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Transcript of Q4FY09 Conference Call
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Presentation Session

Moderator: Good morning ladies and gentlemen. I am Shirley, moderator for this conference. Welcome to the conference call of IDFC. At this moment, all participants 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 keypad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Bimal Giri of IDFC.

Bimal Giri: Good morning everyone. I welcome you to this conference call organized to discuss our financial results for financial year 2009. I have with me Rajiv Lall, Vikram Limaye, L. K. Narayan, and Sadashiv Rao. Before we begin, I would like to state that some of the statements made in today's discussions may be forward looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been emailed to all of you yesterday. These documents have also been posted on our corporate website. I now invite Rajiv to provide key highlights of our performance for fiscal 2009.

Rajiv Lall: Thank you Bimal and hello to everybody. We are doing this call today from our new office. We have moved last week to Bandra-Kurla and we are still trying to settle down. So without getting distracted by all the settling in issues in our new office, let me run you through the numbers and then we can then get on to the Q&A.

To put things in perspective, we have discussed this several times before, fiscal '09 was a challenging year where most businesses that we are in faced significant headwinds. That said, I hope you share the sentiment that the results we have delivered for the full year of '09 are actually very good. We have been signaling to you how throughout the year in response to rapidly changing circumstances and landscape around us, we have been reorienting our priorities and during the year we started refocusing on issues such as capital conservation, profitability, liquidity, asset quality and growth, roughly in that order of priority. I hope you agree that our performance over the year demonstrates our ability, in a very nimble manner, to respond to changing circumstances around us.

Now let's talk specifically about the results, which I would present on a consolidated basis. Our operating income was higher by 17% up from 1,324 crore in fiscal '08 to 1,556 crore in fiscal '09. Within that operating income, net interest income increased by a significant 33% from 694 crore in '08 to 922 crore in '09. And this growth in our net interest income was driven primarily by NII from infrastructure lending, which despite the difficult circumstances expanded 34% from 565 crore in '08 to 758 crore in '09. NII treasury not surprisingly with the change in interest rate environment also did extremely well. We increased that by 27% from 129 crore in '08 to 164 crore in '09. The second component of our operating income, non interest income, held up extremely well. It decreased only marginally from 618 crore in '08 to 613 crore in '09 and it held up despite the very trying circumstances in equity markets and capital markets more generally, which meant that income from our principal investing activities was lower by 15%, declining from 216 crore in '08 to 184 crore in '09, despite the fact that fees from investment banking decreased by 49% from 225 crore in '08 to 115 crore in '09 and despite the fact that our loan related and other fees declined by 13% from 127 crore in '08 to 110 crore in '09. What gave our non interest income stability was our aggressive diversification into asset management activities and fees and income from asset management actually quadrupled during the year from 49 crore in '08 to 203 crore in '09 and this was on account of the new funds we raised in private equity, in project equity and on account of the AUM we acquired through the acquisition of the mutual fund. So overall we have done quite well on the non interest income front. And we would like to believe that our diversification strategy has actually paid off during the year.

Now let us look at the expense line. Operating expenses increased, at least apparently, 45% from 254 crore in '08 to 367 crore in '09, but this increase was basically driven by the new businesses that we built over fiscal '09. A lot of these expenses were on account of the AMC acquisition, which was completed in May '09 and on account of the IDFC Project Equity business that incurred some non-recurring fees. If you strip those two out, our operating expenses were kind of flat for the year. So we have done actually a pretty good job in terms of containing our operating expenses as well.

Another metric to give you a sense for, rough sense of what the core business has been doing, if you look at compare pre-provisioning profits between '08 and '09, you will find that those have grown 11% from a 1,070 crore in fiscal '08 to 1,189 crore in fiscal '09.

We had previously signaled to you that we will be making provisions, one time provisions and true to that signaling that is what we have done. So total provisions for asset classes increased by 119% for the year from 70 crore in fiscal '08 to 153 crore in fiscal '09 and of the 153 crore of provisioning, provision for contingencies against standard loan assets were 151 crore. If you recall, at the end of last quarter, we had made incremental provisions up to 3rd quarter of about 56 crore, but that includes a little bit of write back against these items. So this quarter we have taken basically an additional Rs.100-crore provision against contingencies.

Let's focus a little bit on asset quality now, having talked about provisions. As we have stated to you earlier, starting as early as July of last calendar year we have been extremely focused on preserving our asset quality and I think that those diligent efforts have paid off. We are very confident of the quality of our assets today. We believe that overall the quality of our assets is good. Our gross NPA as on March 31 are now 0.4% of our total loans outstanding, in absolute terms it comes to about 70 crore of rupees and our net NPAs are still a modest 0.2% of total assets.

