there is a gas pricing mechanism that the government has announced which is supposed to be applicable from April 2014. We hope that gas production does ramp up over the next 24 months such that these plants that are commissioned or will be commissioned over the next 12 months will get sufficient gas to operate at PLF levels that would allow them to service debts. We do not expect any of our gas based exposures to not be viable projects but in the interim till gas becomes available, some of the principal repayments for assets that get commissioned will potentially need to get pushed out by a couple of years given that gas production will ramp-up only over the next 24-36 months.

Vikesh Gandhi So sir is there any current book which is restructured. I mean some number around your restructuring book?

Vikram Limaye We have not really given a number but I am giving you some flavor for what you should look at from a restructuring perspective.

Vikesh Gandhi This is for incremental that you are saying?

Vikram Limaye Yes. We are very transparent about what our exposure is in the energy sector. We do not expect any kind of major restructurings outside of the energy sector. The energy sector will be you know obviously one of the larger components of our restructuring. There could be the odd road asset that requires restructuring or some other smaller exposures in other assets that require restructuring but if you would look at from a total volume perspective, as a theme, you can safely assume that gas based assets will require restructuring.

Moderator We will move on to the next question from the line of Devam Modi from Equirus Securities, please go ahead.

Devam Modi You just commented that you do not expect any sort of NPAs from any other sector apart from energy because you said that there will be no restructuring. So would it be correct inferring the same?

Vikram Limaye No that is not what I have said. I have said that 0.2% non-performing assets are not sustainable. You should on a conservative basis assume that over the next 12 to 18 months our NPA levels will be in the range of 1 to 1.5%. I have not said that those NPLs will come from energy. In fact I have said that I do not expect the gas based assets to become NPAs because once gas becomes available, these assets are perfectly viable and there is nothing wrong with these assets. So the gas based assets will require restructuring but if over the next 24 months gas does become available these assets are perfectly viable assets and our call is that it is not a question of whether gas will become available, it is a function of when gas will be available.

Moderator Thank you. The next question is from the line of Umang Shah from CIMB, please go ahead.

Umang Shah Vikram just wanted to understand post the recent development that we are seeing from our RBI's front and obviously post today's policy announcement, how do you see spreads and growth over the coming quarters panning out?

Vikram Limaye Again this is something that we have been highlighting for the last few quarters and it is important to keep things in perspective even in terms of historical context. Last year we grew at 16% in terms of net loan book growth that was largely on account



of refinancing. We said that through the year. We said at our annual results that more than half our growth has in fact come from refinancing, operating assets. In general what we have been focused on over the last couple of years has been to try and figure out lower risk ways of growing because the core infrastructure project finance pipeline has been quite weak. Over the last 24 months investments in new infrastructure greenfield projects has been exceedingly low. That has also reflected therefore in our pipeline of greenfield infrastructure assets that we have been booking. In FY13 large part of our growth came from refinancing because from a cost of borrowing or a funding perspective, we were able to get pretty attractive rates in the bond market relative to what the bank base rates were and we were therefore able to book assets at rates that were attractive to borrowers as well and we were able to maintain spreads.

Going forward given what has happened to interest rates and liquidity, obviously the yield curve is inverted and cost of borrowing at least for the short term defined as even up to one year or 18 months is much higher than what it was even 3 months ago or even 1 month ago for that matter, till the RBI implemented some of the steps that it took and so from that perspective the advantage that we had from a funding perspective relative to bank base rates does not exist today. So refinancing assets which was a large part of our growth last year and you know while we said that even when we did our call for annual results that this cannot be a sustainable strategy. You cannot keep counting only on refinancing to generate growth and unless there is growth in core infrastructure projects and investments in new projects, it is not going to be sustainable to keep counting on refinancings for growth. That obviously fundamentally is true. The problem gets exacerbated by the fact that our cost of funds advantage that we had last year at least today it does not exist. Now if for some reasons the RBI measures are indeed temporary and it is a question of a few weeks and not a few quarters as has been outlined by RBI and Ministry of Finance people then that situation could certainly change you known in the latter half of the year or whenever the Reserve Bank decides to unwind some of these steps. At that point in time we will have to see what kind of opportunity emerge from a refinancing perspective but at the current time given where our rates are and where the bank base rates are, refinancing operating assets is going to be difficult. From that perspective and also from the perspective that banks are also going to therefore be exceedingly aggressive in preserving operating assets that they have on their balance sheets because as you see the components of credit growth even in the banking system, corporate credit growth for all practical purposes as come to a halt and the growth of the banking system happens to be in other areas such as retail and rural, agri or may be some SME but the large corporate credit growth has come off quite sharply. So that is to just put things in context in terms of where our growth has come from even historically over the last 12 -15 months. Now that avenue clearly seems to be limited going forward at least in the immediate term defined as the next 3 months. Because I do not see the Reserve Bank unwinding any of these measures in less than a quarter and so after that we will have to see how our cost of borrowings adjust and therefore what kind of opportunities are available from refinancing perspective.

