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Nirmal Bang Securities Pvt. Ltd., Research Division - Senior Research Analyst

Ladies and gentlemen, good day, and welcome to the IDFC Bank Limited Q2 FY '19 Earning Conference Call. (Operator Instructions) Please note that this conference is being recorded.

I would now like to hand the conference over to Mr. Bipin Gemani from IDFC Bank. Thank you, and over to you, sir.

Good morning, everyone. I welcome you to this conference call organized to discuss the financial results of Q2 of fiscal '19. I have with me Rajiv Lall, Avtar Monga, Ajay Mahajan and Pavan Kaushal. Sunil Kakar has joined us as a special invitee.

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. The results documents have already been shared with all of you. These documents are also posted on our website.

I now invite Rajiv to provide key highlights of our performance for Q2 of fiscal '19.

Thank you, Bipin, and good morning to all of you. This is quite a significant investor call for a variety of reasons, both personal and professional. I will come to that during the course of the call.

But let me basically start with the routine narrative about the quarter. And -- but before I do that, just a word of reminder and context. For the last 2 quarters and more actually, we have been signaling to the market our focus on and determination to accelerate the process of taking care of and cleaning up the balance sheet. And as you recall, I had initiated in -- I think in the April call -- (inaudible) in the April call, to you that we were expecting, as a final push in this drive towards cleanup, to take roughly in the range of INR 600 crores to INR 700 crores in additional provisions. And we will do that in a systematic way, but we will do that by setting and seeking benchmarks for additional provisioning that we will do this by trying our best to sell as many assets as we could to ARC, having exhausted all efforts we thought were reasonable to actually resolve and recover by ourselves, including taking all legal action that is available to us through our judicial system.

So I can say with some satisfaction that this quarter, we have actually delivered on all those indications and commitments that we have made to you. And we did that by taking less-than-expected provisions than we had expected. So we took an additional INR 539 crores of provisions this quarter against our advances and our investments, investments as in loan-related investments, not treasury; INR 539 crores of additional provisions as against the signaling of between INR 600 crores to INR 700 crores. And we also managed to sell close to INR 2,400 crores of assets to ARC at the value we were carrying -- pretty much the value we were carrying, right?

So really that is the headline development for this quarter. As the results of these actions now, just to summarize, we now have only INR 2,896 crores worth of stressed assets on our books, against which we now carry provisions of INR 2,317 crores, which is a provisioning coverage ratio of 80%. And I am confident enough to signal to you that we are expecting that this provisioning cover over the next quarter or 2 will actually improve to 90% because of certain actions and resolutions that are in a very advanced stage. So we will end up with actually less than INR 2,800 crores of stressed assets on the book with close to 90% PCR over the next quarter. At this quarter, we stand at INR 2,896 crores with 80% coverage.

Again, to remind you, we started this journey with a legacy book of close to INR 12,000 crores in stressed assets 3 years ago in October 2015. Against that, we actually -- some assets became performing, and that -- those amounted to roughly...

Unidentified Company Representative, [4]

[INR 2,600 crores].

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [5]

INR 2,600 crores, which brought the book down to...

Unidentified Company Representative, [6]

[INR 9,400 crores].

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [7]

INR 9,400 crores. From the INR 9,400 crores, we have sold in several batches to ARC, the most recent one being this quarter, INR 6,800 crores or thereabout to ARC. And that should add up, if my math is correct, to a residual of about INR 2,800 crores, against which we now have a positioning coverage of 80%. So from INR 12,000 crores down to INR 2,800 crores to INR 2,900 crores with an 80% coverage.

You should also know that the latest sale that we've done, this INR 2,395 crores, this quarter to ARC has been done for cash.

Unidentified Company Representative, [8]

Full cash, full cash.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [9]

Full cash. So this is completely off our balance sheet. And I think really kudos to the team, Ajay, Pavan and [Mahendra] and others who've been involved in this from our side for getting this done in a very focused manner.

So I mean, I'll leave the lessons from this experience to perhaps another time, but I mean, it just shows you that the -- in the infrastructure space, despite best efforts, and time does have value, the longer you let these things fester, the worse the situation becomes. Our experience has been, even with a very aggressive effort, taking full measures to the legal system, invoking guarantees wherever it has to be done, the process is so time consuming and complex that the loss given default is actually very high. And we are really talking about, if you take our total book and you were to assess our cumulative positioning that we've taken for the last 4 years against the INR 9,500 crores or INR 9,000-odd crores of stressed assets we had in the books, we've ended up taking cumulative provisions of, I think, INR 6,500 crores against the INR 9,000 crores, which means that 33 cents on the dollar, 33 paisa on the rupee is what is the current residual value of these assets. So that's just a bit of macro perspective on -- and learning from our experience of cleaning the books.

Now let me come back to -- and this, by the way, obviously explains the onetime quarterly loss that you see this -- in the P&L. But I'll come to the P&L last. Let me now come back to the more routine presentation and suggest to you, if you have with you the presentation, go to Slide 3. And by the way, all the descriptions that I just gave you on the stressed assets -- on our stressed assets are on Page 13 of the investor presentation.