During my earlier calls I have sounded cautious and shared with all of you that we are slowing down the pace of our asset growth and that we will be focusing on capital preservation, asset quality, and profitability. That is precisely what we did over fiscal ’09. As you will recall our provisioning policy for standard assets is based on gross disbursements. Given the slowdown in our loan growth, the current provisioning policy, the existing policy, was not really resulting in the level of provisions against standard assets that we were comfortable with given the size of our book and the environment we found ourselves in. True to our conservative nature we were very focused therefore on increasing our overall positions to bring the overall loan loss reserve to a level that is more commensurate with our own comfort. Our objective in making this additional 100 crore provision this quarter is basically to ensure that the cumulative loan loss provisioning level is now adequate to allow us to focus on business without having to worry about asset quality. This is the strong internal message that we have sent to all our staff, that we want this fiscal year not to be distracted by asset quality related problems, having started focusing on the issues earlier in the game, having developed the cushion we have, I think that we are now ready to prepare ourselves for a healthy year of growth.

So what does the cumulative provisioning number amount to now? Once you have the 151 crore of additional provisions made this year, as on March 31st, our cumulative loan loss provisions stood at 371 crore and this was equivalent of 1.8% of standard loan assets. In addition to that you should be aware, that we have obviously some provisions against specific assets, which is about 33 crore and we have also some provisions against our equity book, which is an additional 35 crore. So against all asset classes, of different kind, equity included, our cumulative provisioning is actually 440 crore.

Now if you just focus on loan assets, the 1.8% cover that we were talking about in terms of the cumulative provisioning amount upped sharply from the 1.2% that we found ourselves at the end of last quarter. So now I think just to reiterate the point I made a few minutes ago, we feel that we are pretty much in our comfort zone with respect to the cushion we have developed against our loan book and we are confident about facing the next fiscal year focused on growth rather than on asset quality.

Now just to look at the PBT and the PAT numbers, post provisions consolidated PBT increased by 4% from 1,000 crore in fiscal ’08 to 1,036 crore in fiscal ’09. Profits after tax were higher by 1% from 742 crore in fiscal ’08 to 750 crore in fiscal ’09. Just a point where I think it may not have been fully appreciated, I just want to reemphasize that for us to have delivered this PAT, having taken the provisioning cushion that we have, I want you all to appreciate the effort we have made, in addition to preserving profitability of our books, is on cost control. So variable compensation for staff around right across the platform has been reduced sharply relative to last year. We have frozen fixed compensation for this fiscal year and so we have been very, very disciplined, also on containing our operating expenses.

Okay, so much for the absolute numbers. Let's go quickly through the standard return on assets' tree analysis that we do. Net interest income contributed 3.1% of average total assets, of that NII infrastructure increased from 2.4% of average assets in '08 to 2.6% in '09 while NII Treasury increased from 0.5% to 0.6% over the same period. The contribution from non interest income decreased, not surprisingly, as a share of average assets from 2.6% in '08 to 2.1% in '09 and that was on account of the changes in various sub components of this revenue line. Total operating income decreased from 5.6% in '08 to 5.2% in fiscal '09. Operating expenses increased marginally to 1.2% of average assets and as I said, if you were to take out non recurring expenses and expenses on account of the AMC, which we acquired only during the year, operating expenses as a share of average assets would actually have come down. Provisions as a share of average assets increased from 0.3% to 0.5% from '08 to '09, tax and minority interest were at 1% of average assets in fiscal '09 and PAT and therefore return on assets after tax decreased from 3.1% in fiscal '08 to 2.5% in fiscal '09. I don't think there are too many financial services businesses that can have return on assets after tax of 2.5%. Buried in all this is what has happened to our net interest income, and I think it is useful to look at the impressive spread on our lending business that we have enjoyed during fiscal '08. The overall average spread actually increased from 2.1% in fiscal '08 to 2.3% in fiscal '09 and we have achieved this by basically focusing and trying to ensure that all incremental assets are booked at higher spreads and that all loans that were coming up for re-pricing were re-priced at higher prices than previously.

The Cost-to-Income ratio has trended up from 19.2% in '08 to 23.6% in '09, but again this number is distorted by the one time non-recurring increase in fees expenditure related to Project Equity and the fund closing and obviously the acquisition of the AMC. The effective tax rate increased from 25.8% in '08 to 27.6% in '09, the leverage in '09 was 4.8 times and our total capital adequacy was close to 24%, tier 1 capital adequacy was 20.04%. Because of this low leverage, the ROE decreased from 15.6% in '08 to 12.5% in '09.

Let's turn now to the balance sheet; we have increased the size of our balance sheet by 7% from 27,900 odd crore on March 31, 08 to 29,800 odd crore as of March 31st, 09. On the liabilities side, our outstanding borrowings increased by about 6% from 22,000 odd crore in March '08 to close to 24,000 crore in March '09. Our loan book actually increased by 2% from 20,495 crore in March '08 to close to 21,000 crore in March '09 and this was on account of significant ramp up of activity during Q4 relative to

Q3. So you have to concede that because of the slowdown in momentum during the year, gross approvals, relative to the very buoyant year of ’08, were down sharply by 49% from 20,000 crore in ’08 to 10,000 crore in ’09, likewise gross disbursements decreased by 33% from 12,000 crore in ’08 to 8,000 crore in ’09 and we also reduced the expansion in our equity book not surprisingly and what this does mean is that as we look forward to next year, we will ramp up business so that we come back to reasonable growth trajectory.