The second point I would make is what I have said before; the core infrastructure project pipeline has been decreasing over the last couple of years and therefore you know there used to be 3-4 different components of our growth, one component was the amount of disbursements we could do from existing pipeline. The second was refinancing and the third was generally loans that we did during the year where we could approve and disburse during the year and those were largely to you know to higher quality corporates that borrowed during the year or there was some special situation that required an acquisition type of financing or some such event based financing. Now as core infrastructure project pipeline kept declining over the last couple of years, the amount of disbursement we can expect from existing pipeline for growth obviously decreases and the other thing to keep in mind



is that loan schedule repayments are obviously what they are because what we have disbursed historically does start getting paid down. As you know 80% of our book, as we have been saying, is across corporate loans and operating assets and 20% of our overall book is in under construction assets. So the operating assets and corporate loans obviously have a scheduled repayment - so you have a situation where you do not see a lot that you can get out of pipeline because the pipeline itself has gone down over time and you have your scheduled repayments kicking in because these are loans that you have disbursed historically and that obviously has its impact in terms of therefore how much you can get in terms of net loan book growth.

The 3rd point I would make is that, as we said before, we have been focused on trying to figure out low risk avenues for growth and refinancing operating assets was part of that theme that given all the uncertainties and risks in infrastructure we were more comfortable trying to figure out a more manageable risk profile for our asset books. The next 12 months we are obviously going to continue to focus on that theme and what that would mean is that we would target the highest quality borrowers and try and see whether there are opportunities to lend to the highest quality borrowers. That obviously will come at the cost of spread and margin because the highest quality borrowers are not going to give you the kind of spread that you get on a typical Greenfield infrastructure project. So while we will obviously attempt to grow our loan book with the highest quality borrowers given where the rate environment is today, many of the high quality borrowers are going to defer that decision because they are not necessarily going to be borrowing at rates that are given with an inverted yield curve where the short term rates are. They would probably have to defer that decision till rates settle down and borrowing costs are more manageable and so I think from that stand point obviously the growth outlook therefore for the current year is quite difficult and the visibility of growth is also therefore difficult and so while we have historically said that we try and target 10% growth for this year that is not a given and a few things will need to fall in to place for us to be able to get close to that number. If we are able to get close to that number I can tell you it would be a terrific result because the reality is there is not very much growth in the environment. So I do not have an exact number to give you if I were to hazard a guess it would be mid to high single digits is where we could end up. To get to higher numbers there are a few things that would need to fall in to place for us to be able to do that and obviously credit growth from the corporate sector has to pick up. It is going to be hard for us to just pull growth from nowhere if rates remain high and high quality borrowers decide not to borrow.

Umang Shah

So obviously now here the trade-off is between spreads and growth. So you clearly mentioned that you are looking at quality which will come at the cost of spread. Now assuming that the RBI measures do get reversed within a quarter so there is a possibility that you guys may not be substantially better off but surely better off than the number that you are putting in right now.

Vikram Limaye

See as we have said all along there is no reason for us to constrain our growth. We have 20% capital adequacy, we have always maintained that we are not going to grow for the sake of growth. We have never followed any kind of reckless growth policy. When we are aware of the environment and the risks in the environment, we have done the sensible thing in terms of pulling back growth and making sure that our growth is in the right areas and to the right kind of entities. Now if for some reason things change and the growth outlook is significantly better and we are able to lend to good quality projects and good quality corporates and the refinancing opportunity reemerges and there are other situations which allow us to lend, we will obviously lend. We are not saying that we are not open to lending. We are just saying that we will be focused on quality and if quality opportunities were to present themselves we would not be holding back growth.



