IDFC Limited Earnings Conference call

Q1FY2011 **(August 05, 2010)**

Moderator Ladies and gentlemen, good morning and welcome to the IDFC Limited Conference Call. At this time, I would 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 first quarter of Fiscal 2011. I have with me Rajiv Lalll, Vikram Limaye, LK 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 e-mailed 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 the first quarter of financial year 2011.

Rajiv Lall Thank you Bimal and good morning to everybody, thanks for joining us today. This has been the quarter after a fairly hectic period of activity, so let me run you through the developments and then we can take questions and answers.

On a consolidated basis, our operating income was up 31% from ₹ 468 Crore in Q1FY10 to ₹ 613 Crore in Q1FY11. Within that, NII (net interest income) increased by 38% from ₹ 244 Crore to ₹ 337 Crore and this was driven primarily by NII from infrastructure lending which expanded 39% from ₹ 219 Crore to ₹ 304 Crore.

The second component of our operating income, non-interest income, increased by a more modest 22% from ₹ 217 Crore in Q1FY10 to ₹ 266 Crore in Q1FY11. If you were to decompose this non-interest income, income from principal investment activities increased 77% from ₹ 68 Crore to ₹ 120 Crore. This revenue line captures capital gains only from our infrastructure and financial investing activities. Capital gains from our investments in funds and the carry therefrom is actually being captured under the asset management line. If you turn to the second component of non-interest income, which is asset management, that actually decreased marginally by 10% from ₹ 72 Crore in Q1FY10 to ₹ 65 Crore in Q1FY11 and this was on account of the additional AUM that the project equity fund mobilized in Q1 last fiscal for which fees was accounted for from first close, exits in our Private Equity Fund in Q4 last fiscal and a challenging environment for the mutual fund industry. Fees from investment banking and broking also decreased by 9% from ₹ 40 Crore in Q1FY10 to ₹ 36 Crore in Q1FY11. We can discuss what the prospects for this business are but it is as we have discussed many times before a volatile business, so this quarter was a subdued quarter but the fees relating to lending activities grew a healthy 18% from ₹ 37 Crore in Q1FY10 to ₹ 44 Crore in Q1FY11.

Turning to expenses, operating expenses increased by 21% from ₹ 103 Crore in Q1FY10 to ₹ 124 Crore in Q1FY11. Pre-provisioning profits increased by 34% from ₹ 366 to ₹ 490 Crore and total provisions for various assets classes showed a very sharp increase. They were ₹ -6 Crore in Q1FY10 and ₹ 45 Crore in Q1FY11 and this was primarily on account of the fact that in Q1FY10, we had some write backs against our equity investment whereas this quarter, because our disbursements have ramped up quite aggressively, you will recall that our provisioning policy against standard assets is linked to disbursement and therefore, we have seen a significant provisioning line item this quarter. As a result of this, profit before tax increased by 20% from ₹ 372 Crore in Q1FY10 to ₹ 445 Crore in Q1FY11. After providing the ₹ 110 Crore towards taxes etc, PAT increased by 23% from ₹ 272 Crore to ₹ 335 Crore.

Now let’s go through the standard return on assets analysis that we do on a 12 month rolling basis where we compare FY10 with a 12 month period from July 2009 to June 2010. In this analysis, you will note that NII increased from 3.6% of average total assets to 3.7% of average total assets. NII on infrastructure was stable at 3.3% and NII on account of treasury was stable at around 0.3% of average total assets. The contribution from non-interest income was stable at 3%. So proportionately interest income is contributing a tad more than non-interest income. If you look at a breakdown of non-interest income on an ROA basis, the contributions to ROA from principal investments, asset management, investment banking were about 0.8%, 1.2% and 0.6%, respectively, of average total assets in last fiscal year and the most recent 12 month rolling period which is July 2009 to June 2010, they were 0.9%, 1.1% and 0.5% respectively, so really not much of a change in the composition of ROA.

Operating expenses and provisions in FY10 were at 1.8% of average total assets and 0.4% of average total assets, they are now 1.7% and 0.5% respectively. After providing for tax, RoA was stable at around 3.4% of average total assets. Overall spread now, this is an interesting bit of data, overall spread over the two 12 month rolling periods was actually stable at 2.7% and the cost to income ratio declined marginally from 26% to 25.3%. The effective tax rate decreased marginally from 25.6% to 25.1%. Leverage as on June 30, 2010, which is before our capital raise, was 5.3x and the ROE for the 12 month rolling period increased from 15.8% to 16.2%. So that is the ROA frame work.