To give you some sense of the sectoral composition of our lending business, our overall exposure decreased from 34,000 crore in March ’08 to about 30,700 crore in March ’09. Energy and transportation continue to be the top two sectors contributing 41% and 24% respectively. I think during the course of the year, commensurate with what happened in the overall infrastructure space, our exposure and therefore concentration in the energy sector has increased. Last year our total exposure to energy was 36%, this year, as I said a moment ago, it has become 41%.

In terms of our outstanding disbursements, I know that this is a matter of some discussion in the analyst community, let me give you some color on our real estate related commercial and industrial infrastructure portfolio and also I will give you some sense of the evolution of our loan against shares portfolio. As on December 31st ’08 our outstanding disbursements to commercial and industrial infrastructure were about 3,300 crore accounting for about 14% of total, whereas in the last quarter we have been able to shrink that real estate book. Total disbursal outstanding to commercial and industrial infrastructure are now down to less than 3,000 crore and they account for about 12.9% of total outstanding disbursements as of March 31st ’09. A similar trajectory in our LAS portfolio, that too has trended down, it has declined from 2,200 crore constituting about 9.5% of outstanding disbursement at the end of last quarter, it is now down by 400 crore to about 1,800 crore. It now accounts for about 7.8% of our outstanding disbursements as of March 31st ’09. Then in the first three weeks of the new fiscal year as of April 24th ’09 I can tell you that the LAS portfolio had shrunk further and it is now down to under 1,600 crore, so we have shaved off another 200 crore from the LAS book. As I have said repeatedly before, we are pretty confident about the quality of this LAS book. We believe that the asset quality here is pretty solid, the loans are essentially to quality infrastructure clients, each of them are well secured and we really have not had any issues with this portfolio.

So, in conclusion I would say that we are feeling much better about ourselves and our performance now that the fiscal year ’09 has come to an end. I think that we have navigated the last 12 months of difficult and turbulent waters with nimbleness and flexibility. We have met the challenges in a way that we are quite satisfied with. Our asset quality remains protected and as I just said, at the risk of repeating myself, I would say that we can focus on the next 12 months without being distracted with issues of asset quality. We can focus back on building the book and on growth. And that's all I have to say by way of opening remarks. let me open the floor now to Q&A.

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. The first question comes from Mr. Prashant Poddar of ICICI Prudential.

Prashant Poddar: Good morning sir. Sir, we just wanted to understand the provisions that you have made of one time this quarter, these are not on specific accounts?

Rajiv Lall: No.

Prashant Poddar: So, they are only prudential provisions made for future contingencies?

Rajiv Lall: Correct.

Prashant Poddar: Okay, the second is you said that last year was a year of consolidation, now you will focus on growth, so what kind of growth keeping in mind both the current environment as well as the capital that you have and a related question is that Crisil was recently saying that you needed 20% tier 1, so that your ratings were maintained, where is that issue and therefore in conjunction with that and current market environment what is the kind of growth that we can see?

Vikram Limaye: On the growth side, I think a couple of things to keep in mind, as you know we are focused on the infrastructure space and given that elections are round the corner, we certainly believe that at least for the next couple of months till there is clarity on the government formation and who is in power and which minister is handling what, etc., there will be some slowdown from a macro perspective in terms of projects being bid out, etc. but we certainly believe that the situation will settle down by June and so I think as we have just come off a fairly challenging year our growth expectations for fiscal '10 are still modest at this point in time primarily given the environment we are in and the uncertainties around the elections. I think post elections we will have a better picture on how this growth environment is going to shape up, but if we were to hazard an estimate at this point in time, I would say that our growth expectations for FY10 would be in the range of 10 to 15%, but that can obviously change as we go along and once there is more certainty surrounding elections and government and all that, so we will have to revisit this. As we have said all along, our strategy is fairly nimble. It is based on what we see in the environment and that will evolve as we go through the year.

Rajiv Lall: I will make couple of additional comments here, that infrastructure space has been hit by lack of access to equity capital and that is something that has, I think slowed down the pace of big ticket infrastructure development by private parties. Because we are in the strong position we are in, we fully expect actually to gain market share in what might be a somewhat difficult environment, so we have to be a little nuanced about describing the growth opportunity. While it is true that the overall macro opportunity may be a little sluggish, we are particularly well positioned to increase our market share, that's one. Second, even with respect to the macro environment, there has been much discussion globally about a green shoots recovery etc., but I think when you look at all the numbers for lot of companies for Q4 of this year, there is a growing sense that business environment-wise the worst is behind us and that fiscal '09 could turn out to be actually better than what a lot of the macro pundits have been predicting presumably infected by the pessimism that relates to the global economy. So, both on macro as well as our positioning in the market, I think we are poised, shall we say, to do better rather than worse for this fiscal year relative to what is happening with our competition.

Prashant Poddar: Loan against shares which is now 6% of the books do you still see some stress on that portfolio?

Rajiv Lall: Stress in what sense?

Prashant Poddar: I mean, any kind of losses that we may have to book in future?

Rajiv Lall: No, not at all.

Prashant Poddar: Okay. Sir, can you just elaborate a bit on this asset management fee which has quadrupled year-on-year, whether this is a sustainable level and what part of this 200 crore would be, I mean carry related income?