- Umang Shah** In this quarter we have had very strong gains on our fixed income book given the way yields have moved, if you could just throw some color as to going forward would we be seeing any kind of losses on your book or how it is placed right now?
- Vikram Limaye** So again the point is 1st quarter we have done exceedingly well in terms of our fixed income trading business as you would expect and I would assume that a lot of the financial services entities in the landscape would have done pretty well in the 1st quarter given how the rate cycle worked out. Obviously 2nd quarter has been exceedingly volatile. What I would tell you is that we have been quite conservative in managing our positions and therefore we have not lost all the gains that we made in the 1st quarter. There is obviously some mark to market impact of the sudden move by the Reserve Bank of India. Those are not necessarily realized losses at this point in time. Our hope is that depending on what happens with the Reserve Bank measures going forward, that we will be able to recover some of the mark to market that we would have experienced as a result of the Reserve Bank moves but in quarter 2 you should assume that it is a volatile environment and so the trading profits that we booked in quarter 1, we are not going to be able to replicate. If at all some of the gains that we made in quarter 1, we would end up giving up in quarter 2.
- Moderator** Thank you. The next question is from the line of Nilesh Parekh from Edelweiss, please go ahead.
- Nilesh Parekh** So we mentioned that the total provisions that we are carrying today is about 1400 odd crores, if you could just repeat the split between investments and loans?
- Sunil Kakar** 1,072 for loans and 400 for investments, it is equity as well as fixed income.
- Vikram Limaye** I think the important thing to also keep in mind is that as we have said over the last couple of quarters our objective is to build our provisions through the year and to try and get to a cumulative provision number as a percentage of our loan book to little north of 2%.
- Nilesh Parekh** For loans?
- Vikram Limaye** We were at 1.8% at the end of March 31st. At the end of June 30th we are at 1.9%, we are saying we will take it up to a little north of 2% for this fiscal. So we will keep building our provisions so that we get to those levels because we believe that is the prudent thing to do given the environment we are in.
- Nilesh Parekh** No on the investment provisions these are largely marked to market - right - provisions that we are carrying on the investments?
- Vikram Limaye** I thought permanent diminutions also. It is a mix of both. I can tell you for instance that includes the entire provision that we took on Deccan Chronicle as an example, right?
- So the position that we had in Deccan Chronicle is fully provided. So that is 100 crores plus provision that sits as part of that 400.
- Nilesh Parekh** And on these loan provisions now out of the 1.9 about 12 bps is specific to a particular asset, specific to identified NPLs. Right? So balance would be towards the assets which we think probably going forward we could see some stress. Now in terms of utilization of these provisions you know we have mentioned that over the next 12 – 18 months we see that you know the NPLs trending up from say 0.3 to may be 1 to 1.5%. In terms of utilization how should we read into this year?

Vikram Limaye

One way to think about this it is you know the way people look at NPL coverage. So if you were to assume that your NPLs get to 1% and you have north of 2% as provisions then you are more than 2x covered. The other way to think about it is and we will have to see as we go along what our view is on provisions on asset quality and the environment you know. As you know we are quite conservative in terms of making sure there is an adequate cushion. So it could well be the case that we keep building provisions and whatever assets are classified as non-performing assets there is obviously an asset specific provision that gets made against that asset as and when it gets classified as a non-performing asset.

In theory or even in practice actually the charge to P&L is more of a derivative number. We actually go through our each and every asset and make a judgment call as to the total level of provisions we should be keeping. This is not specific to any particular asset but on a total portfolio level. It is more like a dynamic provisioning policy and I would guess that for the next 12 to 18 months we will continue to manage around 2% plus.

I do not think there is any question of write back because we are talking about building provisions.

Nilesh Parekh

No what I was trying to understand is if our NPLs are going to move up from 0.3 to 1.5%, would the provisions also in terms of those already created, this you know buffer over a period of time and you know stand at about 1.8% excluding the specific provisions, so the impact on P&L could be restricted because at some point we will kind of draw into these provisions.

Vikram Limaye

See look I mean our provisioning policy as you know is based on gross disbursements. So that we will keep doing right. So that will result in a certain level of provisioning that happens automatically. We are saying from a prudence perspective we would take these provisions to a certain level certainly for this coming fiscal. If you look at the provisioning that we have made even in the 1st quarter of this fiscal we made a general provision of about 40 odd crores which is not linked necessarily to what we would have got out of gross disbursements. More to do with way we want to be in terms of aggregate provisions which we have guided to which is up to 2%. Point I am making is that there will be a certain amount of provisioning that would happen just as part of our provisioning policy on gross disbursements. There is an overall provisioning level that we believe at the current time is north of 2% that we would like to take the overall aggregate provision as a percentage of the loan book. And then we will obviously keep revisiting that number relative to what we see in the environment and what we see with asset quality. As Sunil said that is obviously a dynamic thing. That's our current way.