So coming back to Page 3, to the more routine stuff. What I want to suggest to you and show you is that even as we have been spending so much time and energy cleaning up the books, there has been absolutely no loss in business momentum. And you can see that from Slide 3. If you look at the rate of our customer growth, we are now at 3.5 million customers and 34.6 lakh customers. And this customer base continues to grow at the rate of 120,000 to 130,000 customers a month. If you just look at Q2, we added more than 380,000 customers, of which 53,000 customers were urban, and 330,000 customers were rural. It just -- actually, this is something we are really very proud about.

When we started the retail bank -- and just to remind you, we launched the retail bank only 32 months ago, okay? So in 32 months, we have built a franchise of 34 -- over 34 lakh customers, of which more than 500,000, 0.5 million customers are actually urban, right? So the urban customer base is the anchor for our growing CASA franchise. The remainder of the customers are primarily rural customers, of which a significant chunk are actually rural women. So of our over 3.5 million customers, my guesstimate is that about 2.5 million customers are actually rural women, right? And 0.5 million customers are your urban liability-generating folks. So if we could build it in 32 months and has a very unique combination of customers, I think it's quite an extraordinary experience. I mean, again, on a personal note, thanks to the team, Avtar, [Ankur], for seeing through this journey unto this date.

Second point, quarter-on-quarter pretty much, we've been driving the CASA growth. Our CASA-to-deposit ratio as of this quarter-end stands at 13.3%, up from 8.2% exactly a year ago. Our CASA and retail deposit franchise, or retail TDs, now it is INR 13,000 crores, as you can see from the bottom-right box of Page 3. And this is an indication of our expanding retail franchise, which goes beyond just CASA. By the way, retail CASA itself is about INR 2,600 crores, and it's up from 2,112 -- INR 2,080 crores last quarter. So just this quarter, we've added about INR 600 crores in retail CASA to our liability space.

So if we turn to Page 4, this is -- and the bottom half talks about the customer base. I don't want me to elaborate on that. But if you look at our network, we have promised 206 branches by the end of the quarter. We ended the quarter with 203. But since the quarter, we've opened and we've opened another 3 branches, so we are at the promised 206 branches. These branches are complemented, as you know, with our BC distribution network, which stands at over 450. Our number of ATMs continues to grow, and our -- equally importantly, the customer access points that are powered by micro ATMs are now 20,000.

Unidentified Company Representative, [10]

[This is in 91 cities].

Unidentified Company Representative, [11]

91.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [12]

So these 203 branches are across 91 cities in the -- across the country, but the bulk of them are in the top 35 cities. So the national geographical reach of the distribution network is [tied], and it's depth has continued to grow over the last quarter.

Let me now turn to the financials. I will skip over the slide on the balance sheet and take you to Slide #7, which gives you a snapshot of what has been happening to our funded assets. And here again, as promised, the diversification and the composition of the balance sheet continues to change. The headline story is basically this, that our overall funded assets have remained almost flat. It's almost exactly flat. But the share of retail and non-infrastructure corporate has continued to grow. So retail book now, out of total advances of INR 75,000 crores, stands at over INR 11,000 crores, up from INR 9,300 crores in the last quarter. So we added a couple of thousand crores almost this last quarter. Our non-infrastructure corporate-funded exposure has grown quarter-on-quarter 5%. It now stands at INR 29,000 crores. And our infrastructure-funded exposure has continued to shrink. It is now down to under INR 22,000 crores. It shrunk 8% quarter-on-quarter, 25% year-on-year.

Even as we tame the composition of the balance sheet, we have continued to grow our nonfunded assets, and we have -- and this is despite all the hiccups that we saw in the key finance market. We have pivoted to do derivatives and FX contract given a very muscular treasury that we have. And therefore, our total nonfunded exposure now stands up at over 2 lakhs 66,000. It's a quarter-on-quarter growth of 13%. And when you look at the corresponding numbers in the P&L, you will find that the recurring fee income continues to grow quite nicely.

Turning to Page 8, this is what is happening to our retail assets. As I said a minute ago, it now stand at over INR 11,000 crores on retail assets. These are all originated by us. Again, to have built a retail book this size and as diversified as it is in 30-odd months is quite a remarkable achievement, I think, even if I say so myself.

To again draw the -- your attention to the diversified nature of this book, you will see that our rural book has grown quarter-on-quarter from INR 3,600 crores to INR 4,300 crores. A lot of this is the JLG loan. But the micro enterprise loans are also growing nicely. We're now up to INR 275 crores, up 33% quarter-on-quarter. The micro housing loan book is still small but growing nicely. Likewise, the 2-wheeler loan book is now up to INR 50 crores.

The urban asset book is now INR 6,800 crores. The bulk of this is a very important anchor, which is the secured lending product, which is the home loan. And that is important also for us to develop our liability franchise. This product is a must for attracting the account customers. And that home loan book has grown 16% quarter-on-quarter. The overall book -- urban book has grown 20% quarter-on-quarter.

