IDFC H1FY11 Results

Investor/Analyst Conference Call Transcript
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Moderator	Ladies and gentlemen, good day and welcome to the IDFC H1FY11 Results Conference Call. As a reminder, for the duration of this conference, all participants' lines will be in a listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you 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. At this time I would like to hand the conference over to Mr. Bimal Giri from 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 half of financial year 2011. I have with me Rajiv Lall, Vikram Limaye, L.K. Narayan and Sadashiv Rao. Before we begin, I would like to state that some of the statements made in today's discussions maybe 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 web site. I now invite Rajiv to provide key highlights of our performance for the first half of fiscal 2011.
Rajiv Lall	Thank you, Bimal and good morning to all of you. I will run through my usual presentation starting with the P&L before we open up to questions and answers. So on a consolidated basis, this has been a pretty good first half for us with our operating income being higher by 27% from ₹990 Crore in H1FY10 to ₹1,259 Crore in H1FY11. So all the numbers I would do is first half to first half comparison. So in this increased operating income NII was up significantly by 37% from ₹521 Crore to ₹711 Crore comparing first half 2010 to first half 2011. And this was driven essentially by NII from infrastructure lending which expanded 41% from ₹471 Crore to ₹663 Crore. NII treasury decreased a little bit by 4% from ₹50 Crore to ₹48 Crore. Second component of our operating income which is the non-interest income increased by 20% from ₹444 Crore to ₹533 Crore first half to first half and breaking this down income from principal investment activities increased by 2%, more or less flat, at ₹129 Crore in the first half of FY'10 up to ₹132 Crore in the first half of FY'11. Basically, to remind you this revenue line captures capital gains on a various infrastructure and financial investments and what it basically demonstrates is that we have not really exited very aggressively some of the investments that we have made in the past. The second component of non-interest income are the management fees from asset management which decreased by 14% from ₹141 to ₹121 Crore first half to first half and this was essentially on account of two reasons. One is that the AUM from our third party funds in the alternative business has basically remained flat and revenue stream from those businesses have remained flat to declining marginally because of more funds that have been put to work and therefore the overall commitment amount

has become a little smaller. But more importantly, the revenues accruing from our public market asset management business have declined.

Third component of non-interest income is from our investment banking and broking businesses. These increased by 12% from ₹98 Crore in the first half of FY‘10 to ₹110 Crore in the first half of FY‘11. And then finally, the lending related fee doubled from ₹75 Crore in the first half of FY‘10 to ₹151 Crore in the first half of FY‘11. As against this operating expenses grew by 16% from ₹212 Crore in the first half of FY‘10 to ₹245 Crore in the first half of FY‘11.

Pre-provisioning profits taking all this into account therefore increased by 30% up from ₹778 Crore to ₹1,013 Crore in the first half of FY‘11. Total provision for various asset classes increased by more than four times from ₹18 Crore in the first half of FY‘10 to ₹94 Crore in the first half FY‘11. This was primarily on account of general provisions driven by higher disbursements.

Profit before tax increased by 21% from ₹760 Crore to ₹919 Crore and after providing the ₹246 Crore towards taxes, profit after tax increased by 19% from ₹564 Crore to ₹674 Crore in the first half of FY‘11.

Let us move next to our 12 month rolling return on assets analysis that we provide. So we are comparing the 12-month periods from July ‘09 to June ’10 with October ’09 to September ’10. Comparing these two periods, net interest income was stable at 3.6% of average assets and NII infrastructure was also stable at around 3.3% of total average assets.

Contribution from non-interest income declined as you would expect given the operating income numbers that we discussed, non-interest income as a share of average assets declined from 3.0% to 2.9%. Within that contribution to ROA from principal investment, asset management and loan related and other fees were at 0.9%, 1.1% and 0.5% respectively over the 12-month period July 09 to June 10 and they were at 0.7%, 1.0% and 0.6% respectively for the 12 month period October 09 to September 10. Contribution to RoA from Investment Banking and Broking was stable at 0.5%.

Operating expenses and provisions for July ’09 to July ‘10 were 1.7% and 0.5% versus 1.6% and 0.6% for October ’09 to September ‘010. Impact of taxes across the two periods was 1.1% and 1.2% of the average assets respectively. And therefore, our total return on assets after taxes declined marginally from 3.4% to 3.3%. Over the same two periods, the cost to income ratio declined from 25.3% to be precise to 24.5%. Effective tax rates increased from 25.1% to 26.2% and leverage as on 30th September 2010 was 4.2 times and the ROEs decreased from 16.2% to 14.9% in view of the capital that we had raised in to our balance sheet last quarter.

Let me turn to the highlights of the balance sheet. The size of our balance sheet grew quite significantly by 45% from ₹31,982 Crore as on September 30, ‘09 to ₹46,423 Crore as on September 30, 2010. On the liability side, our outstanding borrowings increased by 40% from ₹25,000 Crore there about on September 30, 2009 to a little over ₹35,000 Crore as on September 30, 2010.

Underlying these trends if you look at what is happening to our pipeline, our gross approvals increased 3.3 times from ₹9,900 Crore in the first half of FY‘10, to ₹32,765 Crore in the first half of FY‘11. Our gross disbursements increased 3.5 fold from ₹4,900-odd Crore in the first half of FY‘10 to ₹17,369 Crore in the first half of FY‘11.