Rajiv Lall: I think it would be a bit heroic to expect us to have generated carry income last year, so all of this increase has come basically from a new asset stream on account of the new fund that we have raised for project equity, which is 900 million dollars and the private equity fund which is 700 million dollars and whatever margins we get on the growing AUM of our AMC business, so these are annuity flows. I think if you look at the next 12 months you can't expect this pace of growth because we are not going to be raising another private equity fund or a project equity fund by the way, but you can expect some growth based on growth in AUM in our mutual fund business.

Prashant Poddar: So, growth over this 200 crore you are saying?

Rajiv Lall: Yeah, I mean, I think you can expect stability of these flows. Can you expect rapid growth on that? The answer is probably, no, but you can certainly expect stability.

Moderator: Next question comes from Mr. Ashwini Kumar Agarwal of JM Financial Mutual Fund.

A. K. Agarwal: Good morning sir. I have got couple of questions. Hello.

Rajiv Lall: Yes, please.

A. K. Agarwal: Sir, why has your interest cost increased in the quarter sequentially over the third quarter in spite a decline in the interest rate?

L K Narayan: No, at this point in time the market is awash with liquidity and rates are coming off the market, so we expect to capitalize on this, but our borrowing program would hinge upon how much we would put these funds to work in Q1, Q2 and therefore we would try to optimize our resource raising endeavor in line with deployment opportunities.

A. K. Agarwal: And sir what has been your incremental cost of funds in the last two months because we have seen a substantial drop in the interest rates, at what rates are you borrowing right now from the market?

L K Narayan: Being rated AAA we are privileged borrowers in the market and like we have said in earlier conversations we have always used our franchise to borrow even slightly below the AAA curve, so that is where we are. So, we do not disclose specific borrowing costs because it depends on which maturities, from which constituency you raise, but generally you are right in your observation that the interest costs have come off in a very significant way compared to what we saw in Q3 last year.

A. K. Agarwal: And sir what are the current yields in the advances, which you are making, or we can just have a range?

Vikram Limaye: In terms of yields, see it depends on the product and it depends on the clients and all that. As you know our spreads have improved in the last year. Based on the kind of deals that we are seeing in the market place, we certainly expect that our spreads will continue to hold out. So, asset yields are quite sticky given the fact that the rest of the financial services landscape is not cutting back sharply in terms of spreads and yields, primarily the banking landscape. So, we certainly believe that for the foreseeable future our spreads and asset yields will continue to hold out.

A. K. Agarwal: Okay sir and something regarding your PE funds, can I have the breakup of fees received from the three PE funds and project equity funds?

Vikram Limaye: We don’t actually give a breakdown of fees across all the different asset management businesses. What you do have is what our AUM is in each of those businesses, so in private equity we have now 1.35 billion under management, in project equity we have little over 900 million under management and in the AMC business, based on the latest information, it is in excess of 17,000 crore.

A. K. Agarwal: And sir, okay, this was the fund which we started with, currently can I know what will be the round about market value of these PE funds and the project equity funds which you are managing because we have seen a current…

Vikram Limaye: There is no market value of these things. The way we expect to generate returns from these funds is through management fees and carry.

A. K. Agarwal: Yes exactly, that is what I wanted to know because we have seen a substantial erosion in the equity value in the last one year and the fund which you raised between 2006 to 2008 must have lost quite a significant amount and…

Rajiv Lall: Please explain that.

A. K. Agarwal: Sir, we have seen significant erosion in the market in last one year and many of the investments which you made between 2006 and 2008 were at very high value.

Rajiv Lall: Well, I am not sure that we have made too many investments, if you had followed the investments we have made in the last two months, there are two large deals that were announced by project equity, both in the power sector, were actually at very compelling valuations, so I am not sure, that's one. Second, these investments are unlisted and as long as the companies themselves in the portfolio are doing reasonably well, meaning that the underlying companies are performing, I am not sure that we have anything to worry about. In any event it is inaccurate for you to try and assess a value for IDFC based on the value of the portfolio of our funds.

Moderator: Next question comes from Ms. Nandita Parker of Karma Capital.

Nandita Parker: Yeah, hi Rajiv. Just on the green shoots, what exactly are you seeing specifically on the industry side in terms of projects taking off or that would give you comfort in terms of IIP picking up in the next few quarters?

Rajiv Lall: Yeah well, I think this is not based on any great scientific analysis, but talking to a lot of people, people in the industry, people in various industries, the broad sense one gets is that the activity is split into two buckets, so things like textiles or BPO related stuff and all that, anything that relies on global markets, automobile components, may be still sluggish, but things like the cement, steel, telecom, power, these continue to grow at actually quite a reasonable clip and so based on that and agriculture seems to be quite good, plus you had an infusion of liquidity into the markets related to the election, so you put all that together, the overall picture in terms of growth is not as bad as a lot of people were fearing a quarter ago.

Nandita Parker: Okay, great and then just on the growth issue there was an earlier question on Crisil and your ability to leverage, etc., so is there like a ceiling and how do you think about it in terms of headroom that you have?

