IDFC LIMITED

Q3 FY17 Results Conference Call Transcript
January 31, 2017

Moderator: Ladies and Gentlemen, Good Day and welcome to IDFC Limited Q3 FY17 Results Conference Call. As a reminder, all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the Conference Call, please signal for an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Bimal Giri from IDFC Limited.

Bimal Giri: Good Evening everyone. I welcome you to the conference call organized to discuss our financial results for nine months' 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 emailed 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 nine months' fiscal '17.

Bipin Gemani: I will briefly take all of you through our progress in respect of IDFC consolidated financial; Bank, Mutual Fund, IDF Alternatives and IDFC Securities.

The consolidated balance sheet of IDFC as on 31st December, 2016 was Rs. 1,21,000 crore, for nine months' fiscal '17 the consolidated PAT was Rs. 564 crore, the consolidated net worth as on 31st December, 2016 was Rs. 10,700 crore. Performance of our Bank for nine months' fiscal '17 has been already shared with all of you. The balance sheet of our Bank grew by 33% from Rs. 86,600 crore as on 31st December 2015 to Rs. 1,16,000 crore as on 31st December 2016. Our non-funded business as a percentage of funded business grew from 19% as on 30th September 2016 to 26% as on 31st December, 2016.

Contribution of Retail and SME including buyouts and on-lending was 13% of gross funded credit as on 31st December 2016. Net profits for nine month fiscal '17 stood at Rs. 844 crore. The Bank network comprises of 4,700 points of presence. The Bank has 1.24 million customers as on 31st December 2016 including 1 million customers of 'Grama Vidiyal'. Its organic customer base was Rs. 2.5 lakhs and in the month of December '16, Bank acquired over 53,000 customers.

Our Mutual Fund business has been growing very profitably. Sequentially, our average AUM, and our revenues have grown by 2%. Margins in Q3 have shown an improvement over Q2, our pipeline from new fund launches is strong and efforts to further strengthen our brand will be visible to all of us. PAT for nine months' fiscal '17 was Rs. 71 crore.

Our IDF has been re-christened as IDFC Infrastructure Finance Limited and as on 31st December 2016 our loan book was Rs. 2,260 crore comprising 36 assets. It is a well-diversified portfolio across renewable, roads, healthcare, IT, SEZ, Power transmission and others. The pipeline for disbursement continues to be healthy; our debentures and CPs continue to command the highest domestic credit rating. The PAT for the nine months was Rs. 53 crore.

In Alternatives, our AUM was over Rs. 17,700 crore in nine months across three asset classes in Infrastructure, Private Equity and Real Estate. To establish our credentials in the startup investing space, we are targeting to close a fund this calendar that will focus on early stage opportunities. We are also exploring possibilities for raising International funds for Domestic Real Estate and Private debt, notwithstanding the macro challenges in this space. Our PAT from this business for nine months fiscal '17 was Rs. 15 crore.

In our Securities business, notwithstanding the structural issues faced by the industry, we continue to do well. We have strengthened our institutional sales and research to service domestic institutional investors and FIIs across the globe translating to a well-diversified broking revenue mix across geographies. For the nine month period fiscal '17 v/s fiscal '16 we have increased our market share in broking across FII, MF and DII segments by 35% to 60% and we continue to have a healthy pipeline of capital market base. For nine months in fiscal '17, our Securities business delivered a PAT of Rs. 10 crore.

To conclude, all businesses owned by IDFC are profitable and are well positioned for growth. With this update, we open the floor for to Q & A.

Moderator: Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Raghav Garg from Banyan Capital Advisors LLP.

Raghav Garg: What is the provisioning of Rs. 49.6 crore on a standalone basis?

Vikram Limaye The standalone financials reflect subsidiaries of IDFC that are beyond the NOFHC, which is a subsidiary. So historically i.e many years ago, we used to have an entity that was focused on project developments and we have a 19.9% stake in a couple of Road assets that were developed several years ago. It is basically two assets that we had. One of the assets is doing well, the other one is not doing so well. There has been an assessment of what the likely impairment has been in terms of the investment that we have made in that Road asset. As I said, this is a 19.9% investment which we have based on the conversation what we have had, taking a provision in order to make sure that by the end of this fiscal year whatever impairment exists surrounding investments that IDFC has made that we end up taking, so that there is no residual that remains for following years. So, that is a provision that has been taken for a specific Road asset where there has been an impairment in value and again this is an asset that was developed several years ago. It was in partnership with a Malaysian entity which owns 80% of the asset.