Let us turn quickly to the balance sheet. The size of our balance sheet increased a healthy 25% from ₹ 30,880 Crore as on June 30, 2009, to ₹ 38,600-odd Crore on June 30, 2010. On the liability side our outstanding borrowings increased by 28% from ₹ 24,400-odd Crore on June 30, 2009 to almost ₹ 31,300 Crore on June 30, 2010. Our net loan book grew by a significant 39% from ₹ 20,854 Crore on June 30, 2009 to ₹ 28,900 Crore on June 30, 2010. On a sequential basis, the net loans grew by 15% from ₹ 25,000 Crore on March 31, 2010. The quarter-on-quarter, the sequential gross in loans really reflects the increasing momentum in our infrastructure loan book. As an indication of things to come in the balance sheet, gross approval tripled from ₹ 4,360 Crore in Q1FY10 to ₹ 13,000-odd Crore in Q1FY11. Gross disbursements quadrupled from ₹ 1,500 Crore in Q1FY10 to ₹ 6,200 Crore in Q1FY11. In terms of the sectoral composition, energy, telecommunication and transportation continued to be the top three sectors contributing 44%, 22% and 21% respectively of total exposure and 39%, 26% and

18% respectively of total outstanding disbursement. To give you another indication, the pipeline as of June 30, 2010, undisbursed approvals were close to ₹ 19,000 Crore. This number was ₹ 16,000 Crore as of March 31, 2010, so again another healthy indicator that we are tracking to accelerated growth.

Lastly, non-numbers related developments, I think you are all aware, the most significant development for us during the last quarter was our notification as an infrastructure finance company by the Reserve Bank of India. We were the first company to get this status and what this means amongst other things is that we can now avail of the automatic route for ECBs for up to 50% of our net worth and also, very significantly, issue tax-free infrastructure bonds to retail investors. We successfully augmented our Tier-1 capital by ₹ 3,500 Crore through a QIP and a preferential issue. Through the QIP, we raised ₹ 2,654 Crore at a share price of ₹ 168.25 per share. The remainder was raised through a CCPS, which was issued through a preferential allotment to two investors. One Khazanah, already an existing shareholder, for ₹ 380 Crore and the other one, Actis, who are the second time investor in IDFC having been a member of the founding consortium of IDFC, who got a preferential allotment of ₹ 460 Crore. The CCPS involves the cash dividend of 6% per annum and can be converted to equity shares any time during the next 18 months at a conversion price of ₹ 176 per share.

Other bit of news, we were ranked 7th in the global project finance lead tables during the quarter by lone volume, this is according to a ranking done by Thompson Reuters. In Asia, we were ranked No. 5, clearly an indication of the growing scale of our business, which is being increasingly recognized at international levels. We were also named Asset Manager of the Year by Asia Investor Magazine for our work in the alternative space as well as in mutual funds; this is the first time that Asia Investor has given this award to an Asian firm. The previous two recipients of this award were actually PIMCO and Blackrock, so we are in illustrious company when it comes to the recognition of the platform we built in alternatives. Last bit of information with respect to senior management hires, we have just hired Chetan Dave this quarter, who has joined us as the president and CEO of a newly established real estate investments division and he will be responsible for developing and building a portfolio of infrastructure-focused real estate assets and related third party funds management business. We're happy to talk about any of these aspects of our performance further in a Q& A session which I will now officially open.

Moderator Thank you. The first question is from the line of Mahrukh Adajania from Nomura Securities, please go ahead.

Mahrukh Adajania How do you read the liquidity environment right now and in the first quarter itself were your incremental spreads lower than what they were in Q4, I saw the rolling spread analysis and that was pretty resilient but just in terms of incremental spreads, were they significantly lower in Q1 than in Q4 and how do you see that panning ahead? Could you elaborate a bit further on your operating expenses? So in this quarter have you taken some amount of amortization for the potential bonuses you would pay out by end of the year because fourth quarter operating expenses and employee expenses were very high?

Rajiv Lall Yeah, I will take the question on spreads and then I will ask LK Narayan to deal with liquidity and Vikram Limaye can deal with the treatment of amortization or provisions for variable compensation. For spreads, I think the spreads have continued to hold on average but that still does not change my view and my guidance to you that this is now tapering off and I think that next quarter you will probably see some decline in spreads for the usual reasons that pertain to this leg of the interest rate cycle. Also to reiterate guidance from the past that we sense that at least for now that the decline in spreads that we are likely to experience in this tightening cycle will not be as severe as in previous cycles and in any event we are much more confident this time around that whatever impact there may be in spread will be more than made up by the growth in the loan book. LK you can cover liquidity.

LK Narayan Yes, to take your question on liquidity, actually we have not seen significant impact of tightening liquidity in the system on our borrowings or even on our cost of funds. We have accessed, in this quarter, the longer majorities which we were privileged to access because of our unique status as an AAA rated entity where we have accessed investors from insurance companies and pension funds in our programs and, as a consequence, the tightening of liquidity in the banking space has not really affected us as much and we continue to see this trend going forward because of our new status as an IFC, we will be able to access a much more diversified constituency especially ECBs route and therefore we really do not see any vulnerability on that score as of now.

Mahrukh Adajania But if you see in terms of incremental funding mix, there was an increase in the proportion of short-term funds this quarter or was it just to match the durations?

LK Narayan If you see historically our percentage of short-term to total liability has been anywhere between 12% and 15%. We continue to hover in that region. So we have not expanded the near term money relative to our total profile of liabilities. So there is no deterioration on that score.

Rajiv Lall Nothing has changed structurally on expenses.

