IDFC Ltd.

Transcript of Q4FY10 Results Conference Call
April 28, 2010

Moderator

Ladies and gentlemen, good morning and welcome to the IDFC Q4FY10 Results Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference call please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bimal Giri of IDFC. Thank you and over to you sir.

Bimal Giri

Good morning everyone. I welcome you to this conference call organized to discuss our financial results for the financial year 2010. I have with me Rajiv Lall, Vikram Limaye, and L. K Narayan. 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 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 Rajiv to provide key highlights of our performance for fiscal 2010.

Rajiv Lall

Thank you Bimal. As you can probably see from the results it has been a very good year for us. Let me just run through the routine presentation and then we can take Q&A and address your specific queries and concerns.

On a consolidated basis, our operating income was higher. First the headlines, our profit after tax on a year-on-year basis are up 42% but on a consolidated basis our operating income is up 35% from Rs. 1,556 Crore to Rs. 2,107 Crore. And within that, I think it is important to note that total NII revenues grew more than 21% from Rs. 922 to Rs. 1,117 Crore. This was driven primarily by a fairly robust growth in NII from our infrastructure-lending activities. So NII from infrastructure lending actually expanded 35% from Rs. 758 Crore in FY2009 to a Rs. 1,021 Crore in FY2010.

A second feature of the substantial growth in operating income year-on-year has been the contribution of non-interest income, which grew by 55% from Rs. 613 Crore in FY2009 to Rs. 950 Crore in FY2010. To give you a breakdown of that Rs. 950 Crore; Rs. 333 Crore came from principal investment activities so the growth from revenues related to principal investment activities was 81% because the last year we did Rs. 184 Crore and this year we did Rs. 333 Crore. Income from asset management increased 42% from Rs. 203 Crore to Rs. 290 Crore. This is essentially on account of growth in fee-based income, in turn related to growth in AUM in our asset management activities. Then the third aspect of non-interest income is fees from investment banking and broking. Revenues from investment banking and broking, which increased close to 60% from Rs. 115 Crore last year to Rs. 183 Crore this year. And then finally fees related to our lending activities also grew 30% from Rs. 110 Crore last year to Rs. 144 Crore in fiscal 2010.

As against these revenues our operating expenses increased quite sharply by 50% from Rs. 367 Crore to Rs. 549 Crore. This was mainly on account of compensation and even within compensation this was essentially on account of variable compensation. Our number of employees actually increased marginally from 542 as on March 31st 2009 to 578 on March 31st 2010.

And then finally expenses other then HR grew by 27% from Rs. 189 Crore in 2009 to Rs. 241 Crore in 2010. As a result of all this the pre-provisioning profits increased by 31% from Rs. 1,189 Crore in 2009 to Rs. 1,558 in 2010. Total provisions for various asset classes were at Rs. 130 Crore, broken down in part from general provisions against our lending activities, which are linked to our disbursements. There were some provisions made against some of our equity positions and as I said as a total therefore we provided a Rs. 130 Crore.

For your information that you may have already in your pack, the accumulated loan loss provisions are 1.8% of our loans. Profit before tax therefore grew 38% from Rs. 1,036 Crore to Rs. 1,429 Crore. After providing Rs. 366 Crore towards taxes etc, profit after tax therefore grew a healthy 42% from Rs. 750 Crore last year to Rs. 1,062 Crore this year.

If you now take a look at the performance using our return on assets breakdown which we do on a rolling 12-month basis. If we compare the 12-month period from January to December 2009 to fiscal 2010 NII contribution to ROA increased from 3.5% to 3.6% of average total assets, which reflects an expansion of our spreads over the most recent 12 months. In particular NII infrastructure increased from 3.1% to 3.3% driven by expanding spreads in our infrastructure lending activities. Contribution from non-interest income increased from 2.8% of average assets to 3% of average assets. Contributions from principal investments, Asset Management, investment banking broking and Loan related fees within that was at 0.9%, 1%, 0.5% & 0.4% respectively last year and these have all moved to 1.1%, 0.9%, 0.6% & 0.5% respectively in 2010.

Let me focus on a couple of other aspects of our performance, I have already mentioned that our spreads improved. If you take our overall spread on a 12-month rolling basis, it expanded from 2.6% to 2.8%. Obviously the marginal spread on our lending will have been considerably higher than the average spread 2.8%. Cost-to-income ratio increased from 23.5% to 26% on account of higher bonus. Probably a word of explanation is in order here. Because of our increasingly diversified activities which comprise many activities outside of pure lending that we do, we have moved to a different management metric for how we look at our HR expenses. So we are now really managing ourselves to an HR expense-to-income ratio, that's one. The second point is that we are holding the lines on fixed HR cost and so an increasing share of our compensation is becoming variable. And as a result of that we are not going to be able to appropriately accrue the total HR expenses during the year and you are likely to see going forward some variability in our HR expenses in Q4 which will be on account of variable compensation which in turn is linked to overall firm performance. Therefore, you know in this way of paying people it is really impossible to accrue on a straight-line basis throughout the year.