Energy, transportation and telecoms continue to be the top three sectors. Energy contributing 42%, transportation 28% and telecoms 19% respectively of total exposure.

Our net loan book increased by 58% from ₹21,785 Crore as on September 30, '09 to ₹34,397 Crore on September 30,'10. On a sequential basis, net loans grew 38% from ₹25,000-odd Crore as of March 31,'10. This increase reflects not only the increasing momentum in loan growth but also our ability to execute much larger transaction post our recent capital raise. Some of these transactions are structured such that a portion of the transaction will be sold down and the net hold position on our balance sheet will be lower. And although the year-to-date growth on our loan book was 38%, the net hold position will be lower. We continue to guide toward the tripling of our balance sheet in the next three to four years. So just to reemphasize that the fact that our net loan book on September 30th to September 30th basis, grew 58% should not be seen as a normal, part of this increase in the net loan book is on account of underwriting transactions that we have done. And once we are done with selling down the effective expansion in the net movement will be somewhat smaller.

As you are aware we have been making provision for contingencies based on incremental gross disbursements. I would like to clarify that these disbursements exclude refinancing of the existing facility for the same project and amounts over and above the net hold position in underwritten transaction. So as I have already mentioned our provisions were up five times in the first half of this fiscal year versus the same period last fiscal. And our loan loss coverage ratio as on September 30, 2010, stood at a healthy 1.6% of loans outstanding.

Recently, through tax-free infrastructure bonds, we raised close to ₹500 Crore from deep retail investors. Over 2.4 lakh investors subscribed to our bonds. From now to March 31 of this fiscal year we could potentially access this source of funding a couple of more times.

Finally, a little bit of non-financial information. It turns out that we were ranked 4 as the global mandate lead managers for the period January 1 to September 30, 2010 in the project finance league table published by Thomson Reuters. And there is another ranking that is done by Dealogic. I think in that we rank #5 globally. So given the rapid growth in the size of our balance sheet, which in turn reflects what is happening to the infrastructure space more generally in India, we have now emerged as a globally significant project financier.

In a nutshell, the story of this half basically demonstrates the momentum of our balance sheet businesses. The economics of those businesses have held up reasonably well, although there is some pressure as we have continuously been guiding you on our spreads given the rapid pace at which the balance sheet is growing. The non-balance sheet businesses are holding steady, but the real story for the period is really the balance sheet. Those are my general comments. I will stop there and open the floor to Q&A.

Moderator: Thank you. The first question is from the line of Arun Khurana from UTI Mutual Fund. Please go ahead.

Arun Khurana: Sir, your balance sheet seems to be increasing at a scorching pace. I think it is probably piggybacking on abundant money which is available in the system at very, very economical rates. Now, considering the fact that the liquidity seems to be vanishing from the system, oil prices are up, and the banks have been net borrowers despite the fact that Coal India money has already come back into the system. Now, your comment about tripling the balance sheet over the next three to four years seems a bit ambitious and challenging in the given context. Would you spell out the strategy in terms of building up that kind of balance sheet size over the next three years? I presume it should be a size about ₹1,25,000-odd Crore. What kind of alternate sources of funding is your company trying to tap in case we run in some sort of liquidity mismatching because given the fact that demand of funds is outstripping supply in a very significant manner?

Rajiv Lall — See, I do not want you guys to be chasing a moving target. We had talked about tripling of the balance sheet at the start of this year. So the numbers that we are talking about is ₹1 lakh Crore, it is not a ₹1,25,00,000 Crore balance sheet. So let us be clear about that. So I do not want to keep saying that with each quarter our balance sheet expands we are going to triple it relative to the size of the existing balance sheet. Our balance sheet size that is already ₹46,000 Crore, so the simple and straightforward answer is that we have been cognizant about the developments in potential development in the market for a while and we have very consciously therefore try to front load the growth in our balance sheet. I do not think that we have guided the market about the smoothness of our growth trajectory. Our attempt has been essentially and you can see it in the results to frontload that growth. So I expect that we will finish this fiscal year with disproportionately high growth and the next 24 months beyond the end of this fiscal the growth rates of the balance sheet will slow down so that you will still be able to meet our 3X target 24 to 36 months beyond this fiscal year. So that is point number one.

Point number two, on the sources of funding, is what you do not see this quarter and you will see more of next quarter is us being able to exploit access to overseas funding. So the true potential of that source of funding is yet to be discovered and it will be –which is certainly our working hypothesis that for the next 12 to 24 months we will be able to rely meaningfully on borrowings from overseas that will give us the requisite diversification of funding as we continue to pursue the growth trajectory that we had articulated. Just to give you a ballpark number, we are looking at borrowing about half a billion dollar a year from overseas starting with this fiscal year

Arun Khurana — Sir, in the context of your funding, what would be your funding mix at this point of time in terms of the overseas versus the domestic borrowings? And what is the targeted funding mix for the next two or three years? And in terms of the fact that you want to really aggressively tap the foreign sources of funding, what kind of approvals in place your envisaging would be there in terms of IDFC moving ahead and aggressively mopping in the foreign funds?

