IDFC Limited

Earnings Conference Call Transcript
July 28, 2016

Moderator: Ladies and gentlemen good day and welcome to IDFC Limited Q1 FY17 Earnings Conference Call. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bimal Giri. Thank you and over to you sir.

Bimal Giri: Good afternoon everyone. I welcome you to this conference call organized to discuss our financial results for Q1 fiscal 17. I have with me Vikram Limaye, Bipin Gemani, and Sunil Kakar who is a special invitee representing IDFC Bank. Before we begin I would like to state that some of the statements made in today's discussion maybe forward-looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been e-mailed to all of you. These documents have also been posted on our corporate website. I now invite Bipin to provide key highlights of our performance for Q1 fiscal '17.

Bipin Gemani: Thank you Bimal. I'll briefly take you all through our progress in respect of IDFC consolidated financials and financials of our key subsidiaries Bank, Mutual Fund, IDF Alternatives and IDFC Securities. The consolidated balance sheet of IDFC as on June 30th 2016 was Rs. 1,06,216 crore. In Q1 FY17 the consolidated PAT was Rs. 182 crore. Consolidated net worth was Rs. 10,298 crore in Q1FY17. Performance of our bank in the first quarter of FY17 was strong. The balance sheet crossed Rs. 1 lakh crore mark and sequentially net profit increased by 60% to Rs. 265 crore. Network of our bank now has over 400 points of presence, around 60,000 customers and its products suite for retail and corporate customer is almost complete.

Our mutual fund business has been growing very profitably. In the month of June the average AUM of our mutual fund business was Rs.55, 000 crore of this equity AUMs were close to 23%. PAT was Rs. 22 crore in Q1FY17. Vishal Kapoor has been appointed as the CEO of IDFC AMC. He's expected to join us before end of September of this fiscal.

Our IDF as on June 30th 2016 has 28 assets totaling to Rs. 1,346 crore, portfolio is well diversified across renewables, IT SEZs, roads, education and healthcare. In Q1FY17 PAT was Rs.17 crore. This is a growth business and expected to gain momentum. In Alternatives AUM is over Rs.16, 000 crore in seven funds across three asset classes - infrastructure, private equity and real estate. We are in conversation with investors domestically and internationally to raise new funds in private equity and real estate. We should be announcing domestic first close of our private equity fund in the next month at about Rs.500 crore. The real estate fund has already raised

Rs.650 crore with a target of final close of Rs.750 crore approximately which we hope to achieve in the next month or two. Our PAT from this business was Rs.6 crore in Q1FY17.

In our Securities business notwithstanding the structural issues faced by the industry we have done well. We have strengthened our institutional sales and research to service FII and domestic institutional investors. We have increased our FII market share in broking and also have a healthy pipeline of capital market deals. In Q1FY17, the securities business has delivered a PAT of Rs. 3 crore. To conclude, all businesses owned by IDFC are profitable and well-positioned for growth. Over the next few years you will witness significant increase in assets under IDF and AUMs under Alternatives and mutual fund. In our securities business we will expand our research coverage and sales footprint to better service our institutional clients. On the bank call today we shared the metrics with all of you to indicate the progress of the bank. With this update we open the floor to Q&A.

Moderator: The first question from the line of Pawan Ahluwalia from Laburnum Capital. Please go ahead.

Pawan Ahluwalia If I look at the revenue margin on the AMC in terms operating income as a percentage of assets under management is lower in this quarter than in previous quarters. I have also noticed that the equity AUM as a percentage has fallen. Can you give us some sense of why that is and what would be the outlook on the ratio of debt to equity AUM going forward and what would be the strategy to build up equity AUM?. On the IDF side, we have got some helpful guidance from the bank this morning on what their aspirations were in terms of building up the book over the next year. As you are in the position to give a sense of what AUM ramp-up we could expect from the IDF for FY17 or FY18?

