IDFC Q1FY12 Results

Investor/Analyst Conference Call Transcript
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Moderator Ladies and gentlemen, good afternoon, and welcome to the IDFC Q1 FY '12 Results Conference Call. As a reminder, for the duration of this conference, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing * and then zero on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bimal Giri of IDFC. Thank you and over to you, sir.

Bimal Giri Good evening everyone. I welcome you to this conference call organized to discuss our financial results for the first quarter of financial year 2012. I have with me Dr. Rajiv Lall, Vikram Limaye, Sunil Kakkar and Sadashiv Rao. Before we begin, I would like to state that some of the statements made in today's discussion may be forward looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been emailed to all of you. These documents have also being posted on our corporate website. I now invite Dr. Rajiv Lall to provide key highlights of our performance for the first quarter of fiscal 2012. Thank you, over to you Rajiv.

Dr. Rajiv Lall Bimal thank you very much. Thanks for joining with us today. Before I run through the numbers and recent developments and then open up the conversation to Q&A.

I think this quarter in particular, it's important to make a couple of comments about the general macro environment. Those of you who follow these calls regularly will recall that starting a couple of quarters ago, as the rise in interest rate cycle was looking like it was going to be more prolonged. We had taken the view that we were in the midst of what I had characterized as an orderly slowdown in the economic activity. And therefore that had consequences for guidance with respect to future growth. I think it is fair to say that the rise in interest rates have turned out or are turning out to be more aggressive than our base case scenario. Some of you may have read a piece, I had written in Mint a couple of months ago. Where several others argued, that it would be unfortunate if the RBI had to take on a disproportional burden of making adjustments only through the monitory policy and hence I was sort of urging the government to do its share on the fiscal side. What has come to pass is precisely that, i.e., that the principle burden of dealing with the inflationary pressure has fallen to the RBI. And hence we saw a 50 basis point rise on July 26. This will have consequences on a general economic growth and given that our activities are particularly sensitive to the GDP headline growth number, as that slows down; it will have an impact on our own activities. And with this transition or these realities in the external environment, are beginning to reflect themselves in our own numbers. So this is the background, I will come in conclusion to give you little more granular guidance with respect to the future.

Let me now turn to the recent developments in our numbers. On a consolidated basis, our operating income was lower by 1% from Rs. 613 crore in Q1 of fiscal '11 to Rs. 604 crore in Q1 of fiscal '12. Within that however this is important; NII increased by 43% from Rs. 337 crore in Q1 FY'11 to Rs. 483 crore in Q1 FY'12. This was driven by our infrastructure lending activities and NII from infrastructure lending, expanding 41% over the period from Rs. 304 crore in Q1 FY'11 to Rs. 428 crore in Q1 FY'12. NII treasury was also up by 65% from Rs. 33 crore in Q1 of the last fiscal to Rs. 55 crore in the Q1 of this fiscal.

The second component of our operating income, non-interest income was down quite a lot. It decreased by 59% from Rs. 266 crore in Q1 of the last year to Rs. 110 crore for Q1 of this fiscal. And if I break this down, the bulk of the decline Y-o-Y has really come on account of principle gain. Income from principle investment activities was Rs. 120 crore in Q1 FY '11, versus zero or less in Q1 of fiscal '12.

Income from asset management decreased by 5% from Rs. 65 crore to Rs. 62 crore. Fees from investment banking, broking activities decreased by 47% from Rs. 36 crore to Rs. 19 crore. Loan and other related fees decreased by 30% from Rs. 44 crore to Rs. 31 crore. And in Q1 last year, some of you may remember that loan related and other fees, including income from our subsidiaries were transferred to the IDFC foundation in Q4 of fiscal '11. So when you adjust with this, loan related and other fees actually decreased only by 15% from Rs. 37 crore in Q1 of fiscal '11 to Rs. 31 crore in Q1 of fiscal '12. So in this quarter, our overall revenue has actually increased, but due to strip off principle investment activities or principle gain they are down Y-o-Y. So this quarter because we are capturing the NII effect of a very aggressive balance sheet growth last year, the income from the lending activity has grown quite a lot, although operating incomes are down.

