IDFC Limited

Transcript of FY14 Earnings Conference Call

April 28, 2014

Moderator: Ladies and Gentlemen, good day and welcome to IDFC Ltd.'s FY14 Earnings Conference Call. As a reminder, all participant lines will be in a listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Bimal Giri. 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 FY14. I have with me Rajiv Lall, Vikram Limaye, Sunil Kakar and Sadashiv Rao. Before we begin, I would like to state that some of the statements made in today's discussions may be forward-looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been e-mailed to all of you; these documents have also been posted on our corporate website. I now invite Sunil to provide key highlights of our performance for fiscal '14.

Sunil Kakar: Thank you, Bimal. Hello, everyone, and thanks for joining us today. I will focus on macro and key highlights related to fiscal '14, I will then invite Rajiv to talk about our prospective banking journey and the way ahead, post that we will open the floor to Q&A.

Talking at the macro level on the 'Interest Rate' front, you are all aware that RBI in its latent policy announcement has kept policy rates unchanged. Looking forward I do not see these rates coming down in a hurry and expect them to stay where they are.

Coming to the sectors, in the power sector although liquidity position in key FRP states such as Tamil Nadu, Rajasthan has improved, one is yet to see the desired progress in terms of the required tariff hikes for this year. CERC has issued orders for compensatory tariff for Tata and Adani, but since it has been challenged at the appellate tribunal for electricity, the implementation of these orders may take some more time. The government has issued cancellation notices to the 28 coal blocks, and Coal India's production continues to languish in the fiscal '14. In the roads sector, again all those are bidding for road project continues to be lackluster; the government has approved guidelines for rescheduling of premium payments for road projects on an NPV neutral basis. In the telecom sector, the recent spectrum auctions essentially saw participation by Bharti, Vodafone, Idea, and Reliance Jio.

To summarize – we continue to hold the view that greater clarity on prospects for revival of investment climate for private infrastructure would emerge only post-elections, and hence it would take a while for us to witness any new capex in the private sector.

Now, moving on to the fiscal '14 Financials: Consistent with the challenging near-term macro for infra, our balance sheet growth was modest at 6% Y-on-Y, our gross loan book increased by 6% from Rs.56,595 crore as of March 31, '13 to Rs.59,829 crore as of March '14. However, this includes a burst during the last quarter due to some short term or rather telecom loans and these may be repaid very soon. So if you adjust for these last minute bursts, I would say that the gross loans actually were flat or decreased by about 1-1.5%. In FY-'14 the gross approvals were Rs.25,683 crore and gross disbursements were Rs.16,296 crore compared to a similar amount of Rs.25,976 crore and Rs.17,695 crore respectively for fiscal '13.

On a consolidated basis, our operating income increased by 8% from Rs.3,468 crore in fiscal '13 to Rs.3,735 crore in FY-'14. NII that is the net interest income increased by 5% from Rs.2,564 crore in '13 to Rs.2,704 in '14. Within this, the NII from loans expanded 5%. Again, Rs.2,365 crore in FY-'13 to Rs.2,488 crore in FY-14. The second component of our operating income which is the non-interest income increased by a healthy 14% from Rs.883 crore in fiscal '13 to Rs.1,003 crore in fiscal '14. Our loan book-related fees decreased in line with lower disbursements by almost 39% from Rs.189 crore in fiscal '13 to Rs.115 crore in fiscal '14. Net-net, our pre-provisioning operating profits (PPOP) before tax increased by 8% from Rs.2,943 crore in fiscal '13 to Rs.3,191 crore in FY14.

However, our provision for loans and investment increased by 80% from Rs.350 crore in fiscal '13 to Rs.628 crore in fiscal '14. Provisions for loans actually increased threefold from Rs.206 crore in fiscal '13 to Rs.604 crore in fiscal '14. The loan provisions in fiscal '14 include provision for restructured loans at 5%. This is the provisioning part. Post provision, profit before tax decreased slightly by 1% at Rs.2,593 crore in FY-'13 to Rs.2,563 crore in FY-'14. PAT decreased by 2% from Rs.1,836 crore to Rs.1,803 crore. As on March 31st 2014 our gross NPLs were 56 basis points as against December 31 at 62 basis points, and our net NPLs were 37 basis points. Our total loan loss provision ratio was 2.4% of loans. As on March 31st 2014 our restructured loans were 4.5%, and our SR were at 0.2%.

The Board has recommended a dividend of Rs.2.60 per equity share for the fiscal '14. I now invite Rajiv to share his thoughts on our prospective bank journey and way forward.