Let me now turn to some highlights from the balance sheet. Our balance sheet grew 13% year-on-year from close to Rs. 29,800 Crore as of March 31st 2009 to Rs. 33,560 Crore on March 31st 2010. Our outstanding borrowings also increased 13% from about Rs. 23,500 Crore last year to Rs. 26,500 Crore this year. Our loan book grew by 22%, it now stands at over Rs. 25,000 Crore. Our gross approvals over this period actually tripled from about Rs. 10,000 Crore in fiscal 2009 to Rs. 30,000 Crore in fiscal 2010. Likewise our gross disbursements increased 60% from about Rs. 8,000 Crore last year to close to Rs. 13,000 Crore in fiscal 2010. And so this gives you a sense for what is already embedded in our balance sheet and particularly in our loan pipeline going forward.

The most important development is that at the Board Meeting we got an approval to raise additional capital of up to Rs. 3,500 Crore. So an enabling resolution to facilitate this capital raise will be submitted to our shareholders at the AGM, which is scheduled for 28th of June. We believe we need to raise this capital because we are on the cusp of very significant growth in the coming years and for the prospects that we see for our business we believe that this is an opportune time to position ourselves to catch the developing wave in the infrastructure sector. That will see our clients require a significantly larger volume of capital going forward. Capital cannot be raised in a straight line, it is a step-function, we recognize that, but it is important for us to embrace this because only if we expand our net worth significantly will we be able to service the needs of our clients and only then will we be able to exploit the growth opportunities that lie ahead of us. So we are very confident that having raised this capital that we will be able to service it appropriately and to the satisfaction of shareholders in the coming years.

Some more highlights finally. Most importantly, there is an update with respect to our becoming an Infrastructure NBFC. Now that our year-end numbers are in and our accounts are closed we will be making a formal application to the Reserve Bank of India for certifying this nomenclature for IDFC. We expect that over the next month or two we will have this certification in hand and that will significantly improve our liability management situation.

Second is that in view of our performance, the board also approved a 15% dividend to shareholders. This represents a 21% payout ratio and 41% of available funds being paid out to shareholders. We think this step up in the dividend yield is only appropriate given the improved performance of the company this year.

Finally, all our businesses continue to gain in stature and recognition across all the categories that we compete in. To give you a few examples, IDFC was ranked #7 in the global project finance league table published by Thomson Reuters for the period ending March 31st 2010. Certainly in the last quarter we were #7 and for the full year we were #15 so if we continue at this pace of growth, I suspect that we will be very much at the top quartile of project financers anywhere in the world.

We also got several awards this year. There is an award by the Infrastructure Investor, which is a magazine, for the Asia Infrastructure Fund Manager of the year and the Asian Infrastructure Deal of the Year. Both of these awards were won by IDFC Private Equity. Our Mutual Fund won two awards at the 7th Annual ICRA Mutual Fund Awards, which recognized the performance of our debt and equity fund management teams. Then in 2009 the Asia Money Broker's Poll recognized us as the Best Local Brokerage House and I won't bore you with other awards that we have received.

So all in all this has been a really good year for us. We are very excited about our growth prospects that lie ahead of us and we are looking forward to being able to expand our capital base in order that we may embrace these opportunities. With that I will draw my introductory comments to a close and open the proceedings for Q&A.

Moderator Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from the line of Aditi Thapliyal of Execution Noble. Please go ahead.

Aditi Thapliyal I did not quite understand what exactly is the trigger for the board approval for capital delivery because you are certainly more than adequately capitalized and it is still some distance away from peak levels?

Rajiv Lall As I explained in my introductory remarks, we are poised to literary triple our balance sheets over the next 3 or 4 years and that's the growth opportunity that we are seeing in the market. What is happening increasingly is that in our core sectors, clients funding requirements are so significant that unless we are able to underwrite completely, offer significant amounts of funding for them, we risk losing our lead position in structuring and making financing available for them. In order to be able to secure that lead position, we have to increase our net worth. And that is why we feel it is very important for us to raise the capital now so that we do not miss the growth wave that lies ahead of us.

Aditi Thapliyal What kind of leverage levels would you and the rating agencies, be comfortable with over the next 3 years?

Rajiv Lall If you look at our current leverage, we are at precisely 4.8x this time and we will grow probably up to about 7x. And there are no issues with the rating agency on this.

Aditi Thapliyal From what I understood, the last quarter of each financial year, going forward, would see similar jumps or drops in operating expenses, as it would not be possible for IDFC to predict the bonus payouts at the beginning of the year and make provisions for it through the year?

Rajiv Lall So we will make what are very conservative provisions during the 3 quarters. And then depending upon how the performance has actually been, our variable compensation would be higher or lower. So there would be some degree of variability in the HR cost line in Q4.

Aditi Thapliyal Right and this is largely because Investment Banking and Broking will be more market-linked as compared to other business segments?

Rajiv Lall It is not just that. We want to keep our entire cost base, the ratio of fixed-to-variable low, because we think that is the more intelligent way of managing our compensation and HR expenses, so we have linked everybody to payouts to overall performance of the firm.

Aditi Thapliyal What explains the sequential jump in asset management income with 19% sequential growth from Rs. 68 to Rs. 81 Crore?

Rajiv Lall It comes from rapid accumulation of assets in our mutual funds.

Aditi Thapliyal If you see on a sequential basis, the assets under management for IDFC mutual fund have not really moved up by that significant an amount, I just wanted to check if there is any carry income that came from the private equity side of the business?

