IDFC Limited

Q1 FY18 Earnings Conference Call Transcript
July 31, 2017

Moderator Ladies and gentlemen good day and welcome to the IDFC Limited Q1 FY18 Earnings Conference Call. As a reminder for all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Bimal Giri. 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 Q1 Fiscal 18. I have with me Sunil Kakar and Bipin Gemani.

Before we begin I would like to state that some of the statements made in today's discussion maybe forward-looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been e-mailed to all of you. These documents have also been posted on our corporate website. I now invite Bipin to provide key highlights of our performance for Q1 fiscal 18.

Bipin Gemani Thank you Bimal. I will briefly take all of you through our progress in respect of IDFC consolidated financials, IDFC Bank, Mutual Fund, IDF, Alternatives and IDFC Securities.

The consolidated balance sheet of IDFC Limited as on June 30th, 2017 was Rs. 125,433 crore. In Q1 FY18, the consolidated PAT was Rs. 299 crore as compared to Rs. 181 crore in Q1 FY17. Consolidated net worth as on June 30th, 2017 was Rs. 11,115 crore. Performance of our bank in Q1 FY18 has been shared with all of you. Briefly the retail bank is shaping up well and the wholesale bank is doing the good job notwithstanding the challenges in the corporate landscape. Our retail bank is now doing over Rs. 500 crore of gross disbursements and Rs. 250 crore of net disbursements every month. Y-o-Y, our direct retail book multiplied 8x from Rs. 427 crore in June 2016 to over Rs. 3,400 crore as of June 2017. We now have over 1.6 million customers and we're acquiring about 80,000 new customers every month. We are expanding the network at a brisk pace. We now have close to 12,000 points of presence in 25 states, covering 300+ districts, 600+ cities or towns and close to 42,000 villages. Our wholesale bank is now focused on emerging large corporates, i.e. corporates with a turnover of USD (+1) billion. We have added close to 100 ELC accounts; have done over Rs. 3,000 crore of funded business and over Rs. 2,000 crore of non-funded business with them. Our non-funded business has grown exponentially, y-o-y June 2016 to June 2017. It has roughly tripled. As on June 2017 we did over Rs. 20,000 crore of non-funded business. The contribution of franchise base fee income to total operating income is now close to 14%. Performance of our fixed income treasury income was strong this quarter. IDFC Bank PAT in Q1 FY18 was Rs. 438 crore compared to Rs. 265 crore in Q1 FY17. IDFC owns 53% in IDFC Bank.

Our mutual fund AUM as on June 30th, 2017 was Rs. 61,000 crore. Revenues and net profits from our mutual fund business during the quarter were Rs. 76 crore and Rs. 20 crore respectively. Y-o-Y we have grown our active distributors by 22% from 2,206 as on June 30th, 2016 to 2,702 as on June 30th, 2017. The folios added have seen 70% growth from 11,399 to 19,327 and our new SIPs have grown by 22% from 32,400 to 39,600. Our strategic focus area going forward is equity and continuing to maintain our strong performance amongst debt funds.

As on June 30th, 2017 our loan book of India IDFC Infrastructure Finance Limited was Rs. 2,893 crore across 36 assets. It is a well-diversified portfolio across roads, renewables, education, healthcare, telecom, SEZ and others. The pipeline for disbursement continues to be healthy. Our debentures and CPs continue to command the highest domestic credit ratings; asset quality is strong with nil NPLs. Net profits during the quarter were at Rs. 22 crore. As you must be aware we own 81% of this business.

In alternatives, our AUMs were over Rs. 17,700 crore in nine funds across three assets classes in infrastructure, private equity and real estate. Our PAT in this business for the quarter was Rs. 2 crore. In our Securities business notwithstanding the structural issues faced by the industries, we continue to do well. We have strengthened our institutional sales and research to service domestic institutional investors and FIIs across the globe translating to a well-diversified broking revenue mix across geography. In this business, we witnessed increased market share when revenue in broking across segments and we have a healthy pipeline for investment banking business. For the quarter, this business delivered revenues of Rs. 35 crore and the net profit of Rs. 15 crore.

To conclude we witnessed a good quarter for all the businesses owned by IDFC and we are confident of maintaining the momentum for the rest of the year. With this update, we open the floor to Q&A.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. Our first question is from the line of Arun Ranganathan, an individual investor. Please go ahead.

