IDFC Bank Limited

Q4 FY17 Earnings Conference Call Transcript
April 26, 2017

Moderator: Ladies and Gentlemen, Good Day and Welcome to the FY17 Earning Conference Call of IDFC Bank Limited. As a reminder, 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 '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Bimal Giri from IDFC Bank Limited. 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 Fiscal '17. I have with me Dr. Rajiv Lall, Sunil Kakar and Pavan Kaushal.

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 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 in Fiscal '17.

Sunil Kakar: Thank you, Bimal. As all of you are aware, FY'17 marks the first full year of operations for us. I will highlight to all of you the progress that we have made in this period and then hand it over to Rajiv for his comments.

One of the key focus areas in the bank is to reduce concentration risk that we were running as a mono line financial entity focused on infrastructure. I am happy to share with you that now almost 25% of our funded credit is retailised it is a new word, but the focus is on retailization and spreading the risk. Equally importantly, our exposure to Infrastructure sector is now 54% from 71.2%. Our Retail business is now gaining traction. Our products suite for both assets and liabilities across customer segments in Retail is now complete. Organic retail assets as of March 31, 2017 were around approximately Rs.2,800 crore and more than that we are happy to share that we are now disbursing almost Rs.500 crore per month in our retail assets. Bank wise, CASA and Retail Fixed Deposits was close to Rs.5,000 crore. All this from a standing start.

We have been focused on sharing with all of you that the network we are rolling out will be branch-lite and will focus on digital channels and partnerships. In this year that we have just completed, we have exploded our network, we now have over 8,600 points of presence covering 20 states, 150 districts, 19 major cities and almost 33,000 villages. We have also been emphasizing to all of you that each of these points of presence is effectively a bank in a box. It facilitates payments, offers liability products and has the potential to offer assets products if need be.

We have been acquiring customers at a good pace. We now have over 400,000 customers organically. Since December of last year, we have been acquiring 50,000 customers every month; in the month of March '17 we acquired over 60,000 customers, of which 60% relate to rural and peri urban retail and the rest 40% pertain to urban retail. Having onboarded close to a million customers from IDFC Bharat Limited (erstwhile Grama Vidiyal), we now call it IDFC Bharat Limited. In total we have now approximately 14 lakh customers. Our CASA grew from Rs.445 crore as of March '16 to Rs.2,100 crore as of March '17.

In Bharat Banking, the savings account per customer was INR 3,000 whereas in Bharat Plus the savings account per customer is almost Rs.27,000 crore. Growth in FY'17 was strong. Year-on-year, our balance sheet grew by 35% and outstanding funded plus non-funded credit which is a measure of credit growth grew by 58%. Funded outstanding credit grew by 36% from INR Rs.48,813 crore as on March '16 to Rs.66,567 crore as of March '17. We also sold net Rs.2,000 crore of stress assets to ARC in the last quarter. Post the sale, our gross NPL is 3% and net NPL is around 1.1%. We continue to reiterate that our asset quality remains good, notwithstanding challenges surrounding the infrastructure landscape. Fee income contributed 12% to our operating income which is a strong performance for a bank in a full year of operation. Most mature banks have fee contributions of around 20% and we are well on our way to get there. Our cost-income ratio in FY'17 was 42% which is well within the number that we have guided to all of you.

One of the key challenges that we have been sharing with all of you is meeting our overall PSL target and the first date for ensuring compliance on this count was March 31, 2017. I am happy to share with you that we have met our overall PSL target of around Rs.17,000 crore as of March 31, 2017. On the profit front, we had guided about 10-15% growth in profit in FY'17 as against that compared to annualized last year we have delivered profit growth of 25%. In FY'17 we have delivered a very strong all-round performance and we hope to continue the strong momentum across key metrics that we have been tracking in FY'18 too.

Overall, when we started this journey 18-months ago, we had taken a call that a bank of the future will need to focus more on technology and partnership and rely less on branches. Subsequent events such as demonetization have strengthened our belief in this call and we are now more confident about delivering on a strong banking franchise over the coming years.

I will now hand over to Rajiv for some additional comments.

Dr. Rajiv Lall: Thank you, Sunil. I just thought that before we go to the Q&A, I just share broader perspective of where we are in our journey. This has been I think the first full operating year for the bank having started operations in October 2016. Reflecting back on the last 12-months it has really been quite a tumultuous 12-months with several known unknowns for which we are prepared for where also a couple of unknown-unknown that came our way. So the unknown-unknown is the most obvious one which is demonetization event of November last calendar year.