Vikram Limaye Basically the margins have come down marginally in terms of average margin on the business and that is a function of equity AUM as a percentage of overall AUM and in general what's going on in terms of the structure of book in terms of what the upfront commissions were historically versus the commissions that are being paid as trade. So it's a combination of things but what I would like to say is that we are on track to growing our equity AUM. The category that we were strong in historically was the mid-cap space. We are in the process of building the large-cap diversified space and as you know Anoop Bhaskar has joined us only six months ago. Some of the funds that he has taken over are now are actually performing quite well which were laggard in the past in the large-cap diversified category. In the last three to six months performance of some of these funds have moved up quite sharply from what was Q3-Q4 performance to Q1-Q2 performance. So I expect the equity AUM will improve going forward in terms of getting more money into a large-cap diversified fund. That should also push up the margin. So I wouldn't worry too much about the quarterly decline which is quite marginal, it's not of any significance when I look at the direction of the business per se. As far as the IDF question; as I indicated we do expect this to be a growth business. Right now the AUM or the loan book stands at about Rs.1,300-1,400 crore. There are lots of undisbursed sanctions that we have in IDF. The issue with undisbursed sanction is particularly on road assets. What ends up happening is that because you need to get a tripartite agreement signed with NHAI, there are delays in getting that done. But we have a healthy pipeline of deals that are not yet disbursed which we have actually signed, sanctioned to the client and we're awaiting regulatory approval. I hope that this business will get to Rs. 2,500 crore by the end of this fiscal.

Moderator The next question from the line of Nishchint Chawathe from Kotak Securities. Please go ahead.

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Nishchint Chawathe Can you share the current AUM of IDFC Alternatives?

Vikram Limaye It's about Rs. 16,379 crore.

Nishchint Chawathe That I guess is the fund size.

Vikram Limaye So what are you looking for?

Nishchint Chawathe The current outstanding.

Vikram Limaye The current outstanding; the invested capital is about Rs. 11,000 crore and as you know in our Infra Fund II substantial amount that remains to be invested. And that has another two years to go for the investment period. That was almost $850 or $900 million fund.

Nishchint Chawathe Is it possible for you to share the PAT of IDFC AMC for first quarter 16?

Vikram Limaye We will get back to you.

Nishchint Chawathe The other thing was the draft guidelines for on-tap licenses of banks. Somewhere its mentioned that there is an option of not having the NOFHC, this is provided you don't have any other non-bank subsidiaries or so. Are you looking at an option where you can merge IDFC Ltd with the bank by doing away with the NOFHC structure, there is a provision for that in the on-tap banklicenses?

Vikram Limaye No I don't think the on-tap bank licenses talks about doing away with the promoter. So if your question is about merging NOHFC with IDFC Ltd that is clearly a possibility. But even in the new bank guidelines the bank has to be promoted by some entity and the promoter entity can set up a bank without an NOHFC is my reading of the guidelines. We will obviously use that new condition to try and see if we can fold our NOFHC into IDFC Ltd which would remove one layer.

Moderator Next question is from the line of Saptarshi Sen from Aditya Birla Finance. Please go ahead.

Saptarshi Sen In terms of your project finance portfolio what is your outlook and strategy going forward and which sectors are you looking at?

Vikram Limaye This is I am assuming you're talking about the infra debt NBFC.

Saptarshi Sen Yes.

Vikram Limaye As you know this NBFC is focused only on operating infrastructure assets. It will not be doing under construction project financing. It is basically to refinance debt of operating infrastructure assets that have completed at least one-year of satisfactory operation. Now our portfolio for IDF is actually quite diversified. It has exposure across all sectors of infrastructure including roads, renewables, also social infrastructure like healthcare, education, IT Parks etc. So it will be a diversified portfolio. There isn't really any sector concentration risk. Basically our idea is to try and find good quality operating assets across all sectors that are defined as infrastructure by the Reserve Bank. So there isn't any kind of strategy which says that we will do one sector and not the other. We will consciously stay away I can tell you from thermal power as a strategy because we still believe that there are various issues surrounding that sector which have not been completely ironed out. But beyond that whether it's renewables, roads, ports, transmission, telecom, IT Park, SEZ, hospital, universities any of these sectors are workable in terms of looking at good quality operating assets.