Rajiv Lall: Well, I think that we certainly have room to grow within our ROE. We will take maximum advantage of that and we are working on the Crisil issue, I expect that over the next few months we will find some kind of solution to that, which will reduce whatever restraint that might be imposing on our ability to grow. So we are cautiously optimistic about being able to tackle that issue in a way that works for all stake holders, but you should keep tuned on that.

Nandita Parker: Right. Okay and then just last question, what would be the probability of making an acquisition in terms of a bank this year?

Rajiv Lall: It is one of those known unknowables. It is impossible to predict, these are completely events that are beyond our control, so I think we have, yeah, you have a good name for your fund – it's Karma Capital, so we will do our dharma, you do your karma and we just philosophise and contemplate the unknowable turns and twists of life.

Nandita Parker: Right, okay on that philosophical note, so are you actively working on it?

Rajiv Lall: Well, we think about it, whether thought translates into action is not clear, so we are not actively working on it to tell you the truth. I think this is not the time to be working on it. We have to let a lot of things settle down before this is taken up internally and we decide on some course of action.

Moderator: Next question comes from Mr. Ashish Sharma of Enam AMC.

Ashish Sharma: Yeah, good morning sir and congratulations on a good set of numbers. First of all just wanted to get a sense of lending opportunities available in infrastructure side, earlier we were getting a sense that you are becoming stringent regarding the project you will be financing, I mean, the equity debt mix would be 20 to 80 has been shifted to 25:75, now as we know that equity is a scarce commodity in these turbulent times, are not we creating a vicious cycle where by being stringent more, we won't be having a viable lending opportunities available in the infrastructure space, sir, can you just throw some light on that sir?

Rajiv Lall: Yeah, if there is no equity there can't be too much debt, I don't think it is a vicious cycle. It is the fact that there is a paucity of equity and that does not give us license to relax the debt equity ratios and invest in capital structures that we know will be fragile over time, but from IDFC's perspective, it doesn't really stress us too much because given that, with the market generally, the opportunity space in infrastructure is more modest than it was last year and growth prospects are more muted than like last year. We have been focusing really on improving our market share, we are very confident of doing that.

Ashish Sharma: So, I mean, the question is, are such lending opportunities available in this market, sir?

Rajiv Lall: Yes, absolutely, because as I said answering the last question, within infrastructure for example power is a sector that continues to grow, there is a lot of activity that is going on there. Power and telecom, the two sectors where there is huge amount of capital required, lot of activity, where we given the strength of our balance sheet can actually play on the basis that we would like to, we don't have to compromise on our standard capital structure and quality.

Ashish Sharma: Okay sir, and sir somebody asked about the asset management fees run rate, I mean, first of all a clarification, the carry income won't come in the asset management fees, it would come in the principal investments, I suppose?

Rajiv Lall: Yes, that is exactly correct. The way you look at the asset management line is basically to get some sense of the annuity fee income stream.

Ashish Sharma: Yeah, and the run rate would be, I mean, in this quarter we have done 78 crore, I mean in the previous quarter it was close to 48 crore to be precise, I mean, what sort of a run rate would be better, in case we want to model it for the next year, sir, the 78 or the 48?

Vikram Limaye: The only way to model it is to do it on the basis of AUMs, right. So, we have already told you what the AUM in private equity and project equity is. As Rajiv said, since those funds have been raised recently we don't anticipate any new fund raisings in the next 12 months in private equity and project equity, so based on that AUM, the fee there will be stable. The asset management business as it relates to the public markets in mutual funds that today is at north of 17,000 crore, that will grow and the growth of that business is, we don't know, it is difficult to predict, but it has grown over the last 12 months. We certainly expect it to grow in the next 12 months, but can't give you a number, so we will have to just see how the AUM develops quarter-on-quarter and your fee on that line will have to be modelled based on your assumptions on AUM.

Ashish Sharma: Okay, can I have a equity AUM on the AMC side, sir? You have mentioned the total AUM of 14,362, what will be the equity AUMs?

Vikram Limaye: I think it should be on all these web sites, in AMFI and all that, but to tell you broadly, it is around Rs. 3,000 crore.

Ashish Sharma: And last question that Unitech Telenor deal done by IDFC SSKI, will be included in the Q4 or will be included in Q1 FY10 sir?

Vikram Limaye: This is a Q1 deal so it will be in Q1.

Ashish Sharma: Okay sir. Thank you.

Vikram Limaye: You are talking about the Unitech QIP? Yeah, that was done in Q1 so it has to be in Q1.

Moderator: Next question comes from Ms. Madhuchanda Dey of Kotak Securities.

Madhuchanda Dey: I have couple of questions. The first is what is the one-off item in operating expense in the fourth quarter?

Rajiv Lall: These are…we had used Citi as a placement agent for our project equity fund, now close to 900 milion, so those placement fees had to be paid up front.

Madhuchanda Dey: Okay. My question was what was the quantum of that one-off?

Rajiv Lall: About 20 odd crore.

Madhuchanda Dey: A 20 odd crore. Even if I deduct that 20 odd crore there is a significant sequential growth in operating expense, if you could just throw some light on the same?

Rajiv Lall: That is because of the AMC, right.