Having just made the acquisition in record time of Grama Vidiyal, we were just about to accelerate the pace of growth of Grama Vidiyal when note bandi hit us and we had to spend the next six weeks stabilizing that. As it turns out, it was fortuitous that MFI was converted into a banking BC because we were very quickly able to turn it around and bring it back on track. So that just gives you a sense for all the various factors that were beyond our control that we have to contend with in the past 12-months. These 12-months have been extremely important for us to systematically build proof-of-concept in our distribution network for the retail build-out. I am really delighted to report that our degree of confidence in the design and rollout of that distribution network is now very solid having spent the last 12-months learning from our experience.

So in essence, the distribution network has three layers to it -- There is the traditional "Bank Branch Layer" which for us up till now amounts to only 74 branches.

The next layer is what we call the "Corporate BC Layer" and that is banking outlets that give us reach at a much lower cost to a large customer base using the power of our relationships strategic and otherwise with corporate business correspondence. The most important one of which is 100% corporate BC that we own which is Grama Vidiyal, now renamed as IDFC Bharat Limited.

The third layer is a real innovation and that is the "Payments Layer" where instead of corporate BC relationships, we are relying on merchant BC relationships to extend the reach of the bank much deeper into a much larger customer base. So if you take these three layers together, we now have 8,600 points of presence across 20 states, 150 districts, 19 major cities and 33,000 villages. The idea is to build out this distribution network, continue to stick it across both urban as well as rural geographies. So it is not that we are focused just on rural and semi and semi urban, we are equally focused on the urban landscape. So the reach is a very important metric that we track and the confidence in which has grown about the cost characteristics of that distribution network is ability to acquire customers and it is our ability to operate it effectively and within manageable cost.

The number of customers obviously is a second metric that we track on our journey to retailization and as Sunil has already mentioned we are now 1.4 million customers. The most important point about our customer base is our organic ability through these three layers of the distribution network to aggregate to a customer. We are now doing 60,000 customers a month, of which 20,000-22,000 customers a month are actually coming from urban India, and that too from a very limited footprint today in the five larger cities, and in those cities it is our salary channel as well as our digital channel that is leading to very effective customer acquisition month-on-month. That was the second metric which is the number of customers.

The third metric is the characteristics of our balance sheet where diversification is absolutely key both for the reasons of risk management but equally and more importantly to systematically drive the average asset yield on our advances higher than what it was before. So the metric that we measure on that front is the share of our advances that our retail, 25% is the number that we reach on March 31st and we believe that is extremely good traction. Again, for those of you who might be thinking, well, you have acquired a lot of these portfolios, to repeat a number that Sunil mentioned, we are now organically doing Rs.500 crore of retail assets a month through our own network, not through acquisition.

The fourth metric that Sunil didn't mention or mentioned only in passing is equally important. I do not want to leave you with the impression that we are not going to be in corporate India. It is a very important and powerful franchise for us. We remain engaged in the corporate business but we are changing its focus very systematically. Again, from the point of view of risk diversification and from the point of view of adding to our ROA. So how do we do that? We are positioning ourselves as wanting to be the banker of choice for emerging large corporate. So these are corporate below a billion dollar in turnover. We have very good traction in this landscape and this primarily for a funded business. In the large corporate landscape, we will continue to engage very aggressively, particularly for non-funded businesses and fee generated businesses. The evidence we have so far is that our ability to generate franchise fee-based income. I repeat, franchise fee-based income which is fee generation that is not ad hoc or related to trading gains or asset sales, this is fee income that come from hard working business banking relationship, cash management, trade finance and such life. We have now done Rs.360-odd crore in fee revenue of this kind over the last 12-months. Our goal is to expand that very aggressively using our brand positioning and our connect in Corporate India.

Finally, the metric that we are all focused on is profit after tax. I think in a difficult year we have delivered on an annualized basis comparing to last year for which we only had six months data, 25% growth in profit after tax which is higher than what we had guided the market. So that is my take on the last 12-months. Every quarter we would come back to these five metrics to keep calibrating our continued progress in this journey.

I want to spend a minute focusing our attention on the future. As I said, the last 12-months have been important for us to build proof-of-concept in our business model and our distribution network in particular, right. We are now confident enough that we want to accelerate the pace of investment in expanding our franchise over the next 24-to-36-months.

So our goal that we have set for ourselves for March 2020 are broadly the following on the various metrics that we have talked about starting with customers: From 1.4 million customers we aim to get, we are confident about getting to 10 million customers and we will do this organically and inorganically. So inorganic growth is very much on the cards. We are examining all kinds of opportunities and options and it is actually active part if not an integral part of our strategy as we roll it out. So 1.4 million to 10 million customers over 36-months was first metric.