Saptarshi Sen And how about your infra portfolio within the bank?

Vikram Limaye As we have said in this last quarter results as well, there has been no deterioration in asset quality. As you may recall we had identified certain stressed assets before the demerger and created more than adequate provisions to ring-fence the bank from any overhang of provisioning and profitability etc. So from that perspective it's still working out okay. That doesn't mean that there won't be slippages in terms of classification of assets from restructured to NPA etc. But we've outlined multiple times even if that were to happen there will not be any P&L impact because the provisioning that we've made in the bank surrounding these assets is more than sufficient even if there is slippage from one classification to another. Sunil you want to add anything?

Sunil Kakar No, I think you have covered everything because these are the legacy assets which moved to the bank and at the time of loan movement we had taken significant provision. As of now you said the only thing it's not improving but it's not deteriorating that's the one line answer I would like to add.

Saptarshi Sen But are you growing this book in terms of under construction projects which do not fit in the IDF, are you looking to grow this book?

Sunil Kakar No, if you were there in the morning session of the bank, the whole idea of the bank is to move more into the operations, retail assets. Project finance is something which we will look at it on a very-very conservative basis. So, no, we are not looking to focus on the growth of this particular sector.

Moderator Next question is from the line of V.P. Rajesh from Banyan Capital Advisors. Please go ahead.

V.P. Rajesh Could you share the book value at the end of June for IDFC Ltd?

Vikram Limaye Our net worth is about Rs.10, 290 crore, we have 160 crore shares so it will be a little worth of Rs. 63 a share.

V.P. Rajesh The second question is this column on page #5 of your presentation, the elimination has this figure of negative Rs.12 crore, could you give a little bit more color on this?

Vikram Limaye There is the associate company provision that has been reversed which is been captured in the adjustment.

Bipin Gemani The loss of the associate is taken as a share of associate line and since it is fully provided the corresponding provision has been reversed.

V.P. Rajesh But this is only the one-time book entry, right?

Bipin Gemani It's a book adjustment, yes because the lines are separate, disclosures are required separately for share of associate versus provision.

V.P. Rajesh So it will continue to the extent you have certain things going on with the associate company?

Vikram Limaye Yes.

V.P. Rajesh Earlier you were talking about reducing the holding company structure. The question I have is I assume you are in discussions with the RBI and do you have the sense of timeline as to when this particular issue could potentially be resolved in our favor?

Vikram Limaye No, unfortunately I'm not able to give you a timeline. The reason for that is we will need to have the discussions again surrounding this when the new governor comes in September. Actually there has been a change in portfolio of the existing deputy governors as well. While Mr. Gandhi was handling all these matters, now Mr. Vishwanathan has taken over as the deputy governor, so we will have to get Mr. Vishwanathan up to speed with what we want to do and then once the new governor comes in place in September we will have to take it up with the new governor. This will take some time because this is not going to be the priority on the new governor's list of items to discuss and resolve. Once the new governor settles down I'm sure we will get an opportunity to discuss this with him and figure out the way forward. I would hope that we would have sufficient clarity before the end of this calendar year on a variety of aspects surrounding this structure. The reason I'm hesitant to give an earlier timeline is because of the change in governor and deputy governor roles and because of which there is no continuity in the discussions that we have had so far.

V.P. Rajesh One quick clarification on the profitability of the AMC business; I have thought that because of the SEBI regulation where the trail commission is capped, we would be more profitable. So am I missing something or is it just because of the transition of the new CEO and the new fund manager coming in it will take some time to get back to a higher profitability?

