Transcript

Conference Call of IDFC Limited

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Presentation Session

Moderator: Good evening ladies and gentlemen. I'm Shirley, moderator for this conference. Welcome to the conference call of IDFC Limited. We have with us Mr. Rajiv Lall, CEO of IDFC and his team. At this moment all participants lines are in listen only mode. Later, we will conduct a question and answer session, at that time if you have a question, please press * and 1 on your telephone key pad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Atul Dighe.

Atul Dighe: Good afternoon everyone. This is Atul Dighe. I welcome you to the conference call organized to discuss our financial results for the first half of financial year 2008 announced yesterday. I have with me Rajiv Lall, Managing Director and CEO, Vikram Limaye, Executive Director Corporate Finance and New Businesses, and L. K. Narayan, Chief Financial Officer of IDFC. Before we begin, I would like to state that some of the statements made in today's discussions maybe forward looking in nature, and may involve risks and uncertainties. Documents related to our financial performance in the first half were e-mailed to you yesterday. These documents have also been posted on our corporate website. Now I invite Rajiv to provide the key highlights of our performance.

Rajiv Lall: Thank you Atul. Good afternoon everybody. It's good to be with you again. It's particularly good because the first six months have been good to us. We are quite pleased with this quarter's performance. What I would like to do is to take you through the numbers – in three steps. I will first give what the P&L comparison six months this year to six months last year. And I will do the same on a rolling 12 months basis, which I think is a useful way of helping you see the business, and then I will take you through the balance sheet.

On a consolidated basis, if one compares first half '08 with first half '07, there's been a substantial improvement in operating income. We delivered 625 crores first half this year, compared to 381 crores for the same period last year. That is an increase of 64%. Net interest income within that expanded 55%, growing to 329 crores from 213 crores. Net interest income specifically from our infrastructure lending business was up 31% to 250 crores from 191 crores. Our net interest income from treasury operations was 80 crores, whereas for the same period last year it was only 22 crores. Non-interest income did extremely well. We did 293 crores for the first half this year. It's nearly double what it was in the first half of last year, which the number was 153 crores. This was in part due to a sustained expansion in our fee-based income streams, from 54 crores in the first half of last year to a 166 crores now. But you have to be careful doing comparisons here, because part of this increase is attributable to the consolidation of SSKI on a line by line basis since we acquired 2/3rd of that company. But we can talk about this income later, even if you strip away SSKI, there has been a very significant improvement in fee-based income.

Profit on sale of equity investments was higher for this six month period than it was in the six month period last year. We did 124 crores in capital gains from equity sales compared to 95 crores last year. Two things to note here, firstly, we continue to manage the exits so that we don't rely disproportionately on capital gains on our investing activities and to demonstrate to you our ability to deliver traction on other non-interest lines of income. Secondly, this is partly because the markets have been buoyant, we continue to have an unrealized gain, notwithstanding having taken from profits this quarter, an unrealized gain of 324 crores on our listed investments, and this obviously does not include the substantial stake that we continue to hold in the National Stock Exchange. Coming to the expense lines, our operating expenses were 100 crore, up from 33 crores, but the increase in operating expenses was substantially due to the consolidation of SSKI. As a result of which, our cost to income ratio has trended up to over 7%, this is on a rolling 12-month basis. On the profits side, consolidated profits before tax for the first half '08 were up 43% to 502 crores. The effective tax rate has trended up on a rolling 12 month basis, is now at 24% vis-à-vis 22% for the previous 12 months. On a profit after tax basis, we are at 375 crores at the end of the first half, which is robustly higher than the 286 crores we did in the first half last year.

Now we are talking about on a 12-month rolling basis, let's look at the numbers. On expanding asset base, our non-interest income was largely stable at 2.2%, of the average total assets. Operating expenses increased from 0.7% to 0.8% after consolidating SSKI. And the return on assets was therefore at 3.2% of average assets on a rolling 12-month basis ended September 30th. Our ROE has dipped somewhat, however to 16.4% on a rolling 12-month basis, but this is because of the equity raise, that we did in July.