Let me turn to expenses. Operating expenses decreased by 9% from Rs. 124 crore in Q1 of fiscal '11 to Rs. 114 crore of Q1 fiscal '12. However the Q1 last year operating expenses included, some expenses relating to our subsidiary activities that has since been transferred to the foundation. Making an adjustment for this, operating expenses decreased by a more modest 3% from Rs. 117 crore in Q1 of last year to Rs. 114 crore in the Q1 of this year. But even so, operating expenses have not only been controlled but they are down slightly. Total provision for various asset classes decreased by 10% from Rs. 45 crore in Q1 last year to Rs. 40 crore Q1 this year. This primarily reflects the slowdown in the growth of the balance sheet and the corresponding levels of general provisioning have come down. Profit before tax accordingly increased by 1% from Rs. 445 crore in Q1 fiscal '11 to Rs. 451 crore in Q1 fiscal '12 ,after providing Rs. 137 crore towards taxes however, Profits after tax decreased by 6% from Rs. 335 crore in Q1 FY'11 to Rs. 314 crore in Q1 FY'12. So obviously, because of the changing composition of our revenues with a significantly smaller component of capital gain, the average tax rate has risen.

Turning to the ROA analysis on a rolling 12 months basis, we are comparing the two 12 month periods, which is to say all of FY'11 with the period July 2010 to June 2011. So when you compare those two periods, 12 months rolling periods, NII increased from 3.8% to 3.9% of average total assets. NII infrastructure was stable at 3.5% and NII treasury increased from 0.3% of average assets to 0.4%. Contribution from non-interest income, not surprisingly declined from 2% of average assets to 1.6% and contributions to ROA coming from principle investments, asset management and investment banking, and loan related and other fees were respectively at 0.4%, 0.7%, 0.5% and 0.5% respectively for fiscal ’11 and they were lower at 0.1%, for principle investment, 0.6% for asset management, 0.4% for investment banking and 0.4% for loan related other fees over the more recent 12 months rolling period.

Operating expenses and provision for FY’11 were at 1.2% and 0.5% respectively versus 1.1% and 0.5% for the 12 month period July 10 to June 11. Impact of taxes across the two 12 month period was 1.2% and 1.1% of average assets respectively. Overall return on asset declined a little from 3% to 2.8%. Importantly, however the overall spread over the two 12 months rolling period was stable at 2.2% of the average assets. Cost to income ratio decreased from about 21% of average assets to 20.6% and the effective tax rate increased from 28% to 29.4%. Leverage as on June 30th 2011 was 4.3 times and RoE decreased from 12.9% in fiscal ’11 to 11.5% for this 12 months period ending June 2011.

Let me now turn to some highlights from the balance sheet. Our balance sheet did cross the Rs. 50,000 crore mark, showing an increase of 30% from Rs. 38,600 odd crore as on June 30th 2010 to Rs. 50,220 odd crore as on June 30th 2011. On the liability side, our outstanding borrowings increased by 24% from Rs. 31,280 odd crore as of June 30th 2010 to Rs. 38,700 crore as on June 30th 2011. So although our balance sheet grew quite nicely over this period, Gross approvals which shows indication of business going forward were down quite sharply by about 55%. They were down from Rs. 13,000 odd crore in Q1 of fiscal ’11 to a little less than Rs. 6,000 crore in Q1 of fiscal ’12. Growth disbursement decreased by 50 odd percent from Rs. 6,200 crore in Q1 FY’11 close to almost Rs. 3,000 crore is Q1 FY’12. As far as the composition of these disbursements and approvals are concerned, energy, transportation and telecom as usual continue to be the top three sectors. Energy contributing 43%, transportation 26% and telecommunication 21% of the total exposure and each contributing 44%, 24% and 21% percent respectively of the total outstanding disbursement.

Commensurate with the growth in the balance sheet, our net loan book increased by 30% also from Rs. 28,900 crore as on June 30th ’10 to Rs. 37,500 odd crore as of June 30th 2011. Our net NPAs are still at 0.1% and our loan loss coverage ratio as on June 30th ’11 stood at a healthy 1.7%.