Rajiv Lall Carry income actually is buried in the principal investment line, so the asset management related fees are basically just fees.

Aditi Thapliyal And what is your general outlook on interest rates and consequently spreads for IDFC?

Rajiv Lall Interest rates are headed north and our spreads are headed south, but our growth is accelerating.

Moderator Thank you. Our next question is from the line of Tabassum Inamdar of Goldman Sachs. Please go ahead.

Tabassum Inamdar Hi Rajiv, first of all you talked about leveraging up to seven times now you are looking at raising Rs. 35 billion which is nearly 50% of the current net worth and then leveraging up on seven times on that. So basically what kind of growth are we looking at in terms of advances over the next 3 years?

Rajiv Lall We expect to triple our balance sheet over the next 4 odd years.

Tabassum Inamdar How do you see the employee numbers changing over the next 3 years? And what is the kind of number one should be assuming in terms of growth in cost for employees?

Rajiv Lall We will manage ourselves to a cost-to-income ratio. This is the first year that we are really looking at that metric very carefully, but we want to be able to maintain the cost-to-income ratio at a very reasonable level. And I think over the next quarter or two, we will have a better sense for what that number is, but today it is in the range of 26% and we expect that it will be in this range through the next 3 to 4 years. Our headcount will grow significantly less rapidly than the growth in our overall footprint. And we are expecting for our headcount perhaps not even to double over the next 3 years.

Tabassum Inamdar I know you have mentioned the spreads will come down, but just looking at your average cost of funding that has come off quite sharply in the last 3 quarters. Clearly at the shorter end of the market we are expecting a big spike in interest rates in perhaps the second-half of this year, so clearly I guess, the spread squeeze can be quite sharp. Would it be the case for IDFC, would you be worried that the spreads could come under significant pressure in the second half of the year?

Rajiv Lall No, again as we have explained in the past I think that in this cycle, unlike previous cycles, we expect the spread compression from rising interest rates to be less severe. And that is a hypothesis, we will find out how it actually pans out, but the hypothesis is that the competition on asset yields this time around will be less severe as well, because the overall cost of funding for the entire financial system keeps going up and therefore our competition will be less inclined to price as finely as they have done in the past in an upward cycle. So that is one reason we expect this spread compression to be less severe. The second reason is that, if we do get, as we expect to, the categorization of Infra-NBFC, then our ability to raise money from a more diverse set of players, both domestically and internationally will increase and we expect that the impact of rising interest rate on our cost of funding will be less acute than it might have been in previous years.

Tabassum Inamdar Okay, thank you.

Moderator Thank you, Ms. Inamdar. Our next question is from the line of Mahrukh Adajania of Nomura Securities. Please go ahead.

Mahrukh Adajania My first question is that would there be any carry related employee payouts in the 4th Quarter or is it all the general ones?

Rajiv Lall Carry to employees is not part of expenses.

Mahrukh Adajania Okay. And the other question I had was on the ECB. There were some rumors that either there could be some ECB relaxations for Infra-NBFCs. Have you heard anything on that?

Rajiv Lall We will know more in the next quarter, when we engage the RBI on these issues but the indications we have is that access to overseas borrowing will be more systematic than it has been in the past. So we are expecting to be able to raise more from overseas is the short answer.

Mahrukh Adajania Okay, thank you.

Moderator Thank you. Our next question is from the line of Dipankar Choudhury of Deutsche Bank. Please go ahead.

Dipankar Choudhury Related to the proposed infra-NBFC status, do you already qualify for the reduced risk weight for bank lending or is this tied to the same status?

L. K. Narayan Even before the IFCs, that is the Infrastructure Finance Company happened, we had already calibrated out so the risk weight for any bank exposure to IDFC is at 20%, which is similar to any other listed corporate entity.

Dipankar Choudhury Okay, understood, so in this regard of course it is very difficult to actually draw a conclusion out of this, but do you think that this has already given you some cost of funds advantage?

L. K. Narayan It is hard to put a finger to that in a very precise manner because the system has been awash with liquidity. Therefore the pricing of a lower risk weight from a 100% brought down to 20%, we have not yet being able to decipher that but I will hazard to say that going forward we might be able to see a much more finer pricing come off simply because of this effect.

Dipankar Choudhury Okay. And the second question is on exposure limits, we heard a lot about banks hitting exposure limits, particularly on power so have you experienced that either on the limits for the sectors or for the companies and groups?

Vikram Limaye We have not actually seen that with any degree of significance because the public sector banks continue to be lending quite aggressively to the power sector.

Dipankar Choudhury Okay, right, thanks.

Moderator Thank you Mr. Choudhury. Our next question is from the line of Hiren Dasani of Goldman Sachs Asset Management. Please go ahead.

Hiren Dasani On this Infra-NBFC, can you elaborate what would be the key advantages of becoming an Infra-NBFC. One you said ECB access could be easier, would there be anything else?

Rajiv Lall Bank lending to Infra NBFCs is less restrictive than bank lending to other NBFCs. For other NBFCs the cap is 15% of a bank's net worth, for infrastructure NBFCs it is 20%. That is on the liability side, we have already talked about the capital allocation required for lending to us is now 20% linked to our credit ratings.