Let's turn now to the balance sheet. On the balance sheet size, we continue to see very robust growth. Overall balance sheet grew 50% from 14,900 crores to 22,442 crores for the first six months ended September 30th. Our loan book has expanded by 36% from 12,400 crores to 16,818 crores. This reflects good trends in approvals and disbursements. Approvals were higher by 36% to 8,593 crores from 6,317 some crores last year. Gross disbursements also expanded by 43% up to 4,938 some crores from 3,440 crores for the first half of last year. On the liabilities side, outstanding borrowings increased little over 40% to about 17,000 crores from roughly 12,000 crores last year. Continue to diversify the liabilities side of our balance sheet, we can talk about that a little more later, but leverage has dipped slightly to 5.2 times for the 12 months ended September '07, this is obviously again because of the capital raised.

A little colour on the sectoral composition of our lending business. Energy and Transportation continue to be the largest share of our total exposure. Total exposure is now almost 28,000 crores and about 2/3rd of that is Energy and Transportation taken together. Quality of our assets continues to be sound as can be evidenced by nil net NPAs.

So summary then, key financial highlights for the period is that size of balance sheet continues to grow at an impressive pace. We are quite pleased with that. Growth in our income from the core infrastructure lending business has also been very robust, and we have demonstrated good traction on expanding our non-interest income and fee income streams. Some highlights on other businesses, a minute on private equity. We now have returned the entire capital and preferred return for the first fund on our private equity business. The exits so far in this fund have shown very good returns. We continue to be very confident of the performance of the first fund from the private equity. The second fund is now 37% committed and we hope that by end of this calendar year, ¾ of that fund will have been committed, and then we can start raising money for a third private equity fund. As far as the project equity fund is concerned, this is our structured equity fund in which Citi and Blackstone are cornerstone investors. We have been on the road with this fund, over the last six weeks. We now have visibility to a first close. We are expecting to announce first close for this fund certainly before the end of this calendar year, but most likely before the end of November, and we expect to have a first dose of at least 600 million dollars, if not a tad more than that.

On the investment banking activities, SSKI has now been renamed IDFC-SSKI. All the formalities with respect to the purchase of 2/3rd stake have been completed finally, and we have begun the hard work of integrating the two platforms. The equity capital markets team or the equity placement team that we had on the IDFC platform as well as the debt syndication team are now in the process of moving, in fact equity capital market has already moved. Debt syndication, the transfer of people will happen shortly. And we think that we will have a coordinated relationship management system in place over the next few weeks. It is already beginning to show results in terms of both the investment banking business as well as the trading business, brokerage business for SSKI. So, all in all quite pleased with the results. We are very happy to take some questions if you have, I will open up the call for that. Thank you.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key pad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

Our first question comes from Ms. Mahrukh from UBS.

Mahrukh: Congratulations on a very good set of numbers, I just wanted to get a few details. What will be the size of your treasury book and how would that breakup into investments into the PE fund and other investments?

L. K. Narayan: The treasury assets as on September 30th would be approximately 3,800 crores and the PE investment is at a strategic level, its not part of our treasury assets. Treasury basically, as we had explained, invested in fixed income securities, which are highly rated AAA, AA kind of products, and a variety of capital market instruments, but it has nothing to do with equity. There is no equity sitting in the treasury.

Rajiv Lall: This is an important point, I mean, the treasury earnings that you see have nothing to do with investments and equity. The investments and equity come from a proprietary book that is quite separate and distinct. Treasury is focused as L.K just pointed, only on fixed income.

Mahrukh: Right and the total equity book is 1,700 crores.

Rajiv Lall: At cost, but that includes all our strategic investment reserves.

Mahrukh: Right. And the other question I had is that you returned the total capital on the first fund, so how many years did it take for you to divest out of the fund, and what is the average IRR, if you could share that?