Second metric is the size of composition of our advance book. Retailization - the word that Sunil used and we will use again and again, from 25% we want to get to between 50% and 60% of our advances to the retail. Retail defines as SME downwards all the way to JLG Finance. So at full range of assets from 25%, our goal is to get it to 50% to 60% and that would mean in terms of volume over 36-months from the Rs.16,000-odd crore the retail book comprises today, our goal would be to take it in excess of Rs.55,000 crore within 36-months. So that is the second metric.

Third metric is the distribution reach. Our cost mitigating distribution architecture. It is a click-and-mortar architecture comprising of the three layers that I alluded to earlier, the core bank branches, the CBC layer and the merchant banking layer. So the core bank branches today are 74. We want to take those from 74 to 200 in 36-months, right. That means that we will be expanding to new cities, we will be in 25 of the larger cities in the country and we will continue to expand our semi urban and rural presence in the form of traditional bank branches obviously with the better and leaner design that some of you have seen from 74 to 200. The CBC layer which is 350 banking outlets today, we aim to take that to 2,000 in 36-months.

The outer most layer which we are calling the “Payments Layer” from 8,600 micro ATMs and payment points, we want to get to 1 lakh payment points in micro ATMs. That means a very systematic expansion is what we are preparing ourselves for both through organic and inorganic means.

Finally, in terms of our franchise fee-based income, we will be very disappointed if we did not atleast, we want to more than double the franchise fee based income that we are generated on an annual basis over 36-months.

So that gives you a sense for now the future and some my own perspective on the last 12-months. I have taken more than enough of your time. So thank you for that. We will now open up to Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Adarsh P from Nomura. Please go ahead.

Adarsh P: Hi, Rajiv and team. Just wanted to check on the breakup of the advances and investments if you can tell where this Rs.16,000 crore – is it a part of some investments with qualified BSN and how much of that was organic?

Sunil Kakar: What we call it as direct and indirect. So your 25% we would say about 11% is buyout and the rest 14-odd would be mixture of loans given to entities as well as organic. Organic is as you know the total number is Rs.2,800 crore. Of the Rs.16,000 crore, about Rs.3,000 crore is organic, that leaves Rs.13,000 crore are purchase portfolio, and we have updated same breakdown with the bulk of what we have done organically is all be there.

Adarsh P: In the purchase portfolio, I just wanted to understand it helps us comply, but from an ROA and NIM perspective, how do you see this because …?

Dr. Rajiv Lall: It is an extraordinary performance and Sunil can correct me if I am wrong on the numbers, but normally you would expect to purchase portfolios that are very significant negative spread, but because we have calibrated it throughout the year, and we have made strategic use of the new certificates. Sunil, what is the effective…?

Sunil Kakar: Effective drag if we had to convert that it into a certain number, remember that there are two aspects to it – one is on an average if my requirement was 17,000 crore, that was to be met as of 31st March, we were not subject to quarter-on-quarter meeting requirements, which is coming up in the next fiscal. So on an average we would say that about 25 basis points at the maximum is a negative drag we have incurred this year compared to your cost of funds.

Adarsh P: Rajiv, when you talk about the journey right from 25 to 60 and as you say that like 4-5% is organic, rest 20% broadly is inorganic as of now with negative spreads, how do you see that journey to say 50% or 60% over a three-year period between certificates and organic, then the NIMs out there?

Dr. Rajiv Lall: We are doing Rs.500 crore a month in organic retail assets, right. So that is close to Rs.4,000 - 5,000 crore of net disbursements.

Sunil Kakar: If I may just add there, as we grow, the dependence on buyouts, etc., will come down, as the dependence comes down, we will be able to reduce the negative drag of PSL on our overall book, and it may still take about 2-3-years before we reach to say that we are now positive on our PSL.

Dr. Rajiv Lall: I will put it more forth rightly, in our plans to expand the retail book… I am not talking about PSL, I am talking about our retail book which is primarily PSL, so Rs.16,000 crore is our retail book, let us say that goes to Rs.55,000 crore in three years, right, our goal is to keep the acquired PSL portfolio constant at what we did last year. So the negative spread on a much larger retail book on account of PSL will continue to decline dramatically.

Sunil Kakar: Remember, when we are growing retail book, very largely and will be enough non-PSL retail growth also which will add to our profit margins.

Adarsh P: So the way you look at it is 16 is divided 3 and 13 and you get to 50,000 crore, the 13 remains constant, so the 3 goes to like 50,000-odd crore, is that a fair …?

Sunil Kakar: That is correct.

Moderator: Thank you. The next question is from the line of Matthew Ingram from Maple-Brown Abbott. Please go ahead.