Moderator

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

Manish Shukla

Today we have peculiar power situation in many parts of the country where power deficit is going down substantially which is impacting spot tariffs as well.

- (a) How do you read that situation? and
- (b) Does that have any repercussions for your energy exposure to the entities that you might have lent?

Vikram Limaye

You are just quoting anecdotal instances but we have instances where the reverse has happened. For example in Andhra Pradesh the industrial units have starved for power for 10 to 15 days in a month. So it is not true to say that the power deficit is



reducing. If you curtail supply and load shed then it looks like you are cutting down and the demand on paper looks reduced but it is not the case that the deficit is reducing.

Manish Shukla But that is impacting spot tariffs?

Sadashiv Rao The spot tariffs are something which is really peculiar. It is seasonal. It can be for various other reasons. During this period they typically tend to reduce because this is the period when the demand is less and typically there is little bit more power from both hydel as well as wind. Wind generating season is typically from June to October and hydel it rains during this part of the year in most parts of the country. And the demand is typically less at this point of the year so therefore the spot tariffs tend to be low.

Manish Shukla But you don't see that as a risk to any of the exposures that you might have?

Sadashiv Rao We do not have much of unallocated power that is most of our projects will have PPAs.

Manish Shukla Now bank license obviously nobody has the visibility when and how that is going to pan out. Growth in the infra space, best of the estimates will take 12 to 18 months. So under that kind of a situation are you evaluating alternate either products or segments which you would want to start implementing from a future growth perspective?

Vikram Limaye You know as we have said before one of the key reasons to think about banking is asset diversification and so that as a theme is something that we will certainly focus on in this fiscal in terms of figuring out other avenues for growth beyond core infrastructure and obviously we will be mindful of the fact that whatever avenues we pursue for growth would also fit in with our objective of becoming a bank should we be given the license whenever it happens. So the avenues that we would pursue would be consistent with what our business plan is for what we would want to do as a bank.

The other thing that I would add is that obviously there are various non-infrastructure sectors that we could think about from a lending perspective but the reality is that the investment cycle has actually stalled across the board. So it's not the case that some of the other capex intensive sectors of the economy are actually seeing any kind of significant investments from our project perspective on new capacities or any of that. So while we would be focused on figuring out non-infrastructure related avenues for growth the capex intensive areas are going to be difficult in terms of finding opportunities for growth because that has actually come to a standstill across sectors not really specific to infrastructure.

Moderator Thank you. The next question is from the line of Mudit Painuly from Max Life Insurance. Please go ahead.

Mudit Painuly Just wanted to understand this NPL that you had this quarter. What is the sort of recovery built there? What sort of collateral you have? Is it a complete write-off or do you expect some recoveries down the line?

Vikram Limaye If I would have had hazard a guess I would say that the recovery on this would be 100 cents down the line.

Mudit Painuly So you are comfortable regarding that. And is it a project based loan or corporate loan, how we would that be?