Rajiv Lall: Thank you, Sunil and Good Morning to all of you. As you all are undoubtedly aware, we received the provisional license from the RBI a few weeks ago and that has opened up a full realm of possibility for the IDFC Group. What I wanted to do this morning is to give you a sense of where we stand. Very broadly speaking, with respect to the challenge that we face in converting IDFC into a bank, give you a sense for the regulatory and the compliance requirement that we have to meet with, and then open up the discussion for Q&A. But the message that you really should be taking away is that it will take a little time for us to get clarity on the exact way forward and so we are by definition entering a temporary period of greater strategic uncertainty. So you would have to bear with us and be patient until our strategy, which is linked inevitably to a certain regulatory and compliance-related conditions as it becomes clearer over the next few months. So, let us focus on the next 18-months; I think you all need to know that as per the guidelines for new bank licenses of the RBI we have 18 months from April 9th 2014 within which to make our bank operational, which means that no later than October 9th 2015, we must have launched our bank. Now, this comes with a lot of conditions attached to it. So let me give you a sense for the conditions but to clarify first and foremost that there will be no additional conditions that have been imposed from us other than those that were already in the public domain in the banking guidelines, but let me give you a sense for those:

First and foremost, IDFC which will be the promoter of the bank has to be a domestic entity. What that means is that foreign ownership defined as FII ownership plus FDI plus NRI ownership in IDFC Limited which is the listed entity has to be brought down to under 50%. As of now, the latest data available that foreign ownership number is between 53% and 54%. We had in anticipation gone to the AGM, if you recall, and sought a cap on foreign ownership which is now applicable at 54%. But, we will have to proactively manage this cap so that if through voluntary attrition foreign ownership declines below its current levels, we will keep ratcheting the cap down. But that by itself is not going to get us where we need to be. We intend therefore to launch a preferential offer for domestic investors only over the next few months, and that has to be the first and most important thing that we will have to do in order to bring down the foreign ownership to be in compliance with the foreign ownership limit requirement of the new banking guidelines. So the first thing is a preferential issuance to domestic investors is what is on the cards and what you can expect will be launched and conducted over the next few months. Through notes and on our website in the coming weeks, we will share more details about that process but that is the first important thing that we have to go through.

The second is that the conditions and compliance requirements require IDFC to create an intervening entity – a holding company, a non-operating finance holding company (NOFHC) that will then have to be created. So the NOFHC will be created once the dilution of foreign ownership is done. That NOFHC will the receptacle for all IDFC groups subsidiaries that are financial and are regulated. So that will comprise the bank, our two asset management companies which means the AMC and IDFC alternatives, it would also mean IDFC Securities. We intend before the creation of the NOFHC also to create a new subsidiary which would be an IDF NBFC. IDF NBFC some of you may recall is a new regulatory structure that has been permitted by the RBI for banks to hive off post construction infrastructure assets of a particular kind. So it is a very narrow definition that the RBI has committed, but nevertheless an important one that allows banks to lighten up their balance sheets of infrastructure assets and fund them in a better ALM match structure in an IDF NBFC. As we move towards the bank, we intend to take advantage of this opportunity provided by the RBI, hence we expect to create an IDF NBFC, and we will therefore transfer all eligible assets from the existing IDFC balance sheet to the IDF NBFC before the creation of the non-operating finance holding company. So that is the second step of creation of additional subsidiaries.

The third step is the creation of the NOFHC.

And then there is a fourth and final step which will be the creation of the bank, and actual structure what it is going to be is not entirely clear, we are in discussions with the RBI, but there are two possibilities, and I will lay both of them out for you to absorb and understand. The first possibility is that there is a de-merger that occurs that effectively separates the bank from the other entities of IDFC. In that circumstance, the bank would be listed day one and existing shareholders of IDFC would hold the bank directly through the listing and indirectly through the NOFHC. So that is, let us call it Option 1. Option 2 is where we create the bank as a subsidiary of the NOFHC to be listed 3 years from now. So there are pros and cons to each of one of these options. We are in conversations, as I said with RBI. We do not at this point have clarity which of those two options will actually be executed but this is again a bit of uncertainty that we will all have to live with, and you will be the first to know as soon as we get clarity from the RBI.

So, all this has to happen over the next 18-months and these are just the regulatory and compliance requirements. So I have given you four hurdles that we have to cross in the next 18-months from a compliance point of view.

Just to recap first is dilution with the goal of reducing the relative ownership of foreign investors in IDFC to under 50%, second is the creation of additional subsidiaries notably the IDF NBFC to transfer certain eligible assets from the IDFC balance sheet to those subsidiaries, third is the creation of the NOFHC, and fourth is the creation of the bank itself either to be listed day one or as a subsidiary of the NOFHC.

Needless to say in parallel with all these regulatory and compliance requirements, we have to focus on getting ready for the bank operationally, and that means investing in technology, investing in people, transferring assets; there is a whole slew of things that have to be done. And so the long and short of it is that we have our work cut out for us over the next 18-months, there are not enough hours in the day for us to get going.

But to summarize the message for you all is that given these circumstances, right, it is very hard for us to be clearer than I have been today about how our business and our numbers are going to track. Today, we cannot tell you what expenses we are going to incur with respect to operationalising the bank, we cannot tell you what tax implications we will have to bear over the next 18 months, we cannot tell you what allocation of capital we may have to make against certain types of assets in view of this banking transformation. So, I can give you colour with respect to the progress of these various initiatives that are ongoing but be patient with us with respect to actual guidance on numbers for the next 18-24-months. So that is my introductory statement.

Moderator: Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from Nilang Mehta of HSBC. Please go ahead.