Now let me make some concluding statements about guidance going forward. Given my introductory remarks about the macro environment, our guidance for loan growth this fiscal is inevitably muted, given the macro headwinds relating to interest rates and the policy process and general inaction on the infrastructure funds. Year to date the interest rates has been hiked by 125 basis points and only to remind you about that, recent RBI announcements indicates higher interest rates regime for most of financial ’12. This will adversely impact credit off take in infrastructure as it affects risk appetite amongst our promoter community and capital markets have also remained weak and therefore headwinds relating through the equity raising environment are also not supportive with the business. On top of all of this, policy issues relating to the power sector continue to dog us. The road program has gained some momentum but resolution relating to the telecom situation seems distance away. So I guess you can sense some degree of frustration in my comment, but that is the reality. What all of this translates into however, as we believe a 15% growth guidance in fiscal ’12 which is likely to be back ended. We will keep you updated if our diagnostic changes, but for now this is where things stand.

Finally let me take you through some other developments for IDFC. IDFC's in-house legal team won the IFLR award in 2011 in the category of best project finance legal team in the country. Pathik Gandotra from our broking business was ranked THE number 1 financial analyst in the wall street journal survey. And IDFC central data centre was awarded much coveted up time institute tier III design certification and the reason why this is significant is that we are only the second company in the country to be awarded this recognition and we are the first in the financial services sector. And so that is basically the round up of this quarter's developments. I would now like to open the session for Q&A.

Moderator The first question is from the line of Parees Purohit from Standard Chartered.

Parees Purohit You gave the disbursement figure for the quarter at Rs. 3,000 crore, is that correct?

Sunil Kakar Yes it is Rs. 2,966 crore.

Parees Purohit And the gross approvals?

Sunil Kakar Rs. 5,700 crore.

Moderator The next question is from the line of Tabassum Inamdar from Goldman Sachs.

Tabassum Inamdar We have been targeting a loan book of about Rs. 800 billion by FY'14. Giving the significant macro challenges, especially on the power sector, do you really think this can be achieved especially given that you have nearly 44% of your exposure is to the power sector? Do you see the need to reduce this target?

Dr. Rajiv Lall My commonsense suggests probably yes if things don't change anytime soon. The only sort of caveat to this statement would be that, if you look at what happened last year, the year before, or what happened from the macro environment point of view in 2008. The economy recovered relatively quickly. We were able to grow the balance sheet last year at a disproportionately fast pace. So let's say if we do 15% balance sheet growth this fiscal, in order to make our original targets, rolling three year targets that we have. It would mean that the subsequent 24 months, the run rate would have to get back up to 30 odd percent. I mean, at one level that is not inconceivable, but given where we are today and given the nature of decision making at the policy level as of now, that may not happen.

Tabassum Inamdar Are you seeing any new power projects at all coming up for approvals, given the situation.

Dr. Rajiv Lall Yes, we are seeing power projects that are coming up but what we have done and I did indicate this last time is that, we have shifted our focus in the power sector where we are more selective than we would be. We have done a fair bit of business in renewable. Especially when it comes to winds on a risk adjusted basis and the spreads we were able to get from this business, it's actually not a bad business. Overall, there is one message, the focus at least for this year is more on making sure that profitability continues to rise, that we are able to deliver a reasonably robust profit growth and focus less on just a balance sheet growth. So given the macro environment, we are not in an environment where it's a formulaic machine where balance sheet growth becomes the appropriate and most obvious indicator of earnings growth. We are in an environment, where we have to do many other things to make sure that our earnings growth remains robust, even as our balance sheet growth remains flat.

Moderator The next question is from the line of Manish Chaudhary from Citigroup.

Manish Chaudhary What would be your total amount of un-disbursed expansions?

Vikram Limaye The internal number used to be about Rs. 22,000 crore with the outstanding disbursement numbers at Rs. 42,000 crore. So roughly about Rs. 20,000 crore of un-disbursed expansion

Manish Chaudhary Was there any incremental slippage during this quarter or there were no slippages in terms of asset quality?

Dr. Rajiv Lall No.

Moderator The next question is from the line of Kajal Gandhi from ICICI Direct.

Kajal Gandhi I just wanted to know as a matter of caution, we were earlier trying to reduce the Loan against Shares book. But this quarter, we have seen a sequential rise in that book. I just wanted to know if it is a fresh disbursement or is it conversion of existing loans in the book? Actually, there is nearly around Rs. 250 crore of fresh increase in the loan against shares book versus the corporate loan book which came down around Rs. 400 crore. So I just wanted to know is there any restructuring or anything by which the loans have been converted into shares or anything like that and there is no fresh disbursement.