Hiren Dasani But that is irrespective of you becoming Infra-NBFC right?

Rajiv Lall That is irrespective of us becoming Infra-NBFC, that is correct. On the asset side, the single company and group company limits are also more relaxed.

Hiren Dasani It would not really be too keen with you as a lender, because it would increase your concentration risk?

Rajiv Lall No, if you are worried about concentration risk then you stay away from IDFC altogether, because we do only infrastructure.

Hiren Dasani No, I am saying more in terms of single borrower and single group.

Rajiv Lall No, I do not agree with that at all, I think that our book is very concentrated in good names. It is actually a very important point, the nature of risk in our balance sheet has to be understood in a very different framework from the balance sheet of a bank. So to remind people when problems really occurred in the market in 2008, it was really our project finance book that maintained its quality best. It was our corporate lending book that was actually the most vulnerable. So as long as you are diversified by different sectors within infrastructure and by diversification across sectors it is actually more granular than that statement suggests. So, for example, just in energy although 40% of our balance sheet might be tied up in energy related deals, within energy there is renewable energy, there is transmission, there is generation, there is distribution, so each has a fairly different risk profile and we want to be diversified across all of those categories. You actually want to focus your book on sponsors and developers of these assets that are more credible, reliable and with a proven track record. So the universe of such developers and promoters is growing, but is still not all that wide. So it not as if we have a thousand transactions or thousand loans sitting on our balance sheet, we only have about 250-odd loans and the number of groups is quite limited as well but as long as these groups have a strong record of executions and performance, we believe that the risk is appropriately mitigated.

Hiren Dasani What you are saying is that the benefit of infra-NBFC essentially leads to good sponsors whom you want to lend to?

Rajiv Lall Yeah, that is true on the asset side and we are actually then able to support these promoters and these clients to a greater size of their own activities, which otherwise we could not with this amount of balance sheet.

Hiren Dasani On the flip side I understand that you have to maintain higher capital adequacy for infra-NBFC is that correct?

Rajiv Lall 15%.

Hiren Dasani Vis-à-vis 12% for the other NBFCs.

Rajiv Lall Yeah, but that is a non-binding constraint for us.

Vikram Limaye No, but even for the other NBFCs the 12% is going to 15%. So it will be on par with the NBFCs. The other point I would make in terms of that potential benefit for infra-NBFC is although it has not been announced officially, is this announcement by the Finance Minister on tax-free infrastructure bonds. So that is another area where, depending on how notification comes out, infrastructure finance companies could be notified institutions for issuance of tax-free infrastructure bonds.

Rajiv Lall That may or may not happen, but I think there are two important points for the infra-NBFC status. One is that it does unambiguously improve our ability to manage our liabilities versus a straightforward NBFC categorization. And second, it actually creates a different channel of communication for us with the RBI, because previously our frustration was that we were treated exactly like any other NBFC and there was no channel for communicating the very specific requirements and special requirements and challenges that we faced. One more benefit about infra-NBFC, we did not mention also on the liability side, is that infra-NBFCs will be eligible for refinancing from IIFCL, so that is the third extension to our sources for financing our balance sheet.

Hiren Dasani Just one thing again on the capital raise which you have kind of proposed. Now if you look at the rough numbers tripling balance sheet over a 4-year period, it would work out to be about 30% CAGR. And on a reasonable ROE expectation you would still be below 6 times at least 2 years down the line. So why now and why not maybe leverage it a little bit more and then go for a raise?

Rajiv Lall Because the growth opportunity is today and if we want to maintain the client relationships, that will actually propel our growth going forward, we have to be able to cater to their requirements. So unless we are able to underwrite Rs. 2,500 Crore in transactions, we would not get to lead them. I mean we want to be in that leadership position given what we're doing, we do not want to be just another member of a large consortium and having terms dictated to us and live with whatever spreads everybody agrees is good for them. We want to be able to lead the consortia.

Otherwise we will not be able to take advantage of the growth opportunities that are available.

Hiren Dasani Sure. Just one last point from my side, if you are expecting the rates to go up, why are you running even the minor ones but still there is a negative ALM in terms of your liability durations lower than the asset durations. With the RBI announcing the HTM for infra bonds, why is it not there for the infra-NBFC, why it is there only for infra developers?

Rajiv Lall So for that you would have to ask the RBI. The ALM delta is very small and it was really on account of some reorganization of the balance sheet that we had to do in order to meet the Infra-NBFC criteria by March 31st. And that duration will be reversed by the end of the 1st Quarter.

Hiren Dasani Thank you.

Moderator Thank you Mr. Dasani. The next question is from the line of Shrey Loonker of Reliance Mutual Fund. Please go ahead.

Shrey Loonker Hi, if we look at our net interest income plus the loan-related fees in 2007. Roughly we used to extract 3.3% out of our infra customers, today we do roughly 4.1% from the same infra customers, what has really enhanced our bargaining power? Could just elaborate a few qualitative points out there?

Rajiv Lall No, part of it is the spread that is the quantitative aspect. On the qualitative aspect, it goes back to actually some of the questions the others have been asking as well, why is it important for us to raise capital? You know in this business, size is important and therefore our ability to extract more value from client relationships depends on ability to service their needs. And so if you are able to service the needs of larger clients, you find all kinds of other opportunities to generate fee-based income and other forms of revenue from that relationship. But if you are just one more player in a consortium then you not only are you much more of a price-taker but you never have the opportunity to develop that privileged relationship with the clients that then leads to additional revenue-generating opportunities that are non-interest income in nature.