Nilang Mehta: Sir, I just had a couple of questions here; one is considering IDFC has always been majorly owned by foreign institutional investors including your strategic investors there, diluting them by doing a preferential offer for only local investors does that to some extent penalize your long standing shareholders? That is my first question and the other follow up question is on the outlook which you have given on loan growth. So going back when you guys would have envisaged exploring the banking option I do not think the guidance to this extent was given that you would look to not grow your balance sheet in the transitionary phase. One would have imagined that you would do your normal current business as normal and banking would be an overlay on top of that. So is that understanding not correct, and is there a change of thought now considering the fact that now you have got the banking license changed the stance?

Rajiv Lall: So both are very fair questions, let me address them in sequence. The first question is what we are suggesting with respect to a preferential offer to domestic shareholders is unfair to foreign shareholders. I guess the honest answer to that is yes, but we do not have any choice. This is a regulation that is imposed upon us, and so the strategic question that we face is do we not take up the opportunity to become a bank in view of this regulatory requirement, that is really the choice or do we pursue it, and then try and manage as best as we can the interest of various shareholders. It is our firmly held belief that it is in the long-term strategic interest of all stakeholders that we make this transition to a bank, and admittedly it will take some time, but we are confident that over time we will generate value for all stakeholders if we are able to make this transition. So that is answer to your first question. With respect to your second question, again, I keep saying bear with us, we are in unchartered waters because the complexity of the regulatory and compliance requirement is very significant, that is point number one.

Point number two is that the macro environment particularly for infrastructure has not been particularly helpful. So now you overlay one with the other. The compliance requirements are that we have to develop a PSL book which if we do not within a certain period of time, the penalty that accrues from that is very significant. Given the macro environment generally and the condition or the prospects for the infrastructure space in particular, we would very much like to expand our balance sheet on the infrastructure side. The risk adjusted-return and when I say risk adjusted and compliance adjusted return on expanding that balance sheet that return is not compelling in the banking context because not only do we have to allow for credit risk and its potential cost on just the infrastructure asset that we book, we also now have to work into it the incremental compliance burden that will be imposed on us as our balance sheet expands in the form of PSL, in the form of SLR and CRR, etc.

So if you take that totality into consideration, we believe this situation could change, the additional very big uncertainty in all of this and we have not talked about – it is the election results. If the election results are "benign" and policy certainty and credit risk comes down significantly, we could revisit this, but under the present circumstances of extreme uncertainty, our considered view is that it would be prudent for us not to focus on very aggressive balance sheet growth for the next 18-24 months rather focus on changing the composition of our balance sheet that gives us the best starting position for the bank.

Nilang Mehta: While I appreciate, sir, your comments and your take on board the long-term strategic value what a banking license could add, but in your own words we are in an unchartered territory and unchartered waters and kind of uncertainty which is there, both from regulatory compliance environment do you not think that foraying into banking at this juncture when IDFC balance sheet has not even seen one real credit cycle on infrastructure lending and exiting that business or moving into bank not exiting, but diversifying into a bank, you are not really looking after the minority shareholders interest here, because there is high amount of uncertainty, valuation of IDFC has come down to mere 1.1 times price-to-book at the current prices, and historically if you have seen your valuations have been at much substantial premium in your earlier years. We feel that the whole idea about expanding instead of, while there are gains to be made but the medium term to long term thing which is in your own words is a tenure of 24 months at least, but too long a period to subject all your shareholders to?

Rajiv Lall: We necessarily have more information about business prospects than minority shareholders. So it boils down to this. It is a strategic call that management have made. As shareholders, you are totally entitled to disagree with that call. It is our firmly held belief that strategically, it is absolutely critical for us to make this shift now because based on the experience that you have seen unfold, I am not unraveling any secrets, you have seen what the policy environment in this country has been for private infrastructure in this country. It is our belief that a mono-line business relying on concentrated risk only in infrastructure whereas it made eminent sense 5 years ago in today's environment we do not feel that that is an appropriate positioning for any business, and therefore as painful as it might be, this is a necessary, absolutely essential strategic shift which will generate value in time. So, I think we should give opportunity to other people to discuss and debate this issue, we are very happy to talk to you offline, but let us not take up more time with you particularly on this specific question.

Moderator: Thank you. Our next question is from Umang Shah of CIMB. Please go ahead.

Umang Shah: I just have two questions; one is regarding the loan loss reserve that we have created, do we have any particular number in mind to take up this loan loss reserve? So last year we ended with 1.8%, this year we have closed it at 2.4.

Rajiv Lall: The short answer to your question is 'no' but it will be higher than the current number, and that is because again of just extreme uncertainty. You have seen on our website which we have transparently disclosed for all this while, what our exposure to gas asset is for example. Now today, the reality is that on gas asset, there is no clarity on their ultimate resolution. It is our expectation. I would say hope that over the next 24-36 months especially with the new government in place, there would be enough focus devoted on this issue by government that some gas will become available that these plants can become operational within that time period. But now as we contemplate the bank and we want to launch the bank 18 months from now, right, as management what would you have us do – would you have us underprovide for this in the expectation? I would say hope that something is going to happen, which rationally speaking it should, but I cannot tell you with certainty that it will, and therefore, depending upon really what the policy environment is, what the engagement of government is, and we will know all this in three or four months or six months, we will then be able to give greater clarity on whether we need additional capital cushion or not.