Vikram Limaye On your specific question surrounding bonus provision, as we said even on the previous call, this is a number which is very hard to predict with accuracy at the beginning of the year. So what we have done is this year, considering what happened last year, where in Q4 there was a significant increase in the bonus provision. That also had to do with the kind of year we had last year where as you recall the first half of last year was relatively weak compared to the second half and so the momentum really picked up in the second half of last fiscal and the year ended much better than what we had anticipated in the beginning of the year and so it required us to therefore do higher provision in Q4 of last year. This year based on what we have outlined as prospects for infrastructure and growth and all that, we are trying our best to make sure that the bonus provision number is built into our quarterly results, based on our best estimates of how the year is likely to evolve. That is not to say that this number will not be volatile because the markets could change, a lot of things could change over the next three quarters, but based on how we are looking at the year unfolding over the next three quarters, we have provided an appropriate amount this quarter and as the year evolves, we will either adjust at number upwards or downwards based on what we have said is the likely outcome on annual basis. So this number will continue to change but we are trying our best to try and normalize that on a quarterly basis based on how we see the year unfold.

Rajiv Lall Yeah, we are expecting that there should be less of a surprise for you in Q4.

Mahrukh Adajania Okay, thank you.

Moderator Thank you. The next question is from the line of Suresh Ganapathy from Macquarie, please go ahead.

Suresh Ganapathy Yeah, just wanted to understand a bit better on the impact of these zero coupon bonds which you have started issuing from November 2009. Last year, your annual report showed that your profit after tax is about ₹ 30 Crore higher because of the zero coupon bonds since you take the discount directly through the reserves and not pass it through the P&L. Any idea, how much has been issued this particular quarter and what could have been the impact on profits because of those zero coupon bonds?

Rajiv Lall Let me deal with the question conceptually before getting to the numbers. Conceptually the idea of taking the zero coupon bond through the share surplus account was really to match the nature of funding to the nature of use of funds. So the investments for example that we have made in our subsidiaries and some of the illiquid investments that we have made are long-term investments which will not generate any dividend income for the foreseeable future. So it is really a longer term capital appreciation kind of gain, so to the tune of our investments, that is how much of zero coupon bonds we have issued with this accounting treatment, not to say that we would not do zero coupon bonds as a financial instrument but we will not use this accounting treatment for zero coupon bonds unless it is matched to an appropriate kind of long-term investment.

Suresh Ganapathy Does the accounting treatment give you complete flexibility as to how to do it through the P&L or through the balance sheet?

Rajiv Lall It does, provided we give them an appropriate rationale and the auditor needs to be comfortable for why it is that we are doing it and we cannot be changing policy arbitrarily; this was done only for a certain corpus of investment to better reflect the nature of investment for which those funds were used. It is not something that it is going to be an expanding portion of our liability base.

Suresh Ganapathy Yeah, coming to the numbers specifically.

LK Narayan Yeah. Just to take off what Rajiv said from a matching concept in financial terms, that is what was the intent since some of these investments do not have an impact at this point in time on the revenue statement, therefore, we have received instruments on the liability side such that there is no impact from a cost point on the revenue statement at this point in time. So it is a matching concept of showing not the income as well as the cost attached to these financial and strategic investments that we have made. So coming to the numbers, in aggregate we have about ₹ 2,700 Crore of zero coupons that have been issued which follow this new accounting treatment and we clarify that this would be the cap at this point in time on the number of instruments that they will issue for this reason.

Rajiv Lall So, we would not be issuing additional zero coupons with this accounting treatment and this number broadly matches the long-term investments that we have made in our subsidiary companies and the additional funding that we expect to make in the next quarter to two to support to the subsidiaries as well as our financial strategic investments that we have made.

Suresh Ganapathy Assuming that if this was passed through the interest expense line, what would have been the spreads if it had not been 2.7?

Rajiv Lall No, the 2.7 is adjusted and we have excluded the zero coupon effect to give you the spread because otherwise you get a distorted notion of the spread.

Suresh Ganapathy Okay, on the loan growth front, I see that the outstanding disbursements to telecom sector has gone up some 40% quarter-on-quarter, so are these really short-term loans which are likely to go off the books. What could have been the genuine loan growth if you exclude the 3G and BWA auctions?

Vikram Limaye These are not short-term loans, there is a component in this that is clearly for the spectrum investments that have happened. These are by no means short-term loans that are disappearing next quarter.

Suresh Ganapathy So you mean to say that they will be there for the entire year.

Vikram Limaye Yes, that is the expectation.

Rajiv Lall Yeah and the guidance on that is that we feel pretty good about traction on loan growth.

Suresh Ganapathy So, you are still maintaining your 30% guidance say for the next 2 to 3 years on an average.

Rajiv Lall Mota mota, as they say.

Suresh Ganapathy What would be Tier 1 ratio on the capital adequacy post the capital raising?

Vikram Limaye It is about 26%.

Suresh Ganapathy And Tier 1 would be?

Vikram Limaye Total capital.

Suresh Ganapathy And any plans of how much infrastructure bonds you want to raise is tax-free bonds, the pricing of them, anything which you have budgeted for this year.