- Vikram Limaye** It would be in the nature of a corporate loan and it is like I said we have enough asset security, the company itself is in the process of monetizing assets and getting strategic investors and so it's more of timing in terms of debt servicing capabilities versus being able to recapitalize and get strategic investor in and in any event we are senior secured lenders with enough asset coverage.
- Mudit Painuly** The other thing is when you say 1.5% NPL ratio, are we talking about the gross NPLs, net NPLs or what sort of number you are talking about?
- Vikram Limaye** I would say it would be gross.
- Mudit Painuly** And the last thing obviously is because loan growth is slowing down, disbursements are slowing down so that 2% of the loan target of provisions does it hold? Do you think that we would have to revise it upwards?
- Vikram Limaye** No the point is as I said at the current time we believe based on the environment, our asset quality and our provisioning levels, for this fiscal I am not saying that 2% or 2.1% or 2.2% or wherever we end up for this fiscal is going to be the final provisioning number. I am saying I would like for this fiscal to be at a level which is little north of 2% in terms of aggregate provisions as a percentage of loans. So it is not about a static number.
- Moderator** Thank you. The next question is from the line of Ritika Dokania from Birla Mutual Fund. Please go ahead.
- Ritika Dokania** Sir I wanted to ask if you follow any strategies with respect to how big will be the investment book and how big will be a loan book as in the any percentage mix like 90% loan and 10% investments?
- Vikram Limaye** I think the reality is we are not making any kind of significant investments. These are all historical investments that we make. I think the only investments that you would see would probably be treasury related investments. So basically the treasury book is a function of our total balance sheet size and I would say that broadly it will be about 10% of total balance sheet size.
- Sunil Kakar** See the guiding factor is the amount of liquidity we want to maintain and anyway by regulation we have to maintain 75% of our assets in infrastructure. What we maintain in treasury is largely governed to ensure liquidity management and as and when we have any opportunity to take care of the interest rates we do that also but roughly 10% to 12%.
- Ritika Dokania** Sir what is the yield on the incremental loans that you are disbursing?
- Sunil Kakar** You have already seen the average spreads in Q1 right - so it is more or less stable. It has come down very marginally from 2.5% to 2.4%.
- Vikram Limaye** Now as I have outlined before, going forward if our growth is going to come from high quality borrowers and low risk assets then you are going to necessarily see that the spreads on the incremental loans will be lower than the average spread on the entire book. If you were to ask me what that number could be, it could very easily be 100 – 150 basis points lower than the average spread on the book in terms of the incremental disbursements that we end up making. You would assume that if these are going to be AA+, AAA type of entities and we are AAA entity, we are not going to be able to get 250 basis points on top of our cost of borrowing.



- Ritika Dokania** Sir what will be the range in these yields?
- Vikram Limaye** I have given you an indication of what incremental spreads could be relative to what the average price is. Now the yield is a function of what my base rate is and what my cost of borrowing is. That I have said is volatile. It is at a certain level today which is much higher than what used to be a month ago. It could be much lower one month from now. I have no idea. That's why I have given you an indication on spread and not on yield.
- Ritika Dokania** What percentage of your loan asset book would be floating in nature?
- Vikram Limaye** While everything has a reset so if you look at our duration I will give you some sense. It's about 1.2, 1.3 in terms of duration on the loan book. The total asset duration is about 1.5 that includes treasury assets and loan assets. The loan book duration is about 1.3. So that will give you a sense because that builds in the reset period.
- Ritika Dokania** What are your borrowing plans in the near future?
- Vikram Limaye** Borrowing plans are linked to the asset level so to that extent depending on how the asset growth happens we will borrow to match fund from the liability side. So yes it is true that currently, incrementally the cost obviously will go up. If Government of India is borrowing at 11 for short-term then we will be borrowing around that if I borrow a short-term but again we follow a matched ALM Policy so depending on as and when the asset growth becomes visible we borrow in the market. Generally we borrow in the bond market as well as from the banks so there could be a shift in the mix depending on which source of fund is cheaper.
- Moderator** Thank you. The next question is from the line of Hiren Dasani from Goldman Sachs. Please go ahead.
- Hiren Dasani** Just one accounting policy question. So this NPA which has happened during the quarter would that be the only exposure to that particular corporate or you may have other exposures which are still current?
- Vikram Limaye** No that's the only exposure.
- Hiren Dasani** Just like banks do you also follow the same policy that if one facility becomes an NPA the entire exposure to that particular corporate has to be classified NPA?
- Vikram Limaye** Yes. You got to remember one thing, okay. We are largely lenders to specific SPVs. Let me give you an example. If I have an operating road asset that has got enough traffic volume, enough cash flow to service debt within an operating role and I have an exposure to another power asset if I were to take an example where for some reason PLFs are exceedingly low and debt servicing is a problem.
- Hiren Dasani** As long as it is different SPVs and projects and all it is separate but let's say if there are two or three corporate loans given to the same?
- Vikram Limaye** Then obviously I don't think there would be a situation where we would classify one corporate loan as an NPA and the other one as a standard asset.
- Hiren Dasani** And the other thing on accounting again on the MTM just like banks you also have to mark-to-market or treasury book? And if there are any MTM losses it has to pass through P&L?