LK Narayan — Yes, just to explain, at this point in time, foreign currency liabilities on balance sheet are about 6% of total liabilities. And obviously, for the last several years, we have been constrained because RBI has not been forthcoming with approvals for us to borrow overseas. Since our status has now changed to an IFC, we have access to external commercial borrowings on the automatic route up to $500 million per annum which is the single company cap that is applicable and therefore, what we will be consciously doing is to access foreign funds through ECBs up to the maximum that is available to us every year. That said, the composition of the liabilities will emerge in a dynamic way because like what Rajiv mentioned, we had just done a retail bond and potentially there would be opportunities for us to extend the franchise to deep retail markets in India as well. So, we will examine all of this. The construct of the liability profile will in many ways emerge over a period of time and the current breakdown is essentially 94% rupee funded, and we are three constituents in the rupee markets, we borrow from commercial banks, insurance companies for the longer maturities and the mutual funds for near-term money. Essentially the banks are basically about 30 to 35% of the total liabilities whereas the insurance companies constitute a much larger portion. And we had near-term money which is approximately 15 to 17% on balance sheet.

Arun Khurana: Sir, with mutual funds now starting borrows in the market I think that source of money seems to be extinguishing and near-term solution in terms of liquidity infusion apart from open market operations not really being there. How do you envisage bridging the gap? And finally my last question is regarding your expansion in the balance sheet which has happened, to extent it has been funded by short-term liability, short to medium-term liabilities up to a maturity of two years? And is there any mismatch in terms of funding pattern to the extent of matching or with the lending pattern?

LK Narayan: Just an observation, just to reiterate for everybody to hear is that we do not depend in a very significant manner on short-term funding. Like I said, our existing short-term funding – short-term as defined as less than one year is only 15% of the total liability franchise. And everything else, 85% of our borrowings are basically beyond that one year. As far as the management of the liability franchise is concerned, it reflects what is happening on the assets and effectively, we manage duration matching and therefore, your question about mismatches between asset and liability durations is managed through the ALCO and just to give you a data point on that. Our asset duration is 2.1 years, whereas the liability duration is effectively 2.3 years.

Arun Khurana: I had also put across a question what the mutual fund funding which seems to be drawing up at the moment, given the fact that mutual funds have more or less become borrowers in the market, now to what extent that source of funding is drying up and what kind of strategy the management has in the context of the fact that the liquidity remains tight in system, how is that going to get the short term funding?

Rajiv Lall: The answer is just diversification; we are not seeing any particular stress on the market or our ability to raise money of a suitable maturity. In fact, of the maturity profile of our liabilities has remained very stable and we remain duration matched. We are looking as I said actively over the next 12 months to diversify much more aggressively into foreign sources of borrowing and you will see the results of those efforts starting from next quarter. So we are not particularly concerned at this point about being able to appropriately fund the growth trajectory that we have guided the market towards.

Moderator: Thank you. The next question is from the line of Vijay Sarthi from BNP Paribas. Please go ahead.

Vijay Sarthi: On your asset and liability durations from being very closely matched last quarter, now your liability durations are slightly larger than the asset duration, is it fair for us to assume your better protected on your on liability cost increases versus asset increases for the next few quarters? And we have seen the worst of spread compression that was likely.

Vikram Limaye: As far as liabilities, you are right, we have expanded the liability duration at this point in time with a perspective that interest rates in the system could harden. And that is why there is a certain degree of flexibility that we have built in to the operations at this point by stretching the liability profile. But asset yields have been completed in some sense, largely because the asset growth itself has been significant in this quarter on balance sheet and therefore we have traded some basis points on that.

Rajiv Lall: Again, this is nothing new. At this point of the credit cycle, there is a tendency for spreads to compress and we have guided the market and that is what we are facing. Although we have also argued and we continue believe that during this particular credit cycle the extent of spread compression that we are experiencing or likely to experience will be less than in previous credit cycles. So we continue to hold on to that view and that is where the matter stands.

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

Jatinder Agarwal: Two questions; one on a sequential basis we have seen loan related fees rise significantly. Could you give us a breakup in terms of how much is advisory and what is actually related to disbursement?

Vikram Limaye: We do not give a breakdown of loan related fees, but as you would expect, as disbursements have picked up significantly there are fees associated, upfront fees and other things that lenders get when they disburse loans. So, it is very closely tied to what is going on with the balance sheet. But there are some components of that prevailing to certain items, upfront fees, guarantee commissions, etc., we do not really give a more granular breakdown of that number. It is all linked to balance sheet growth.

Jatinder Agarwal: During the quarter whatever asset growth that we have seen, was it during the full quarter or was it actually back ended during the period?

Management: It was back ended and that is just the nature of business. It is very difficult to plan for this business on a straight-line basis. And so, what we found is that in this quarter in fact a large part of the growth was quite back ended, so hopefully, we will see the impact of that balance sheet growth on NII in the next few quarters. But in this specific quarter while you have seen a significant increase in the balance sheet the impact of that balance sheet growth on P&L is expected in the next few quarters.

Jatinder Agarwal: Perfect. And my second question is from your annual report, there is a management comment that suggested that losses at the SEBevel have been rising and that could create some problems for the sector as a whole. Could you give us an update on the same and Planning Commission also has forecasted that these losses are rising and continue to rise to about 1 lakh-odd Crore as we go forward. How do you think this problem will finally get sorted out?