Vikram Limaye See, the point is that on the tax free bonds as you know, there is a limit by regulations which is 25% of, our interpretation is, gross disbursements to infrastructure that we have done in FY10, so that would basically mean that we could raise approximately ₹ 2,000 to Rs. 2,500 Crore of tax-free infrastructure bonds, as far as the rate is concerned again that is governed by regulation, the notification from CBDT says that there will be a cap on the interest rate for such tax-free bonds which would be the equivalent of the government bond rate for that tenure, so if it is a 10-year bond, the equivalent 10-year government bond rate would be the cap from interest rate perspective for these tax-free infrastructure bonds.

Suresh Ganapathy Okay, fine.

Moderator Thank you. The next question is from the line of Anand Vasudevan from Franklin Templeton, please go ahead.

Anand Vasudevan There has been an increase in the duration of both your assets and liabilities during the quarter, can we understand the reasons?

Vikram Limaye See, the duration increase has been relatively marginal, it is not a significant increase, it has gone up from around 1.9 to 2.1 if I recall, so it is not a significant increase but what we tried to do, at least from a liability perspective, is over the last 12 months we have tried to borrow longer term to the extent possible and what we are seeing is a rising rate environment, you would expect issuers to also have longer resets than in a falling rate environment because people expect rates to go up, they would rather lock in these rates for say 2-year period rather than a 1-year period, so we are seeing some extension of reset periods on the asset side and as a policy since we do not run deliberate mismatches, the liability side is reflecting what we are seeing on the asset side in terms of matching duration. So we have raised longer term liabilities as well to try not only because we believe in the last 12 months as given the liquidity situation there was an opportunity for us to raise resources at pretty attractive rates, so we have tried to lock in our borrowings as well for a longer duration and that has obviously been in line with what we are seeing on the asset side as well.

Anand Vasudevan I was actually a little more curious about the lengthening on the assets side given that a big part of your growth in assets this quarter has been through the telecom lending. Unless of course the duration you factor in for the telecom loans are much longer.

Vikram Limaye No, the way we look at telecom is while there has been some component of that in our overall loan book, when we look at the overall gross approvals that we booked of ₹ 13,000 Crore, telecom is not a significant percentage of that.

Anand Vasudevan But approvals will not reflect in your durations, right? It's only the actual…

Vikram Limaye So even if you look at the actual duration as of March 2010, the asset duration was 1.95 and as of June 2010 it is 2.18, so it is not any kind of significant increase. It is around 2 but what we are seeing is in a rising rate environment, we are seeing borrowers wanting longer resets and so as you know the reason why the duration is 2 years on a 10-year door-to-door loan is because of these reset features and we are seeing based on the conversations we are having with our borrowers that borrowers want longer resets than shorter resets.

Anand Vasudevan And just to clarify on the impact of the zero coupon bonds interest expense on spreads, does it mean that the 2.7% spread has added back the interest expense on FCDs.

Vikram Limaye Yes, so the spread of 2.7% does include the interest expense on the zero as well.

Anand Vasudevan Okay, finally on the previous discussion on staff bonus provisioning, you said that you have tried to factor in your view of revenues for the year. We look at staff expenses as a percentage of revenues for this quarter that was about 10%. Is that representative of where you are targeting to be for the full year and therefore cost income ratio is about 20% for this quarter, is that representative of the full year numbers?

Vikram Limaye Cost to income ratio is more like 25.3%. So what we have said is that it will be around 25% for the whole year.

Anand Vasudevan Okay, so you are looking at a 12 month rolling basis, because for the quarter the numbers are not 25%.

LK Narayan We do not focus on the quarterly so I think the guidance for you guys to think about modeling the year would be around the same number and cost to income around the 25%.

Anand Vasudevan Okay, thank you.

Moderator Thank you. The next question is from the line of Ramnath V. from Birla Sun Life Insurance, please go ahead.

Ramnath V. On this tax-free bonds that you plan to issue, you said that you are looking at around ₹ 2,000 to ₹ 3,000 Crore. Now, what exactly is the overall market for such kind of bonds in your opinion?

Vikram Limaye First of all, it is not ₹ 2,000 crore to ₹ 3,000 crore, it is ₹ 2,000 crore to ₹ 2,500 crore, because regulatory, we will not be able to exceed that number because of disbursements that we did last year. And in terms of just the overall demand for this, as this is a product that is most attractive for the pure retail investor because what it does is it gives you a ₹ 20,000 deduction from your taxable income and there is no benefit in investing more than that because you do not get a tax break and given that the interest rate cap on these bonds is supposed to be the government bond rate, then the maximum benefit you would get is if you restrict your investment to ₹ 20,000. That is in the implied yield on that is significantly higher and so I think the demand for this would have to be looked at it in the context of the total number of tax payers that exist in this country and what percentage of that are the guys who would be potential buyers of this paper. Who are looking for the ₹ 20,000 impact which is material to them from a taxable income perspective and so that really falls into the category of somebody whose income profile is probably in the ₹ 3 to ₹ 10 lakh zone rather than somebody who is earning ₹ 1 crore. I think you are looking at that kind of investor base and so the aggregate demand for this could be somewhere in the ₹ 8,000 to ₹ 10,000 crore range.

Rajiv Lall But the challenge will be distribution.

Ramnath V. That was the other question that I was trying to drive at, like if you look at some of the players who would be getting the IFC status and also the banks coming into this, what do you think would be the realistic target that you could hope to achieve through these bonds because this could be fairly efficient from a spread management perspective.