Shrey Loonker Sure. I just wanted to have your honest view on the success of takeout financing given the track record?

Rajiv Lall I feel that the takeout financing proposals are, actually, unlikely to be very successful because they are too prescriptive *ex ante*, because it is a mandatory take out at the end of the construction period. By mandatory I mean unconditional, so there are too many bells and whistles that would be attached to it for it to become interesting to various players. That said, my sense is that the equivalent of takeout financing will happen naturally and autonomously and will be market-driven as more and more assets become cash-generating. So today if you look at the infrastructure spend, where we are in the cycle, most of the assets are greenfield but as some of them get past the construction stage, a few things will happen. They will start generating cash and the construction risk will be completely gone so the risk profile of the asset becomes mitigated, we will see more predictable cash flows ahead of you and that opens the door to refinancing which effectively is a takeout.

Moderator Our next question is from the line of Suresh Ganapathy of Macquarie Securities. Please go ahead.

Suresh Ganapathy Hi Rajiv, just a quick question on the spreads this quarter. Obviously the spread has improved substantially because even on a rolling basis your spreads have gone up 20 basis points so I assume that for the quarter it would be much, much higher than that. I just wanted to know whether a significant proportion of this spread improvement has come because of the asset yields or has the cost of funds also contributed to some extent to this spread improvement?

Rajiv Lall Both, because the cost of funds have fallen by more than assets yields have fallen, that has basically accounted for the expansion in spreads.

Suresh Ganapathy Okay, fine. And on an incremental basis if you look at it on a Q-o-Q level, your exposure to the telecom sector is roughly about 50% of outstanding disbursement this quarter. Have you participated in the lending to telecom companies that are involved in the 3G license auction?

Rajiv Lall Yeah, we do have exposure to that. We are standing behind a number of the bidders. How much of that will be taken up we will see in the coming weeks.

Suresh Ganapathy Okay fine, thanks so much sir.

Moderator Thank you Mr. Ganapathy. Our next question is from the line of Jatinder Agarwal of RBS. Please go ahead.

Jatinder Agarwal On your staff cost for Rs. 3.07 billion for the full year, could you give us some more flavor if there are any one-time expenses or any non-recurring expenses and if you could give some more finer details into how much is fixed and how much is variable?

Rajiv Lall I think in the course of the next few months we may decide to share that breakdown with you, but right now I am reluctant to share that with you. So there are no one-time expenses here, they are basically variable compensation. I would just reiterate the point I made before that you have to examine our overall HR costs relative to our income. You know our income per head in this company is about the highest in any financing servicing company I know. And on top of that, we have been very disciplined by holding the line on fixed compensation, so what we are saying is that, yes we will compensate our people well, provided we perform. And so the share of variable compensation in total compensation will be significantly higher for our company than most others, certainly in banks. To give you a precise breakdown of how much is fixed and how much is variable we have not decided at this point to share that information, but should we get over our hesitation on that, we will definitely share that number with you.

Jatinder Agarwal Just taking this question forward, in terms of variable component, obviously it has to be linked to targets. So probably in investment banking it is linked to revenues I presume it would be the same in the asset management. And for the core business on loan either disbursements or absolute loan growth. Would that be a fair assumption to make on our annual models actually?

Vikram Limaye I think it is fair to assume that, as you know, we are focused on shareholder value and outcomes and results. Different parameters for the different businesses, some of it which you have outlined will be part of measuring the performance of the business and the contribution of that business to the overall results of IDFC. And the compensation of each business will obviously be driven by how that business has performed but also linked to how the overall organization has performed and so it is a fairly detailed exercise about having specific performance metrics by which you measure a business and then obviously how it rolls up into overall IDFC performance.

Jatinder Agarwal And can you give some more flavor in terms of the business growth that is likely to come over the next 2 to 3 years, which are the segments where you see business growth to be much stronger relative to others. And do you see the composition changing as we go forward?

Rajiv Lall The headline on the growth prospects, as I said earlier, we are gearing ourselves up for tripling the balance sheet over about 4 years. The composition of that growth by sector will, as it has been in the past, continue to be a reflection of the broad macro trends that drive infrastructure spending, especially spending in private infrastructure development. So the bulk of this growth will continue to be driven by the energy sector, broadly defined, by the transportation sector, broadly defined, and I would imagine to a lesser degree going forward by the telecom sector. So the future growth will primarily in a sectoral sense come from transport and energy, it is possible that in the next 3 years we might even see some growth coming from urban infrastructure, but right now we do not have visibility of that. To give you some color on the type of product, how we see the growth occurring, I think that the broad contribution in terms of revenues from interest and non-interest sources will roughly remain the same. So 50-50 or 55-45 will continue to be the breakdown between interest and non-interest sources of revenue.

Jatinder Agarwal Thank you, sir.

Moderator Thank you, Mr. Agarwal. Our next question is from the line of Ramnath V of Birla Sun Life. Please go ahead.