Drilling down in Slide 9, and this is deeper into the composition of the wholesale book. The most important thing here is, if you look at the line that is normally taken, ELC, emerging large corporate, as promised to you, that is continuing to grow. It now stands at INR 7,900-odd to crores, up 10% quarter-on-quarter. We've also done well in building our MNC book, which is quite a profitable book for all the cross-sell opportunities that it provides. And that is now -- stands at INR 937 crores, up 32% quarter-on-quarter. Infrastructure, as I had mentioned to you earlier, has shrunk 8% quarter-on-quarter, 25% year-on-year.

Again, this is our provisioning strategy you are aware of. Our PSL book continues to shrink not because we are not within our PSL requirements but because it is much more efficient and less costly to build PSL compliance through the purchase of certificates. And we, the PSL team, will continue to do that through the year in order that we maintain PSL compliance. So we are, overall, PSL compliant. It's only in the subcategory of agriculture that we fall short. So it's such a large balance sheet. We've maintained the PSL compliance in such a period of time is again, I think, quite a significant achievement.

Slide 10, our treasury book. Our treasury book for the last 2, 3 years had been -- have grown very substantially. It has grown very substantially because we were opportunistically trading in the market in order to take advantage of interest rate calls. We've made very significant profits over the last 3 years on the treasury book. As the macro environment has changed and the direction of rates has begun to change, we have commensurately shrunk the size of the trading book, and therefore, you'll see our total treasury book continues to shrink. It is now down to under INR 39,000 crores as of September '18, down from INR 40,273 crores last quarter. Even as the size of the treasury book and particularly the trading portfolio has shrunk, we have also acted to shorten the duration of our treasury exposure so that we are protecting ourselves from any MTN risk on treasury.

Turning to Page 11, a little more color on the composition of our borrowing franchise. I think we have already seen the number I've shared with you on CASA. Our CASA is now almost 13% as a share of deposits. It stands at INR 6,426 crores as of September, of which INR 2,600-odd crores is retail. And the wholesale CASA has remained more or less steady. The future growth of the CASA book will come -- as the branch -- expanded branch infrastructure takes hold, will come from the retail side.

And I wanted to give you at least my prognostication on the prospects for retail CASA growth. I mean, if you look at our overall customer base that is -- that does savings account, it's about 514,000 customers have savings accounts. And we have INR 2,600 crores in retail CASA. So that comes to about INR 5,000 per customer, right? Now over the last 8, 9 months, we have expanded the branch infrastructure very significantly, as you have seen. So my expectation is that this 500,000 customer base could actually, with not too much difficulty, double from the existing branch infrastructure that we have. Right, Avtar?

Avtar Singh Monga, IDFC Bank Limited - COO, Head of Retail Banking & Executive Director [13]

Yes.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [14]

So the customer base doubles. And I'm expecting that the CASA per customer will also rise steadily. So -- and if that doubles -- and to actually more than double, it should be closer to INR 15,000 per -- or INR 16,000 per customer rather than INR 5,000, from the existing investments that we have made, we should get to our CASA base of anywhere between INR 12,000 crores to INR 15,000 crores would be my guess. So these are the investments I think we have made. We have seen traction on the developing CASA franchise quarter-on-quarter, and this is what I hope and I fully expect will continue. So that's on the CASA element of our liability space.

The other very important aspect of the developing liability space is retail CDs, which has grown from INR 5,200 crores to INR 6,800 crores. And this has been a very conscious decision on our part. We have actually made the rates on our retail CDs quite attractive in the marketplace. They are very, very competitive in the marketplace. And this is to prepare and develop a bill headroom for liquidity related to the merger. We will now -- we are moving towards a significantly larger onetime expansion in the balance sheet with the merger with CFL, and we had built up the retail TD base to test how quickly we could build that up. We've actually run down our corporate TDs from INR 21,000 crores to INR 12,000 crores because we know that, that's the pillar. So having tested what else we can do to build the liquidity gap, we now are very confident, especially in this uncertain environment where NBFCs are going through some turmoil, our TD paper, bank TD paper, we believe, will become much more attractive. And we should have little difficulty in building up those necessary liquidity for the merger -- pending merger. So that's on the borrowing.

Let's turn to Slide 12. So our stated strategy with respect to the changing composition of the balance sheet retail-ization, retail-ization, retail-ization of the composition of our loan book has been with one singular purpose, not only to diversify our risks away from infrastructure but also to drive up the average yield on our advances.

So you can see from this table that we have actually done that. So quarter-on-quarter, it's not been the easiest thing to do, but our retail yields have gone up from 14.9% to 15%. And if you look at our wholesale banking yield, they have held flat. As a result, the composite yield of our advances has gone up from 9.1% to 9.4%. Unfortunately, given the turmoil in the bond market and general matter turmoil, our cost of funds has also gone up by 200 basis points, and we continue...