Rajiv Lall This announcement was made only a few weeks ago. We have now got a team that is evaluating precisely all these aspects. What would be the method of distribution, what would be the cost of distribution, what would be therefore the anticipated all in cost to us. All this is still to be tested. All I can say is that the preliminary sense is that this is going to be potentially a tough, but very interesting opportunity for us. But we will have to very methodically position ourselves and distribute the products. So I hope that we will be able to share with you more specific contours of our strategy for fund-raising in this instrument over the next quarter as we ourselves come to grips with precisely what we need to do in order to get this off the ground.

Vikram Limaaye The other clarification I want to add is that banks are not eligible to issue these bonds. So as of now, the only institutions that permitted are LIC, IDFC, IFCI, and Infra Finance Companies which currently includes IDFC, L&T Infra, and PFC. Banks are not eligible to issue these instruments.

Ramnath V. And finally on this new mechanism that you have from banks in terms of the base rate mechanism, how do you see that kind of changing over the next few quarters in terms of how do your see borrowing profile changing if any?

L K Narayan Thus far we have been constrained to be borrowing only in rupee markets and within the rupee markets, we have broadly three constituencies which is the insurance and the pension funds for the longer dated, the banks for the mid-maturities and the mutual funds for near term instruments. But now into this mix, we have as a consequence of being an IFC, we are now permitted to borrow overseas in ECB markets. Therefore, what we will hope to accomplish is to have a wider diversification of our liabilities and just to make the point that historically also our borrowings from commercial banks is a small percentage of the total resources mix and going forward, it will continue to be a composition of our total resource mix which will get further diversified through ECB. So my sense is that the impact of any base rate change on our cost of borrowings will be there, but I do not think it will be to that same extent if we were predominantly a bank-funded institution. So my sense is that on the cost front, there would be a marginal increase, but it would not be substantive.

Ramnath V. One small clarification from my side. When you are going for this ECB borrowing, would you be constrained by the 500 million for year kind of restriction that the RBI has got currently for ECB borrowings or is it the 50% net worth is actually overruling that in a single year?

L K Narayan Our view is that we are not going to be constrained by the 500 million because it is defined for us as a percentage of our net worth and that is really our sense of this at this point.

Ramnath V. Sure, so you got the levy to go up to 5000 crore overall ECBs roughly?

L K Narayan It is possible, yes.

Ramnath V Thank you sir.

Moderator Thank you. The next question is from the line of Hiren Dasani from Goldman Sachs. Please go ahead.

Hiren Dasani Thank you. Just a couple of questions on this zero-coupon convertibles, you said ₹ 2,700 crore is where the interest is essentially not booked through the P&L and if I understood correctly, the reason is that these are funding the long-term investments. Now if you look at the balance sheet, is it possible to say which all investments are included here because predominantly the two subsidiaries where you have invested, which is the asset management company and the broking company, SSKI, adds up to about ₹ 1,300-odd crore?

Rajiv Lall The short answer is no.

Hiren Dasani Does it mean that there are some other investments which are not in the nature of subsidiary which are also treated as long-term investments funded through these bonds?

Rajiv Lall Yes, so I did mention in my remarks that we applied this to our investments in subsidiaries as well as some other investments that we have made.

Hiren Dasani Yes, but when you sell this investment the capital gains will be booked through the P&L, right?

Rajiv Lall Eventually yes.

Hiren Dasani In that sense, logically then the capital gain also for that portion should not be booked through the P&L?

Rajiv Lall The idea is that there is no interim gain. So when the zero-coupon comes back, it is set off against the capital gain.

Vikram Limaye We cannot get it into the details of this. There are several other structured instruments that we made, even to infrastructure companies where there is no coupon. These are not coupon yielding instruments, these are more in the nature of cumulative instruments that are peak with redemption features. So these are not yield generating instruments and these are not insignificant beyond the two subsidiaries that you outlined. So as you would expect for auditors to approve this treatment, we had to share with them the nature of investments that balance the zeros that we've raised.

Rajiv Lall So the important thing for the market is to understand that this is not something that we are doing systematically, this is done very deliberately to match a certain subset of investments and there we shall keep it.

Hiren Dasani Okay, one question on the fees from the alternate assets, why is there a decline in the YoY basis?

Rajiv Lall Because the total income from the alternative business comes from two sources, one is the fee from the asset management, AUM, and the other one is to our share in carry….

Hiren Dasani I am referring to the non-carry portion only which has gone down from ₹ 43 to ₹ 38 crore?

Vikram Limaye There are two things that have happened. One is on account of some exits in private equity. Once you exit the investment, you do not get a management fee on that investment. Second, as we said, the mutual fund AUM for the June quarter was obviously relatively soft given the liquidity drain that everybody saw as a result of 3G and advance tax and all that and then the last aspect of it has to do with some effect of AUM that was raised in our project equity fund which was mobilized in Q1 of last fiscal for which the fees get accounted for from the first close thats just the legal contract in private equity or project equity because you can have multiple closes to a project equity fund, but the fees on every AUM that you raise in project equity get accrued from first close.