Umang Shah: Just a related question to this; what is the provision breakup for this 4Q?

Sunil Kakar In terms of the loan loss provisions, some of it comes through the fact that based on RBI circular we had to provide for restructured assets that is almost over Rs.150-160 crore odd. Just to take this opportunity to share the philosophy, which we are being prudent and cautious, as per RBI regulations, I need to provide only 2.75% from a stock basis, but we went ahead and provided 5%. Just a philosophical point, just an evidence to the fact that we want to cushion, we want to build buffers as we transition. There is enough uncertainty around, and hence we should always make the provisions ahead of the curve in anticipation rather than after the event has happened. So, our philosophy needs to be more proactive rather than reactive. So large part of it comes from, as we said, restructured assets. The other is one-off provisions, because, you remember, our old policy is to create provisions with disbursements. Now since disbursements have not been happening, we had to relook at our total asset book and come to a judgment call as to the level of provisions which we need to make and hence had to make some one-time provisions as we call it, but basically again as I said, philosophy remember prudent, cautious, and reviewing our asset quality portfolio every quarter, if not earlier, and taking calls. So we are moving towards directionally what RBI may call dynamic provisioning or countercyclical provisions, so that is how it has been. So I guess that should answer your question.

Umang Shah: So we have 18 months starting April before we operationalize the bank and obviously, we have PSL requirements to meet in. So is it fair to assume that starting the current fiscal we would see some PSL assets being built into our book from current fiscal onwards?

Rajiv Lall: Yes, I think that is fair.

Moderator: The next question is from the line of Parag Jariwala of Macquarie. Please go ahead.

Parag Jariwala: You had said that second step would be hiving off some assets to investment development fund, you said that there are only particular kind of assets which will qualify for this. So can you just quantify how much of our asset will qualify transferring to IDF?

Rajiv Lall: So it is still on work-in progress, but it will be Rs.1,500 crore to Rs.2,000 crore. Depending upon again some conversations that are happening with both the RBI and Government of India, we will have more clarity in the next two, three months we will share that with you as and we get it, but right now it could be a lightening off of the balance sheet of about Rs.1,500 crore to Rs.2,000 crore.

Parag Jariwala: Then once we convert into a bank, this would not be taken up for PSL or SLR kind of a requirement?

Rajiv Lall: That is exactly right.

Parag Jariwala: Sir, your fourth step about creating a bank, I understand that you have given us two possibilities and the clarity is not there, but our preference would be for demerger?

Rajiv Lall: Yes, our preference is clearly for demerger.

Parag Jariwala: Lastly, Sir, your 4.5% of restructure bank, can you break it up in terms of the sector?

Sunil Kakar: 74% of the restructured assets come from energy sector.

Parag Jariwala: And anything 26%, the sub breakup even on a rough basis?

Sunil Kakar: As I said, if you want, there will be some in the road sector, transport sector, some from telecoms and some other, those are evenly distributed. The uneven part is we have 40% of exposure in energy, but the trouble is 74%.

Rajiv Lall: Yeah, that is the right way of looking at it.

Moderator: The next question is from Anand Vasudevan from Franklin Templeton. Please go ahead

Anand Vasudevan: Again, on the profile of restructured loans, you said 74% is from energy sector. I would like to get a breakup of how much is infrastructure loans and how much is non-infrastructure.

Sadashiv Rao: Everything is infrastructure.

Anand Vasudevan: How much would be from the gas power projects?

Sadashiv Rao: More than half.

Anand Vasudevan: More than 50% of total restructured loans?

Sunil Kakar: No, of the energy sector.

Anand Vasudevan: How much of the total that you restructured has already availed of the regulatory forbearance that RBI has for banks in terms of rescheduling prior to commencement of operations?

Sunil Kakar: None.

Anand Vasudevan: So RBI allows banks to reschedule?

Vikram Limaye: So the simple point is, the assets that we have disclosed as restructured have not gone through the DCCO benefit that banks have got, which are now available to NBFCs as well.

Anand Vasudevan: Presumably, other banks also will have co-exposures in the loans that you call restructured?

Vikram Limaye: Yes.

Anand Vasudevan: How have these assets been classified by the other co-lenders?

Rajiv Lall: We do not know, but most likely similar.

Vikram Limaye: These are not always consortium restructurings. Some of these we have done even as bilateral research, but very often what we found historically is that the kind of restructuring that we would like to do, is to try and find a real restructuring solution as opposed to some sort of temporary fix. Very often what has happened is that, as you rightly said, there could be some DCCO benefit that was available to a bank that historically was not even available to us, because of which the banks could have done a certain kind of rescheduling, we have done a more longer-term rescheduling, the terms of which could have been different from what the banks did.

Moderator: Thank you. The next question is from Vishal Goyal from UBS Securities. Please go ahead.

Vishal Goyal: Rajiv, I think the question is about banking strategy; I think since it has been almost eight, nine months you applied for license, so you already would have some plan of how you plan to differentiate, especially now in this environment, you have private banks already gaining market share well established, so how you plan to differentiate overall as a bank and you obviously move out of a purely infrastructure focus?