Vikram Limaye The profitability is very much on track and we hope to be at least as profitable as last year if not higher. It doesn't have to do with the new CEO coming in, in September, etc. As far as the trail commission is concerned it is really a balance between what the upfront commission was when it was done and therefore what the trail was. We had a higher up front and lower trail it would reflect in a different way. We had a lower upfront and higher trail it reflects in a different way.

Moderator Next question is from the line of Pritesh Vohra from Incedo. Please go ahead.

Pritesh Vohra There was one news article sometime back that management is thinking of merging IDFC Bank with IDFC again. Can you throw some light on that?

Vikram Limaye It is infeasible because the Reserve Bank does not want banks to own non-bank businesses fundamentally as a structure. Because of which they required us to set up the bank through a holding company structure. So as I answered this point earlier, what we've got as a part of the bank license structure is that IDFC Ltd. is the promoter of the bank and the promoter is required to set up the bank and all other financially regulated businesses under another intermediate holding company which is 100% owned by IDFC. That intermediate holding company we believe based on the recent guidelines that have been issued for small banks and other the banks can be folded into IDFC Ltd, intermediate holding company.

Pritesh Vohra But Management is not thinking directly merging the IDFC Bank with IDFC itself?

Vikram Limaye You can't because if IDFC Ltd and IDFC Bank were to merge, the bank would then end up owning IDFC AMC, Infra NBFC, IDFC Securities, etc., which is infeasible in RBIs guidelines because they do not want banks to own nonbanking businesses. In fact, the existing banks, actually have that structure. So if you look at ICICI or Kotak or any of the other banks, they have non-banking businesses as subsidiaries but that's because of the legacy issue in terms of how they were set up. RBI in its internal thinking would also want those banks to transition into a holding company structure so they will therefore not permit. This was quite explicit in the new bank guidelines when they gave new bank licenses that we would be able to set up this bank only through a holding company structure.

Moderator The next question from the line of Aditya Singhania from ENAM Holdings. Please go ahead.

Aditya Singhania Could you give us some color on what are the various options possible as you are ruling out a merger of IDFC and IDFC Bank?

Vikram Limaye I'm not ruling out anything. I'm just saying that I'm not at liberty to discuss various structures because I'm just speculating in that case. You can also imagine whatever structure you want. It doesn't matter what I imagine and what I think. I want to be able to give you a proper guidance in terms of which way we are headed. After I have a conversation with the regulator and understand what is actually feasible and what they are prepared to do and not do. Otherwise you know how these things work. I show out 2 or 3 different structures, one of them look exciting, interesting to people, they start running with it, they start imagining that this is feasible. I have no idea what is feasible. Till I have a detailed conversation with the regulator and understand what he is willing and he is prepared to allow us to do so therefore I don't want to speculate.

Sunil Kakar I just wanted to add because I understand this shareholder and holdco discount aspect; all of us are working towards minimizing it. From a timeline perspective and this is again our best estimate most likely as Vikram said by end of December quarter we should have some clarity received from the regulator as to what is a feasible option. So whenever we do the quarterly results call after December that's the first point in time I think we shall be in a position to share with you a reasonable plan which could be acted upon. Anything before that is pure speculation and as a prudent management I don't think we can comment on it.

Vikram Limaye As I said earlier, there is a change of Governor; there is the change in responsibilities of Deputy Governors. If for some reason we are able to get clarity sooner than that obviously we will come out and issue a press release and actually do a press conference surrounding that. We won't wait for the quarterly call or anything. We are just giving some indication given how long it takes with regulator, some outside timeline that by December we will have clarity from the regulator in terms of what direction we can take.

Moderator Next question is from the line of Krishnan ASV from Motilal Oswal Securities. Please go ahead.

Krishnan ASV Just wanted to understand your thoughts on the various segments of infra that you are currently present in. Are you seeing any early indicators of the logjams moving away, are you seeing any early signs of probably all the reform measures that we have seen over the past 2-2.5 years, are those making any sense on the ground at all right now?