Sunil Kakar: If I may just add more from an accounting and a concept perspective. One is investments of IDFC into its subsidiaries. So, one is standalone and one is consolidated. So, whatever we see in standalone, a large part and sometimes even more than that gets reversed, because whatever are the losses which have been incurred in this subsidiary entity, those operating losses have already been accounted at the consolidated level. So, then there is an adjustment. So whatever at a consolidated level impact we have on the P & L, the consolidated P & L is not Rs. 50 crore. I just want it to be very clear that the impairment of assets or investment is at the standalone level. But at the consolidated level, since large part of those losses is already accounted for, you do not count it again, it gets reversed. So, at a consolidated level if you look the numbers are different.

Moderator: The next question is from the line of Abhinash Pattajoshi.

Abhinash Pattajoshi: How has demonetization affected IDFC? Could you provide some guidelines or future strategies to cover up the impacts of the demonetization on the company for the coming fiscal year?

Vikram Limaye I think the demonetization obviously has a different impact depending on the business we are looking at. As it relates to the Bank, I will request Sunil to address what we have seen in terms of the impact of demonetization which has various aspects to it including liquidity and therefore resulting interest rates, credit growth, etc. When you look at the other businesses which are, say in the Securities business, we have not actually seen any difference in trading volumes or anything. So there we have not seen very much of an impact. In the Asset management business, at the margins there have been inflows because the deposit rates went down in terms of the Banking deposit rates. So there was some movement from fixed deposits into bond related funds. So, the effect was slight positive for the AMC business on account of demonetization. Again, for the Alternatives business there has really been no impact from demonetization. So, Bank is obviously has the largest impact of demonetization. So I will request Sunil to address that.

Sunil Kakar: So the demonetization impact on Bank needs to be looked at from two or three different perspectives. During the period from 8th November to 31st December, it was all hands on the deck and just trying to manage. But fortunately or unfortunately, we do not have too many branches and therefore it was not that we gathered whole amount of deposits or new accounts. So, that was not there. I also have to share with you the impact of demonetization. This is the urban story in the rural space. We have recently acquired as you are all aware, now it has all merged with us, a microfinance institution called 'Grama Vidiyal'. Now the good news from there was that our collection efficiency was not impacted at all. It had normal 99%, 99.9% collections. But on the other hand, credit growth from disbursements at the micro finance institution was almost negligible for our credit disbursements if I may say so for almost 6 to 8 weeks, it was very little but it was there. But if I had a run rate of say 100 units, we were initially disbursing only 10 units which slowly came up to 50 units. The reason being, disbursements could happen only in new currency notes and so we did not have new currency notes for disbursement perspective. So, the impact of that is that the balance sheet or the loan book from this micro finance or the 'Grama Vidiyal' started shrinking because repayments were coming which is good but new disbursements got impacted. But third more importantly I want to leave it because this is now a conjecture but I do want to share some part of it is that indirect effect of demonetization which is post 30th December 2016. On 1st January 2017, as you are all aware and I think it is a consequence of demonetization, large Banks, large public sector Banks followed by private sector Banks had cut down their marginal MCLR significantly. Just to put an example, the market rates or G-SEC rates went down by 30 to 35 basis points whereas MCLR's dropped more than 100 basis points in many cases or around 100 basis points. I am comparing September to December. Now this impact of a sharp drop in MCLR will play out in the next few quarters as it impacts our interest earning ability whereas as we just mentioned our cost of funds did not change significantly because we did not get huge chunks of cheap deposits but the marginal lending rates coming down which the market has dropped significantly and there is a kind of a gap which means market bond rates or borrowing rates and the lending rates this will for all unless I mean how things play out we all have to see but this will cause a margin compression going forward. So, that is the three level of analysis. From an asset quality perspective, as I said from the marginal MFI, there is good news as there has been no change in collections. Growth slowly came down picking up. By January end, we are almost there, by February or so the 100 units I gave as an example will come back to 100 units. But margin compression is expected or likely going forward.

Moderator: The next question is from the line of Pavan Ahluwalia from Laburnum Capital Advisors Pvt. Ltd.

Pavan Ahluwalia: I have two questions. My first question is with respect to the provisions you saw in the standalone. I assume these are sort of one time in nature, I am inferring from what Vikram said, it is one time in nature or should we expect and do you have a number these assets were just given the infrastructure scenario in the country, you know, we should expect to see a regular flow of this, as you revaluate assets where you might have a stake that are worth less than what you were carrying in them as. The second question is, on the Bank side it seems you talked a bit in the Bank's call about Stressed assets and obviously you have taken a fair bid of provisioning. I was curious what are the areas in the book that you think are most vulnerable right now? Rajiv said something about Gas based power plants, are there other areas? When we look at the results of power companies, we find that even companies that are pretty competitive producers of thermal power are having a problem getting power evacuated because there is not enough demand, the SEBs are not signing agreement. Are you seeing that even projects that might end up tripping in the book in the next few quarters?