Matthew Ingram: Just wanted to ask a question about the NPL additions, looking through the Basel-III it looks like your NPL additions were quite elevated in Q4, I understand in Q3 there was one NPL that was an issue, but some expectation was that was to normalize going forward near-term, we are still looking at an increase of well over I think Rs.361 crore the new NPLs in the fourth quarter, I wanted if you can give some color on why that was still elevated and where it came from, etc.,?

Sunil Kakar: If I may summarize, we have been saying over the last few quarters, this is nothing but a classification change, this is a part of our portfolio of identified assets which we came to us from the legacy portfolio. So there is no increase in NPL, it is just a reclassification from…

Dr. Rajiv Lall: No increase in stressed assets, there was an increase in NPL.

Sunil Kakar: So the NPL is a classification, it has moved from restructured to NPL and you would also see that correspondingly however that there is no provisioning impact because it has already been provided for. So this is just a classification and an interesting movement between the total stressed assets.

Dr. Rajiv Lall: We have not provided historically basis the regulatory minimum requirements. We have provided significantly higher amounts. So even if the technical classification of an identified asset or a stress asset in our book, move from non-NPL to NPL, it does not have commensurate implications on our provisioning because we have taken that upfront.

Matthew Ingram: So basically the whole Rs.361 crore was just the reclassification from the…?

Sunil Kakar: That is correct.

Matthew Ingram: I guess the follow-on question then is, how much can the provision coverage fall because obviously that will happen as the reclassifications continue, your provision coverage has to fall if you do not provide additionally, how low can that go before you are going to have to start providing some additional specific provisions?

Sunil Kakar: Our estimate is that our provisions are adequate to cover all the expected losses. So the point is that we did make the provision at the time of transfer or demerger and we continue to measure it quarter-on-quarter basis and as of recent measurement we are comfortable with the provisioning we have, we do not see any additional provision requirement for those assets.

Moderator: Thank you. The next question is from the line of Manish Karwa from Deutsche Bank. Please go ahead.

Manish Karwa: On the asset sale that we have done, what would be the gross amount and what is a kind of provision that we used up when we sold the asset and what is the SR that we have got on this?

Sunil Kakar: We have net value of assets is about Rs.2,000-odd crore, there are 14-assets which we have sold and on an average as you know we have been saying we are carrying 50,000 provisioning, so you can estimate it to be around 4,000 gross.

Manish Karwa: This is 15 cash, 85 SR?

Sunil Kakar: That is correct.

Manish Karwa: Rs.300 crore of cash is what you would have got?

Sunil Kakar: Correct.

Manish Karwa: Since you have already made the provision, would it be fair to assume that the SRs that you will be holding you should be able to realize that value over time?

Sunil Kakar: Absolutely correct.

Manish Karwa: A follow up on this; historically, prior to this asset sale, we had about Rs.9,000 crore of stressed assets, on which you are carrying about Rs.4,500 crore of provisions. So now should we assume that 9 minus 4, you have 5,000 crore of stress assets and on which you carry about 2,500 crore of provisions?

Sunil Kakar: Approximately correct.

Manish Karwa: On your margin outlook, now obviously given the amount of PSL that we have bought in this quarter, there should be some impact on margins as we move forward, plus the fact that you have sold down some assets which were giving you some cash interest earlier, that also should be negatively impacting your margin this year, but you are growing fast on retail and generally interest rates are low, so that should be a positive margin kicker. In summation, should we expect a better margin next year or I think there would be pressure on NIMs as we move forward?

Sunil Kakar: For the next year, that depends on what timeframe are you looking at, as Rajiv mentioned, if we look at it over a three-year period, I think we shall be able to recover our margins, but remember, the challenge we have had is we have fixed rate long-term liabilities which we have shared long time back also and given the fact that the interest rate scenario is not yet clear, whether it is going to come down or whether it is going up, you know the RBI is signaling higher interest rates, whereas there is higher liquidity right now in the system, and MCLR coming under pressure, and keeping in mind that next year we will have to keep a full year of PSL as compared to six months, I think it would be appropriate to say that for the short period of next 6-months to 12-months, the margins would be a little bit under pressure but we hope to recover soon our focus on the retail…

Dr. Rajiv Lall: I will be more forthright than Sunil. It is no secret that our corporate margins are under pressure and you have seen this in our strategy, it is the aggressive retailization of our book and the growth of that book through organic and inorganic means, that is strategic vital for us and we are very focused on that and confident on delivering on that.

Manish Karwa: On your distribution outlook, you said that you are now more confident in investing into distribution. Would that also mean that you will become a little bit more aggressive on the urban side in terms of the branch network?

Dr. Rajiv Lall: If you heard my opening remarks, I said, branches are going from 74 to 200 and you can draw your own conclusion.