Arun Ranganathan: My question is regarding this RBI guidelines on the number of shares we have hold in the bank. Now we hold around 53% in the acquisition we are proposing, what will happen and actually what is the basic guideline, 53% should go to 40% in 3 years and stay there for the next 5 years, is that true?

Bipin Gemani: Slight correction, you are right, 53% has to go 40% within 3 years and stay at 40% up to 5 years that means another 2 years after that.

Arun Ranganathan: If the proposed acquisition happens within this 90 days period, the thing is that the IDFC stakewill not go below 40%? From 53% we will only dilute to 40%?

Bipin Gemani: That is correct.

Arun Ranganathan: The next question is that there is a huge discount because of this holding company, as everyone knows that the interest rates are so low. Why can’t we borrow money, why can't we buy our 10% of equity which will cost about Rs. 1,000 crore and extinguish those shares so that the market, we also know the real price or we will get at least the bottom in the stock price, will get the support in the stock price, is there anything contemplated in that fashion in your internal discussions? Because we are trading at around 50% discount and the market is not giving a fair value for the stock so why can't we go ahead and buy that 10% of the equity in these low interest rates with borrowed money?

Bipin Gemani: I agree that the market is not giving us the fair value of the underlying assets we have. But this business we will have to check the rules and regulations, we can't borrow money. Lending to an NBFC by banks etc. is extremely tightly controlled by Reserve Bank of India and doesn't give you so much freedom for the end use of the same that one can attempt to buy back your own equity. And these are measures which are temporary in nature, the best way is to be strong and improve the earnings so that the hold-co discounts start coming down. A temporary aspect of just borrowing and trying to support a particular price will not have a long-term value. But it’s an idea we will see how it can be--the whole thought process is to reduce this hold-co discount which currently is also constrained by the fact that we can’t do many activities even under NOFHC by RBI, the 3 years are ending in July of 2018. And subsequently we can start planning some new different lines of business and if we get the ‘proposed’ merger comes through it is our expectation that the earnings ability of the IDFC Limited will improve and will allow us to push out a much higher level of dividends and hence the hold-co discount should come down.

Arun Ranganathan: As you know the market is not good valuing us in a fair manner and the other thing you said the IDFC is going to get 100% of Shriram Transport into it in this proposed scheme if it goes through as you said. So if we go and buy 100% of Shriram Transport with this by valuation will the small shareholders like us be affected enormously because we are not trading, the stock is our currency, so it is trading is below par. So, going and buying a currency which is far much decently valued, they care quoting at more than 2 times book. And we are not even quoting at 1-time book, so what is the thought process there, what went through because the minority shareholders are already affected because of the huge holding company discount and now the dilution is going to happen if this happens, so how are you seeing this?

Bipin Gemani: Any comment at this point in time without determining the swap ratio would be speculative in nature, so I don't think so I can comment anything except for the underlying principle that nothing will be done which impacts the minority shareholders negatively.

Arun Ranganathan: The other thing is that I want to have a clear picture on the bank. This quarter of the bank had a huge other income gain which was always welcome. The earnings is going on good trajectory but on this call I didn't join at the right time, so I missed a lot of things. What I wanted to ask is that for the quarter the trajectory the net interest income because of this fixed rate book which we have got from IDFC, the NIIs will keep going down for the next year or 2? What happened this quarter will continue for the bank for the next year or 2?

Bipin Gemani: I think the minutes or rather the meeting Q&A and everything is recorded and is on the website. I would encourage you to just go back and listen to it. But just to put curiosity, yes, the net interest margins are under pressure and we had taken certain positions to manage that through treasury book and all that stuff. But yes, it is a fact and it is you are seeing what a SBI is also doing that the loan yields are coming down, banks with excess money are sitting there and credit growth is not happening in the corporate stuff. So net interest margin is under pressure, we are doing our best by expanding into retail space and ensuring that we continue to prevent the decline or slow down the decline as and when my fixed income borrowing start coming down this thing should improve. But the pressure seems to continue till the overall market and demand picks up.

Arun Ranganathan: Around 3 years ago being a listed company both the bank and the IDFC Limited put together was valued at around Rs. 180 and now it is at around Rs. 130, both the things put together. Is the market in any way not assessing the growth whatever it is the plans in the bank in a right manner because I can understand IDFC Limited's holding company discount and all that stuff? But is the market is not a valuing the bank also properly because it's not even quoting at 2 times book and we seem to be showing good numbers but the market doesn't believe or do we have messaging problem? We don't have the proper messaging of the growth plans ahead, what is the problem there because I don't think at Rs. 10,000 more than Nifty we have not getting more than 2 times book for the bank.