Vikram Limaye The quick answer to your first question is, it is only one asset so there is no other asset where there would be any kind of provisioning required. So there is this one Road asset that I have talked about. Now this is obviously being settled with NHAI, right. So the final number will be known say in the next two, three weeks but we have conservatively taken a provision that we believe will be at least we hope at least 60%, 70% if not 100% of what is required. So, I do not think the incremental amount even if we were to make something in the last quarter, is going to be material to the results when you see the annualized results. To the point on the Bank, on stressed assets and areas where the stress is, Sunil can answer that question.

Sunil Kakar: So, the comment was, see our total exposures on stressed assets largely is on the energy sector. Almost 80% of our stressed book is exposed to energy. Both your observations are right, what we did say was that specifically of the lot; the worst of the lot are the gas based assets because they are not even able to produce. So if you are not able to produce at all or you have irregular supply of gas and sometimes you get a 30% PLF or sometimes you get 0%, then they are obviously in a situation where the stress levels are much higher. The second category which is less stressed would be where at least they are operating, they are producing and yes it is true that these assets, off take of that from the State Electricity Boards is irregular in nature and even if there is an off take the payment cycles continue to remain slightly stretched. Having said that, in many cases or in some of the cases there is a take or pay arrangement for this electricity board. Slowly but surely means within 6 months, 3 months, 9 months they do pay up with stretching of working capital rather than a completely non-payment because historically even for last 30 years, 40 years, State Electricity Board somehow or the other do make the payment at the end of the day. So to summarize, your overall observation is correct, we were trying to differentiate between the shades of grey, the worst of the lot continue and we do not see a very clear strategy from the Government, etc. of how to revive the gas based assets. Whereas on the coal based or thermal power sector, the level of stress is lower and in our view more or less in most cases as we had said at a portfolio level our provisioning should be sufficient.

Moderator: The next question is from the line of Sneha Ganatra from Shubhkam Capital Ventures Pvt. Ltd.

Sneha Ganatra: There were some discussion with the RBI on the merging of the IDFC Bank and the IDFC Limited. What is the status on that? My second question is on the Bank side. What is your growth outlook considering the overall system is growing by 5% and where do you see Bank to be growing for the next two to three years?

Vikram Limaye I have said this repeatedly surrounding this merger of IDFC Limited and IDFC Bank, that it is regulatorily infeasible. We actually put out a press release also, I do not know more than six months ago on this and I have said it repeatedly that you should not expect this to happen. It cannot happen by regulation. So there is no merger of IDFC Bank and IDFC Limited that was ever contemplated, nor is it regulatorily feasible. So I cannot be more clear than that as I have said before. So please do not expect that to happen because it is infeasible.

Sneha Ganatra: Could you share the reason behind that? Why it is regulatory infeasible?

Vikram Limaye This is because the Bank promoter is IDFC Limited and based on the license condition IDFC Limited has to continue as promoter of IDFC Bank. Second, the Bank cannot own a non-Banking business which means if IDFC Limited and IDFC Bank were to merge, IDFC Bank cannot own asset management, securities and all the other businesses that we have. RBI has said categorically that going forward; they want the Bank to be ring-fenced from non-Banking activities through a holding company structure which is what we put in place based on the licensing condition.

Sneha Ganatra: Sir but that discount would be continuing for IDFC Limited, the holding company?

Vikram Limaye Yes. If it continues as a holding company and therefore it has a holding company discount then yes that is a structural situation that I cannot solve for because it is regulatorily infeasible to solve for.

Sunil Kakar: See over the period of time, the ownership of the holding company of the Bank has to come down as per regulatory requirement. So correspondingly the weight of the Bank will come down slowly and the weight of other businesses will go up, so that is a longer-term outcome. Now with respect to Bank-related growth that was your second question, right?

Sneha Ganatra: Right.