Rajiv Lall: Obviously, we have thought about it very deeply, but it is an iterative process, we are really now rolling up our sleeves to get clarity on the first three years of operations of the bank. I can give you some colour, but my suggestion to you and others who may have this question in their minds is to give us another quarter at least and then we can have a proper session on the strategy of the bank. But I do not want to duck your question, so the color I have already given you one line of thinking, which is that quite apart from the strategy and the positioning of the bank itself, the compliance requirements of the guidelines and of the banking regulations in general push us in a particular direction, and that direction is no aggressive balance sheet growth, change in the composition of the balance sheet with slightly less emphasis on infrastructure and term lending, greater emphasis on the other products and non-infrastructure on the corporate side. On the retail side, the focus has to be by definition on developing the liabilities base. So, broadly speaking, a liability led strategy on the retail side, on the asset side, no aggressive growth and a change in the composition of the balance sheet that is what I can leave with you today, but we will then refine this and then discuss in greater detail in the coming quarters.

Vishal Goyal: On SLR, do you have investments already which are like closer to SLR in some sense, like without significant deviation in yields for you?

Sunil Kakar: Yes.

Vishal Goyal: How much would that be?

Sunil Kakar: Our overall treasury book is about Rs.9,000 odd crore, large part of it can be transferred into SLR securities very easily, some we will have to shift a little bit. So that is almost more than half the requirement of the bank.

Vishal Goyal: There will be yield differential no on that...

Sunil Kakar: Yeah, there will some yield differential, not all of it is in G-Sec.

Vishal Goyal: Can you give a number for G-Sec then?

Sunil Kakar: That it will be getting too specific, but as I said, managing that will not be a major challenge in terms of meeting the requirements. Yes, there will be yield compression. Overall, I can tell you in the bank in an ongoing state the cost of deposits or rather the cost of funding would increase by 75-80 basis points after adjusting for SLR, CRR.

Moderator: Thank you. The next question is from Jatin Mamtani of Barclays. Please go ahead.

Jatin Mamtani: I just had a question on the formation of the bank. You mentioned that the IDF NBFC will take about Rs.1,500 crore to Rs.2,000 crore in loans and that would reduce some of the CRR, SLR burden. It still leaves a pretty big loan book within the bank. Just wanted to understand if there is any thought around maybe reducing the size of that loan book selling off some of the loans, is that a possibility as you seek to reduce the burden of CRR and SLR as you become a bank?.

Vikram Limaye: Yes, that is certainly a possibility.

Sunil Kakar: You also must recognize that even to maintain the level, on an annual basis, more than Rs.15,000 crore to Rs.20,000 crore approximately of loans runoff on their own.

Vikram Limaye: But, as we have said before, over the next 18 months our hope is that we will try and build some PSL assets as well. So we will have to manage the balance sheet transition over the next 18 months, both on the asset side and the liability side, so that we are in good shape to be compliant with the banking norms.

Jatin Mamtani: But is it fair to say that maybe over the next two years, balance sheet growth could even be below 0%, because as you try to balance both growing the PSL and maybe possibly reducing the infra loan size?

Rajiv Lall: It really depends on so many other factors, but yes, it is a possibility.

Moderator: Thank you. The next question is from Sandeep Bedi of Intellectual Asset Management. Please go ahead

Sandeep Bedi: First of all, to team IDFC, my compliments. I am a practicing economist. So it feels very nice to see someone talking so much quantum of prudence and risk management. Two questions; one relates to the numerics. When you are going to come out with the bank 18 months from now in the first one year, what is the kind of branch rollout you are likely to have? The second question is relating to your Asset Management side, I notice that you fees income has approximately gone up by Rs.100 crore from Rs.180 crore to Rs.280 crore. What is the future of IDFC Asset Management Company? In the past there have been rumours that you are probably at some time contemplating disposing off Kenneth Andrade's arm, is that still on the cards or you will now continue with the AMC business?

Vikram Limaye: So the objective is not to divest the Asset Management business. Asset Management business is actually doing quite well. As you know, we have brought in a strategic partner Natixis of France in order to grow the Asset Management business primarily as it relates to the offshore businesses, where we obviously do not have a distribution footprint or relationships. So the idea is to try and get the much larger share of offshore flows and investments into India through a strategic partner; Natixis owns 25% of the Asset Management business. The fees in Asset Management have grown on account of not only the public markets Asset Management business, but also the alternatives business, whereas you know last year we successfully raised an infrastructure fund in a very difficult environment and the fees on that fund accrued from the date of first close. Therefore, there has been some incremental fee on the alternative side as well that we have earned as a result of a large infra fund that we were able to raise. So, I think we are certainly positive about the prospects for only our public markets asset management business but also our alternatives asset management business in terms of the size and scale potential that it has over time. On the branch rollout, obviously, at this point in time, we are not going to be able to give you any specific numbers of how many branches on day one, etc. We are in the process of obviously making sure that we prioritize where we open branches and how we phase that out. It would be too early to start talking about the branches on day one at this point in time.