L K Narayan: The aggregate expenses for AMC for the year or since the time we acquired it in 30th of May

Vikram Limaye: No, as we outlined earlier, we do not look at this quarter on quarter and all that. The AMC business we are investing in that business, that business is growing in terms of presence in the country in different cities and the number of people they are adding in terms of sales, so there is growth in that business in AUM, which require support in terms of manpower and operating expenses so some of these increases in account of that. The other is on account of as Rajiv outlined placement fees paid on account of project equity fund.

Rajiv Lall: Just to clarify though, you have to understand that some of our businesses are in early stages and other businesses are at more mature stages, right. Now that is one. Second clarification or nuance that you need to understand is that even some of our newer businesses the lead time for them to become mature is shorter than others. So when you look at business wise project equity, as you are building that business there are some HR expenses that you run to have to keep a team in place and the moment you raise money and you are accruing fees on that you are actually generating a nice profit on that business, so project equity if you just take out the non-recurring expense related to placement is already in that spot, but you take a business like the mutual fund that is a longer gestation business. We have to invest in the distribution system and network for a longer time before the profitability and the revenue stream really kicks in. So, when you look to evaluate the growth in our operating expenses, we have to keep all this in mind, so that it will enhance your understanding of what is happening to our OPEX this year. I wanted to exclude the OPEX related to AMC, which is a long gestation period and I wanted to exclude the non-recurring expenses related to project equity.

Madhuchanda Dey: So, can we take Rs.100-110 crore could be the quarterly run rate for OPEX?

Rajiv Lall: No, if you look at Rs.100-110 crore on top of OPEX that gives you a sense for what run rate with commercial revenues will look like.

Madhuchanda Dey: Okay, it will depend on the AUM growth of the AMC content. That will be the key variable component, right?

Rajiv Lall: That would be a definite component. So, you will have to strip out the revenues and cost associated with the AMC. That business is pretty much flat and so if you strip those out whatever remains will give you a pretty good sense of businesses that are already matured, or businesses that reach maturity that is project equity and so operating expense metrics relating to that part of the businesses gives a sense of core and then everything else is related to business that you build up.

Madhuchanda Dey: My second question is this 1.8% provisioning that you have done. Is it dictated by any deterioration in the macro or is it just you wanted to be safe before taking the big crunch next year?

Rajiv Lall: No. You know how concerned we have been about the general macro environment over the last several months and there has been some impact of that environment on our loan book and on our asset quality. In view of all that we were very concerned that the loan loss reserve that we had been building up was falling short of our comfort zone and the specific provisioning policy that we had put in place that called for formulaic provisioning against standard assets. Unfortunately, it was linked or has been linked to gross disbursements, but because gross disbursement themselves were going down during the year, we were seeing cumulative loan loss reserve number tracking down, not up, at a time when it should be tracking up. So the only way to catch up is to make a one-time provision against contingencies, which is what we have done to come back to our comfort zone. We have to look forward now that it is better not to be distracted by asset quality related issues, but focus on growth.

Madhuchanda Dey: So the normalized loan loss provision would still be about 1%, right in a three year kind of a period or?

Rajiv Lall: Again I would say we can get into a big philosophical discussion about what a normalized loan loss provision should be, but then you will have to say what it should be through cycles. The point is that our comfort level with cumulative loan loss provision would change depending on what point of the cycle we are in. So today 1.8% net has been comfortable, it could be that the macro environment improves in the next two-three years - that comfort zone we could reset down.

Vikram Limaye: Also the thing to remember is that today we are at 1.8%, the provisioning will continue to build so far as policy that we have in place of providing against growth disbursements continues. So based on what we disburse in the next 12 months there will obviously be additional provisions that get made and these are all against standard assets, these are not because there are any specific assets that are not working out or any of that. These are just general provisions against standard assets. So the provisioning will keep building up. The additional provision is something that we have had to do more given the environment and to play catch up relative to what the formulaic provisioning we were ending up with.

Madhuchanda Dey: My third question is if you could mention the unrealized gain on the equity book?

Vikram Limaye: We do not discuss that number. All we can say is…

Madhuchanda Dey: You used to be giving that still sometime back also?

Vikram Limaye: I know, but we have stopped discussing that number given the volatility of the market. All I can tell you is that there is an unrealized gain.

Rajiv Lall: And as of yesterday the unrealized gain became larger. So it keeps moving around.

Vikram Limaye: The point is there is an unrealized gain. The portfolio is still in the money.

Madhuchanda Dey: And my last question - there have been lots of questions on this rating agency diktat. What kind of relaxation do you expect or do you sense given the green shoots stuff you have been talking about?

L K Narayan: It is premature to comment on that. Basically, our endeavor as you would can appreciate is to resolve the issue and focus on growth and therefore, their position vis-à-vis ours last year has been to have a capital adequacy tier 1 at 20%, so we are seeking resolution on that single parameter actually and that is therefore not simply a mathematical issue. It is surrounded by other issues relating to the macro environment, their assessment of risk in the macro environment, their assessment of the risk on our balance sheet, the quality of our assets liquidity, etc. So it is accumulation of all of this that has therefore impacted their perspective and suggested a 20% tier 1 capital adequacy. So if some of these macro issues play out in the manner that we anticipate, then perhaps we would get there.