Sunil Kakar It is not, I mean everybody at least we are also seeing the same thing that in the large corporate space or corporate area, the growth is quite muted, even anaemic. Quarter-on-quarter, even for us the funded credit whether in the form of loans or bonds was almost flat. So growth in the corporate sector will continue to remain muted at least and I am talking of the next few quarters, not next year, few years because things should change. However, as we have said from a strategy perspective, our focus area is to grow the retail portion of the Bank. We are today both direct and indirectly, the retailisation of the funded book is about 13%. Our objective is to grow this and over the next two, three years reach double it, maybe 25%, maybe more. So growth although it is from a low base, you will see our retail part of the book growing significantly. A lot of investment is being done in that space and lot of the investment both on the assets and liability side is being done on digital platform, whether it is we are experimenting on our digital lending where we now actually have a platform whereby people can open savings account seamlessly on the digital through our website. We already have seen that run rate around 4,000 to 5,000 accounts opening online i.e savings account, earlier it was fixed deposits and now savings accounts can be opened. So a lot of effort and development of network as well as points of presence through micro ATM, Banking correspondents and the focus is to grow a retail book digitally, so that is the broad outcome. Having said that, if you look at it at a total balance sheet level, the fact that corporate constitutes even today 85% of the book and that book may not grow as fast as we would like it to be, as per environmental situation, the balance 15% will grow significantly. But overall 15% weight cannot overtake the 85% weight so which we should see a regular trend to 15% growth at least for the next year. Beyond that, there will be, I hope structural changes and the impact of I mean tomorrow something will come out. So let us see as soon as things change from the large corporate space, we are ready to pick up on that growth. But credit growth, we will not take unnecessary risk to ensure that our book grows in the large corporate space.

Sneha Ganatra: Post demonetization how has your AMC business picked up and how do you see the growth panning out for your AMC business?

Vikram Limaye Like I said, it is not a continuous positive impact on account of demonetization, it stabilizes. There is an immediate impact when people move some money from deposits to mutual fund, etc. If interest rates on deposits were to keep coming down, I certainly believe that there will be movement of savings from fixed deposits to market-related products whether in debt, equity, blend whatever it is and I do see that given the kind of liquidity that there is in the Banking system, unless credit growth picks up and we will see if the withdrawal limits are completely opened up, how much of those deposits are sticky. But even if 20% of those deposits are sticky or 25% are sticky and credit growth really does not pick up, you could see a shift of domestic savings from fixed deposits to mutual funds. So from that perspective, there could be a positive impact of more money flowing into asset management products.

Sneha Ganatra: Okay. My last question is on the Banking side. I forgot to ask you, on the cost-to-income ratio could you give me some guidance, considering that in last two quarters there was a huge spike in the expenses front?

Sunil Kakar: So I had mentioned in my call that the last quarter spike is a spike and need not continue going forward. The absolute cost numbers will adjust next quarter. Now cost to income-to-ratio, the ratio, however, will continue to move up because as we are investing and growing, the returns on these investments are not immediate in nature but as measured through the income line but the returns are more in the nature of franchise value being build up through customer acquisitions and network growth. So, if you are looking for an absolute number, all I can say is that in this year we should end up around 40-ish or actually hopefully slightly below 40 but let us keep the number at 40.

Moderator: The next question is from the line of Sameer Bhise from Macquarie Capital Securities (India) Pvt. Ltd.

Sameer Bhise: I just wanted to understand on the dividend adjustment line. Is it primarily the dividend by the Bank to the NOFHC and AMC as well as NOFHC to the parent, is that right?

Bipin Gemani: Yes that is correct. When you prepare consolidated numbers, the dividend needs to be eliminated since the profits have been taken into account of the Banks and subsidiaries.

Sameer Bhise: Right. Secondly on the IDF Business, is there any requirement to hold standard asset provision?

Bipin Gemani: Yes.

Sameer Bhise: And what would that proportion be?

Bipin Gemani: It is 0.4%.

Moderator: Next question is a follow up question from the line of V.P. Rajesh from Banyan Capital Advisors LLP.

V.P. Rajesh: Earlier you were talking about the stress book on the Bank side. Sir, are you starting to see the benefits of the 'Uday scheme' where SEBs is being recapitalized. If you have not started to see the benefits, then could you tell me when you will start to see some benefits from that? Could you give me some sense on that?

Vikram Limaye: The benefits of 'Uday scheme' are not yet visible. State Electricity Board situation is still not good. Obviously you are aware that all the power plants are still operating at a very low PLFs. It has got to do with long terms PPAs not being signed, merchant power rates are still in the Rs. 2-2.5 zone and we were actually seeing that even for the areas that are of focus for the Government such as renewables. Certain states are actually not taking the amount of power that they are supposed to be taking and even if they are taking the power, there have been significant delays in making payments. So all of which indicated that the health of DISCOMS still has some ways to go before it gets to a level that we would all want to see. And therefore, the power sector resolution has also taken longer than what we would have liked.