Vikram Limaye I think incrementally the change is positive. That has to do with not only some of the issues being sorted out although not as quickly as we would have liked but in terms of overall infrastructure spending and investment picking up, I am seeing evidence of that largely on account of government investment and spending on infrastructure and that is in 3 or 4 different areas, road is an active area. The government has introduced Hybrid Annuity Model which enables the developers to participate in road projects because the equity requirement is much lower than the earlier model. So we are seeing a lot of activity in roads in terms of project that the government plans to bid out, etc. Railway is another area where there is a pipeline of contracts that are supposed to be awarded, some have already been awarded. Renewable has been quite active given the government's focus on solar and renewable energy. So there has been a lot of activity and lots of people are participating in this. Transmission is one area where I expect to see pickup in activity so those are broadly the areas. I do believe in the next six months many of the reforms as well as actual government spending and investment in infrastructure will start showing up in the numbers in terms of construction activity and contribution to GDP growth, etc. I think from that perspective there is certainly improvement from what the situation was 9-12 months ago.

Krishnan ASV This is about activity level. I also want to understand is the commercial viability of the contract, is that looking any better now compared to how things were?

Vikram Limaye That's really a function of how people bid. For the Hybrid Annuity Model, the upfront equity requirement is much lower but that doesn't prevent somebody from bidding irrationally. None of these projects was structured to be commercially unviable, so it depends on how you bid for it. So for a solar project if you decide to bid very aggressively where there is no equity return then you will make it unviable because of how you bid for the project not because the project inherently is unviable. You do see some aggressive bidding every now and then in roads or in renewable. But I think that is something that any kind of framework that bids out projects in the private sector you will see from a competitive perspective that dynamic playing out. It's a lot less than what it used to be because there aren't many players in the infrastructure space that are aggressively bidding for these projects just given that many of the corporates are still struggling to sort out their leverage issues and to recapitalize their balance sheets. So from that perspective the froth is a lot less although renewable is some cause for concern given the way some of the recent bids have gone in terms of the price at which these projects have been bid. The other issue is the execution risk which was the bigger reason. Why some of these projects became unviable in terms of delays in getting land or clearances and in some cases obviously because of the cancellation of licenses whether it was telecom, on coal blocks, etc. So that again the hope is going forward. Any way there aren't any new projects that have been planned in coal based power plants. So the issue surrounding availability of coal or bidding for coal blocks is not really relevant because I don't see any activity in new project development in coal based power plants or gas based power plants. It's all mainly focused on renewable energy and in roads as I indicated rather than the pure BOT model most of the projects are being bid out either in this Hybrid Annuity Model or in pure construction contracts. So to that extent the risk is lower than what it used to be in terms of the traffic risks as well as the developers were taking when they bid for road projects. I think the environmental approval process has been streamlined quite significantly so one doesn't care of delays in getting environmental approvals, etc. So that's one part of execution risk that is lower than what it used to be. Land will always be an issue but I don't think projects are being bid out now unless substantial part of the land is already in place. Therefore, I think from execution risk standpoint the risks are lower, partly because of certain actions that government has taken and partly because of the nature or the format in which the bids have been made in order to reduce the risk on the private sector, a better sharing of risk between private sector and government.

Moderator The next question from the line of V.P. Rajesh from Banyan Capital Advisors. Please go ahead.

V.P. Rajesh You mentioned that some of the banks like ICICI; Kotak, etc., have other businesses within the banking entity. So the question I have is do you see regulator asking them to go the IDFC way in terms of having the bank being listed separately and the holding company being listed separately or what's your forecast on that regulatory aspect getting resolved with respect to other banks?