Sandeep Bedi: One quick input from you of the infrastructure side of the economy, do you think now that we are in transition period into the next government, what is IDFC's own agenda of expectations, are there any thoughts that you have on this issue?

Vikram Limaye: My true sense, certainly, starting hope is that we get a strong government and that we get a stable government that is able to take some decisive measures to reduce the bottlenecks that have cropped up in terms of getting investments and asset creation in the economy. I think it is also equally important that the next government tries to do whatever it takes to bring back confidence and trust, certainly of the domestic business community as it starts, so that the investment cycle is revived, and obviously there is a lot to be done, so you have to try and make sure you pick your spots and try and identify the high impact areas that you can sort out quickly so that you can get investments back on track. I think expectations are quite high, which at one level is a cause for concern. Expectation is defined as expectations of the market as well as of the common man and businesses on what the new government can deliver, in what timeframe. I think people expect the government to deliver on various things in a fairly short period of time, which may actually practically not be that easy to do, particularly, as it relates to new legislation that might have to be taken through parliament or in fact unwinding some of the things that have been put into place, because those might take much longer, given the politics and given the situation in the Lok Sabha Vs the Rajya Sabha, etc. So I think it is fair to say that we are all counting on a strong, stable government. We do hope that they will take decisive steps to not only debottleneck the system, but bring back confidence and investments. The timeframe of that, I think, is going to be important, because if it takes too long to get some of these issues sorted out, then I think it would cause incremental problems, because the environment is actually quite stretched already, I do not think some of the corporate balance sheets have the luxury of time in order to see cash flows come back in any kind of meaningful way. I do not know, Rajiv, you want to add something to it.

Sadashiv Rao: If you want to just go a little granular, in the energy sector, the power sector, the three main things that plague the sector is fuel, second is tariff resolution, and third is basically the SEB financials. Now we believe that the fuel, the gas and the coal shortage or price issues should get resolved given the new government and therefore we are hopeful of some positive news. On the tariff resolution, there has been some progress by CERC, etc. and matter somewhere has gone into appellate or some other courts, so we believe again that should be resolved positively. The third part is the SEB financials has just been playing in the sector for so many years, decades now. There has been some start in the form of what is called the financial restructuring plan and then start basically and we believe that hopefully should be a step forward. So on the energy sector we see some way forward.

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

Nishchint C: Can you give us some guidance on the pipeline of restructured loans?

Vikram Limaye: I am not sure we will be able to give you any specific numbers, the reason for that is, as we have said before, it also depends on how things work out over the next few months relative to the new government coming in and policies that they adopt, etc. I think the one point I would make is that the restructured assets number is going to be higher than what you see today. I cannot give you a pipeline in terms of how much next quarter versus second half and all that, but fiscal '15, the restructured assets number would be higher than fiscal '14.

Nishchint C: I think in the past you did highlight that you have seen gas-based power plants have been a pain area for you and in all possibility some of these loans could be restructured. So is it something that we are done with that in the quarter or is it something that is something which is chilled because that is somewhere you have little bit of clarity that there is a pain point?

Vikram Limaye: It is not entirely done. So if your question is, has our entire gas-based exposure been restructured, the answer is 'no.'

Nishchint C: You made a large provisioning during the quarter. So was it something to do with the change in norms because of the bank or anything of that sort, or was it in normal course of business?

Vikram Limaye: There are two-three aspects to that as we have highlighted before. One is just from a matter of prudence and what we feel comfortable given the environment we are in and the issues that we know exist in the environment as well as in terms of asset quality. There is a certain level of provisioning that we thought was prudent. Our provisioning policy did not result in that kind of provisioning level because the balance sheet growth has been flat as you know, and disbursements have not been as robust as you would have seen in other environment. So from that standpoint, we have to therefore do additional provisions in the fourth quarter. The second point is as we have said, unless we get some visibility of resolution of some of the uncertainties that we know exist, we want to make sure that we are adequately provided, so that two years down the road, there is not any kind of large negative surprise after we have operationalized the bank. So we want to make sure that we have cushion that has created against any kind of eventuality or uncertainty that exist today, for which there is no visible solution. As we go through fiscal '15, if some of the issues that we are talking about and uncertainties that we see get resolved, we will revisit our thoughts on what is an appropriate level of provisioning, and then accordingly adjust what we need to do during fiscal '15. But, it is not therefore going to be as smooth as you would like or as we would like in terms of a quarterly number, because a portion of it will happen automatically through whatever we disburse based on our provisioning policy and then the delta will be our assessment of the environment, assessment of asset quality, assessment of resolution of issues that we are dealing with, and then a call on therefore what an appropriate level of provisioning is.

Moderator: Thank you. The next question is from Pankaj Agarwal of Ambit Capital. Please go ahead.

Pankaj Agarwal: Sir, currently, most of your liabilities are coming from long-term non-convertible debentures and infra bonds. So as a bank you would be allowed to raise this kind of instrument?

Sunil Kakar: Two answers; one is the current liabilities can and will be grandfathered into the bank, and "Will I raise new bonds?" even as a bank for infrastructure lending, one can do that. So it will depend on what kind of asset mix we play around in the bank, but largely speaking, the emphasis on bonds will decrease as we move into the bank.