Vikram Limaye There is no restructuring that has resulted in loan against shares going up. As we have said earlier as well, in many cases the loan again shares that we do are with the core clients of IDFC and so there will always be opportunities where some of the high quality promoters that we are working with will require financing and that is what it relates to. It doesn't relate to any restructuring on transfer of loans from one category to another.

Kajal Gandhi Generally it is seen that after the March quarter and the June quarter our treasury book rises substantially. Is there any general philosophy that we follow?

Sunil Kakar No there is no particular philosophy around this pace. If we see some opportunistic assets available, across the banking industry after March the loan slows down and therefore assets are available on the short-term basis in the treasury book and therefore we pick it up. So treasury balance sheet is more of an opportunistic play.

Moderator The next question is from the line of Subramanian P.S. from Sundaram Mutual Fund.

Subramanian P.S. When you said that the focus this year would be on profitability and it look to grow much ahead of what your balance sheet would grow at. In the light of your other income schemes, outside of the lending business that you are doing and given that rates are also rising. So that would intuitively mean that spreads might be lower. How do you seek to achieve this objective of growing profits faster than the balance sheet growth?

Dr. Rajiv Lall Well there are two components, firstly, when you are basically growing the balance sheet in a more mechanical manner, the composition of deals that you do is somewhat different. So what it means in the current context is that we are focusing much more on selective opportunities that give us disproportionately large spreads and associated fee related income. So there are a number of significant transactions of this nature that we are pursuing which should generate an income stream that a) comprises a higher spread. And b) has other ancillary income attached to it. But overall the number of transaction and the number of deals that we do, declined. That's one aspect of it. The other aspect of this strategy is that, we will need to focus at least this year on taking some money off the table from the investments that we have made in the past and that have done quite well. So there would be some capital gains that we will harvest this year as well. That is how we expect to maintain the momentum of profit growth at a pace that is not normally commensurate with the balance sheet growth.

Moderator The next question is from the line of Manish Ostwal from K.R. Choksey.

Manish Ostwal What is the environment especially for the new sanction and what we are targeting for the full year for the sanction book?

Vikram Limaye Its very hard to talk about sanctions per se. what we have said earlier on is that the new project pipeline particularly in the power sector is obviously significant to slowdown as it relates to projects focused on, or dependent on coal or gas given the uncertainty of fuel. There is activity in the renewable space. If the road program actually picks up steam, you could see sanctions picking up quite significantly because the road program is actually large. So the Ministry actually achieves its target of bidding around 7,000 Kms of roads, that is about Rs. 70,000 Crore of financial closure that may happen in the current fiscal if all those 7,000 Kms actually get bid .So, from that perspective it really depends what happens in the landscape in terms of new projects being bid or the private sector actually participating in new projects. It's very hard for us to predict that number per se.

Manish Ostwal Could you throw some light how we will capture the momentum in the non interest income, in particular the capital gains?

Dr. Rajiv Lall There is no particular thing about capital gains. We have not used capital gains to smoothen our earnings profile on a regular basis and we have taken the view that we will harvest capital gains as and when it makes sense for us to do so, since it is a lumpy thing. It is difficult to predict the movement of an investment because there are all kinds of deal related uncertainties but we feel pretty confident that from the range of investments that we have, we will be able to harvest some over the cost of the remainder of this fiscal year, that will become a useful contribution to this year's profit performance.

Manish Ostwal Could you explain when you said earlier in the call, this year we will focus on profit growth as compared to the balance sheet growth?

Dr. Rajiv Lall I explained that there are two components to it, firstly we are focusing on multidimensional transactions that not only give us a high spread but also generates an associated key. So, these are transactions that focus in large measure on what we characterize internally as tier 2 companies, although there are some tier 1 companies as well. And these allow us to structure deal where the spreads are actually quite decent. Second is principle gains, I am not in a position to disclose to you what are the investments we have. Some of them are in the public domain that you are aware of. And you can easily make some projections about the feasibility of monetizing some of those gains. The third aspect is that we are opportunistically within the definition given to us by the RBI. We are doing the odd deals that are not strictly infrastructure that gives us again disproportionate earning capabilities to book this year. So, those are really the three ways in which we expect to deliver a decent profit performance. Even as we expect the balance sheet growth to slow down to 15%.

Manish Ostwal What is currently the incremental spread?

Sunil Kakar We have been able to maintain our incremental spreads at somewhere in the range of 235 to 240.

Manish Ostwal And what is your outlook on sustainability of these spreads?