Unidentified Company Representative, [15]

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20 basis points.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [16]

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20 basis points, sorry. That's a big difference. 20 basis points, right? And we continue to be -- hobble and handicapped in -- at the speed at which we can manage our cost of funds because of our legacy borrowings that are still -- if you go back to the previous slide, they are still, INR 18 crores plus INR 10 crores, they're about INR 28,000 crores, and that they will sit at 8.8% plus. And unfortunately, that is not shrinking, as I said, until 2021.

So -- but despite all of that, we are building up the CASA franchise at some speed. We have been able to contain the rise in our cost of funds to 20 basis points, such that, such that our spreads have actually held steady, okay? So that's -- so in other words, this is a vindication of the very simple strategy that we've put in place about the changing composition of the asset side and the liability side of our balance sheet. We just need to keep doing this and need to keep doing this even faster. And as I've said in my previous commentary, having -- strengthening the balance sheet very significantly, cleaning up the balance sheet. Our goal now is to strengthen the drivers of profitability. And this again reinforces the importance of the merger with PSL because that is precisely what that will do.

Coming back to the point about stressed assets, there are 2 additional points that I didn't mention in my introductory remarks about stressed assets. It's that -- and there are 2 data points really I want you to focus on. The first is look at our gross NPLs and net NPLs. Our gross NPLs now are down to 1.6%, and net NPLs are 0.6.

One more number that you will find, I think, in the very last slide, which is the capital adequacy ratio, Slide 15, is having cleaned up this book in the efficient aggressive manner that we have, our capital adequacy is still at 19.2%, okay? So it's a significantly stronger balance sheet than we had technically hoped.

Okay, last point before I come to the P&L, and this is not a slide that you have. This is a slide on our expenses. So if you focus on Slide 14, your slide on P&L, and you look at our operating expenses, that for the first half stood at INR 1,100 crores, INR 1,108 crores, right? My commitment to you was that this, for the year, will be around INR 2,100 crores. And I think that was...

Unidentified Company Representative, [17]

Standalone.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [18]

Standalone, right. So this is done in good IBL as IBL is another INR 100-odd crores, right?

Sunil Kakar, IDFC Bank Limited - Nominee Director [19]

Okay, INR 1,100 crores includes IBL. For the commitment, INR 2,100 crores standalone.

Unidentified Company Representative, [20]

Yes.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [21]

Okay? So Sunil is being very cautious here. And I would say that we need to be more aggressive about cost cutting. I'll explain to you now how we can go about doing that cost cutting.

So this is minimal color I want to give you on our operating expenses because we have not, contrary to the section, lost control of our operating expenses. And I want to emphasize this point. So the breakdown of this INR 1,108 crores for the first half of 2019 is as follows. Of this INR 1,108 crores operating expenses, INR 606 crores is the expenses on account of our entire retail operations, which are growing very rapidly. And when I say retail operations, I'm only talking about L1, L2. I'm not talking about corporate overhead. So L1 allocated and L2 allocated expenses related to all of our retail operations, out of the INR 1,108 crores, it's INR 606 crores. This is for the first half of fiscal '19. This number in the first half of fiscal '18 was INR 349 crores. So the increase in expense has come almost entirely due to the expansion of our retail operations. Now the residual cost, which in the first half of '19, out of the INR 1,108 crores, is INR 501 crores. INR 501 crores plus INR 606 crores is INR 1,108 crores. INR 606 crores, as I said, is L1, L2 for retail. INR 501 crores, therefore, is some surrogate number for all the expenses related to our wholesale banking and all our corporate overheads, including unallocated technology, right? That number in the first half of 2019 was INR 501 crores. In the first half of 2018, that number's just INR 478 crores. So that's a 5% increase. It's less than inflation.

So please understand that we have not lost control over managing our expenses. There may be room to cut some of these expenses. And I'm saying to you that we had indicated to you INR 2,100 crores, INR 2,200 crores. We will come under INR 2,200 crores for the entire bank for this year. Now before that, the merger will happen, so it will be very difficult to figure all this out. But this is my commitment and my reiteration of our focus as management to make sure to communicate to you that we have not lost control over our operating expenses.

Now when you put all this together, you come to the overall P&L. And the profit after tax for this quarter, driven primarily because of the additional INR 540-odd crores of provisioning that we have taken this quarter, that profit after tax number is -- what's the PAT now?

Unidentified Company Representative, [22]

[about INR 360 crores]

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [23]

INR 359 crores.

Unidentified Company Representative, [24]

Loss.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [25]

INR 359 crores loss, right? And if you look at now -- go to the income line, our operating income in Q2 FY '19 was INR 596 crores. It was more or less the same as it was in Q1, and this sort of reflects what I've been indicating to your earlier. Our overall advances are pretty much...

Unidentified Company Representative, [26]

The same.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [27]

Constant. All that has happened is that the composition of our advances has changed, but our spread has remained stagnant. And therefore, overall interest income has gone up. Net interest income has gone up only marginally, but it's gone up from INR 448 crores to INR 468 crores (sic) [INR 464 crores].