- Vikram Limaye** Yes.
- Moderator** Thank you. The next question is from the line of Jyothi Kumar from Spark Capital. Please go ahead.
- Jyothi Kumar** Do you see restructuring in gas based projects coming through even for operational assets or will it be only for the under construction assets?
- Vikram Limaye** It could also be for operating assets because the reality is that the PLF levels for operating assets have also collapsed, right. So it is not clear that operating assets are getting sufficient gas to operate at PLFs that could service debt so it is not necessarily restricted only to under construction assets.
- Jyothi Kumar** If I see your presentation data it shows that 2.7% is to gas based projects which is under construction. So would that be a fair indication of your total exposure to gas based assets or would it be much higher?
- Vikram Limaye** There are some under operations also. But you have to understand that we might have lent to an operating entity which has expanded brown field and therefore there is cash flows from the existing asset which is relatively debt free which can sustain the operations of the expanded entity up to a point.
- Moderator** Thank you. The next question is from the line of Tanuj Mukhija from Ambit Capital. Please go ahead.
- Tanuj Mukhija** Can you provide some color as to which sectors will lead to increase in NPAs over the next 12 to 8 months as per your expectation?
- Vikram Limaye** It is a mix of sectors. It could be energy. It could be roads transportation.
- Tanuj Mukhija** Sir, can you provide further details because you mentioned that you won't expect gas based projects to become NPAs so which projects or which sector are you looking at to become NPAs?
- Vikram Limaye** We can't get into specifics on which assets and which sectors and while we are being conservative and trying to assess the situation I am trying to give you an overall number that could potentially be nonperforming asset so there could be some corporate loans that potentially get into trouble right. For instance the asset that we booked as NPA in the last quarter as I indicated to you as the corporate loan. It wasn't a project specific loan and has more than adequate coverage of asset security and all that. So it's hard to tell when we look at our book obviously as you know many of these assets require some time because of uncertainties that have nothing to do with the viability of the project so the first thing that ends up happening in most of these infrastructure assets is to take into account some of these uncertainties and do an appropriate restructuring so that you give adequate time for these uncertainties to get resolved. Corporate loans obviously fall into a different category because you don't have the same work because they are more in the nature of balance sheet risk. So if I would characterize between project loans and corporate loans, I would say that corporate loans are obviously the larger component so that's the way I would think about it rather than sectors. So the NPAs would largely come from corporate loans and less from project loans.
- Moderator** Thank you. The next question is from the line of Sanjeev Agarwal from Ficus Research. Please go ahead.



- Sanjeev Agarwal** Just I want to cycle back on the loan book for a while. Would it be fair to assume that roughly 50% of your loan book will be repriced in FY14?
- Vikram Limaye** The duration of our book is only 1.2 to 1.3. So by definition you will have a large percentage of assets that come up for resets because in the last, I would say, 18 months or 24 months most borrowers have focused on shorter-term resets because the expectation was that interest rates would come down overtime so people were not locking in long-term rates. Now the reality is you are in an environment where that has not happened and in fact the rates have stayed at the same level or in fact moved up. So if you look at even our duration we are actually positively positioned because our duration on the asset book or on the loan book is about 1.2 to 1.3 and our liability duration is 1.7 so our assets are repricing faster than liabilities and in an environment where interest rates are either at the same level or higher in theory that should have a positive impact because of the way the asset liability duration has been positioned.
- Sanjeev Agarwal** But in the context of 100 to 150 basis point spread compression on incremental book?
- Vikram Limaye** That has got nothing to do with resets. You are asking me about reset on the existing book. That is different from incremental loans that I booked. Incremental loans that I booked will have one year reset if they chose to do a short-term reset which will come up for reset in FY14.
- Sanjeev Agarwal** Let me tell you the way I am approaching it and tell me if I am getting it wrong. So you have about 57,000 crores worth of your loan book. You think roughly 50% of that will get re-priced. So when you get repriced given that banks today are more competitive in terms of financing cost, it might be possible that large portion of that loan book moves out to your competition. Also holds for incremental loans that you will book and in the context of AAA borrowers that you will be focusing on. Would it be fair to assume that we will see significant compression in your aggregated spreads?
- Vikram Limaye** That could well be the case but that is more a function of what kind of borrowers you are talking about, etc., so I can tell you an instance that banks are not necessarily getting aggressive on pricing infrastructure risk. You will tell me that it's a high quality corporate borrower like Reliance Industries or Vodafone or one of these larger AAA type of borrowers. That I would agree when those type of entities come up for reset, there will be compression in terms of what kind of spread we could get on those loans relative to what the original spread was but where it's a regular SPV project, non-recourse project financing type of loan that's coming up for reset I think the impact on spreads will be more muted.
- Sanjeev Agarwal** Any guidance on spreads?
- Vikram Limaye** I have already given you guidance for incremental disbursements to the extent they are high quality borrowers.
- Sanjeev Agarwal** Yeah.
- Vikram Limaye** So I think on average you can expect that the average spread on the loan book will come down. It has already come down from 2.5 to 2.4. It could come down by another 20-30 basis points.
- Sanjeev Agarwal** Will your fee based income on loan books will that get impacted?