Dr. Rajiv Lall We are very positive about that.

Moderator The next question is from the line of Manish Shukla from Deutsche Bank.

Manish Shukla If I see that borrowing mix, the short term borrowings seems to have jumped significantly and in an answer to the previous question you said that there were some opportunistic investments that you did in the treasury book, so is it fair to say that it is largely funded out of the short term borrowings?

Dr. Rajiv Lall Yes.

Manish Shukla Would that be the reason that the duration of your portfolio is down from about 2.2 years at the end of the previous quarter to about two years at the end of this quarter?

Sunil Kakar Yeah, it is correlated.

Manish Shukla Will you be able to share the unrealized gains on listed investments?

Vikram Limaye We don't share that.

Manish Shukla Given that we are in the rising interest rate environment and the trend is that there will be more of investments and relatively less of lending. I just wanted to understand how do you expect to sustain the spreads at current levels?

Dr. Rajiv Lall Because incremental spreads will go up at the margin. So, if you are growing the balance sheet at a very fast pace then you have to do a certain variety of deals where our pricing power is much more limited and therefore that tends to drive the average spread lower. But if we have to do fewer deals where we can be much more selective and charge the spread that we can get, where we have some pricing power then on a slower balance sheet growth, it is easier to actually deliver higher spread.

Moderator The next question is from the line of Sagar Tanna from Kotak.

Sagar Tanna You talked about a 15% balance sheet growth, where in likely to be back and at any particular vertical which you would be looking to grow in, which would drive growth for us?

Dr. Rajiv Lall There is two or three things that we have indicated in various ways. Firstly, there has been and there will be some growth in the renewable sub vertical in power. There continues to be some activity not as robust as we would like in roads although we are hoping and expecting that it will pick up and thirdly, in the telecom space, our core clients continue to require an amount of financing and refinancing. In which we are participating and fourth, I think that we will turn to a select number of what the RBI considers to be non infra, but in the old definition it would still be infra. So, we will do some of those deals and we have been doing them at some interesting spreads.

Sagar Tanna So, this is not hinged on any regulatory change or improvement from the government side?

Dr. Rajiv Lall Well not so far, it is not contingent upon that. We will be able to do that without any regulatory change. There has been some talk within the government for sorting out the definition of infrastructure. The talks to sort out any differences in definition that exists between the Ministry of Finance and other parts of government and the RBI are getting delayed since two months now. I have stopped relying on any of that so, when it happens, it happens and meanwhile, we are just getting on with our business.

Sagar Tanna You did not mention thermal power as one of your growth areas. What will be one variable which would make you look at the thermal power projects once again?

Dr. Rajiv Lall Well in the immediate future it will have to be the fuel supply situation. I think we need some more action on the fuel supply situation for us to feel comfortable with thermal power.

Sagar Tanna You mean domestic fuel availability?

Dr. Rajiv Lall Yes.

Sagar Tanna What about imported coal?

Dr. Rajiv Lall Beyond a point, transport and logistics challenges and technical challenges will make it hard to depend on imported fuel but there is so much more that we can do on domestic fuel so that is really where the policy action needs to happen. From long term point of view, there is some talk on the losses in the distribution system and the state electricity board

Sagar Tanna Things have started up.

Dr. Rajiv Lall Everybody has made the right noises but again given by a past track record, talk is cheap. Until they start acting on it, we will not be inclined to believe it.

Sagar Tanna You mentioned about domestic coal availability, do you see that impacting us, if this current stalemate continues? Do you see that impacting us down the line or do you see any major systemic issues because of that?

Dr. Rajiv Lall There is two types of consequences. One is that growth plans of a lot of people will get seriously disrupted. So, people who had ambitious plans to develop portfolio of power assets are already reevaluating that and they will certainly slow that down. The other type of consequences could be for certain assets that become stranded. And if there are some of our competitors who have lend to these projects, it could trigger some restructuring of certain assets. Just to reiterate the point, we have stress tested our portfolio numerous times. We have actually worked with even some of the analyst community and we have worked with various stakeholders on this and we fell that as far as our portfolio is concerned, we are very well protected from these risks but what it does mean inevitably is that, given the current state of affairs, expect to grow the thermal power portfolio, unless we throw caution to the winds.

Moderator The next question is from the line of Anand Vasudevan from Franklin Templeton.