More importantly is our noninterest income line, which has actually gone up from INR 123 crores in Q1 to INR 133 crores in Q2. And in that, look at the recurring fees. Recurring fees has gone up from INR 120 crores to INR 128 crores; trade and cash management, up from INR 36 crores to INR 39 crores; wealth management, relatively stable. But the bulk of the increase in recurring fees is coming from loan-related fees and from trade and cash management fees. And this goes back to the importance of our nonfunded franchise that we are building in parallel. Other fees, which include investment banking, syndication and such like, they're up, but I'm not giving much credit to those because of the volatility inherent in it. So please focus on our ability and execution on developing our recurring fee-based franchise income.

Likewise, for treasury, we had to take some mark-to-market losses because of what happened to FINRA valuations with respect to our longer term -- the longer duration, some assets that we had on the book. And so we've had to take some losses and provisions basically on our treasury book, which -- given the volatility in the market, it's a volatile income line.

Operating expenses, I have talked about. Provisions, I have talked about. And hence, the result of INR 359 crores in losses.

So let me now conclude with the, again, summary. What have we done? We have cleaned up the books, and we have strengthened the balance sheet. We have continued to change the focus of the corporate banks away from infrastructure. We have built the retail bank, we continue to build it aggressively, both to generate liabilities and CASA, especially retail CASA, but also to move and favor to higher-yielding retail advances. And we have restricted our spending, so basically, only those parts of the business that we are investing in, are expanding in, and that's retail. The rest of expenses have pretty much been under control.

And so I am quite satisfied with the performance. I can say with some pride that this management team has delivered on the commitments that we had made to stakeholders.

I would like to now spend just a minute on a very important matter, which I haven't dealt with so far in the presentation, and that's the impending merger. So we'll give you an update on where we are with the merger process. We got our shareholders to pool, and thanks to all of you that voted for the merger. We got, if I remember correctly, 99.98% yes votes in our AGM. So thank you all for your support. We really, really appreciate it. Even the government, and thanks to them, they voted for the bill. Capital First had their AGM as well. They also got their result being positive vote. So both of the respective shareholders have now given their concurrence to the deal. We have all the regulatory approvals in place. We are now going through the final leg of this very long and arduous process, which is on NCLT public hearing, which lasts for 40, 45 days. So we expect by the end of November, both our NCLTs, ours in Chennai, and CFL's in Mumbai, to have completed that process, hopefully, by early December. And then we will need to go to -- once again to the RBI to report to them that we have now completed the entire process, get their concurrence and then finally go to the ROC. It is our expectation that this entire process will be done before the end of the calendar year so that we will start the new calendar year as a merged entity. That's the first point with respect to the merger.

Second point with respect to the merger, and this is also -- on top of everything else that we've been focused on, there is also a lot of work on the transition that has been happening. And I would like to say that on the transition world, this is one merger I would like to be able to say, when it's complete, where the preparation that -- for the transition, the preparation for day 0 has been much more significant and thorough than in most other mergers. And the consultants that are working, helping us with this, are asking really -- I mean, that is to sit back as they're doing, Mr. Vaidyanathan and myself, that (inaudible). And it is a delicate process because it involves some uncertainty. And we have a little bit the uncertainty on the front book, communications have gone out to all staff in both organizations and down to (inaudible) in the organization, explaining to them what the organization structure is going to be for the merged entity. And I should give you a sense for that. 4 levels down to N minus 2 in the merger entity, out of 45-odd positions that had been clarified in theory, about 33, more than 3/4, actually are with IDFC personnel -- IDFC Bank personnel. That's the first point on people issues. Second point on people issues is that all the control functions will remain substantially with IDFC people.

So the nuts and bolts on the finance side, all the risk-related work, internal audit, compliance, all the things that are fighting for us to be compliant on day 0 are now our singular focus over the next 2, 3 months to make sure that as this date persists towards that, around the first day the merged entity goes live, that we are ready to seek compliance out of everything that we have to do.

This requires actually a huge amount of statesmanship from people -- on some people who will be displaced, which is inevitable in a merger in this kind, and I have to thank from the bottom of my heart to everybody that has stood by my side, who continue to apply to by themselves to the best of their ability under very difficult circumstances and complex circumstances. And you can see the results of how this management team has applied itself, could continue delivering even as we hand over to the new management.

So I want to single out a few people and thank them: Avtar, who is here sitting next to me; there's Pavan; Ajay; Bipin; M.N. Shah, who's not in the room; Rajeev Uberoi (inaudible) from the legal team; N. S. Rajan, our Head of HR, who has a very difficult task, delicate task to deal with. There are many people. I mean, Sunil...

Sunil Kakar, IDFC Bank Limited - Nominee Director [28]

Hi.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [29]

Who's sitting right opposite me. There are lots of people involved in this. Just thank you to all of you.