Vikram Limaye: Fund was actually raised in 2003-2004, the first fund, right? So it closed in 2004. So it has taken three years basically to invest and return. It's very unusual though, this is not typical of a private equity fund. It is representative of where we were in the infrastructure investment cycle, and obviously the ability to deploy quickly markets were cooperating, and so it is a set of circumstances that you shouldn't expect will continue for fund 2, 3, etc.

Rajiv Lall: So we will again, the management team will urge you not to think of us as masters of the universe, we certainly don't think that. Markets have been extremely cooperative in delivering the results we have achieved on our investing and the private equity investing.

Mahrukh: And would you have any breakdown of your fees for the first half, into debt market, equity market fees?

Rajiv Lall: I can give you some sense of that. So we had what, total non-interest income for first half was 293 crores compared to 153 crores last year. Of this, capital gains were 124 crores, so that means that fee based income was 166 crores, and of that 68 crores came from SSKI. Even if you strip that, you get to a number of what, 98 crores, in all other fees, which includes our lending related fees, which is the front end fees and the guarantee commission, and it then has the equity syndication, the debt syndication business, and the advisory businesses. All that taken together, was 98 crores for the first half of this year, compared to 54 crores for the first half of last year.

Mahrukh: Thank you.

L. K. Narayan: That also includes the asset management fee, that we get on private equity fund etc.

Mahrukh: Thank you.

Moderator: Our next question comes from Elizabeth of Keynote Capital.

Elizabeth: I just have a question related to the figures and the ratios. I just wanted to ask, for the half yearly of this year, what is the yield on assets, what is the spread, on the quarter funds?

Rajiv Lall: Okay, so we have now in response to requests from lot of analysts, we have decided to change the way we present this information, and what we are going to do on regular basis is to basically give you the information on spreads, overall spreads. So I can give you the spread information going back to fiscal '06 and this is on a rolling 12 month basis.

Vikram Limaye: You should actually have that in the presentation that's on the web site.

Rajiv Lall: Yes. But I will just give it to you since you have asked the question. Fiscal '06, the overall spread was 1.77%, fiscal '07, was 1.9%, 12 months ending June '07, the spread was 1.89% and for the 12 months ending September '07 was 2.02%. So that is in fact by and large the trend in the spread, which covers our lending businesses as well as our treasury business.

Elizabeth: Right, on rolling basis if I see, then it is growing, but I just wanted to compare it on a half yearly basis, if you could give me the numbers, how it has grown, the spread?

Rajiv Lall: I would like to encourage you to think about the business on a rolling 12 month basis. Because as I keep saying, there is a lot of volatility in our business. So a fairer representation and a more consistent representation of what is happening to the business is actually on a 12-month rolling basis.

Elizabeth: One more question, the equity book has grown by 177% on a half yearly basis from 600 crores to like 1,700 crores. But isn't that because the SSKI

Vikram Limaye: There are a bunch of things in there. There were some preferred equity investments that we made, some structured equity stuff, there's some strategic investments relating to SSKI, and then there are some other investments in infrastructure companies that we made. So there are six or seven investments that will comprise that increase, the largest of which is an investment that we have made, I can't get into details on that, but broadly they are investments in preferred stocks, strategic investments, and other infrastructure companies.

Elizabeth: Right, okay, thank you.

Moderator: Our next question comes from Mr. Jatinder Agarwal of ABN AMRO.

Jatinder Agarwal: Sir, can we have some details on this Citi Group Blackstone for 600 million, which you plan to close before the year end, in terms of fee structure and any carry that you are able to get on that one?

Rajiv Lall: I think we will be in a position to announce that once we get the first close, the documentation is going on right now. So, it is not in the public domain, but broadly speaking it is in the ballpark of the numbers that we had guided to you before, but full disclosure will happen once we get to first close, okay.