Anand Vasudevan If you can talk about the asset quality outlook and not just for the power portfolio but roads, your entire book. What are you seeing over the next 12 to 24 months?

Sunil Kakar If you look at the composition of our book, basically power and roads are the two largest components followed by telecom. Power and transportation mainly includes roads and ports and also airports. The power relates to the thermal portfolio within our overall book. We don't anticipate any issues on the renewable side whether its wind or solar or hydro. The road portfolio again is fairly strong. We do a fairly thorough evaluation of our book on a very regular basis and we do not expect any issues with our road portfolio or our port portfolio for that matter and the telecom exposure we have again is to the highest quality, companies whether in the tower landscape or in the operator landscape within the country. So, in general we feel pretty good about our book. Having said that obviously, we cannot be completely immune to what is going on in the landscape and it cannot be the case that clients that we are dealing with will be immune to any of the risks in the landscape because these are the largest developers who actually matter in the landscape. So, there will be issues that some of these developers will also go through in some of the areas that we have been talking about. It is possible but by no means do we expect any kind of large increases in NPAs in our asset.

Anand Vasudevan There was some issues with the staff turnover few quarters ago and that resulted in some instability in the year end as well. So, can you please give an update on both these issues on the staffing as well as the stability of AUM?

Dr. Rajiv Lall There is no instability in AUM, there was a key man clause that was triggered because of the departure of the person that led the Private Equity team. Satish Mandhana is now the new head of the Private Equity team with the full participation of the LP community. If you ask anybody in the LP community, they will tell you that the way IDFC handled the transition was absolutely exemplary and there were only two or three marginal LPs and in fact what we actually did was we voluntarily offered them the choice to reduce their contribution to facilitate their transition. So, now we have the full backing of the LP community and we have hired a fourth partner into Private Equity, somebody who has come to us from the Tata Group and the team is stable. In terms of actually what is happening with the alternative asset class Recently in Project Equity and in Private Equity as the general public markets have gone through a bit of a challenging time, the deal flow and the deal closures in our alternative group has gone up. So, we have actually closed two fairly large transactions, one in Private Equity and one in Project Equity recently at the current phase. I think by the end of this fiscal year, we would be ready to start raising money again. So, we actually feel pretty good about what is happening in the alternative asset class as of this time.

Moderator Thank you the next question is from the line of Nischint Chawathe from Kotak.

Nischint Chawathe I am just trying to get some more colour on your strategy. What you did mention was that you will be looking at enhancing your asset deals possibly focusing more on Tier-2 corporate, etc. Now given the environment where we are in and your views that risk-return rate of this kind was clearly unfavorable. Should you not be doing exactly the other way round?

Dr. Rajiv Lall We have three buckets, the risk reward is the trickiest in Tier-3, Tier-2 is actually a sweet spot and Tier-1 is a volume game. We may continue to do the Tier-1 obviously but in order to keep the incremental spreads on average on the higher side, we are focused particularly on large transactions in Tier-2. I would also say that there are some transactions in Tier-1, where the fee earning potential can be quite large although the spread earning potential will be obviously lower. So, those are the mix of transaction that we are looking at and that is the strategy for now. Since now that the RBI has raised rates by 50 basis points its not as if we must surely be closer to the end of the rate cycle than we would have been a quarter ago. So, it is true that rates have risen higher than we had hoped for but although it may not feel that way today, it will peak and will begin to come down. We expect over the course of this fiscal year that the rate cycle and the mood will change. So, it is not that this will be an indefinite strategy.

Nischint Chawathe This is because in 2009 you had done exactly the other way round. You actually reduced your exposure to such plans and you shrunk your balance sheet as well so.

Dr. Rajiv Lall Right.

Nischint Chawathe Would you want to continue with the provisioning policy this year as well, or should we expect any changes?

Dr. Rajiv Lall No I think for now, we are okay with the new policy. In fact our loan loss reserve ratio is cushioned pretty well and the distortions in our provisioning policy will begin to manifest themselves only as our balance sheet growth becomes fast. We have enough cushion, we believe, to deal with this red cycle. We don't expect any change at this time.

Nischint Chawathe During the quarter, was there anything other than pure provisioning for disbursements like any equity provisions or anything for fees or anything of that sort?