V.P. Rajesh: Right, and do you see that coming through in fiscal year '18 or you think it will take longer?

Vikram Limaye: I have stopped predicting how long it will take. I had thought that by now it should have happened. But it has not. So there is no point in trying to predict. When it happens we will all be delighted and we will stop discussing when it is going to happen.

V.P. Rajesh: Okay and relatively if it continues to get pushed out, does it impact the provisioning that we have accounted for at the Bank level?

Sunil Kakar: It depends on how long it gets pushed out. So we keep measuring and refining our judgment on what is the level of provisioning which is required. In my last call, few days ago I did share that assuming that there were 50 assets. Some assets especially in the energy sector, gas related may require additional provisioning but at the same point in time, there are some assets which have, we are aware, performed much better than the provisioning we have created for and therefore there will be some release of provisions. The challenge we are having is that under the current accounting standards, I mean, we cannot time it exactly every quarter and as luck would have it the worst things happen before the good things get done. Also, even the standards of writing back on an upgrade of an asset are obviously much stringent compared to deterioration. So from an overall portfolio perspective our current read is that these provisions which we have made are still adequate at a portfolio level. At an asset level, there could be some timing differences. But if something needs something extra, hopefully going forward some of it will come back. So we will have to just see. But at a portfolio level our current assessment is that, it is appropriate.

V.P. Rajesh: My next question is regarding the equity portion of our Mutual Fund business. It can be seen that over the nine months, it has hardly grown and therefore it implies that we are losing market share. So I was just wondering what is the commentary with respect to that?

Vikram Limaye: So, we have not actually lost much market share because the point is that the equity AUM has not grown significantly, net addition to assets. So, as it has to do with MTM performance, etc., also. But what I would tell you is Equity Fund performance is certainly improved quite a bit over the last 6-9 months. Therefore we are seeing distributors distribute some of our fund products more aggressively. Just to give an example, 6 months ago, Classic Equity, was Rs. 200 crore or something and now it is close to Rs. 600 crore plus. We launched a Balanced fund in December that mobilized 300 on launch but has now garnered more. So, I am quite confident that the equity AUM will come back. What I would like to say is that in the Asset Management Businesses, we have got a lot of new talent. We got Vishal Kapoor as CEO only about four-five months ago in September. We also hired a new head of sales and marketing from Templeton. Anup Bhaskar has now been on the platform for only a year and in the last six to nine months we have already seen fund's performance pickup on the equity side. Our distributor connect has improved quite significantly and there are many distributors that were not selling our products earlier who have started selling our products. So there is a new product pipeline, I had already mentioned about the balance fund. There will be another fund launch that will happen in the next two to three weeks. So there are more new products that are planned that have already got approval that we will launch in a staged manner. So I think you will see growth in this business over the next 12 to 24 months, given all the plans that we have in place and new management that we put in place. The PMS business is another business where we are growing. We have already hired one person for that and there will be different products in the PMS business that also get launched.

V.P. Rajesh: My next question is with regards to your nine months' provisions figure of Rs. 290 crore. Is it fair to assume that all of that relates to the Bank provisioning plus the one that you have taken in this quarter with respect to the road assets. There is nothing else apart from those two things?

Sunil Kakar: Yes that is correct. Standard assets provisioning as I said out of Rs. 290 crore, Rs. 278 crore belongs to the Banks just to give the numbers in perspective.

Moderator: The next question is a follow-up question from the line of Sameer Bhise from Macquarie.

Sameer Bhise: My question is with regards to the dividend. So basically, the dividend which we are accounting this year is primarily the one which was declared for FY16 right?

Bipin Gemani: Yes that was from Bank and Asset Management Company which was declared in March 16.

Sameer Bhise: And there have not been any interim dividends paid by say the AMC and IDFC Bank?

Sunil Kakar: No.

Sameer Bhise: While discussing about IDFC Bank, we have also referred to some non-legacy assets which was provided for this quarter. Could you comment what sector was it from?

Vikram Limaye: I am sorry, but no. See it was a one-off. Obviously, it was non-infra that much I can comment.

Moderator: I now hand the conference over to Mr. Limaye for closing comments.

Vikram Limaye: Thank you very much for joining us for this conference call and we will talk to you again few months for the Annual Results.

Moderator: Thank you very much members of the management. Ladies and gentlemen on behalf of IDFC Limited that concludes today's conference call. Thank you for joining us and you may now disconnect your lines.