Pankaj Agarwal: Specifically, on non-convertible debentures, is the bank allowed to raise such instruments?

Sunil Kakar: As I said as long as it is for infrastructure, there are certain conditionality such as five-years etc. it can be done only for infrastructure purposes.

Pankaj Agarwal: In terms of when you will transfer your assets to IDF, who would fund those assets – you would issue some securities or IDFC itself would fund these assets?

Sunil Kakar: We will raise bonds, it is a standalone entity, it will get its rating done

Pankaj Agarwal: And it would be transferred at the book value?

Sunil Kakar: Yes - fair value, book value, whatever is the right way to do it.

Moderator: Thank you. The next question is from Alpesh Mehta of Motilal Oswal Securities. Please go ahead.

Alpesh Mehta: Currently, our leverage is at around five times and post raising capital end considering the balance sheet is likely to be flattish over the next one, two years, so we will be having a leverage of roughly 4.5 times or so and under the banking license, after converting into a bank our ROEs will be relatively lower than the current levels. So, is there any guidance in terms of ROEs that you would like to achieve over the next three to five years, is there any plan already in place?

Rajiv Lall: So we are reluctant to give any guidance but I think it is commonsense that ROA will decline. That for what period of time will become clearer over the next year or so, I guess, once we start operations. The idea is not to see a depression or a reduction in the ROE for any extended period of time, but to manage it expeditiously and as aggressively as we can. With respect to the corresponding ROE it really then depend on how quickly we are able to return to a robust growth of the balance sheet, and then growing to the capital that the bank will inherit.

Alpesh Mehta: Considering the current guidance in terms of flattish kind of a balance sheet growth and some capital raising, is it fair to assume a single-digit kind of ROE over the next two to three years?

Rajiv Lall: I would not bet my life on that, no. But it is possible, but we do not want to be there.

Alpesh Mehta: Just a data keeping question… what was the restructured loan as of 3Q and last year, if you can share that number as well?

Vikram Limaye: No I think we should just look at it going forward, so 4.5% for the year, and obviously, going forward every quarter we will be disclosing this number

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

Amit Premchandani: I had a question on the management of the banks; will the CEO come from within IDFC or one of the current MD will become the CEO there, or will it be outside candidate, what is the thinking behind it?

Rajiv Lall: Current expectation is the CEO of the bank will be from IDFC. This will be subject to RBI approval. So once we get RBI approval, then we can share with you how that is going to actually work out.

Moderator: Thank you. The next question is from Adarsh P from Prabhudas Lilladher. Please go ahead.

Adarsh P: Just two questions; again on the gas portfolio, you all have shared the detail on the underconstruction gas exposure. What is the completed part and what part of that book you all think is kind of having some issues?

Vikram Limaye: You have 'Tree,' right, on the website that has the details of the gas-based exposure.

Adarsh P: The 'Tree' is for the under-construction plants. I was more referring to the already existing plants, but probably they may not be receiving gas or they will be kind of inferior, getting less gas than what you would require to run operations?

Vikram Limaye: Another 1% of exposure in operating gas-based assets. Now the issue on operating gas-based assets, again, as you know, in the absence of gas it does not matter, right, whether you are operational or under-construction. Now the reality is some of these gas-based assets have been receiving gas, but the PLF at which they have been operating has been much lower than what anybody would like. So to the extent that they remain at 15 at much lower levels of PLF than what they were expected to achieve then these assets would also require some sort of restructuring, because at a certain level of PLF, it is not possible to service debt.

Adarsh P: So broadly it is a 3% under-construction and about 1% of already completed plants?

Vikram Limaye: That is correct

Adarsh P: Because I think, when we are giving out some details on restructuring, I was just trying to work out that number 75% energy and greater than 50% of that, it comes to about 2% of loans, which means that 50% of gas would have already got kind of restructured in that sense?

Vikram Limaye: Right.

Adarsh P: On the 3% of under construction plants, just wanted to understand what kind of completions would these project be at – there will be roughly 70%, 80% complete largely, just about waiting to gas not getting commissioned, because the ICD keeps adding on to the capital?

Vikram Limaye: These are actually completed gas-based plants.

Adarsh P: Most of it, is it?

Vikram Limaye: Just that we are waiting for gas.

Moderator: Thank you. Our next question is from Tithi Barot of Deja Vu Capital. Please go ahead.

Tithi Barot: My first question is regarding why you did that much of provision that is 1.92% year-on-year, and 1 to 0.5% that is quarter-on-quarter?

Vikram Limaye: I think I have already answered that question; I said that there were various reasons why we have done an additional provision in Q4.

Tithi Barot: In banking sector, what is the main guideline for the banking, like which are the segment you choose for the banking?

Vikram Limaye: It is going to be a universal bank, so we will have banking across all segments including Corporate, Retail, SME and Rural Agri?

Tithi Barot: The third question is, you got the license from the RBI. What is the main effect of SLR and CLR in your balance sheet and price performance?