Hiren Dasani Vikram, I think why I am getting confused here is that if you look at the disclosures in the asset under management for fund 1, fund 2, fund 3 as well as the project equity fund, those have remained constant since June 09 and there is no change between June 2009 and June 2010, whereas the actual fees which are booked under the alternative assets under the management fees which is non-mutual fund part has gone down from ₹ 43 crore to ₹ 38 crore. So even if you look at the project equity fund, actually it should be lower in June 2009 because assuming that part of it came through the June 2009 quarter and it was not there for the full June 2009 quarter.

Rajiv Lall We can look into this and get back to you, but my sense is that even though the AUM remains the same, the portion of the AUM on which you generate fees changes as you actually start delivering exits. So there were two exits from private equity last quarter if I recall and the effective AUM on which you're earning fees therefore comes down proportionately. Also, I do not remember of the top of my head but in certain fund structures, there are tapering fees beyond the commitment period of the fund, I am not sure if that is the case in our private equity fund too. We can verify and come back to you on that, but those could be the only explanation for why the fee income has come down, although the reported AUM is the same.

Hiren Dasani Thanks for that and lastly with the senior hire on the real estate asset management side, are there any immediate plans to launch a real estate related fund?

Rajiv Lall This is a work-in progress, I think the idea is for us to first try and do some of this business on balance sheet and then we will test the market for third party funds. So I do not think that we want to guide you to understand that we will be raising third party funds against the real estate asset class certainly this fiscal year, but it is possible that we do that in next fiscal year.

Hiren Dasani Thank you.

Moderator Thank you. The next question is from the line of Raunak Agarwal from RBS. Please go ahead.

Raunak Agarwal We read about some bottlenecks facing various segments in the infrastructure sector. So when we assume a CAGR of 30% over the next 3 years, is this a base case scenario assuming that reasonable pace of reforms or can you just throw some light on this?

Rajiv Lall I suppose it is a scenario that you could characterize as base case. It is the scenario that probability adjusted we feel has the greatest likelihood of actually happening. There continue to be challenges in the infrastructure space. There are certain patterns that are becoming clearer and are developing on a sectoral basis, but overall our sense is that at least for the next 2 to 3 years, the overall pace of investment activity and therefore financing activity relating to the infrastructure asset class is set to accelerate to the point where we can comfortably get our share of the market. I think what was happening over the last couple of years is that as the overall space was growing, we were losing market share. We were losing market share because the constraints of our net worth and our balance sheet. We feel that now with the QIP and the additional capital that we have raised that we will be able to claw back some of that market share. So even if the overall market does not grow as fast, we feel that at least for the next couple of years, we will be able to get our disproportionate share.

Raunak Agarwal One more question, just to confirm the outstanding approvals as of date is ₹ 19,000 crore, is it?

Vikram Limaye Yes, un-disbursed approvals, ₹ 19,000 crore.

Raunak Agarwal Thank you so much.

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

Nischint Chawathe Just a small book-keeping question. I am looking at your disclosures on the income of SSKI. When you are referring to the broking income, does it refer to that pure broking income of SSKI or is the income of the broking company because I believe that the broking company does get some income for on an investment banking deals as well.

Vikram Limaye Which disclosure are you referring to, are you looking at our investor presentation or something else?

Nischint Chawathe The investor presentation that talks about the….

Vikram Limaye The investor presentation has investment banking and broking.

Nischint Chawathe So are these referring to the company’s or are we referring to the business heads.

Vikram Limaye It is the business.

Nischint Chawathe Okay and the other more broader question is how significant is FOREX borrowing or ECB borrowing at this stage for IDFC given the fact that where the markets are I mean how much ECBs do you plan to raise and what kind of advantage do you really see on that and I guess you are always been saying in the past that you will want to fully hedge the interest as well as principal?

LK Narayan If you see our numbers, they remain unchanged between March and June, we have not increased our FX liabilities yet. They continued to be about 8% of our total liability base but as I said our intent is to increase that number and now as an IFC, we have access to ECBs on the automatic route up to 50% of our net worth and even beyond that, through the approval route. So the intent of management is to increase our FX liability footprint. So from a diversification of resources that would be one objective as well as from cost management, therefore we would always be judicious to balance both diversification and cost of funds for IDFC. So we could see in the foreseeable future an increase in FX composition of our liability base.

Nischint Chawathe So my question was more pertaining to the way you are seeing various markets today. In the near-term are you looking at raising ECBs in the sense that in the past it used to be ECBs become very attractive and sometimes ECBs on a fully hedged basis do not really make financial sense. So where are we at this point in time?

LK Narayan In the past, we were not allowed access to ECBs even if we had wanted to do it, we were not allowed, but at this point in time that barrier has been removed. As an IFC, we have automatic access up to 50% of net worth and just to give you some sense we are already in conversation for some FX borrowing and you will see it in the coming quarters.

Nischint Chawathe And the policy just remains the same of hedging the interest and principal?

LK Narayan Yes.

Nischint Chawathe Okay, thanks a lot.

Moderator Thank you. The next question is from the line of Pankaj Agarwal from Execution Noble. Please go ahead.

Pankaj Agarwal Your broking income is down 33% YoY basis. So it is purely because of market related factors or you are losing some market share in total?