Moderator: Thank you. The next question is from the line of Rahul Maheshwari from IDBI Mutual Fund. Please go ahead.

Rahul Maheshwari: I have two questions; first of all, in your balance sheet disclosure which is there under the advances part, can you explain in detail nature of credit investments which have grown by 78% on QoQ and 451% YoY basis, the exposures regarding to the different sector because till now 75% is your Corporate part as you have scaled from 7% to 25% Retail, so apart from 54% Infra, what are the other sector? For the quarter what are the slippages which is there and what is the restructured asset book standing on the books?

Sunil Kakar: The credit investments that we are saying is nothing but a form of loan and it is diversified across various sectors. We do not have bond-by-bond, I cannot share the specifics, but the idea behind that is instead of giving a loan, which is getting reset in a shorter period of time, you get a fixed rate asset as well as it does not lead to any further PSL requirement on that. So, it is nothing but a loan substitute in that sense. So that is why we added back to say that it is part of a credit advances. Now, with respect to NPL as the previous question was asked, we share that was about Rs.350-odd crore which moved as a reclassification from our identified stressed asset, so that question I think is already answered. But with respect to sectoral concentration, etc., is I think the industry concentration is already there in one of our disclosures but generally our focus area is it is not that we are not doing anything in the Infra space, we are very credit conscious about that. Other than that it is in the space of as you said emerging large corporates, mid-markets. The sectoral industry concentration is there, it is a big list on Page #17 of the Basel disclosures, so you can look at it there. And it will continue to remain as our highest 20% and transport and other 10%, so it is distributed now.

Rahul Maheshwari: What is the restructured book standing as at year end?

Sunil Kakar: As on 31st March 2017, the restructured book is net Rs.690-odd crore.

Moderator: Thank you. The next question is from the line of V P Rajesh from Banyan Capital Advisors. Please go ahead.

V P Rajesh: The question is as we talk about growing the PAT inorganically, are you looking at smaller acquisitions like GMV or looking at a bigger transaction and related how do you think about other valuation measure, the valuation of the entities you are looking at?

Dr. Rajiv Lall: It is not at all appropriate for us to even directionally hint at what kind of inorganic opportunities we are looking at because that is just from deal dynamics point of view that is completely counter-productive, but not to avoid your question, retail obviously is our very particular focus and as we build out the retail book, our goal is to build a very well-diversified retail book, retail book that will straddle all the way from SME customers down to JLG customers and everything in between. So, if we have to build a mosaic of two-three acquisitions that is one way to look at it. Could we be looking at one or two larger ones or a couple of smaller ones? It is difficult for me to say but our goal is to build a diversified book and to make acquisitions across the spectrum sooner rather than later.

V P Rajesh: In that context, how do you think about the valuation, in case of JLG, that is an excellent transaction in terms of what we paid for that particular book. So could you share some thoughts on that front?

Dr. Rajiv Lall: The thought is very simple. We stick to fundamental principles. The acquisition should be accretive to our shareholders.

Moderator: Thank you. Next question is from the line of Rahul Ranade from Goldman Sachs Asset Management. Please go ahead.

Rahul Ranade: Just was looking at the QoQ growth in the CASA deposits. So just trying to understand more if it could be possible to give a rough proportion of how much of this growth has actually come from new customers and new accounts what is the addition to the existing ones?

Dr. Rajiv Lall: 20,000-25,000 customers a month that we are doing in urban India. There a very significant chunk of those are salaried customers, right. Now, the average balance that we are getting per salaried customer is about Rs.35,000 ab initio. Now, the longer the salaried customers' stays after being on-boarded his/her average balance begins to rise. The first salaried customers we would have on-boarded would have been 12-months ago. We do not have robust enough data to do systematically project what that average goes to from Rs.35,000 per customer, but our goal at least is to get that to Rs.40,000-Rs.45,000 within six months of on-boarding. I do not know if that answers your question.

Rahul Ranade: I was just trying to understand that more from demonetization perspective where some of the deposits may actually flow out back the withdrawal limits are lifted?

Dr. Rajiv Lall: You need to understand really did not have that material impact on our liability franchise. I think you may have about Rs.100-150 crore of additional in terms of deposit mobilization as a result of demonetization. Demonetization has other consequences. But unfortunately, we did not benefit from flood of liquidity that came into banking system as regards to that.

Moderator: Thank you. Next question is from the line of Cyrus Dadabhoy from Anand Rathi. Please go ahead.

Cyrus Dadabhoy: I just wanted to understand how the micro finance entity collection rates are doing?

Pavan Kaushal: Our book is 100% as of this March end across all our partnership and our direct origination.