Rajiv Lall: Also a thing to remember is that last year we had consciously slowed down our balance sheet growth more in view of our assessment of the environment, what our comfort zone was, what our focus should be in, and priority should be in terms of liquidity capital and asset quality and so we were able to deliver decent results, which was based on internal accruals and the growth that can be built surrounding internal accruals, so that is something that you should keep in mind. As we deliver profit each year, there is certain amount of growth that we can deliver by just maintaining our capital structure as is. There is obviously incremental growth that, depending on the environment, we can target and that has to do with resolution of the CRISIL issue that LK just outlined.

Madhuchanda Dey: But a more positive growth outlook that you mentioned is partially contingent on a relaxation from the credit rating agency right?

Rajiv Lall: No, there are two issues. There is growth and then there is explosive growth. So, I think it is fair to say that we will not be able to deliver explosive growth until the formulaic constraint imposed on us by the rating agency is relaxed and that conversation is ongoing and it could relax. We do not have anything to report as of now, but even if it weren't - the point we are trying to make and we are demonstrating through performance is that even through difficult times, through the toughest of cycle you should be able to expect that a company like IDFC will deliver steady, relatively predictable, well balanced growth through cycles up or down and to have that ability, quality and consistency, we think, is a valuable achievement and that is what we are striving to, even as we try to tackle other constraints that might be able to surprise all of you and us on the upside.

Moderator: Next question comes from Mr. Jitin Bhasin of Aviva Life Insurance.

Jitin Bhasin: Hi. My question is that if you go back to the borrowing analysis your loans under FOREX loans have increased by 3% year on year, so how would you see the impact of rupee volatility on this. Secondly, could you throw some light on the resource mobilization for FY10 given the impact of CRISIL if you can quote the number please or arrange?

Vikram Limaye: Anyhow on the loan side the thing to remember is that it is the net growth in the loan book. Our gross disbursements were Rs.8,000 crore as we have outlined so we obviously done a lot of business during the year. There are obviously repayments, prepayment and all that and that results in the net growth that we have outlined of 2%. There is no rupee volatility that impacts that. This is all pure rupee business and our FOREX borrowings are, if any, small relative to our borrowing book and, so there is no currency risk on our business at all. So you should just take that out of the equation. On the borrowing side LK would outline.

L K Narayan: Yeah, borrowing side, as you perhaps know, historically we have a significant treasury operations going and part of the treasury is liquidity management and the other part is principal investments and on liquidity management, today the market is awash with liquidity and we are perhaps one of the prime AAA borrowers on the street and therefore we are able to drive the rates the way we perceive it. So, our borrowing for Q1 of next financial year would also hinge upon the disbursement opportunities that we see because we need to be mindful about negative carry. So keeping that in mind we think that there would be a benign interest rate, definitely for this quarter and therefore we would time our market interventions based on opportunities and lending opportunity.

Jitin Bhasin: So at this point in time you cannot give us a number for the financial year as in the borrowing program, roughly?

L K Narayan: We do not disclose that.

Vikram Limaye: No, but that is something that you guys should be able to model right. You have what our capital base is, you know what our growth is likely to be, and what our leverage is likely to be, and so that is the difference. That is the difference beyond capital once you model growth.

Moderator: Next question comes from Mr. Gaurav Jain of Macro Capital.

Gaurav Jain: Hello. Sir just on your policy of how you account for goodwill since the time you acquired AMC business - you can reasonably argue that there is at least a 10% decline in the value of that business, so why wouldn't you write off goodwill?

Rajiv Lall: I think that what is reasonable is in the eyes of the beholder. While you can argue that the value has diminished by 10% I can argue that the value has actually increased by 10% because the AUM since we acquired the business has increased - contrary to industry AUM, which has declined by 18%, while our AUM has gone from Rs. 13,000 crore to Rs. 17,000 crore. Now has the value diminished, has the value increased, you tell me, but as far as accounting treatment for goodwill is concerned I will ask LK to elaborate on that.

L K Narayan: As far as goodwill is concerned the accounting rules prescribe a test for impairment and that test has been carried out and like what Rajiv said, not merely in the perspective of the management, but we have had independent evaluators who have assessed the valuation of the AMC business and they have tested that there is absolutely no impairment of that business and therefore there is no question of any write down of goodwill that we carry on the balance sheet.

Vikram Limaye: You have got to remember that this is a strategic business for us. It has to be looked at from a longer-term perspective. It cannot be looked at on an annual basis. So this has been a difficult year for all market facing businesses. Next year could be a very good year, so you cannot do this on an annual basis. On a long-term basis is there any permanent dimunition in the value of this business, we certainly do not believe that to be the case.

Rajiv Lall: But even if you read it on a year-to-year basis, AUM has gone up while the industry AUM has gone down, we would disagree with your reasonable assessment.

Moderator: Next question comes from Mr. Ajinkya Dhavale of Motilal Oswal.

Ajinkya Dhavale: Hello sir. Most of the questions have been answered. Just one question, I am unable to understand the fourth quarter fee income jump on a Q-o-Q basis?

Ajinkya Dhavale: The asset management fees I am talking about.