Ramnath V This is regarding your policy on the loan against shares, that component was around Rs. 1,500 Crore. How do you see that panning out in the next 1 or 2 years?

Rajiv Lall Well, we have really aggressively cut down on that product, I think we are very disciplined about it. It is not really a product that we are relying on to any great degree. To the extent that we make it available, it is made available in the context of a wider package of deals, products that we are providing a particular client and it will depend very much on the nature of our relationship with that client.

Ramnath V Okay. So you are saying that that should not be expected to increase materially even despite you growing at 30% CAGR growth over the next 4 years?

Rajiv Lall Yes, we are saying that.

Ramnath V Okay, thanks very much.

Moderator Thank you. Our next question is from the line of Ganeshram Jayaraman of Spark Capital. Please go ahead.

G. Jayaraman You had a rating downgrade when you were about 5.6 times leverage and now you are sounding confident of a 7 times leverage, what is giving you the confidence that you can take it up so much?

Rajiv Lall That we have changed our rating agency.

G. Jayaraman No, but still you need two out of the three and don't you think that you are running the risk of losing one more if you take it up to 7 given the importance of AAA to your overall business?

Rajiv Lall I do not think so, no.

L. K. Narayan Just to throw further light on this, soon after the CRISIL downgrade you would recall both ICRA and Fitch reaffirmed the AAA for IDFC and they have been completely cognizant of our business model and management's comfort of expanding the leverage in the zone of about 6x to 6.5x going up to 7x. So they are completely comfortable with that kind of an expansion in leverage and my own sense at this point in time is that there is no further challenge to that.

G. Jayaraman Okay. My second question is on the fact that you are predominantly PSU-bank funded and given the base rate just like to come in less than a quarter and most PSU banks are talking of at least an 8% base rate how do you see your funding cost getting affected as a result?

L. K. Narayan We will have to wait and see how the base rate itself is calculated, my own sense is that it will be calibrated by counterparty. Like we have said earlier, the risk weight for IDFC by any bank would now be rating-influenced and therefore it will be calibrated. It is not, to my mind, expected to increase substantively, but it would be nested within the overall movement in interest rates. Like what we have described would be marginal to start with, at least for the next 1 or 2 quarters.

G. Jayaraman Okay, that is it from me.

Moderator Thank you Mr. Jayaraman. Our next question is from the line of Poonam Saney of Ambit Capital. Please go ahead.

Poonam Saney Is there any quantification that you would be able to give us in terms of the improvement in the cost of funds if and when you get the infrastructure IFC status?

Rajiv Lall It is very difficult to do that because that is a counter factual kind of analysis in an environment in which we are expect rates to be rising, it is difficult to figure out how much higher our cost of funds would have been had we not got the infra-NBFC categorization.

Poonam Saney I understand that you are looking to raise Rs. 3,500 Crore of capital but would you be able to give some idea at what time like is there a certain capital adequacy at which you would want to go ahead and raise the capital or would you just be preempting it and just going ahead and raising capital rather than waiting for certain levers in your balance sheet?

Rajiv Lall We cannot be too cute about when exactly we raise capital. So we will now be guided by the condition of the markets and we will calibrate that very carefully to see when is the best time to raise capital rather than wait for the extra quarter or two to get our capital adequacy to a certain threshold. That will not be the guiding principle now having attained this approval from the board and hoping to get approval for it at the AGM. We will then go out and raise capital as soon as markets look constructive for us.

Poonam Saney I understand. Thank you sir and wish you all the best.

Moderator Thank you. Our next question is from the line of Nischint Chawathe of Kotak Securities. Please go ahead.

Nischint Chawathe Since we are talking about acceleration in the growth rate, growth rate moving to almost 30% now, so in terms of what does that do asset quality because till date asset quality has an impeccable track record and what happens now when in light of higher growth rate are you looking at changing standard asset provisional requirements or anything like that?

Rajiv Lall Well I should hope not. Not just hope not, unambiguously not. Our track record speaks for itself and by the way, this growth rate of 35% that you are projecting, is really a return to our CAGR previous to the 2008 turbulence so we have delivered that kind of growth for several years without any asset quality issues. And we have demonstrated our ability to act proactively in the event that there are macro conditions that might affect our asset quality so that we are able to move preemptively. Obviously I think the best antidote to asset quality problems is vigilance on the part of management and vigilance on the part of all our staff. There will be absolutely no relaxation in standards that we pursue to book assets. We are bullish because we genuinely believe that there is quality growth out there to be pursued in the infrastructure space.

Nishchint Chawathe Okay, thanks.

Moderator Thank you Mr. Chawathe. Our next question is from the line of Amit Premchandani of UTI Mutual Fund. Please go ahead.

Amit Premchandani If you see the return on capital employed of non-infra business for a year like FY2010 is around 9%, so what would be the guidance on the profitability of non-infra business on a return on capital employed basis?

Rajiv Lall I do not know how you are calculating that number.

Amit Premchandani You have a segmental breakup in the consolidated numbers.

Rajiv Lall Right.

Amit Premchandani So if you see the consolidated numbers, Rs. 164 Crore is the PBT and you have Rs. 1,430 Crore capital employed so if you just take out the tax, the ROC would be about 8.5 to 9?