Bipin Gemani: Markets value the way they have interpret, we have been doing our job in the investor relations meetings everything to our ability, we are transparent, we communicate but market is market, they determine on their own what they think is the right value where you and over a period of time when the sustained performance will be there it will value us fairly. Our job is to do good business, once the business starts paying and we continue to communicate regularly with all investors. We have no issues with that, we do regular conference calls and we are transparent. Sooner or later the truth shall prevail.

Arun Ranganathan: But as a promoter IDFC Limited, is happy with the way the bank's progress has been, really happy because the branch rollout and the CASA accumulation those things are happening at the rate at least at which the management expected, the market expectations other thing. But is it going with a rapidly or is it going as planned by the management as a whole in between IDFC and the bank?

Bipin Gemani: I would request you to listen to the bank's Investor Call. It is answered there.

Moderator: We will take a next question from the line of VP Rajesh of Banyan Capital Advisors. Please go ahead.

V.P. Rajesh: My question is regarding the Spike in the gross NPL percentage and net NPL percentage and if you can give some color around that?

Bipin Gemani: When you see the gross NPL and net NPL, also please look at the provision P&L line. This is part of our legacy assets and therefore it's just a reclassification from the restructuring to NPL. There is no P&L impact of the same, so if you will recollect when we had moved from IDFC Limited to the Bank there were some legacy assets for which we had made adequate provisioning. But the classification keeps moving between restructured to NPLs, so answering this was an identified problem and there is no additional provisioning requirement for this asset at this point in time.

V.P. Rajesh: My second question is, a few calls or may be several quarters ago bank was thinking about developing the deposit base on a granular basis and not really going and giving high interest rates like some other banks do, so curious what the thinking on that is now?

Bipin Gemani: We will continue to modify our deposit rates in line with the market and the fact that my savings rate is today at 4%, better off than State Bank of India. So, let me tell you at the philosophy level, we have adjusted our rates to attract deposits in the product called fixed deposits, not in the savings line. Fixed deposit gives you more stable source of money rather than a bit volatile money. Secondly the savings deposit and other types of short-term savings product, what is more important is the kind of service you provide so that the customer sticks with you. Interest rates keep fluctuating up and down and a liability which is more transactional in nature which is influenced by interest rates is better to do that through the short-term interest rates in the fixed deposit line. Savings account is more transactional in the sense that it is more about service and it is more about how easy it is to access. Whereas investment thought processes which are driven by interest rates that we manage through our time deposit interest rates which continue to remain one of the best in the industry, so that's our strategy and philosophy. Just as a number, our CASA plus retail deposit in March 2016 was Rs. 532 crore and in June 2017 it is Rs. 6,282 crore. That is the evidence of that this strategy seems to work.

V.P. Rajesh — On your current CASA acquisition rate for the bank, you had mentioned it’s around Rs. 2,500 crore per year. So let's assume that if this transaction goes through what could this number be like for the bank?

Bipin Gemani — Again I will repeat it's too speculative to comment at this point in time. As and when we are ready with our set of numbers but, the intent is we get the access to 3 million customers and by providing them the full suite of banking products we should be able to garner the CASA much better. But we don't have any numbers to share at this point in time.

V.P. Rajesh — Grama Vidiyal transaction has been there for a while, what kind of deposit base have we been able to create from that customer base?

Bipin Gemani — We have just started a process or rather a product. We have introduced product and I think given the next 60-90 days we should be able to share with you more in terms of what kind of deposit base, so initially you remember we took it in October and then the demonetization happened and all the focus was towards to ensure that the collections and the efficiencies are maintained because if you look around the whole MFI industry got really badly hit but we did not. So, 6 months from October we were very strongly focused on getting the assets back into this normal run rate and ensuring that the asset quality does not fall down. Now that the things are stabilized we are starting with that focused-on on deposits gathering and hopefully in the next 3-6 months we will have enough experience to share with you along with certain data. Had the demonetization not happened this exercise would have happened at least 6 months ago.