Vikram Limaye It is a market phenomenon. So trading volumes margins, you are in the broking business as well. So you know it pretty well that margins in broking, the mix has changed from cash to futures and options, etc. All of that has an impact on, everybody's broking business have been down.

Pankaj Agarwal But if you see other brokers, their range has been like 5% to 15%. So yours is down like 33%.

Vikram Limaye No, so the answer is our market share has not declined, this is more on account of market dynamics, volumes, and margins.

Pankaj Agarwal And in terms of your loan-related fee income as a percentage of disbursements it is coming down like in last year's first quarter, it was around 2.4% of your disbursements. Now it has come down to 0.71%. So are you seeing any pressure on this line item?

Rajiv Lall I do not think there is any secular pressure. It is actually what had happened if you recall Q1 last year, there were some exceptional deals that we did, which were from a fee basis very-very high margins for us and if you strip those out of Q1 of last year, you will actually see a pretty steady pattern. So there is nothing structural that is happening that is putting pressure on loan-related fees.

Vikram Limaye And as we have said all along we do not look at this on a quarterly basis. So if you look at our rolling 12 month numbers, loan-related and other fees as a percentage of average asset in FY08, it was 0.5%; FY09, was 0.4%, FY10 was 0.5%, and the last rolling 12 months is also 0.5%. So I would encourage you to look at it more on a rolling 12-month basis rather than a quarterly basis because there could be distortions surrounding a deal or two but that is not indicative of any kind of structural change.

Pankaj Agarwal Okay, thanks that is from my side.

Moderator Thank you. The next question is from the line of Manoj Dengla from Carlyle. Please go ahead.

Manoj Dengla From rating agency perspective, what kind of Tier-1 and what kind of loan to equity ratio are you comfortable operating with?

LK Narayan There is no description from any of the rating agencies or management of maintaining a certain threshold of Tier-1 or total capital adequacy even that was an issue that was by one of the rating agencies which was CRISIL and as of March 2010, there is no program of IDFC that has an existing CRISIL rating, so that issue is behind us totally. Therefore the guidance that we suggest is from what the regulators themselves want us to carry which is about 15% total capital adequacy for IDFC and that is really the point that we have been making consistently from our IPO days.

Manoj Dengla And given that the risk weightage is on some of the assets are less than 100%. Would you monitor your total loan book-to-equity ratio also or is there a guidance on that?

Vikram Limaye No, we said that from a leverage perspective given the amount of Tier-1 that we think from a long-term perspective we are comfortable maintaining. We have said that we could lever up certain times so which means that we would keep a Tier-1 for about 13 to 14%.

Manoj Dengla Okay and one last question given that in project finance, the credit cost show up with a lag of 2 to 4 years depending on the project duration before it goes on line, are you making any proactive provision?

Vikram Limaye No, we are providing as we disburse. So as you know basically our provisioning policy is on average, we are providing around 0.7% of gross disbursements.

Manoj Dengla Okay, thanks.

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

Shrey Loonkar I just wanted to get some sense how you are seeing the pricing power of lenders in the system given that there is enough competitive pressure from the banking system now and even more so from your other NBFC peers. If you could just give us a flavor of how do you see the pricing environment panning out. How has it panned out in Q1 and how do you foresee panning out for the next 3 quarters that is question number one.

Question number two is I just wanted to get some sense how do you see your cost of funding curve move because this quarter also we have seen a sequential dip out there, when do you see it bottoming it out because we have seen it happening for some of the private banks already in this quarter? Just wanted to get some sense how does this base rate regime, will it at all have any affect on it and third is just wanted to get some sense if you could share the unrealized gain on equity book that we may have as of June end?

Vikram Limaye We do not share the unrealized gain on the equity book. It is suffice to say that, we feel reasonably comfortable that the principal investment game plan that has been a steady contributed to our P&L, will continue to be a part of our P&L. LK do you want to take the cost issue then we will come back to the lending.

LK Narayan Like I mentioned in an earlier question we are essentially as of this point in time, a rupee funded organization. 92% of our total liabilities are from domestic markets and within the domestic markets, we access across maturities, diverse constituencies which are mutual funds for near-dated, the banks for the mid-term and the insurance and the pension funds for the longer maturities. And as an IFC we are now allowed automatic access to external commercial borrowing and as well the new intervention of retail long-term infrastructure bonds. So we will definitely in this financial year access the ECB markets as well as issue retail bonds which would give us diversification in our liability profile as well as have a positive impact on our cost of funds. So on balance, this base rate issue that you are asking about, to my mind will percolate in to IDFC but it will not be as significant as if it would have been if we had essentially been a bank-funded institution.

Rajiv Lall And that is because a growing share of funding base will come from non-bank loan instruments.