Jatinder Agarwal: No problem, sir. And sir, on the fund that you just returned capital for, the first one which you raised in 2003-2004, can we have some sense in terms of what return, IRRs were there on those investments for the investors?

Rajiv Lall: The IRRs are very high, but I don't want you to think that this is the state of affairs.

Jatinder Agarwal: Yes, but generally could we have some idea on that broadly?

Rajiv Lall: I will give you some sense, they are well north of 45%.

Jatinder Agarwal: Okay, and sir, in this 614 crores to 1,700 crores, which includes strategic investments, can we just have a breakup as to how much is strategic and how much is others, in which you will probably look at profit booking on a later date. Basically, some sense in terms of this 1,100 crores on the increase, how much has gone in strategic will probably may not get unlocked and the balance, how much can get unlocked?

Rajiv Lall: Actually, that is a fair question and I am not able to give you an answer today, we need to think about how we define strategic versus other investments and so there is, for example, is our investment in ourselves strategic, so far we maintained it is strategic, but it is not to say that we won't sell it. But, investment in SSKI, we are not going to sell it, therefore that is, for one unambiguously it is strategic. Even there, there is a little bit of shades of grey, but we will think about that and we will present to you a distinction, so that I think it is a good question, we will give you some sense for that.

Jatinder Agarwal: Perfect sir, that's it from me, thank you sir.

Moderator: Our next question comes from Mr. Hiren Dasani of Goldman Sachs.

Hiren Dasani: Just on the private equity side, like you said once you commit the second fund you would also be looking at raising the third fund, this will be separate from the Citi Blackstone project equity fund, which we are talking about?

Rajiv Lall: Yes, it is a different asset class, that will be private equity, this is the infrastructure fund with Citi and Blackstone as corner stone investors, is a structured equity fund, so you can call it senior equity, its got different risk reward matrix than the private equity funds. It is lower risk and lower reward.

Hiren Dasani: Okay, would you have any size in mind for that?

Rajiv Lall: Any?

Hiren Dasani: Any corpus in mind for that?

Rajiv Lall: Size, for what?

Hiren Dasani: For the third fund which you propose to raise?

Rajiv Lall: We are actually in the process of determining that. We have to be cautious about when we actually go to market with that fund because we want to make sure that the first close on the project equity fund is done before we really set out on the road for the third private equity funds. So, again by next quarter we will be able to tell you.

Hiren Dasani: Okay and a related question, like you said the first fund earned IRRs well in north of 45% and those are clearly not sustainable, so in your mind what would be the sustainable IRRs, looking at the current valuations and the current markets?

Rajiv Lall: Well, I can give you a theoretical answer to that, you have some kind of equity risk premium over the risk free rate, if you are not delivering 15% unlevered IRRs in your equity investments then you are not doing a good job.

Hiren Dasani: Okay, but you think looking at today's market where almost everything is bidded up too much, do you think there are still enough opportunities to earn at least those kinds of IRRs?

Rajiv Lall: On an unlevered basis, you see you have to think about through cycles. So far we have delivered, not unlike other private equity funds I would suspect, super normal returns, but if I look at the next five years, if we are not delivering a 15% IRR on our principal investing businesses, then yes, I would be disappointed.

Hiren Dasani: Okay and Rajiv, one question on the loan book size, I mean, we saw very good 50% growth, do you think, quite a few sectors are seeing much more decent trajectory now in terms of disbursement?

Rajiv Lall: No, again probably even the loan growth numbers, I don't want people to get to thinking that 50% is going to be our normal trajectory, it has to be more modest than that. You have to understand that the base is also increasing quite rapidly. We can't keep growing at this rate, but shall we say that the markets are, the deal flow is for the time being looking to be strong.

Hiren Dasani: Sure, and a word on your cost of funds, may be how they have moved, have they kind of started already declining?

Rajiv Lall: Well, our spreads have improved marginally and I think we have, notwithstanding volatility in the funding markets, we have done a pretty good job of protecting our spreads in terms of pressures for cost of funds becoming easier, we haven't seen it yet.