Sunil Kakar Other than the general provision which we make on disbursements, there was some provisioning because of fixed income security which are mark-to-market losses because the interest rate went up and some small provisions on mark-to-market of equities. These were there for most of the quarters, it was slightly higher because of the interest rate impact on fixed income securities.

Moderator Thank you the next question is from the line of Pankaj Agarwal from Ambit Capital.

Pankaj Agarwal You said that you would be able to increase your incremental spread but do you think you will be able to manage your spreads on your existing portfolio because I believe your cost of funds will go up and in that scenario you would be able to increase yields on your existing portfolio without worrying about NPAs or repayments?

Sunil Kakkar We mostly are on a fixed rate loan, where we balance our assets and liability. So, our existing portfolio is well balanced and they are actually not susceptible to interest rate changes largely speaking and because of the ALM management. So, the impact is mostly on the new loans and as we have been mentioning that depending on the type of client, the type of product, we will make an attempt to ensure that the spreads do not go down. The fact that we are not growing our balance sheet in a very fast manner, will allow us to take some good decisions and ensure that the incremental spreads are maintained. Having said that just as a reference point, today our incremental cost of funds is still lower than some of the bank's prime lending rate.

Sadashiv Rao The existing portfolio when the loans come for reset, we are actually competitive compared to the current rate because the bank's base rates have gone faster than our own cost of borrowing. So, if we have to reset our existing portfolio, we get better spreads as a matter of fact, compared to competitor banks which will try to refinance with the new price. Our PLR is lower than the bank's PLR.

Pankaj Agarwal But if you raise these rates due to this environment, it might become difficult for some of the borrowers to serve the loan because of the economic environment?

Sunil Kakar That's a different issue. Basically as interest rate rises, the viability of projects tends to reduce.

Moderator Thank you the next question is from the line of Praful Kumar from Principle Mutual Funds.

Praful Kumar Just for understanding, how does one evaluates project when there are a few linkages but they are likely to be just on paper.

Vikram Limaye We have been meeting with the Ministry of Coal and Coal India and we get a good idea of what would be the sort of coal availability from these coal linkages. So, when we evaluate a project, we take a conservative number of what we would get from a coal linkage and take alternative sources of coal, typically imported coal, and price the cost of generation based on this sort of coal mix and after that we look at the viability. If there is a component of merchant sales, then we take a very conservative number of merchant tariffs and therefore we just look at from a conservative view point where we stand currently.

Praful Kumar The way we have seen PSU banks, they have ballooned their exposure to power. How far are we from a restructuring or a haircut (57.51) scenario if you envisage any?

Dr. Rajiv Lall It is difficult to say. These things, if they do happen, will not happen very transparently. So the exposure of PSU banks on average to the power sector is really very high. And commonsense suggests, if these assets too become stranded, then some practical ways will have to be found to defer cash flows and so on. I don't know exactly how this will pan out but…

Praful Kumar But you think that's the possibility?

Dr. Rajiv Lall I would suspect yes, it is possible. How the matter is handled is less clear but there are precedents for all of these. How the government and RBI have handled the airlines and all that kind of thing.

Praful Kumar We are still struggling with it.

Dr. Rajiv Lall And if we get to that then all those things will begin to kick in.

Praful Kumar And lastly as we are talking about it, a lot of PSU banks are hitting ceilings in their books so, have you seen a lot of proposals now coming to you for sanctions or you are getting more choosy about the projects and thus the spreads will be maintained.

Dr. Rajiv Lall Precisely for this reason, we were never really too much concerned about competition from the public sector banks in terms of booking business from us. But now you are right, even if somebody come for us, it is not clear that we want to do it.

Moderator Thank you the next question is from the line of Mudit Painuly from Macquarie.

Mudit Painuly What has changed in the last three months other than the interest rate hike by RBI to warrant almost halving of the loan growth guidance. Has there been something else that we are missing here?