Cyrus Dadabhoy: With respect to this RBI new provisioning norm, any divergence in the provision versus RBI?

Sunil Kakar: For '15-16, we were not even a bank at that time. So the new circular, also talks about telecom sector, etc., So I may ask Pavan to give a little bit of color on what our exposure to the Telecom sector looking like and what is it going to be going forward also.

Pavan Kaushal: So our telecom sector comprises two big segments– One is the operator and the tower. Total outstanding up to Rs.11,500 crore give or take. A large substantial part of our portfolio is in the 'AA' category of customers. So we have been dealing with the top end of the operators and the top end of the tower operators. So even looking at what we have in our book, I think we are quite comfortable with our telecom exposure.

Cyrus Dadabhoy: Finally, some qualitative thoughts on NPA resolution, so what is your sense?

Dr. Rajiv Lall: For at least last six months, engagement with ARC was more productive than I had anticipated. So that sort of if you like good news. But that good news has now been tempered by changes in regulations that have made any negotiations for transfer of stressed assets from banks to ARC, more challenging for an undercapitalized or not so well-capitalized ARC. So our ability economy wise to transfer stressed infrastructure assets at scale to ARC, having developed the momentum in the last six months, our expectation is that momentum will probably be slow which is unfortunate. With respect to wider resolution and such like, the coordination failure type of challenge in bringing a bunch of consortium banks together to drive at a consensus on how to resolve, that still remains unfortunately quite elusive. On the positive side, what we do see is that governments and RBI are slowly stepping up their pressure on at least articulating some possible solution including the centralized bad bank. So I do not know if that will end up happening, but certainly there is much more systematic and serious thinking about how to resolve the coordination failure issue amongst banks to accelerate the pace of resolution. So it is a mixed bag, tonality generally I would say is disappointing.

Moderator: Thank you. Next question is from the line of Raphael Foo from Target Asset Management. Please go ahead.

Raphael Foo: I have a couple of questions; You have a huge bond book, the credit advances and you mentioned that you try to diversify your book and they are fixed rate and they do not have any PSL requirement, those are the benefits. But I just wanted to understand, what is the risk to this book, how is the treatment of the mark-to-market?

Dr. Rajiv Lall: I will make a general comment and then I will ask Pavan and Sunil to supplement. It is absolutely true that our treasury book is really quite large and there was an opportunistic strategic reason for it. Last year, while we were investing in building out to new bank and because of margin pressure and because of demonetization, all those kinds of issues, there was general revenue pressure, and pressure on a corporate loan margin. So in order to hedge that, we decided to take consciously some treasury risk on the bond book, making the bet that we could make treasury gains should interest rates decline. The bet was for a decline in interest rates. So that bet has not been a bad one because we had generated significant treasury gains as a result of that which has materially mitigated our revenue issue for last year. But the fact is that you make a bet like that, you are vulnerable to MTM risk. So now given where we are in the interest rate cycle, our dependence on treasury gain, we are very clear, is declining and needs to decline further. But equally we are now as I said because of the proof-of-concept momentum that we are building in our core business, we actually need that bet less than we did last year. So it is a bet purpose, the treasury book has served its purpose but now it is time to reduce its footprint. Pavan, do you want to add?

Pavan Kaushal: I will add sir. So Rajiv just cover the trading side of the investment, also, talking about our credit book which are held as investments. We are very-very stringent about what we put in that group. Typically, the same onboarding criteria as for loan, so it is in the range of our average rating, the portfolio which will be 'AA, 'AA-' range, not worse than that, and these are all 'A' asset book, so they are held to MPN standards, plus the PTC book which is also sitting in our investment book, typically has overcollateralization of 5-10% either in the form of cash or in the form of security. Typically, the PTC that is 'AAA or 'AA-' paper which we would now.

Sunil Kakar: So just to expand one was we said hedge, that was on our trading side or GSec, there is no credit risk there. So one we are talking is credit book here. The

Rs.17,000 crore which we have talked of as our PSL requirement. Instead of taking on loan which could expose us to credit risk, we adopted for a pass-through certificate (PTC) which were overcollateralized to ensure that the credit quality of the book remains good. So significant portion of this number pertains to PSL-related PTC which are as he rightly pointed out 'AAA' kind of rated and overcollateralized. So from a credit risk perspective on the bond book, we do not see any exposure.

Raphael Foo: Can I just also check, what is your NPA coverage ratio, do you just quote there?

Sunil Kakar: We do not exactly disclose that number, but we can say we are well covered, I have said that statement over and over again and from time and again we have been able to prove that our coverage ratio is adequate or more than adequate.