Rajiv Lall: There is good news and bad news. The bad news we have already sort of articulated. There has been an increase in the officially recorded losses of State Electricity Board. The good news is that the government and various concerned agencies are working very hard to make sure that this does not become a deteriorating trend. So, one of the things that we are watching very carefully at this time is the outcome of the deliberations of what is being called Shunglu Committee. So Mr. Shunglu who was the Auditor-General of India few years ago, has been mandated to sit down with the State Electricity Board and other concerned agencies to figure out a program of adjustment over the next two, three years, which will be monitored very closely. We do not have any insight into how those conversations are actually proceeding, but the indications are that concrete plan of action will be announced in the course of the next few months, so as we learn more about it, we will share that with you. I think the absolutely worst case scenario from a credit point of view is that there are two aspects to it. One is that the dispersion of performance across State Electricity Board is growing or has grown as a result. Although the average has deteriorated, there is deterioration that is marked in certain states versus other states. So, one of the pointers for us as creditors is that in terms of risk management, we have always been very careful but we need to be somewhat more vigilant about making sure that the end-state exposure that we are taking indirectly through a portfolio is directed towards those states that are better performing rather than those that are worse performing. That is one. The second thing is a somewhat cynical view but I will share it with you anyway is that in the absolute worse case even in the poor-performing states, what the most likely outcome is that the state government will have to make good one way or another. And then how that the fiscal burden of that gets distributed between central government and state government I think is something that will eventually have to be negotiated but from a very narrow focus, that is not a good outcome from a public policy perspective, but from a creditors perspective I think there is that ultimate safety net, but it is not something that we as a lender would be relying upon. I think we would be relying upon, first and foremost, our ability to direct our portfolio in such a way that we are exposing ourselves only to the better states and second, we will be very actively following up with the Shunglu Committee to keep our finger on the pulse and figure out how credible is the plan that is being articulated and what is the progress that is being made against that plan.

Jatinder Agarwal: Could you just give us a broad sense as how does it impact merchant power producers and the states electricity boards who are also into power generation?

Rajiv Lall: See, the opportunity for merchant power producers arises in two kinds of ways. One is there is an opportunity on a contractual basis to sell a part of their power outside of long-term PPA. But then there is also an opportunity on an ad-hoc basis, on peaking terms, to sell power to states when they are most desperately needed. So, it is the latter kind of behavior that is symptomatic of very bad management, because what is happening is that at peaking time there are certain states who desperately need the power, who have not properly planned their power supplying needs, and then end up spending in a financial sense much more than they should have in order to be able to provide power, at that moment. So, from the point of view our producer mismanagement on the part of the State Electricity Board is a good thing but that might be good for a year, two years, in a long-term sense, it is not good for anybody. If you like, something again which you would have to watch, and if we are finding that power generators are making disproportionate revenues or rent from peaking power sales at egregious prices, and that is not a good sign for the overall health of the system.

Jatinder Agarwal: And for SEBs?

Rajiv Lall: For SEBs, as I said, those who are spending a huge amount of money on buying peaking power at high rates, their financial decline will only be exacerbated and they will need a bail out or some kind of restructuring sooner rather than later.

Jatinder Agarwal: I am not sure if you do the financing but some one has to be funding this working capital loss that SEBs running into. Could you give a broad sense on who finances in the system?

Rajiv Lall: So, basically this is fungible in state government finances. So, that is why the comment I made is that at the end of the day given the ownership structure of these state electricity boards, their accounts are fungible with the accounts of state government finances. So, in a big picture macro sense, if you are seeing the official average state level deficit as 3.5% of GDP, conceptually, you could add another 0.5% of GDP or 0.75% of GDP on account of potential losses that on average, State Electricity Boards are running across the board. So the effective deficit, if you like, of the state government could actually be higher than the officially reported 3.5% by another 0.5% of GDP equivalent. So that puts the overall thing in perspective. Now, is that a huge problem? Will it break the bank? Is that an unmitigated disaster? In a financial planning sense, from a point of view of financial discipline, it is not good. Let me be blunt about it. But in an overall fiscal sense it is not unmanageable. Not to encourage anybody to behave in this particular manner but it is not unmanageable. And so, from a creditor's point of view, I think we can take some comfort from that but only in the medium term. I think we cannot continue to remain sanguine or comfortable about this unless we also get confidence that financial planning and discipline is being improved, and for that, we are looking to the Shunglu Committee to point the way ahead.

Moderator — Thank you. The next question is from the line of Amit Premchandani from UTI Mutual Fund. Please go ahead.

Amit Premchandani — On Opex, last year you had employee expenses of around 300 Crore while for the first two quarters of this year it is only 120 Crore. So shall we expect some significant increase in the second half?

Vikram Limaye — No, Opex has different components to it. So what we had discussed last year was in Q4 of last fiscal year there was an increase in employee related expenses on account of bonus provision. What we try to do this year is try and be more streamlined about the bonus provision along based on how business is tracking rather than disproportionate increase in any one quarter. This is obviously very difficult to plan. The real expense on account of HR and bonus, etc., would crystallize only depending on how the overall year is worked out. So what you should actually focus on is that as we have said look at rolling 12 months, if you look at the rolling 12 months number on the cost-to-income ratio, it is at about 24.5%, in FY10 the cost-to-income ratio was 26.5% and basically. as we have guided even when we were raising capital, we expect this number to be somewhere in the 20 to 25% zone over the next three to four years as our balance sheet growth picks up the way we have outlined. Because there is some operating leverage, and we would not be incurring the same amount of expenditure to grow the book or the size of the loan book relative to the expense ratio. So I do not know whether that answers your question, there is nothing unusual about the expense line this year relative to last year. And the cost-to-income ratio has come down as you would expect it to because of some operating leverage that we have in the model

Amit Premchandani — I was wondering whether the absolute amount of employee cost has actually increased from last year level or stayed flat? Because even if I assume that will stay flat, the second half exclusively much higher than the first half.