Vikram Limaye: As we have said it repeatedly in the external context that we will be compliant with RBI norms when we operationalize the bank. The guidelines for new banks is that you have to be compliant on CRR, SLR on day one of operationalizing the bank and we are quite comfortable that we will get there. On priority sector loans, 12 months after operationalizing the bank, you have to be compliant with priority sector norms. Therefore, we will be working in the interim 18 months as well to try and see how we mobilize priority sector assets and then we have another 12 months after operationalizing the bank to meet the priority sector norms.

Moderator: Thank you. The next question is from Kashyap Zaveri of Emkay Global. Please go ahead.

Kashyap Zaveri: Apart from this Rs.9,000 crore treasury, we also have about Rs.3,000 odd crore of equity investments… I am talking about consolidated balance sheet. So can that also be sort of liquidated into some part of that into SLR, CRR, would we intend to do that?

Vikram Limaye: Those investments also include our investments in strategic businesses such as the asset management business and other subsidiaries that we have. So those are not all investments that we can monetize. Obviously, financial investments that we have made such as in National Stock Exchange, etc., those we have been monetizing over time and those we will continue to monetize.

Kashyap Zaveri: Second question is on your provisions; in consol balance sheet where we have shown another about Rs.1,280 crore of provisions which might include some of which we did in this quarter, could we have used those also, some part of that also if we did not pass it through P&L? Let us say, if we intended to not pass it through P&L, some of this Rs.900 crore of provisions as of previous quarter could have been used?

Sunil Kakar: Yeah, but could and would are different aspects. As we said, we look at the overall asset quality as we stand today, and we look forward where it is heading. So keeping that perspective in mind and our indication that we do not believe that the worst is over in infrastructure space. So if you agree with that hypothesis then the rest follows.

Moderator: Thank you. The next question is from Mangesh Kulkarni of Almondz Global. Please go ahead.

Mangesh Kulkarni: I just wanted to know of the Rs.59,000 crore loan book, what will be the short-term loan book for IDFC?

Vikram Limaye: I think it would not be more than 8% to 10%.

Mangesh Kulkarni: So it will directly be transferred to bank because of the short-term nature obviously?

Vikram Limaye: No, because by definition if it is short-term, it might not even last for 18 months, it might come back during that period. But to answer your question, all loans will be transferred to the bank except for the ones that we are moving to the IDF-NBFC.

Mangesh Kulkarni: Suppose, in the meantime, definition of the priority sector gets changed and infrastructure becomes the part of priority sector, then our strategies will change again?

Rajiv Lall: Yeah, that will be a terrific result, I think we should all pray for that.

Mangesh Kulkarni: What is the timeline for this preferential issue before or end of this Q2?

Rajiv Lall: We have to get it done before December end.

Sunil Kakar: But we have to time it at where the market is what will happen, those kind of stuff.

Mangesh Kulkarni: What kind of dilution we are expecting?

Sunil Kakar: That is not very large. I think it depends on how much foreign holding, but my guess is about 7% to 8%, because if you are at 53.5, we have to come down to less than 50, you need to do 7% odd.

Moderator: Thank you. The last question is from Manish Ostwal of KR Choksey Shares. Please go ahead.

Manish Ostwal: Basically I understand the complexity of the banking business, the point is moving from the infrastructure NBFC platform to banking, so, in your assessment, what is your near-term financial implications, whether it is net interest margin level or building a negative carry SLR book, how do you look at the near term model for the IDFC banking platform?

Rajiv Lall: So, let me give you as much clarity as we can; the near-term ROA is a decline in ROA, the medium term ROA is a recovery in the ROA, and the medium to longer-term ROA is a very significant improvement in ROE relative to our current situation.

Manish Ostwal: Because when you talk about universal banking model, because currently in India, the highest end of the ROA is 2%. So from that level, if we are into moving that class of bank, then in that case also there is a meaningful contraction of ROA from the current?

Rajiv Lall: Actually, let me just spend a minute on this, so that it also gives people a little more granular sense for where we are coming from. I think the transitional challenges of converting ourselves into a bank are well-known, there is no doubt that the burden that is placed on us through additional CRR, SLR and the incremental cost that will entail, the burden of booking PSL assets where yields may not be the most compelling, all those things we do understand, and it is part of our strategic call, and this is something that we will elaborate in subsequent quarters, right. Look at our starting position. Our starting position is an extremely well capitalized balance sheet. The bank will start with around Rs.11,000 crore, Rs.12,000 crore of net worth on day one. We have no branches; literally, we have three main branches and we may have about 39 branches of the AMC, other than that we have no branch presence in the country. We have employees that are less than 600. We have no legacy technology platform. In the last 10 years, there have been very important developments in banking regulation and in technology, both of which, for somebody like ourselves, i.e., with deep pockets and no legacy creates in our judgment a very important opportunity. We can actually build a branch infrastructure at a meaningfully lower cost than legacy players. That is a very-very important opportunity for us. Somebody asked a question “What is going to be your differentiation?” We intend to leverage technology, changes in regulation, and our starting position to create a value proposition in banking that can be delivered with comparable if not better service levels but at lower cost than legacy banks.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the floor back to Mr. Sunil Kakar for closing comments.

Sunil Kakar: Thank you all for patiently hearing with us and we hope to see you next quarter and share further on our journey towards the bank. Thank you all.

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