Two more points I had, and I can now disclose it because we had a board meeting yesterday. And I can now share with you the name of the merged bank, which still is subject to shareholder approval, but I expect and hope that the shareholders will approve because it's a very sensible name for the new bank. The new bank, the merged bank will be called [IDFC First Bank]. So this will also be subject to RBI approval and the shareholder approval, both of which are pending. But our board, the IDFC Bank board, has approved it in principle, subject to all relative -- relevant regulatory approvals and shareholder approvals. I think that the name signifies an important evolution of IDFC Bank itself, absolutely consistent with our strategy of retail-ization. And it brings in the best of what Capital First also brings to the table and to create what we hope will be an extremely powerful franchise and a differentiated universal bank that will first focus particularly on retail market in a manner that competitors will have difficulty matching.

A final point is that this could well be the last investor call that I'll do as CEO, and I just wanted to say that it's been heck of a ride. It has been a great privilege to serve our stakeholders. And I will remain engaged, as you know, at the level of the board. And if the merger does take place, as we hope it will over the next quarter, then we'll have more engagement to look forward to in the form of a merged franchise.

So I know it's been a little long-winded, but as I said at the beginning of today's comments, for professional as well as personal reasons, this is an important call, so I've taken a little more time away. Thank you.

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Questions and Answers

Operator [1]

(Operator Instructions) We take the first question from the line of [Udit Kumar] from Udit Investments.

Unidentified Analyst, [2]

I'm [Udit Kumar] from Udit Investments. (inaudible) I would like to know that in the merged entity that you said will be completed in the end of the -- by the end of this year, so what do you think -- how Mr. Vaidyanathan -- V. Vaidyanathan will remain in charge?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [3]

Sorry, repeat that?

Unidentified Analyst, [4]

When the merge is completed by the end of this year, so when will Mr. V. Vaidyanathan take charge of the bank?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [5]

We will take charge the day the merger is completed.

Unidentified Analyst, [6]

So when will they get the shares of IDFC Bank, the shareholders of Capital First?

Bipin Gemani, IDFC Bank Limited - Interim CFO [7]

Post merger completion, there will be a board meeting for allotment of shares to the shareholder of Capital First.

Unidentified Analyst, [8]

So how much time it will take, approximate?

Bipin Gemani, IDFC Bank Limited - Interim CFO [9]

Post the first board, then it approves the allotment of shares, it will take close 3 to 4 weeks to complete the entire completed formality

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Unidentified Analyst, [10]

So most probably by the end of January?

Bipin Gemani, IDFC Bank Limited - Interim CFO [11]

Somewhere around that.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [12]

Yes, that will be safe.

Bipin Gemani, IDFC Bank Limited - Interim CFO [13]

Yes, yes.

Operator [14]

(Operator Instructions) We would take the next question from the line of Rahul Marathe from Akash Ganga Investment.

Rahul Marathe, [15]

Sir, just wanted to get some color on the NBFC exposure that you could be having and to IL&FS, if any?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [16]

Sorry, sorry, repeat that?

Rahul Marathe, [17]

Are there NBFC exposure and -- particularly in NBFCs to IL&FS.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [18]

So we have no exposure to IL&FS, [nothing new]. Our total exposure to NBFCs is...

Unidentified Company Representative, [19]

[INR 3,800 crores]

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [20]

Is -- for INR 10,000 crores, of that, INR 3,800 crores is to housing finance company. And then there's a whole call it -- there's a whole...

Unidentified Company Representative, [21]

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[56]

Unidentified Company Representative, [22]

[like 5%]

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [23]

(inaudible) No. That's 56 borrowers in NBFC space, the total exposure of INR 10,152 crores. No exposure to IL&FS.

Sunil Kakar, IDFC Bank Limited - Nominee Director [24]

And I'd just like to add also, this INR 10,000 crores exposure, maybe 96%, 97% -- 96% total exposure is [68-plus] (inaudible). So it's a very, very strong exposure, yes.

Operator [25]

We take the next question from the line of [Aditi Shah] from Vikram Advisory Services.

Unidentified Analyst, [26]

Sir, I just wanted to know that were there any additions to the stressed assets during this quarter? And this year has been what?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [27]

No. So in case of -- we took additional provisions against existing stressed assets. Basically, that's all we did.

Unidentified Analyst, [28]

Sir, because from what I understand, in June 2018, your stressed asset total was INR 4,827 crores, and the provision coverage was 77%. If you want -- if you wanted to do a 90% coverage, which you had mentioned in the last call...

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [29]

Right.

Unidentified Analyst, [30]

The total coverage, the provisioning would be around INR 4,344 crores. Minus the INR 3,717 crores you already did, the remainder would be only INR 627 crores of provisioning to reach a 90% level. Out of that, we've already done INR 539 crores this quarter. So the remainder provision coverage to reach a 90% level should only been INR 100 crores or INR 90 crores. But as per the September '18 results, we show only 80% PCR. And to reach 90%, it will be around INR 280 crores additional. So where is the gap of INR 180 crores?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [31]

So we are pertaining to get to 90% coverage not by increasing provisions but by reducing the stressed assets themselves.