Vikram Limaye — As I said it is about the spreading expense line for the first half of related to what we have seen first half of last year or in all of fiscal of last year. What the bonus provision will be will depend on how the year evolves.

Rajiv Lall — So this year the bonus provision is going to be smoother than last year. You should not get a fourth quarter surprise. So the number as far as Opex is concerned that you should really be focused on is the cost-to-income ratio and we are guiding to a number that is below 25%.

Amit Premchandani — This quarter the tax rates were around 28%. Was it kind of structural or just one-off? Because of the overall loan book, the corporate loan book is growing much faster than the overall loan book. So is it somewhat related to that?

Rajiv Lall — Yeah, it is basically because of the composition of our revenue stream, the comment I made in my introduction was that the story basically this quarter is the resurgence of the balance sheet. In the balance sheet, the bulk of the income is interest related. And the tax rate on that is higher than the revenue we get from principal gain. So in the past, certainly in Q2 of last year because of the larger contribution from principal gain, the effective tax rate may have been lower, but because we have disproportionate revenues are coming from interest income, the composite tax rate has gone up

Amit Premchandani: So it is not related to your plan of sell down of some of the loans, which maybe short-term in nature or because income tax provides some benefit for long-term lending?

Rajiv Lall: No.

Amit Premchandani: And just to have an outlook on what is the whole structure of this sell down of loan and how is it going to impact? Does it impact the volatility of the spreads and is the strategy to book syndication fees, the outlook is to book more and more syndication fees, and then sell down their own book and what percentage of the loan book you are planning to sell down?

Vikram Limaye: The strategy as we outlined was based on what we see in the marketplace as an increasing need from promoters to go to just one or two banks to get quick financial closure. So when we were raising capital as well, we had outlined this phenomenon that increasingly promoters would like to deal with only one or two banks. Get the loan under written and achieve quick financial closure and then the banks would be responsible for distributing that in the marketplace. So we are now able to more effectively do that given that we have got enhanced capital and what you see is that we have therefore been able to underwrite transactions and distribute them in the marketplace so that would necessarily involve fees for underwriting in syndication, and that I think has got nothing to do with what our hold position would be because that is more a question of what we are comfortable holding in terms of company group exposure and the specific project, etc., But we are able to commit to the client a much larger amount because we are able to distribute that into the marketplace and we have the capital to be able to commit upfront.

Rajiv Lall: To answer your question about potential volatility, I think after a couple of quarters, there should be smoothing out. The disproportionate growth is seen in the loan book has occurred on account of the first batch of underwriting which is now as the process is being sold down but as that pattern repeat itself the smoothing out of growth in the effective loan book post our sell down each time we underwrite so a pattern will emerge, so that again is a comment I made in the introductory remarks, you are seeing a particularly sharp increase in the loan book this quarter for that reason but over the next three to four quarters that will smooth itself out, and if you want it to make longer-term projections in your model, then we continue to glide to that number of 3x grow over in 36 to 48 months.

Amit Premchandani: And just a target in terms of percentage of disbursement which you are targeting to sell down or is there any target as such?

Vikram Limaye: No, there is no such target at all. It depends on the nature of transaction and what's going on in that particular quarter or year so it really depends on the project as well in terms of what portion of the underwritten commitment we are willing to hold on our books so I cant give you any number as a formula in terms of x percent of underwritings will necessarily be sold down. It depends on the size of the transaction what our limits are to the group etc, etc.

Rajiv Lall: But to add to what Vikram is saying, it has been our objective to continue to grow the balance sheet so its not as if our every hundred rupees, hundred Crore of loans that we are making were necessarily going to sell down 30, 40 Crore in order to juice up in a particular quarter, our fee related income. We are actually selling down more or less in a way that allows us to hold on in our own book as much as we think from our risk perspective and our single company and group company limits we are comfortable taking. The balance is sold down and whatever income we generate on that we generate in the form of syndication and underwriting fees.

Amit Premchandani — And when you sell down the loan book will you book anything on the NII because of the difference in lending rates of sell down and the actual lending rate?

Vikram Limaye — It all depends on the type of transaction and what is going on, so it's not always the case that you will be able to book any kind of gains on sell down, but there could be situations where you are able to sell down at a profit. I think I know where you are coming with this question. One thing that stands to reason is that in this kind of strategy it does have benefits for our P&L because whether in the form of syndication fee or some profits that we are able to make if we are able to sell down at a discount to where we have underwritten, the overall economics of the balance sheet business improves as a result of pursuing business in this particular manner.

Amit Premchandani — And just a last question, on your target leverage for the next year say FY12?

Vikram Limaye — So we have long term sustainable leverage is that 7x so we are working towards that diligently.

Moderator — Thank you. The next question is from the line of P Subramanyam from Sundaram Mutual Fund, please go ahead.