Vikram Limaye As it relates to the pricing environment and leverage that lenders have, there are few things to keep in mind. As we said earlier our own experience has been that in a rising rate environment our spreads have tended to expand that has been our historical experience, through the cycle right? But the early stages of a rising rate environment could see some compression. We certainly believe we are in the early stages of rising rate environment and so as we outlined it is conservative to estimate that in the near-term there could be some spread compression, but there are some other things that are happening in the landscape because of which we believe that the pricing environment on the asset side could actually hold up quite well and some of the things that are going on in the landscape as you know is the cost of deposits for banks in general its growth is going up. There is also fairly a tight liquidity situation in the market given that there isn’t a lot of surplus floating around in the system. The third aspect is as infrastructure growth picks up significantly, many of these banks as they have already outlined are hitting exposure limits as far as certain sectors are concerned. They have already talked about the power sector being one sector where they seem to be stretched in terms of limit. As the road program picks up significantly, there will be a significant amount of capital that the system will have to commit to roads given the size of that program and so we certainly believe that the banking landscape in general based on some of the things that I have just outlined is not going to be aggressive in pricing infrastructure project risk. Then, there are obviously certain other structural things about our landscape relating to the developer landscape per se where you do not really have 100 developers with whom you do business in size and so the banking landscape and the lending community does have exposure limits to single companies and groups and the larger developers are going to be the guys who are going to be coming to the market for more financial closure. That is another layer of constraint that the system will face in terms of the lending to infrastructure and so you put all these together, the point I am trying to make is that we do not expect the asset side to get priced aggressively if at all. We believe that infrastructure project risk will continue to be priced rationally by the banking system and as borrowing costs go up for the entire system in terms of the financial community, we certainly expect, through the cycle, that to feed into the lending rates.

Shrey Loonkar In that sense would it also mean that we would actually be in a better spot than the banks in the next 3 months given that we have access to tax-free bonds and we have a free access to ECBs? And another question is as of today what would be the cost benefit if we talk about raising ECBs in substitution to domestic funding for a matched tenor for a matched quantum, would ECB come 50 bps cheaper 75 bps cheaper?

Vikram Limaye Today, we do not believe that there is any kind of benefit on a fully swapped basis for ECBs versus domestic cost of borrowing. The benefits that we have in terms of having the flexibility to raise ECBs is more a diversification phenomenon where we now have access to more diversified sources of borrowing as opposed being b constraint purely from the domestic institutional lenders because we now have retail access as well as offshore access. There is no clear cost advantage today in ECB market on a fully swapped basis. In terms of your question surrounding whether we would be at a significant advantage relative to the banks from a cost of borrowing perspective, I would not assume that to be the case because ultimately our overall cost of borrowing has multiple things in it. So the composition of that includes domestic borrowings, offshore borrowings, retail borrowings, and how that evolves relative to the overall interest rate environment and the different components of our liability base, I would not assume it would result in any kind of significant advantage relative to banks.

Rajiv Lall But in a competitive sense, we are much better placed than we were a quarter and two ago because of our balance sheet constraints having been largely addressed through the IFC status and through the additional equity fund raised. So what it means is that as a package, we are much more competitive vis-à-vis with the banks than we were a quarter ago because we can match them for size and underwriting power to lead manage syndicated transactions.

Shrey Loonkar The infra focus real estate business that you have just set up and the on balance sheet exposure that we planned to take up in the next 1 to 2 years - would this be interest yielding exposures? Would this be loans that will be given to real estate projects or would this be again something what we do in the infrastructure side, some bit of equity, some bit of structured….

Rajiv Lall It would be yield-generating, let us put it that way. So there will be a running yield to this business.

Shrey Loonkar And just wanted to get some sense if internally we have quantum of net worth that we will be the maximum percentage of net worth that we can allocate to equity investments?

Vikram Limaye I think it will be around the same proportion, it would not exceed 4-5% of the assets.

Shrey Loonkar Okay, great that is all from my side. Thanks.

Moderator Thank you. Ladies and gentlemen due to time constraints, the last question will be from the line of Kajal Gandhi from ICICI. Please go ahead.

Kajal Gandhi I did not get the real estate exposures on the books?

Vikram Limaye If you look at the composition of the loan book which we have in our investor presentation, the real estate component of that is relatively small. I do not think it would exceed…

Kajal Gandhi So the annual report which we have seen it stated around over ₹ 3,000 crore?

Vikram Limaye Total exposure is almost ₹ 50,000 crore.

Kajal Gandhi In that just less than 10%?

Vikram Limaye Significantly lower than 10%, it would not be more than 4-5%.

Kajal Gandhi And from this quarter onwards, as you have shared this number of institutional broking, can we get the volumes that are being done?

Vikram Limaye No.

Kajal Gandhi And regarding AUM, there is a significant fall, and as you explained its mainly MFs but are we planning to exit the Asset Management Standard Chartered which we had purchased?

Rajiv Lall No, unless you are a buyer.

Kajal Gandhi Because there was some news, a month back or so.

Rajiv Lall There is no such plan of exit. We have been looking at strategic relationships to expand our management of flows from overseas into the Indian market.

Kajal Gandhi In case of our non-funded exposure on a sequential basis, this has gone up by around ₹ 600-odd crore, so is there anything specific in that?

Vikram Limaye No, nothing specific, still very small.

Kajal Gandhi Thank you sir.

Moderator Thank you. I would now like to hand the floor back to Dr. Rajiv Lall for closing comments. Please go ahead sir.

Rajiv Lall Thank you very much for being with us today. As always if you have questions that you have not had an opportunity to ask, please address them to our investor relations team and we will do our best to respond to you. Hope to connect with you again next quarter. Thanks again.

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