Hiren Dasani: Okay, thanks a lot.

Rajiv Lall: Thank you.

Moderator: Our next question comes from Mr. Anil Agarwal of Morgan Stanley.

Anil Agarwal: Yeah, hi Rajiv, Vikram, L.K. Rajiv, two, three questions, the first is on what you said, that you have returned the entire capital, the initial part of capital, that is 200 million or so, when do you start booking performance fees on this fund now?

Rajiv Lall: Sorry?

Anil Agarwal: When do you start booking performance fees on this fund now?

Rajiv Lall: We will start seeing it from next quarter.

Anil Agarwal: Next quarter onwards.

Rajiv Lall: But it won't be a smooth stream obviously. I mean, now the next time we have an exit, we will get our carry, having returned capital and preferred return now, whatever the next exit is, you know, in the structure for remuneration on that fund, we will be entitled to carry.

Anil Agarwal: Yeah, I remember because you had guided that probably the performance fee on this fund will start from late 2008 onwards, so this is like, kind of a year earlier.

Rajiv Lall: Yeah and that is just a testimony to what you guys have been doing to our markets.

Anil Agarwal: Okay, second thing is the spread, I guess, in the second quarter, spreads appear to have increased by about 20 odd basis points on a sequential basis for the quarter, now can you give some clarity on how the third quarter spreads are panning out, are they improving over second quarter, any kind of clarity there?

Rajiv Lall: See, I will come back to my general thesis on this, when you look at the interest rate cycle, in the early stage of an interest rate cycle hike, early stage of a rising interest rate cycle, our spreads tend to compress, then as that cycle matures, our spreads tend to improve and that improvement or stability continues until the early stages of a downward rate cycle. It is only usually in the later stages of the downward cycle that our spreads come under pressure again. So, we are sort of midway in that trajectory right now.

Anil Agarwal: Okay and last question is on IFCI, you had mentioned that you are also looking at buying a 26% stake, what is the rationale there?

Rajiv Lall: Not very strong. So, are we looking at it? Yes, we are looking at it. Are we very serious about it, - probably not, unless something dramatic happens to the price of that stock.

Moderator: Our next question comes from Ms. Kajal of ICICI Direct.

Kajal: Good afternoon, sir. Sir, I just wanted to know, in this first half of FY08 we are seeing our NII from infrastructure is 2.4% and treasury is 0.8%, a dramatic rise from last half at 0.3% and even FY07 at 0.2% and this has basically led to a steep rise in our NII as a percentage of ROA giving 3.2%, so how do you see this going forward, this treasury NII has gone very steeply up and with interest rates, we may expect slightly firm for some time and then a downward trend, so this treasury NII will continue at these levels?

Rajiv Lall: So, I will come back to you again, my constant theme, that over time our NII will trend down, these are cyclical changes, we are very pleased about them, but in the long term, secular pressures remain the same, so we still expect we are prepared for our NIIs to continue trending down, partly because of our growing leverage, so we had a bit of a windfall partly also because we raised some equity, so that improved our NIIs. As that equity starts getting used up, just for that reason, the NIIs will start shrinking, then depending upon what happens to interest rates, our spreads could come under pressure again. So, for both those reasons as well as secular growth in competition from banks, I don't want you to think that our NIIs will go up from here or remain stable here forever.

Kajal: Okay, thank you sir.

Moderator: Our next question comes from Mr. Vivek of Enam Asset Management.

Vivek: Hi guys, congratulations on a good set of numbers. Our leverage stands at 5.2 times book, in earlier calls we had mentioned that our target leverage should be approximately 7 times, how soon do we see that being achieved?

Rajiv Lall: It depends on the growth.

Vikram Limaye: But there is one thing to clarify, the 5.2 number that you are looking is a 12 month number, right?

Vivek: Absolutely.