Rajiv Lall See, we have a fairly detailed framework for capital allocation for each business. And we have a fairly sophisticated system of MIS accounting that holds the performance of each individual business to certain return targets. The nuance in this is that there is a return on equity calculation for each business, which is based on the equity requirements to actually run that business. And the equity requirements to run that business may be quite different from the capital invested in that business because we actually acquired a couple of business. So you have to look at those two things separately. The way we are manage internally is based on ROE where the 'E' is some notional allocation of capital that we think is necessary to run the business on a going concern basis. But to answer your other question, we are very focused on unlocking value from the investments that we have made. So whether it is the acquisition of IDFC Capital or it is the acquisitions of the mutual fund, we would want to deliver a rate of return, that is eventually not very much lower than our composite return on equity for the entire franchise. And we expect that going forward on a long-term sustainable basis, our return on equity should target 18% on a sustainable basis.

Amit Premchandani Okay. And a related question on the previous question on telecom, are you funding existing operators or are you also funding the new operators in the 3G bidding process?

Vikram Limaye We are basically backing people who we believe are credible long-term players in the telecom industry. So we do not want to obviously back people who have a low probability of success. Beyond that, we won't give you any more color, you can make your own conclusions.

Amit Premchandani Okay, thanks a lot.

Moderator Thank you Mr. Premchandani. Our next question is from the line of Nitin Kumar of Quant Broking. Please go ahead.

Nitin Kumar Do you have any plans of fund raising in your principal investments business because the total AUMs over there have remained fairly the same over the last 2 years?

Rajiv Lall And you would mean that private equity businesses that we have?

Nitin Kumar Yeah, that is right.

Rajiv Lall We have raised about $1.7 billion in 2008. So meanwhile the fund raising environment for these kinds of funds has not exactly been the best in the world, but we have to deploy the funds that we have used before we can go out and raise new funds. So, as far as deployment is concerned, we have deployed roughly 40% odd of the capital that we raised so it is only when we get to 75% to 80% of the capital raised that we will be in the market for raising new funds.

Nitin Kumar And when do you expect that to be, any timelines on that?

Rajiv Lall I would say certainly within the next 18 months we will be back in the market.

Nitin Kumar Okay. And you have also increased your stake in IDFC SSKI, IDFC Capital to 100% so can you share that consideration amount for that?

Rajiv Lall No, not really. It will be in the balance sheet.

Nitin Kumar Okay. And you mentioned that under the new infra-NBFC norms you will have to maintain a capital adequacy of 15% so how much is the Tier 1 under that?

L. K. Narayan Tier 1 will be 10% and Tier 2 will be 5%, that is the RBI construct on that.

Nitin Kumar Okay. Yeah that is it from my side.

Moderator Thank you Mr. Kumar. Our next question is from the line of Ashish Sharma of Enam AMC. Please go ahead.

Ashish Sharma I just wanted to ask the question on the spreads, I think you have already always given a guidance that the long-term spreads would be under pressure, do we now see the historical spreads IDFC used to make earlier of close to 1.8 to 2? Currently we have 2.8 and the worst case scenario for spreads should be 2.4 I am just trying to make a scenario that the historical spreads for IDFC would be in the range of 2.3 to 2.5 now? Would it be a fair assumption?

Vikram Limaye See as Rajiv pointed out, it is not clear that spreads would necessarily decline in any significant way. What I would certainly point out is depending on how the landscape evolves and our own loan book growth the composition of that loan book to the extent that it is more project finance and projects oriented, we do not expect any kind of significant decline in spreads. What we certainly expect is that certain types of borrowers; particularly as it relates to 3G or some of the other large corporate borrowing that might happen, will clearly not be at the same spreads as we would get on project loans. And so depending on how the mix of that loan book evolves, the spread decline would be more on account of that as opposed to any kind of structural decline in spread in the market place.

Ashish Sharma But would it be fair to assume that the historical spread which you were really guiding would not go down to the 1.8% to 2% level. You have been quite bearish on the spread itself from on the last 3 to 4 con-calls you always maintained that this is not a sustainable spread. And each quarter sequentially we have seen increase in spreads.

Vikram Limaye We do not expect spreads to go down to the 1.8% level any time soon.

Ashish Sharma Fine. And a last question on the principal investments, I assume in the last 2 quarter there has been some carry-income booked. I just wanted to know the status in the first equity fund, we have only made four exits as of now?

Vikram Limaye Six exits, not four.

Ashish Sharma Six exits, was this was the same number as in December 2009?

Vikram Limaye There were a couple of exits that happened this quarter.

Ashish Sharma Okay. And what would be the overall outlook on this principal investment income?

Vikram Limaye It is really a function of the market. I think the principal gains line has been a steady contributor to our results and if you look at it more inline as a percentage of assets, etc. it is being more or less stable. In FY2009 it was much lower because that was the nature of the markets. Because this is something that is obviously contingent on how the markets behave and our objective is not smoothen this out on a quarterly basis or anything. Exits from our funds are dependent on the state of the market, yields that we book on investments that we have made is again a function of the markets and what we believe is fair value when we should be monetizing an investment. So what I would say is that as you have seen you can monitor this now over the last 5 years, it has been relatively steady contributor to income. We expect that to continue going forward.

Ashish Sharma Fine, I missed the employee base figure, it was 578 for March 2010.