Raphael Foo: Can I also just understand that your retail loans have come down QoQ and your number of retail customers has also decreased QoQ. I just wanted to understand what happened.

Dr. Rajiv Lall: When we acquired the business correspondent subsidiary, Grama Vidiyal that is called, now renamed IDFC Bharat Limited. It has close to 1.1 million customers. As a result of the demonetization, if I recall correctly we closed sometime in October, literally weeks after closing that acquisition. Demonetization happened second week of November and that was quite a shock. So that 1.1 million customers have declined by 300,000 and it has taken us sometime to build it back up to what it was. So that is what you see.

Sunil Kakar: So you will appreciate that during that period of almost three months or two and a half months, the ability to disburse loans on cash because these guys are basically loan customers and we did not have currency to disburse loans, so that activity for between November and right up to December end, just collections are happening and there was no disbursement taking place. So we are happy to say that the things have got reversed, we are now back to normal and last few months indicate that we are back to normal and we are growing very well. As I have mentioned in opening comments, we are now doing almost Rs.500 crore of disbursement which includes the large part through the GV and collections are also normal to about 100%.

Raphael Foo: Can I also just understand the decrease in your employee cost -- is that a one-off or do you do something?

Sunil Kakar: It is one-off. If we go back to Q3, there was an excess out there. So if you normalize Q3 plus Q4, it is appropriate.

Raphael Foo: Can I just understand in your segmental breakdown of retail assets? I notice that your retail assets increase but then your retail loans did not increase. So what are the assets that increased?

Sunil Kakar: Segmental reporting if you referring to that, loans are loans in fact we have been buying certificates, right. So those are in accounting terms as investments and not loans, but they are assets.

Moderator: Thank you. We take the next question from the line of V Karthik from Investec. Please go ahead.

V Karthik: You had mentioned that the employee expenses is going to normalize run-rate. So about Rs.150 crore of quarterly expenses is what we are looking at as a normalized run rate?

Sunil Kakar: There is no normalize for a growing organization, right. We are at 3,900-odd employees today and that is only on the bank books and definitely as time passes, and we are in the investment phase, it will grow. So to that extent, it will not be appropriate to take even the annual numbers and use that as a forecast because we are growing in terms of investments into the network and opening new branches. But yes, the overall numbers if you look at to interpret, you should take for HR cost both Q3 plus Q4 by two. But remember that every quarter we will be adding more employees and hence the HR cost will continue to grow.

V Karthik: The other bit is as you mentioned the reduction in treasury book which is almost down 50% on a sequential basis. So that is likely to run down eventually through FY'18 or you intend to bring it back once you feel you are comfortable on the rate cycle?

Sunil Kakar: It is a part of the rate cycle call and as we see for the next at least six-odd months if not longer, we do not see the rate cycle moving downwards again. So this is a trading call which we look at in our ALCO very carefully and take appropriate decisions and directionally it is not our intent to be a trading bank and make earnings out of that, as Rajiv mentioned, franchise fee-based income is where we are focused on. So I would say directionally we are right. As a proportion of the overall balance sheet that number will remain, will start coming down.

V Karthik: Finally, on one of the slides which is slide #15 disclose your quarterly disbursements across various retail category. If you could talk in brief about sourcing of retail assets, the disbursement, Rs.550 crore out of?

Dr. Rajiv Lall: These are all through our own sales forces, through our BC partners and/or through DSA, there is a digital channel and there is our own feet on street.

V Karthik: What proportion of this would be digital sir?

Dr. Rajiv Lall: Digital is still small but I think we are doing a run rate of about Rs.50-odd crore a month now and that could grow quite rapidly in the coming months, but right now, that is our run rate.

Moderator: Thank you. Next question is from the line of Dhawal Gada from Sundaram Mutual Fund. Please go ahead.

Dhawal Gada: Just two questions; if you could talk a little more about the inorganic opportunity you mentioned that in your initial comments that things are in advanced stage, so just wanted to understand little more in terms of are we looking at multiple opportunity or is it one sum which has been discussed in the media, just some more color there? Second, as you also mentioned that recovery cycle has been elusive. So if things remain broadly as it has been in last one year, how do you see resolution for the balance stress which is on book right now?

Dr. Rajiv Lall: Let me take the second question first, "how do we see evolution for the balance book." I suspect that we will make some progress but it will not be a silver bullet. Those of you who have known me for some time, I have been very-very cynical about resolution for quite some time. I can say quite honestly that I have been pleasantly surprised by positive developments in our ability to resolve. So it has actually gone little better than my very conservative and cynical expectations. So maybe I will be less cynical for the coming 12-months but I am not expecting any miracle. So that is on resolution. On the acquisition, it is a very delicate thing. I do not want to give you the impression that we are in very advanced stages of any conversation nor do I want to disabuse your assumption. That we are looking at multiple opportunities, I can certainly lend credence to that. Whether what you are hearing in the press is correct or not, it may be and I would just have to be as cryptic as that unfortunately.