Vikram Limaye I can only relate what my understanding of RBIs philosophy is based on the conversations we had even when the structure was put in place for new bank licenses. The basic principle was, and this is true globally not unique to India, that regulators want to segregate or ring-fence the bank from nonbanking risk. So fundamentally the Reserve Bank also is of the opinion that banks should not own non-bank businesses that expose depositors to risks that are unknown in other businesses. And therefore as part of their discussion the Reserve Bank's view and it may even have come out in their discussion paper, etc., is that they wanted the existing banks to transition to a holding company structure which would own the bank, insurance, asset management and any other business they have separately under the holding company. Now whether they will enforce that, when they will enforce that I don't know. But philosophically that's where they want the banking system to transition to in terms of structure. Now for the existing banks to evolve to that structure is complicated. There are tax issues, there are stamp duty issues, and there are all kind of issues which were actually raised even when this was being discussed by the Reserve Bank 3-4 years ago. If there is a way to flip to that structure that is not as onerous as from, what I recall, banks were saying it could be from a tax and stamp duty standpoint. If we were to get to that point, then I'm sure the Reserve Bank would also be better positioned to try and enforce this change for the existing banks. But I'm just telling you directionally that it is RBIs philosophy in terms of how they would like the financial system to be structured in terms of banking and nonbanking businesses.

V.P. Rajesh Just a follow up on your comment on thermal power projects. I suppose I heard you say that you guys are not very keen on lending on that side. What's the thinking on that front?

Vikram Limaye Today we already have significant exposure in power so that one is just a concentration issue, second is we don't see any new coal-based power plants being built. That has to do with couple of things. If you just look at the plant load factors on the existing generation capacity that exists, average is between 50%-55%. DISCOMS are not really buying power in a way that they should, post this Uday Scheme, we will see whether they get more discipline and start buying power and revising tariffs, etc., so that they get healthier because unless they buy power you have a lot of surplus capacity in the existing capacity that has already been set up. There is no reason for anyone to set up new capacity. And if these plants operate at 50% capacity then these projects are stretched anyway, in terms of capability of servicing debt. I think there are issues surrounding power sector that still need to get sorted out. There are various tariff related issues that are still stuck with the regulators and courts. These coal block licenses that got cancelled and re-auctioned, some of those issues are not entirely sorted out in terms of how those plants will be viable based on the bids that were put in. I've already described to you the DISCOM problem, where there are significant delays by certain DISCOMS in paying for power but they are also not buying enough power. Therefore, the capacity of the existing generation units is quite low. If you look at the entire scenario it's not a scenario in which you would want to finance a new project.

Moderator Next question is from the line of Aditya Singhania from ENAM Holdings. Please go ahead.

Aditya Singhania Jus to press-on on the structure issue again; I appreciate that Kotak and ICICI are legacy structures and I understand the philosophy of the Reserve Bank as well from the license conditions. But there is also the case of another private sector bank which has received the securities as well as an AMC license in the last 12 months, so is that sort of pertinent case for our example or how should we see that?

Vikram Limaye That's I'm assuming you're referring to Yes Bank?

Aditya Singhania Yes.

Vikram Limaye That is something that I did observe as well. But I think the logic I am told behind that is because Yes Bank falls into legacy bank. In terms of the license condition around Yes Bank are different from the new bank license conditions that were put in place when we got our bank license. And I think that is the reason why they have been permitted to do what banks that were granted licenses in 2002, 2003 and 2004 etc., permitted to do. So that's my explanation for what you have observed quite correctly in terms of existing banks which didn't have non-banking businesses so far being now permitted to set up non-banking businesses and subsidiaries.

Moderator Ladies and gentlemen that was the last question. I would now like to handover the conference to Mr. Vikram Limaye, MD and CEO at IDFC Limited. Over to you Sir.

Vikram Limaye Thank you very much everyone for joining us on this call. I think Q1 has been a good quarter and we do expect that coming year will be a good year. We are seeing traction in all parts of our businesses and therefore we hope we will be able to deliver a strong set of results for this fiscal year. Thank you very much again.

Moderator Ladies and gentlemen on behalf of IDFC Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.