Rajiv Lall Correct.

Ashish Sharma Fine, thanks a lot and all the best.

Moderator Thank you Mr. Sharma. Our next question is from the line of Amit Ghatge of JP Morgan. Please go ahead.

Amit Ghatge Hello, the first question is that you already talked enough about the capital raising part, but what I wanted to understand is your desire to not want to be part of the syndicate. Is it driven by some kind of irrational competition from the other banks or NBFCs? Or is it also driven by any potential increase in the borrowing cost?

Rajiv Lall So the first part is, it is not driven so much by irrational behavior by competitors, it is just based on an appreciation for the earning potential that is associated with taking on a leadership position. So as I tried to explain that if you are able to play that role to the satisfaction of clients then that makes that relationship much stronger and opens the door to numerous other revenue streams than has just participating as a lender in a consortium.

Amit Ghatge Okay. And does it also have to do with any potential increase in the borrowing cost, are you also trying to protect on that front?

Rajiv Lall No, the short answer is no. The correct way to look at it is that this expands our revenue pool, no matter which way you look at it, but that is really the driving force.

Amit Ghatge Sure. And the second question that I had on your outstanding exposure, if you look at that the incremental increase in exposure came mainly from telecom as almost 56% of our exposure increase is from telecom sector. And similarly if I look at the outstanding disbursements again the increase is highest in the telecom space. And similarly you mentioned road is going to be a big driver but I do not see any increase in the outstanding disbursement for road so if you can just touch up on these issues again?

Rajiv Lall The reason why the exposure number for telecom has gone up is because we have sanctioned some loans in support of the 3G bids. So, some of this money is not going to get disbursed because not all bids are going to win so there is some element of that. And the roads are actually quite different from telecom so all this kind of lending is fast-disbursing.

The thing about roads is that we may have sanctioned against a growing number of projects, but it takes longer to disburse because they are really the traditional project finance type of norms so that is the difference. So over the next 3 years we are probably going to see a smaller contribution coming from the telecom because once the 3G and all that gets done then that big business is behind us. Where as the roads portfolio grows and the disbursement profile can somewhat elongated, you would see the share of that sector in total disbursements expand related to telecoms.

Amit Ghatge Lastly, in terms of the loan book growth that we saw during this year, the loan book grew by about Rs. 4,400 Crore. Of this growth, which is the biggest contributor to this during the current year?

Vikram Limaye It is really power and telecom.

Amit Ghatge Okay, great, thank you so much sir.

Moderator Thank you Mr. Agarwal. Our next question is from the line of PS Subramaniam of SBI Capital Securities. Please go ahead.

PS Subramaniam You said that you do not expect much pressure on yields on advances because pricing seems to be more fair and you also highlighted that you are not worried about group concentration because the kind of groups that you fund are actually reputed corporate groups. Now in light of the recent permission given in the budget for these infrastructure companies to raise tax-free bonds, don't you see these large corporates trying to fund their requirement for infrastructure by accessing the tax-free bond route, and if that happens, how would you propose to still maintain these kinds of yields on advances?

Rajiv Lall First of all, I do not think there is any permission being granted for companies in the sense of developers to raise infrastructure bonds on their main balance sheets. What is being contemplated is that in SPVs, so if there is a particular power projects that somebody is sponsoring, can that SPV issue tax-free bonds. So getting an appropriate credit regime for SPV like that, and to invite retail participation or even significant institutional participation from the likes of insurance companies is not going to be easy. Because if this is primarily greenfield risk, then the rating for these projects will not even be BBB, it will most likely be sub-investment grade because the sponsor or the promoter is unlikely to provide any recourse to their own parent balance sheet and so I do not expect that the volume of this kind of paper will be very large at this time. But over time, when more and more projects become cash generated, then if they are allowed to issue tax-free bonds then that should become an interesting proposition. That is 3, 4, 5 years down the road.

PS Subramaniam My next question is on growth. You were talking about the 30% growth or so, presuming that the banking sector grows at 20%. Have you done any kind of calculation as to how long could you grow faster than the banking sector without hitting these revised exposure norms that banks have been given in terms of funding infrastructure finance companies?

Rajiv Lall I think for 4 years we are okay.

PS Subramaniam Okay, so for 4 years you would still be able to grow at 50% more than a bank.

Rajiv Lall We can grow at rates that are faster than the financial system, for at least 4 years. Now that we are getting the Infra-NBFC classification.

PS Subramaniam Okay, so you are saying without resorting to other sources of funding this bank funding would …

Rajiv Lall No, bank funding, may be some ECBs, may be some insurance companies, it is a combination of things, can be some refinancing from IIFCL. All of that can be taken into account.

PS Subramaniam Thanks a lot. That is it from my side.

Moderator Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments. Please go ahead.

Rajiv Lall Thank you all very much. We, not unexpectedly, note that there are number of queries with respect to the timing of our capital raise, I hope that we have answered your questions satisfactorily. If you have additional questions, please do not hesitate to e-mail us or contact our investor relations team. Thank you again.

Moderator Thank you gentlemen of the management. Ladies and gentlemen, that concludes this conference call. On behalf of IDFC, thank you for joining us on the Chorus Call Conferencing Service and you may now disconnect your lines. Thank you.