V.P. Rajesh — My last question is on the trading investment book on the bank's balance sheet. Trader has jumped quite a bit from March to June and I was wondering what is the idea behind sort of becoming almost like investment bank like trading on the fixed-income side?, so it will be helpful if you can provide some color. Obviously, it gives you tremendous trading gains but it's not a very steady source of revenue.

Bipin Gemani — That is correct. If you go back and we have shared this earlier also, our structure as a legacy, assets and liabilities was long-term fixed liabilities and the interest rate declining scenario that was hurting us and as an NBFC we had to borrow long-term because we were funding long-term assets. Long-term assets that the interest rates were being reset annually so that mismatch was there, so as a hedge the only way to increase duration on the asset side was to buy long-term G-Secs. Over a period of time as the interest rate view has started to change, we believe that we are almost towards the trough of the interest rate curve and we will now not see too many cuts going forward. And hence we have started to unhedge the position if you want to say and therefore your trading income gains pop-up. Now you also rightly identified that this is not a sustainable source of income. It will continue for some maybe a few more quarters and has been there in a few quarters. But sometimes we get it right and sometimes we get it wrong. So overall, we have done a very good job, even if you go back and check for the last 3-4 quarters but that is not the reason why we became a bank. The reason we became a bank was to diverse and therefore a few acquisitions of customers both organic and inorganically, we hope to change our product or our concentration mix from being purely wholesale to more of retail. And in that period, in that strategy the proposed merger is also being talked of. So yes, going forward the focus continues to be in the retailizing of our loan book and this credit strategy was a hedge against declining interest rates and going forward we don't believe, interest rates may change over a period of time—but as of now we feel that it is almost bottoming out and simultaneously some amount of fixed-rate liabilities will also start to unwind over the next 1 or 2 years. And we are utilizing our asset book hence the NIMs should start improving after 1 or 2 quarters.

V.P. Rajesh: But as I look at your balance sheet for the bank, the borrowings only went up by Rs. 6,000 crore or so, yet the trading investment book went up by 80%. So the question that comes to mind is then we are taking more interest risk or interest rate back at this point in time in the cycle or is that not correct?

Bipin Gemani: No, so interest rate bet is also a function of duration. What you don't see the duration of those assets in a very short term so maybe we are just playing the short-term yield curve and generating some amount of interest income as long as the trade is not negative it doesn't matter.

V.P. Rajesh: So you are saying that basically whatever you are garnering from CD deposits or from other deposits that you are getting because borrowing hasn't really moved that much, you are just deploying it in the short end of the curve?

Bipin Gemani: Yes, this is the regular activity. We have a great treasury team and they continue to manage and the results reflect. So remember these are also points in time so it is possible that March 2017 was not even average, it was quite low and suddenly again June 2017 is high.

Moderator: Thank you. We will take the next question from the line of Vivek Kumar from Shivsagar Investments. Please go ahead.

Vivek Kumar: I just want more clarity on the dilution for the IDFC Bank because IDFC Bank is around Rs. 20,000 crore market cap and Shriram City Union at around Rs. 15,000 crore, so can I assume 75% dilution in IDFC Bank? How is the structure being done?

Bipin Gemani: As I said at this point in time I cannot comment on anything. Neither can you come to any conclusion till the swap ratio is determined.

Vivek Kumar: But Shriram City Union will be 100% merged with the bank, right?

Bipin Gemani: Yes, it is proposed.

Vivek Kumar: The dilution could be around 75% at the current market rate, it is safe to assume that?

Bipin Gemani: No it is not safe to assume that. As I said please don't make such assumptions or any assumptions till the company and organization shares the swap ratio with you.

Moderator: Thank you. Our next question is from the line of Arun Ranganathan, an individual investor. Please go ahead.

Arun Ranganathan	You need not borrow on the buyback at least give the market the direction on the price of the IDFC Limited stop, the real value, at least we should be at around 100. So please a suggestion from my side is that if we announce a buyback at a fair price and if we even don't buy a single stock but still the market will get the correct perception of what the stock prices all about, the valuation all about and the true value of the assets underlying IDFC Limited. So this is just a suggestion sir, please consider this.
Bipin Gemani	Thank you for your suggestion.
Moderator	Thank you. Ladies and gentlemen that was the last question. I now hand the floor back to the management for closing comments. Over to you sir.
Bimal Giri	Thank you so much for attending the call. Look forward to catching up with all of you next quarter. Thank you.
Moderator	Thank you members of the management. Ladies and gentlemen on behalf of IDFC Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.