P Subramanyam — My question was again on the sell down of loans what we are increasingly seeing is that most banks have reached their internal limits in terms of the infrastructure exposure that they can take. So in such a scenario who would you think would be the potential parties to whom you could actually sell off these loans or do you think that the overall size of the loan book, I mean the amount that IDFC plans to sell down would be insignificant for the other players?

Vikram Limaye — Yeah, I don't know where this data is coming from because we only know what we are able to do in the market so far I can tell you that we haven't had any difficulties selling down, but anecdotally this thing is going around and every bank you talk to has reached its limit with respect to infrastructure loan so when I talk to the investors and analysts they keep saying that these limits have been reached but we continue to find banks that are willing to participate in our syndicate and that we are able to sell down to. So I don't know what sense to make of this kind of comments my hypothesis is that there are a subset of banks that have clearly reached their limits, particularly when it comes to power sector lending, but there are a large number of other institutions that are still reasonably hungry for assets and are willing to participate in the syndicates that we are putting together, so it must be that there is some kind of dispersion in terms of the various players in the market about who has reached limit and who hasn't. I don't know whether that is factually correct but it sounds right because we continue to find buyers.

P Subramanyam — So this 55% loan growth was after some settle downs that you have done during the quarter?

Vikram Limaye — It is always as we said there will always be deals that are underwritten and sold down that the syndication process takes a few months it doesn't happen overnight so some of the underwritings that could have been done in September will get distributed in the

	coming quarter. But that is the rolling exercise. This is not a one-off thing so this as a business will be an ongoing thing
Moderator	Thank you. The next question is from the line of Mudit Painuly from Macquarie, please go ahead
Suresh	I have a quick question on the securitization thing. Just about the accounting norm because currently RBI has issued some draft proposals, which is stating that NBFCs need to have at least nine months of those loans on their book before they go ahead in securitizing and 10% of the amount should be retained. Do you think it would be applicable to you as and when it becomes final that's one thing? And then secondly how is the accounting treatment for the gains on securitization done? Is it amortized over the life of the loan, or do you book it upfront because I believe NBFCs do have their flexibility to treat it in their own convenient way?
Rajiv Lall	We are not a small balance sheet. So we are not that kind of NBFC in the market that underwrites and then has to sell down 90% because we are seeing capitalization. We are as you guys keep reminding us overcapitalized our sell down is only restricted to that part of the loan that is in excess of either internally asset risk limit vis-à-vis a particular borrower or more importantly in excess of the single company or single group borrower limit that is being imposed on us by regulation. So whatever the RBI finally mandates with respect to how much of securitized asset we need to hold on our books, we would be very well within that margin. As relates to the accounting treatment of it, we are basically following Indian GAAP on this, which means that we continue to book the revenue when it accrues.
Suresh	So you don't amortize it over the life of the loan? Immediately you book it in the same quarter as and when you settle down?
Rajiv Lall	No, whatever is the gain will be amortized over the residual life.
Suresh	Okay, Again coming back to the securitization its not the question of the 10% its always the question of the duration of the loan I mean the point here is that if you originate a loan in 2Q you cannot sell down in 3Q or 4Q because you need to have that loan in your books at least for the next nine months, so is that going to affect you in anyway?
Vikram Limaye	This is not securitization; this is underwriting
Suresh	Okay, you take the loans in your book and then you sell it off right?
Vikram Limaye	Yeah.
Suresh	So the point is first you are taking the loans on your book; therefore, it has to be there nine months on your book before you sell it down. That is the rule which RBI states now in the revised guideline if you have originated the loan and taken the loan as a funded exposure on your balance sheet and if it is going to be there fore nine months, it has to be there for nine months before you go ahead and sell it off that is the revised circular telling right?
Sadashiv Rao	The securitization you are referring to are two types one is asset based securitization other is mortgage based securitization. The RBI rule you are referring to relates to these two type of securitization, and what we do is different we basically take a loan exposure in our book, underwrite it, and then it sell it off, so for our underwriting this is not applicable. In fact in vehicle financing which is securitized or mortgage based security

which is securitized. It's not going through our PTC or anything like that so it is not securitization of that nature its really a transfer of the entire risk of loan from our books to whoever it is we are selling to.

Suresh So this could be something like a bilateral assignment?

Sadashiv Rao Yes.

Moderator Thank you. The next question is from the line of Vivek Jhunjhunwala from Equirus Securities. Please go ahead

Vivek Jhunjhunwala What would be your average duration without considering the options that you are having at asset side? The put call option that you have I mean your average asset duration is about two and a half years, but I assume that is factoring the put call options that you would have.

LK Narayan Basically, the duration reflects the reset period that is reflected in the loan agreement, so as we have said, it ranges from one to three years in terms of preset dates in our loan agreements so the duration reflects that.

Vikram Limaye But your average maturity on the asset is obviously longer. It is more like five years although the duration is 2.1 years.

Vivek Jhunjhunwala So the average maturity is close to five years; on infrastructure would it be longer?

Vikram Limaye Yes, the average maturity of our assets is 5.2 years, and the average maturity of our liability is 4.2.

Vivek Jhunjhunwala Okay. And regarding the infrastructure bonds I believe the target is closer to about 3400 Crore for FY'11 but do you expect that you will have to shell out more of an interest the next time you decide to deepen in the market or do you think the 7.5 and 8% regiment will get you to a target of 3400 Crore?