Unidentified Company Representative, [32]

(inaudible) Finding a reason to...

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [33]

So there's a resolution that they are in advanced phase of execution.

Unidentified Analyst, [34]

So again, so there was no addition to any [asset] this quarter?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [35]

No.

Unidentified Analyst, [36]

(inaudible)

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [37]

Correct.

Unidentified Analyst, [38]

Okay. And when do we see, sir, the funded book really? Because what happens is that when we are increasing the retail but we are reducing our infrastructure book, so the funded book does not increase. So when do we see that funded book increase?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [39]

Well, so -- what we are -- as of now, our priority is to get the merger done, right? So the expansion in the balance sheet will come very dramatically through the combination of the CFL balance sheet into ours. So our retail portfolio will certainly be INR 25,000 crores, INR 30,000 crores larger.

Unidentified Analyst, [40]

Yes. So that is because of the merger, right? But after merger, when do we really -- do we see further infrastructure loans decrease, but it's allowed? Or by increasing retail assets?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [41]

You'll continue to see -- you will continue to see the infrastructure book shrink, but you will see the rest of the book continue to grow. So since the rest of the book will be significantly larger than the infrastructure book, the net decline in the infrastructure book will be more than compensated by the expansion in the rest of the book. So you will see net growth in the funded assets, it will start from next quarter.

Operator [42]

Next question is from the line of [Satish Bansal] from Albatross Capital.

Unidentified Analyst, [43]

I just want to sort of ask a question around certain exposure towards the housing finance companies, whether you think in term of a prominent building and construction companies are reporting losses, with undervaluing and (inaudible). I just want to understand from your perspective what is your current exposure to them? And how do you see this particular exposure of yours are panning out (inaudible)?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [44]

(inaudible)

Sunil Kakar, IDFC Bank Limited - Nominee Director [45]

I can put some color on that. So as I actually mentioned earlier, we have I think INR 3,700 crores (sic) [INR 3,800 crores] of housing finance companies. And I also mentioned that 96%, 97% of the portfolio is very strong (inaudible).

Unidentified Company Representative, [46]

We are not seeing any [exposure] on our portfolio from what we've indicated (inaudible). So I don't know like to give the color.

Unidentified Company Representative, [47]

And we also don't do anything in construction part?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [48]

Yes.

Unidentified Company Representative, [49]

Because we don't have any uncertain finance -- building finance exposure.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [50]

So that's the overall picture of that. We are also obviously aware that the NBFC world is quite turbulent right now. So I mean, if there is, God forbid, some systemic problem in the housing finance market or NBFC more widely, we don't know exactly what the impact of that on our portfolio will be. We just have to hope that the best-quality NBFCs will remain liquid and remain protected. And if that were the case, then our portfolio will be just fine.

Operator [51]

Next question is from the line of Sneha Ganatra from Subhkam Ventures.

Sneha Ganatra, [52]

Sir, you just now mentioned there could be some release of the provision that will lead to the provision coverage from 80% to 90% of the stressed book. So there are chances there could be some release of the income also from the stress book, which you are expecting some resolution on that front?

Unidentified Company Representative, [53]

Yes.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [54]

When this asset is resolved it will release provision, and it's also becoming an operating kind of asset. There'll be some write-back, there'll be some write-back that will come through the P&L.

Unidentified Company Representative, [55]

Yes.

Sneha Ganatra, [56]

Yes. And so these are resolutions coming from that sector? Or which segment it is?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [57]

So we don't want to get into too much detail on that. But yes, I mean, you can figure out, basically, this must be something in infrastructure because (inaudible), these are in infrastructure.

Sneha Ganatra, [58]

Basically, it's from the power sector or telecom or other sector?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [59]

No, it is not from the power sector.

Unidentified Company Representative, [60]

[You think too fast].

Sneha Ganatra, [61]

Okay. And the next question is, you mentioned on the OpEx spend, but how do you see your fee income will be panning out?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [62]

So the fee income, I think, will be -- we expect to remain steady -- the recurring fee income to remain quite steady because one thing we are seeing is that the cash management business quarter-on-quarter beginning to build quite nicely in parallel with the diversification of our wholesale book. The fee income from treasury and from other items will continue to be volatile, so that I can't predict. Although over the next quarter or 2, operating income should improve. Beyond that, as to the volatility, medium term, of that income stream, it is what it is. And therefore, we are focused on investing in and building out and stabilizing and growing the recurring fee lines that we have.

Sneha Ganatra, [63]

Okay. And so third quarter, the provisioning would be just on the standard assets and normal provision?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [64]

That is correct.

Sneha Ganatra, [65]

Okay, got it. And the model is expected by the January 1, right?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [66]

Correct.

Sneha Ganatra, [67]

Okay, got it. And my last question is, any stress that's been still left out or pending in our books? Or everything has been done and clear on that front?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [68]

Everything is cleared at least related to the past but are gone now.