- Vikram Limaye** The loan related fees actually track the loan business.
- Sanjeev Agarwal** In terms of percentage of your disbursements?
- Vikram Limaye** Correct and again depending on what type of lending you are doing and the opportunity to earn fees is different. So the opportunity to earn fees from AAA and AA+ type of borrowers is lower than the opportunity to earn fees on a traditional project finance loan.
- Sanjeev Agarwal** Sir would it be fair to assume say a 25 basis point kind of fee income on incremental lending to AAA borrower?
- Vikram Limaye** Yeah I mean although it depends on the situation. It all depends on how the deal gets done. Very often the client doesn't necessarily want to pay a fee but just wants to pay and all in spread and just all in rate. So that really is a function of the borrower and what the negotiations.
- Sanjeev Agarwal** How do you see momentum in the investment banking?
- Vikram Limaye** That business again given market conditions is obviously quite volatile and while it has made money historically and has made money even in Q1 it's really a function of whether we are able to get deal closures done in the current environment. I would say that there is no reason to expect this year to be significantly better than last year. I don't expect it to be significantly worse than last year so it would be kind of a flattish year relative to last year is my view at the current time. Roughly if things change going forward either positively or negatively then that would have an impact because this is very much a transactional revenue.
- Sanjeev Agarwal** Any updated target on cost to income for an equity?
- Vikram Limaye** No we have already come down probably to 14.7.
- Sanjeev Agarwal** It is little volatile so I just wanted to see if you have any updated target?
- Vikram Limaye** I would not expect any kind of material reduction from current levels in terms of cost to income.
- Moderator** Thank you. We will take our final question from the line of Sneha Kothari from Subhkam Ventures. Please go ahead.
- Sneha Kothari** Sir just wanted to know, what is your outlook from the further reforms can be expected on the infrastructure side?
- Vikram Limaye** There are already some measures that have been announced by the government. If those were actually to be operationalized in a reasonable period of time that would obviously go a long way in solving some of the uncertainties that we have been talking about for some time. So, whether it is importing coal and pass through of the increased price of coal or whether it is certain discussions that have been had surrounding groups in terms of structure of how payments get made and whether developers are able to exit, etc. Some of these measures that have already been announced, it is important to see tangible results of that on the ground. Those would go a long way. I think there are some projects that are being put through certain special committees that have been set up to sort out tariff related issues. Depending on the outcome of some of those cases that would set an example for other projects that could follow in the same framework. So there are



already a few things in the books. The hope is that we will see tangible results of some of the announcements that have been made in the last few weeks, months so that sentiments and confidence in the infrastructure sector comes back. I mean the telecom sector for instance there is still an uncertainty surrounding license renewal, spectrum pricing, M&A guidelines. So if you would ask me, some clarity on the telecom front would certainly help. If there is more clarity on the road sector that would certainly help. There are some discussions that have been had surrounding TAMP and ports. So the uncertainty surrounding that if it were to be resolved and a framework put in place that would certainly help in terms of getting more investments in the port sector. So there are obviously many things that are in works and the hope is that what has been already announced can get operationalized quickly and some of these other areas where there are uncertainties if there are some tangible guidelines that are announced that would also help.

Sneha Kothari

Sir but some of the projects are already getting delayed and some of them companies are already entering into the CDR structuring?

Vikram Limaye

I don't have a solution for that unfortunately because that's really a function of each specific company and group. From a macro policy perspective if you are asking me that's what I have outlined in terms of the areas of focus.

Moderator

Thank you very much. I would now like to hand the floor over to Mr. Sunil Kakar for closing comments.

Sunil Kakar

Thanks and we will meet next quarter.

Moderator

Thank you very much members of the management. Ladies and gentlemen on behalf of IDFC Limited that concludes this conference call.