Rajiv Lall I would say that two things, the shelf registration is for 3400 Crore, because that is the maximum allowable by the ministry of finance. Our internal target we don't have any real target because we have never raised money in this format, so we didn't know how much we could or we couldn't. What we are learning from the first experience is that the pools of money that we had been able to raise from this instrument are not going to be egregiously large, let's put it that way. And they are going to be very sensitive to tax arbitrage on the part of potential buyers that had deep retail coming in Q4 of the fiscal year. So we raised about 500 Crore in the first tranche. If we raise another 700-800 Crore over the next six months or so, we would actually be doing quite well in this particular instrument, which as you may or may not know is capped in terms of the interest rates that we can charge, so we cant charge more than the commensurate maturity government paper which is why the interest rate on the last tranche that we just raised in the market was kept at 8%

Vivek Jhunjhunwala: What would be the gross yields and the cost of funds?

Vikram Limaye We don't disclose our cost of funds. What we have said is basically we had a AAA borrower, and our spreads are basically what the AAA spreads are relative to the government in the market. The overall spread is 240 basis points. That is our average, our overall spread for the last 12 months.

Vivek Jhunjhunwala	What would be the indicative gross yield?
Vikram Limaye	We said that the overall spread over cost of funds is about 240 basis points over across two months
Vivek Jhunjhunwala	Okay, and what would be the main sectors of exposure?
Rajiv Lall	Main sectors of exposure are the same old, I mean it's energy, transportation and telecom, so as a share of our exposure I think the energy is 42%.
Vikram Limaye	Transportation is about 28%; and telecom is 19%
Vivek Jhunjhunwala	What would be, looking at the scale up of the asset side, the cost to income ratio? Would possibly drop going ahead?
Rajiv Lall	If you don't want us to pay ourselves or what?
Vivek Jhunjhunwala	I mean the economies of scale coming out of the picture something?
Rajiv Lall	There would be some economies of scale but not major; so we had been guiding to last year was 26.5%. We have been guiding this year to a cost to income ratio that is below 25%. How much further down it goes, I don't promise anything.
Vivek Jhunjhunwala	When you talk of tripling of the asset book in the next three to four years would that mean that you would need to have newer clients because right now you will be doing business with most of the key market players so basically would it imply that you require many new clients on your debt side and would this mean higher risk as well?
Rajiv Lall	No, see as I explained this before the way we construct our book is fairly concentrated, so the top 20 groups today account for about 68% of our exposure, and very few of these groups are at that capacity relative to the maximum that we can lend to each particular group in view of the additional capital that we have raised. So there is significant amount of room, if you like, to grow within the top 20 groups that we have. As I have said, we haven't reached the group limits for most of these entities, and therefore there is significant room for further development. So that's two thirds of our growth. Then there is a 2nd Tier that constitutes another 20 odd groups that we deal with, and these are groups that are growing their footprint in the infrastructure space fairly rapidly, so we see a fair bit of room still to work with these entities and then there is a 3rd tier of clients that we deal with, which are those groups that are the next generation of companies that are entering the space of infrastructure development. They constitute the smaller share of our balance sheet, but they are potentially also the most lucrative relationships that we have. So broadly two thirds within the top 20, you will have maybe less than 10% in the 3rd tier, and there is 20% in the 2nd tier.
Vivek Jhunjhunwala	Okay and you have got principal investments of around Rs. 2100 Crore or this will be roughly how many investments?
Vikram Limaye	Our annual report actually discloses all the investments that we have made, so there is a long list of investments that we have got in various vehicles whether individual companies or such other investments and funds etc. So if you look at the annual report, it gives you a fairly detailed list of all the investments that we have made. But it's in the range of 20 to 30 investments

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

Nischint Chawathe: If you look at the numbers this quarter it appears that the business from the transportation sector seems to have picked up quite significantly, and I guess this is after multiple quarters that we have seen some kind of traction in the transportation sector. Do you think this is one-off or are you actually seeing a lot of action at the ground level on transportation, and should we see heavy numbers from the segment over the next few quarters?

Rajiv Lall: Okay, so a couple of points on that because you need to look at the data very, very carefully as we have outlined broadly speaking we said roads and power because there is large opportunity for infrastructure for the foreseeable future. The roads are part of the transportation sector as we have classified the different exposures we have. What we found is that obviously in the first half of this fiscal there were some financial closures that we achieved for road projects that were allocated. What you will find when you look at the numbers on disbursement though is that the transportation sector disbursements as a percentage of outstanding disbursements is 22% so what that means is that while financial closures have actually been achieved, disbursements haven't yet happened because these are project disbursements. The other point I would also make is that over the last few months, we have seen some slow down in the number of road projects that have been bid out and allocated in the landscape, and so that obviously will feed into how the overall share of transportation and overall book evolves over the next few quarters because all of this has a lag effect from the point that bidding takes place to actually awarding roads to specific developers to achieving financial closure and then disbursements. So it's a fairly long cycle, and so the slowdown that has happened in the roads over the last few months will actually be reflected in the data for the transportation sector going forward, but we do expect the bidding for roads, etc., to pick up again towards the end of this calendar year and early part of next year.

Nischint Chawathe: Okay, so the blip during the quarter would be maybe something kind of episodic is what you would say?