Dr. Rajiv Lall It's a combination of things and at some point it doesn't make sense anymore. Interest rates need not have risen so high if the government had been more proactive. When it comes to all the actions that are necessary to facilitate, the execution and completion of projects, whether it is the environmental clearances or making fuel linkage possible, etc., there are many initiatives that were ongoing in terms of articulating what are the steps that needs to be taken to address these things in a timely manner. Number of people have been working very hard to get the system, to identify, acknowledge, and then take appropriate action. We were hopeful that people would actually take action by now but as I said beyond a point this action is not taken. It changes your perspective on what our system is capable of doing or not doing. . It is not dissimilar just to exaggerate or just to point a little bit to what is happening in the United States. We are four days away or five days away from August 2nd and those fellows have not been able to agree on a plan to increase the debt ceiling. So, that's the nature of decision making that we are facing currently in the country, particularly as it affects infrastructure. Beyond the point you can't magically hope that the momentum will continue to drive things. Even if you talk to promoters, who are such optimistic beings by definition, some of them even today might be talking about their businesses but the expectation is that we will at the last minute be able to find solutions to difficult problems and we have in the past but right now it seems like too little too late and we will just have to live with the slowdown, which at least in my personal opinion would have been avoidable.

Mudit Painuly What do you think is the definite time period or approximate window, do you think if action starts now, how long would the growth take time to come back? Would it come in FY 13 or FY 14 or are we seeing an extended period of low growth basically for the infra sector and for you basically?

Dr. Rajiv Lall It is complex, difficult and not easy to prognosticate. Our forward thinking is that as the interest rate cycle turns, then general activity and moods will also turn which is not a blinding insight but in the current situation people tend to forget that we might also be very close now to a completion of the interest rate tightening cycle and thereafter as rates begin to fall, things will necessarily change. Risk appetite does come even in the phase of relative policy inaction. Capital markets do come back. Today, it is a confluence of all these things together so, on top of the policy inaction you have limited access to the capital market and the cost of borrowing is also very high. If access to capital markets and the cost of borrowing comes down, rarely half the problems is solved, even if policy inaction remains frustratingly slow you will see some pickup in activity.

Moderator Ladies and gentleman we will take the last question from the line of Devam Modi from Equirus Securities.

Devam Modi What is the absolute amount of gross and net NPAs?

Sunil Kakar Absolute amounts would be about Rs. 80 Crore, Rs. 78 Crore and half of that Rs. 35-36 Crore.

Devam Modi You mentioned that doing the odd deal that is not strictly infrastructure, it is basically as per these norms of the IFC status, I think you are supposed to have at least 75% of the infra assets so, currently what would be the non-infra exposure per se .I guess it would be much lower than that 25%?

Sunil Kakar Yeah, we will maintain all regulatory limits.

Devam Modi What would be the current level of non-infra exposure?

Vikram Limaye In any loan you should know that there are current guidelines in calculating the 75% threshold for infrastructure also taking into account all the treasury assets that we need to keep in terms of liquidity in order to finance the asset book growth. So, the entire treasury balances that we keep whether it is in liquid funds or government bonds, CDs, CPs, etc. comes in that 25%. So, that doesn't leave very much cushion to do non-infra, as what you should know.

Devam Modi When you are talking of monetization of gains as one of the kickers for enhancing profitability, this is typically in this1.07.03 . Would it be slightly difficult to go for exit from principle investments, given that valuations are not great in the current great atmosphere for infra evaluations per se?

Dr. Rajiv Lall It depends on when these investments are made and what the investments were Again. I cannot reveal a particular transaction at this time but as and when they happen, I hope you will agree that they make sense.

Devam Modi Any reason for the negative level of income from the principle investment.

Sunil Kakar We had equity sales where we incurred some losses of small amount.

Dr. Rajiv Lall No are you talking about the negative figure?

Devam Modi Basically I am talking about in the principle investments column, there is a negative 20 under non interest income which is there. So, I think its minus 2 Crore instead of normally where we have a team of around 15-20 Crore of dividend probably that comes across.

Sadashiv Rao No see the principle investments are different and it is just the sale of a few equity items where we thought it's better to get out of way and book the loss..

Devam Modi Regarding the investment banking, we see a real drop in the transaction. So, would it be safe to assume that this sort of environment can persist till this current atmosphere continues, practically this revenues would remain muted for at least another one or two quarters going ahead.

Sadashiv Rao Yes. That is fair to assume.

Moderator Thank you ladies and gentleman that was the last question I would now like to hand the flow back to Dr. Rajiv Lall for closing comments. Please go ahead.

Dr. Rajiv Lall Well thank you all once again. It has been a tough environment. There is no hiding from that but we have a lot of work to do in terms of continuing to do the best we can under the circumstances and we look forward to when we meet in the next quarter.

Moderator Thank you gentleman of the management. Ladies and gentleman on behalf of IDFC that concludes this conference call.