Vikram Limaye: Okay, so as of September 30th 2007, the leverage is not 5.2, because the QIP happened only late July and so, if you build that in, the leverage on the book as of September 30th will be more in the 4s rather than the 5s.

Vivek: Right, okay.

L. K. Narayanan: So, there is enough room based on the numbers that we have mentioned from a target leverage perspective.

Vivek: Sure, so can we see this 7 times by the end of this financial year?

Rajiv Lall: No, no way.

Vivek: Okay, thank you.

Moderator: Our next question comes from Mr. Ajay of Birla Sunlife.

Ajay: Hello.

Rajiv Lall: Yes.

Ajay: Okay, this is again on your raising of funds by way of borrowings, if you could just elaborate on what is the quantum that you would be raising by the end of this financial year, in terms of borrowings?

L. K. Narayanan: Okay, if you look at first half of this year, we have done on a growth basis in the ballpark of about 7,000 crores. So, this is both for the asset book, that means for our disbursement that we anticipate on the asset side as well as the maturities on the liability side, so if growth continues to be as we have seen it in first half, we would be in the ballpark of again another 7,000 to 8,000.

Ajay: Okay, that's all sir, thank you.

Moderator: Our next question comes from Mr. Sunil Kumar of Birla Sunlife.

Sunil Kumar: Yeah, hi, I just wanted to check on SSKI, is there any condition in the agreement that you can't raise your stake from the current 66%?

L. K. Narayanan: No.

Sunil Kumar: Okay, there is no such condition?

L. K. Narayanan: No.

Sunil Kumar: Thanks.

Moderator: Our next question comes from Mr. Piyush of HSBC.

Piyush: Yes sir, just a small question, you are raising borrowings recently, so in a decreasing interest rate scenario, do you think you will be in a negative position as the duration will be increasing?

L. K. Narayanan: See, it depends on what maturities we want to construct. See, the liabilities will be always reflective of the duration that we see on the assets and around that we would like to keep the liability duration profile, so by definition what we are saying to you is that we first get a sense of where the asset duration is and then we try to decide where in the interest rate cycle we find ourselves and then borrow or keep the liability duration around that number. So, it is a mix of various things. So, as we stand at this moment our asset duration is in the low 2s, it is 2.02 or something and the liability duration is about 1.5. So, this is really where we will try to keep the gap between the asset and the liabilities because we believe in a falling rate cycle, keeping the liability duration short, it could work to our advantage.

Piyush: So, sir, finally what is your call in the interest rates, just a very general feed back?

Rajiv Lall: What is yours?

Piyush: Sir, my call is that it should remain at this level sir.

Rajiv Lall: Yeah, we don't disagree with that, I guess we probably think that the interest rate has peaked. Is that right, L. K?

L. K. Narayanan: Yeah, that's correct.

Piyush: Okay, thank you sir.

Moderator: Our next question comes from Mr. Nishchint of Kotak Securities.

Nishchint: I just wanted to know, what is the policy for provisions against standard assets, is this always going to be 0.5% of incremental gross disbursements?

L. K. Narayanan: That's when we have crafted our policy and we would like to hold it at that level, it's not something that we could move from time to time. So, this has been our policy for quite a long time now. We will see at some point in time going much forward as to what our provisions to loss reserves to aggregate loan assets stand at, at that point we would like to review that, but not earlier.

Nishchint: Okay, thank you.

Moderator: I request the participants to press * and 1 for your questions. There are no further questions. Now I hand over the floor to Mr. Rajiv Lall for closing comments.

Rajiv Lall: Good, thank you very much, it is always good to interact with all of you. If you have any additional questions that our web site is unable to answer for you, please do contact our investor relations team and we will do our best to give you clarity. We look forward to connecting with you again next quarter, thank you.

Moderator: Ladies and gentlemen this concludes your conference for today. Thank you for your participation and for using Door Sabha’s conference call service. You may disconnect your lines now. Thank you and have a pleasant evening.