Rajiv Lall: That is correct.

Nischint Chawathe: Okay, the other question pertains to the mutual fund business I think Rajiv did touch upon this in his opening remarks, but I was not very clear as to why was there a sharp decline in the income from the mutual fund business on a Q-o-Q on basis when your AUMs I think have come down around to 12% on a Q-o-Q basis?

Vikram Limaye: I don't know what kind of decline you are talking about broadly. When we look at first half versus first half, there has been decline in AUMs quite significantly on account of a lot of money flowing out of the liquid funds. And that has to do with obviously the fact that there isn't that much liquidity in the system as you know, and banks that were parking a lot of the surplus liquidity with mutual funds are actually now borrowers from the Reserve Bank to the extent of almost 80,000 Crore. So there has been sufficient withdrawal of money from liquid funds which has resulted in the decline in AUMs and that has been reflected in the income from fees from the mutual fund business. The equity funds, etc., have held up quite well in terms of the markets being stable and having run up, etc., although there hasn't been necessarily a lot of inflows from retail investors into equity mutual funds.

Nischint Chawathe: Okay, so the decline in mutual fund income can be purely assigned to the decrease in AUMs?

Vikram Limaye: Yeah.

Rajiv Lall There are no losses sitting there. On account of mismatches or things like that.

Moderator Thank you. The next question is from the line of Ganeshan Jayaraman from Spark Capital please go ahead.

Ganeshan Jayaraman My question is on the compulsorily convertible preference shares that you have allotted to private equity fund about 800 odd Crore ,the new RBI regulation on CCPS is making you look at it as debt rather than as equity so how do you see that changing in that context?

Vikram Limaye No, I don't think there is any RBI regulations, that treats CCPS as debt and this is a compulsorily convertible instrument there is no option. If you are referring to the structure you are referring to as options build in for people to not convert and get their money back and all that our instrument has no options just converts for sure its not redeemable.

Ganeshan Jayaraman I know but still its not too clear on RBI too but what they have said is CCPS needs to be looked at as debt rather than as equity and its also dating back to six months back there is a recent article the recent notification I read about a couple of days back?

Rajiv Lall This CCPS converts mandatorily within 18 months for us. So within 18 months these guys have to convert into equity.

Vikram Limaye Yeah, I think what you are referring to is RBI's view on even if it is structured as an instrument that is preference share if there is any optionality in there because of which the investor can get his money back then the Reserve Bank is saying that you cannot treat that as equity. In our case there is no such optionality built into the instrument it mandatorily converts within 18 months and at the option of the investor he could convert earlier there is no question of the investor getting his money back in our instrument, any mandatorily convertible instrument is considered as a equity.

Ganeshan Jayaraman On the asset management business, the sharp drop in fees if you look at it Rs. 17 Crore this quarter vis-à-vis Rs. 28 Crore in the first quarter and Rs. 132 for entire last year is there a need for you to relook at your goodwill in this light. I guess your goodwill in your balance sheet is significantly related to the AMC business which you got is there a need for you to test it for impairment or if not why do you think so?

Rajiv Lall No, we have in fact done an analysis of this and we have got external valuers to look at the asset management business for impairment as you would expect as part of our exercise for the audit, etc., and that analysis suggest that there is no permanent impairment in the value of that investment and so there is no question of taking any kind of goodwill amortization at this point.

Vikram Limaye And the reason for it is that not withstanding the headwinds that we are facing in that business relative to when we bought the business AUMs were under 14,000 Crore or something like that, now we are closer to 20,000 and so the view of independent assessors is that notwithstanding as I said the under performance of the business relative to the price at which we bought it at there is no impairment at this point.

Ganeshan Jayaraman If you have booked the carry income does the asset which brought you the income does it go off the yield in assets under management?

Bimal Giri Yes and therefore the management fees will also be on the assets that you have under management then so as this business evolves what will happen is steady state you will be able to get some carry income and you will have some assets that go out on a regular basis and you will have regular fund raisings that happen at this point what is happening is that as assets get monetized your management fee income will go down because it is based on the assets under management.

Ganeshan Jayaraman I am just wondering vis-à-vis the June quarter I don't see a drop in your assets under management in the private equity or the project equity business so if you booked a carry it shouldn't have logically seen a drop in the AUM also?

Rajesh Lall Yes, I suppose Bimal, can you check that whether you have adjusted the AUM for exits that we have had.

Bimal Giri We haven't.

Rajiv Lall So the answer is we haven't and we should probably.

Vikram Limaye But if you are using the AUM as a way of projecting revenues from fees then the numerator or the denominator that we are offering you is incorrect?

Bimal Giri We will correct that,

Ganeshan Jayaraman Okay, could you just tell me the quantum or the amount?

Rajiv Lall: Can we get back to you on that? If you just send up an email we will respond to you.

Vikram Limaye You know, the investor presentation that we have has a schedule of assets under managing in different funds and what we will do is we will just update that presentation post this call and post it on the website okay, so you guys can take a look at that by the end of day today certainly be available.

Moderator Thank you, ladies and gentlemen that is the last question. And now I would like to hand the floor back to Mr. Bimal Giri for closing comments please go ahead sir

Bimal Giri Thank you so much everyone and I think we look forward to connecting with all of you in the third quarter this fiscal. Thanks a lot. Thank you.

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