Vikram Limaye: You got to understand how the private equity and project equity businesses accrue fees. Whatever increase in AUM you are able to get when you finally close the funds, you accrue fees on the total AUM from the date of first close. The project equity fund is still open for another month till June. The date of first close of that fund was June 2008, so if you get incremental commitments in Q4 of 09 and if we get some more in April, May of fiscal 2010, fees on that incremental commitment accrues from June of 2008, which was the date of first close. Also on the AMC business there would have been an increase in fees on account of increase in AUM. As you know, the December quarter was a fairly difficult quarter for all mutual funds. So the AUMs dipped quite sharply for the entire industry as they did for our mutual fund as well. The pickup in AUM from Q3 of FY09 to Q4 FY09 has been extremely sharp for our mutual fund, not for the industry, as Rajiv outlined net the industry is still down for the year at 18%, but our AUM has picked up quite sharply once the market turned for investments in mutual funds.

Ajinkya Dhavale: Okay, fine so there is nothing exceptional. We can be fairly sure that right and second question is a more of clarifactory question. Mr. Rajiv said in the opening remarks the operating expenses adjusted for all one offs etc. and is flat YOY, right? So Rs. 112 crore is addition in absolute amount ‘09 over ‘08 for exceptional items and Stan C has added Rs. 67 crore, so the Rs.50 crore is an exceptional one, is that the way we should be looking at it?

Vikram Limaye: See there are two items – the project equity business was as I said the first close of that fund happened in June 2008, so in FY08 there was no assets under management for project equity. We did have some people and we did incur some operating expenses, but not nearly the run rate that you expect on that business because now it is the actual investment business once the fund has been closed. Both the AMC business and the project equity business are largely FY09 businesses from a profits perspective. In addition to that there are one time fees that we had to pay relating to the fund raising that Citigroup did for us for project equity. That combined results in that delta. If you exclude the OPEX of AMC and project equity and the one time expenses you will get to the numbers that Rajiv was talking about.

Ajinkya Dhavale: Right, got it sir and can you throw some light on the profitability of the mutual fund business for the year?

Vikram Limaye: It is marginally profitable, but you should take it as a flat business.

Ajinkya Dhavale: Okay, so it is a break even, zero profit kind.

Vikram Limaye: It is marginally profitable for FY09, but from your perspective you can take it as flat.

Ajinkya Dhavale: Right. Then one question on this provisioning, which are stepped up, do we get a tax deduction on this provision?

L K Narayan: No, there is no tax deduction.

Ajinkya Dhavale: No tax deduction and this accumulated provision does not even qualify for a capital adequacy?

L K Narayan: It will come in tier 2.

Ajinkya Dhavale: It will come in tier 2. So the question here is if you are stepping up at a cost of hampering tier 1, especially when we are a bit constrained based on CRISIL's observation, so what is?

Vikram Limaye: Now we are north of 20%.

Ajinkya Dhavale: Yeah, right. If you are talking about 20% growth for now, 15% growth for the next year again we will face the problems?

Vikram Limaye: As we said there is modest growth that we can deliver just based on our current capital structure that is the growth based on the profits that we have for the year. We will leverage on profits that we will also deliver next year right?

Ajinkya Dhavale: Right. I understand. My question was that these kind of provisions could have been done below the line or something like that if we are not getting any tax deduction on these provisions. If you just wanted to strengthen the balance sheet and Tier 1 might have looked better than what they reported already, just a way of looking at the same thing.

L K Narayan: No, the accounting is that you have to make up provision above the line.

Rajiv Lall: There was no way we could avoid this.

Moderator: Last question comes from Mr. Jatinder Agarwal of ABN AMRO Securities.

Jatinder Agarwal: Sir, couple of questions. In terms of your subsidiaries for the full year, can we have individual subsidiary wise PAT?

Rajiv Lall: When we send you the annual report you will get all the details down. We do not want to look at the PAT, it is a matter of not on principles, but it is a matter of approach here. The way we look at all these businesses irrespective of the legal structure, we have an MIS system, which is actually more closely reflective of how the businesses are run. So if we actually share all the breakdown or if you start to analyze the company based on legal structures your ability to predict an accurate model may actually be somewhat compromised.

Jatinder Agarwal: Sir, if we just look at your stand-alone numbers and your consolidated I think for the first time probably you have seen stand-alone being actually higher than what consolidated is for the quarter so just within the quarter could you give a break up as to where the negative impact has come from?

Rajiv Lall: The reason why you are getting that is there are several businesses that we are building that are not showing up anywhere. AMC is one that you could assess, although it does have a profitable impact. Project equity has not made any profit this year because of the one time non-recurring fee, the placement fee that we had to pay to Citibank, so that is why it is so.

Jatinder Agarwal: And sir any plans to raise equity capital in the near to medium term?

Vikram Limaye: We now have 24% capital adequacy…so not for the foreseeable future.

Moderator: Now, I hand over the floor to Dr. Rajiv Lall for closing comments.

Rajiv Lall: Well, so I think in closing just thank you for your time. If you have additional questions, please do not hesitate to contact our investor relations team. We will try to be as helpful as we can and look forward to the next quarter and delivering on what should be a better year for all of us. Thank you.

Moderator: Thank you sir. 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 day.