Moderator: Ladies and gentlemen, we take the last question today, that is from the line of Nilanjan Karfa from Jefferies. Please go ahead.

Nilanjan Karfa: Thanks, Rajiv. Three questions. If I have to look at the Slide #13, right, where we talk about product suite and the segments. In 36-months' time which of these segments do you think contributes most to the overall retail ROAs and if that is going to be driven by organic or inorganic and probably what product suite is still missing from this any would you like to add?

Dr. Rajiv Lall: This product suite you will agree is already very comprehensive and that we are able to deliver this product suite in a short period of time that we have been operating is in itself both from technology and observation point of view quite an important achievement and milestone. Looking to the future, I would reemphasize the message that I think I signaled earlier which is as you build out a retail book, it is extremely important not to lose sight of risk management. What that means in any retail book for any book or the entire advances has to be suitably diversified. So we would not be doing our job from a risk management point of view if we had too many eggs in just any basket or in the enterprise basket. There is a lot of growth that lies ahead of us and we believe that it is possible to deliver that growth in a balanced manner. For the targets that we have in terms of expanding our retail book, it is fair to say that inorganic growth will be an important part of the strategy and so we are extremely focused on that and I think I just have to leave it at that.

Nilanjan Karfa: But when you did this 15,000 equals 3,000 and 13,000, do you want to keep 13,000 in constant versus what you just said that inorganic is going to be a large part of the scheme. How do these two add up then?

Sunil Kakar: Why? What do you mean how do these two add up? So 13,000 is the acquired portfolio na. Why do we have to acquire a portfolio? We have acquired the portfolio for two reasons – One is that we wanted to diversify our risk into stake. But more importantly, we also had these very onerous compliance requirements for PSL. So by keeping the acquired book at a constant, what we are saying is that, we want to reduce our dependence on acquisition for meeting our PSL requirements. So we see our ability to organically generate retail asset that are PSL-compliant, organically or inorganically, not through acquisition of portfolio, but through acquisition of companies of businesses, we are pretty confident about doing that and therefore, we will not have to turn to acquiring portfolio that much. Either way we will diversify our risk, expand our average asset yield, retailize balance sheet and meet our PSL requirements.

Nilanjan Karfa: I think I was mistaken. When you said 3,000 grows to let us say 40,000, I thought that is purely organic without acquisitions.

Dr. Rajiv Lall: It cannot be and it will not be.

Nilanjan Karfa: Second thing is, you also talked about five parameters that you are going to watch. I think the first one was the number of customers which grows to 10 million, the second was percentage of retail which grows to let us say, 50% or 60%, the third thing you talked about is the distribution architecture, and the fourth one was about franchise fee. What is the fifth one?

Dr. Rajiv Lall: Balance sheet, profit, the usual metrics.

Nilanjan Karfa: Since we are going to move to IFRS next year, do you think our provisions are enough versus whatever the discussions that might be going back and forth between the banks IB and the RBI today? Just some color if you can throw in terms of how the discussions have been moving – is there a possibility some of the short-term expected loss curves would be diluted?

Dr. Rajiv Lall: I am not 100% sure where the other banks are placed. In our conversation with the RBI, we have been guided to believe and expect that IFRS will remain on track. Now, whether or not, the implication and the fallout of that for other banks in particular for capital adequacy, how the regulator intends to deal with that, I do not know. But I know there is some thinking about how to mitigate that potential impact. As far as we are concerned, this is a technical question. I will ask Sunil Kakar to address for you.

Sunil Kakar: Yes, I will cover it both sides. As you know, the IFRS measurement of expected credit loss, includes discounting factor which actually comes back as income over a period of time. So yes, numerically, the numbers will change because we now have to add a discount factor which actually comes back as an income. But the more important one is what I want to know again based on network information, there is no information to say that, it would appear that RBI will look into the fact of a sudden change in the capital requirement only due to change in accounting standards will probably come out with..

Dr. Rajiv Lall: Some mitigating framework. Also, I think the RBI guidance whether they will prescribe any flows and gaps on provisioning requirement. So these are all still expected and we will wait for those to play out.

Moderator: Ladies and gentlemen, with this I now hand over the phone to the management for their closing comments. Over to you, sir.

Sunil Kakar: Thank you, all. We had a productive first full year and we look forward to a better year next year.

Moderator: Thank you very much sir. Ladies and gentlemen, on behalf of IDFC Bank Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.