Operator [69]

We will take the next question from the line of Nilanjan Karfa from Jefferies.

Nilanjan Karfa, Jefferies LLC, Research Division - Equity Analyst [70]

Rajiv, this is kind of probably repeating another question. In the Pillar 3, we do have a realistic exposure of about INR 1,900-odd crores, a little bit of construction of like 25 not necessarily related to developments. But what I really intend to speak is, beyond the home loan and loan against property, which has been put out in the PPT, what are the loans in business, MSME, maybe working capital which has one -- a land building, commercial or residential as a collateral?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [71]

So we have a LAP book. You have a sense of the LAP book we've provided to you in our -- in the composition of our retail portfolio. It's about INR 1,000 crores (inaudible).

Unidentified Company Representative, [72]

[INR 997 crores].

Nilanjan Karfa, Jefferies LLC, Research Division - Equity Analyst [73]

So other than that, there is no exposure, either directly or through a collateral, to any land or building? Is that the assessment?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [74]

No.

Unidentified Company Representative, [75]

[MSME is INR 843 crores]

Unidentified Company Representative, [76]

We do have what we call lease rental discounting of commercial building, which are not realistic construction -- under-construction asset. These are rental asset that we have. But we do not have any under-construction real estate, property finance within that portfolio. [That's all on rental].

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [77]

These are operating assets generating rental yield.

Nilanjan Karfa, Jefferies LLC, Research Division - Equity Analyst [78]

That's fine, I guess. Yes, yes. And any exposure in MBS, the mortgage-backed securities, at this point?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [79]

No, no.

Nilanjan Karfa, Jefferies LLC, Research Division - Equity Analyst [80]

Okay. Because I guess we used to have close to INR 2,000 crores, right, as of last year-end, by March, I guess?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [81]

Ajay?

Ajay Mahajan, IDFC Bank Limited - Head of Wholesale Banking [82]

I don't think that's correct. It was 1.3 that we did in the leasing books in terms of one very large (inaudible). It was called CMBS. But that was more than -- over 90 days, so there is no exposure to MBS. What you may be referring to is what others has already answered. This will be related to some are largely discounting with these operators, [2 or 3] operators in the country. That is what the exposure, to the best of our understanding, in MBS or in construction finance or in any other form of builder financing.

Operator [83]

We take the next question from the line of Manish Ostwal from Nirmal Bang.

Manish Ostwal, Nirmal Bang Securities Pvt. Ltd., Research Division - Senior Research Analyst [84]

Sir, my question on this provision during the first half, we have made of INR 500-plus crores or INR 562 crores, to be specific. My question is whether we are done with the -- this INR 750 crores provision? Or are the provision requirement may increase further? Or what is our assessment now?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [85]

[1,200?] Sorry?

Unidentified Company Representative, [86]

[No, pre-set provision, can it be increased?]

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [87]

So no, the number we have closed out of September, this is to account all our expected provisioning on the legacy books.

Manish Ostwal, Nirmal Bang Securities Pvt. Ltd., Research Division - Senior Research Analyst [88]

So I mean before merger, we had a number of INR 750 crores. Again, then we've already done INR 562 crores.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [89]

There's no need to do any more than what I'm telling you. We've done better than we had expected.

Manish Ostwal, Nirmal Bang Securities Pvt. Ltd., Research Division - Senior Research Analyst [90]

Okay. And the second question, sir, on operating expenses growth, which is around 34%, and we are in -- continuously investing in both in branch and the employee base. So I mean, this kind of growth rate will continue? Or do we see some moderation over there?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [91]

This is examined when the -- we will examine when the new management comes on board.

Operator [92]

Next question is from the line of [Sumit] from (inaudible).

Unidentified Analyst, [93]

A couple of questions. First, if I look at the operating profit for the quarter, it's a loss, and I'm talking before loan loss provisioning. So could you talk about what's the path to actually turn it around and make profit at pre-operating -- pre-provisioning operating profit line? And second, if you could help me reconcile the movement in net worth quarter-on-quarter. Has there any item been taken directly from the balance sheet as well, considering the change in net worth versus how much loss you made in the quarter?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [94]

So I'll ask Bipin to answer on the net worth question first, and I'll deal with the other one.

Bipin Gemani, IDFC Bank Limited - Interim CFO [95]

So net worth has gone down from INR 15,400 to INR 14,800, largely on account of the dividend payout that we did in July with the shareholders and partially due to the loss in the current quarter.

Unidentified Analyst, [96]

Okay. So there's no -- nothing has been taken from the balance sheet, right?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [97]

So, yes. And on the other thing, it's a continuation of the strategy. So the moment we are able to grow the funded balance sheet with yields that are superior, profits will begin to grow. And this will start happening next quarter.

Unidentified Company Representative, [98]

The vast majority will be [this year].

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [99]

And as the branches mature, the CASA franchise or the CASA generation from those branches increases, and incrementally, that has a mitigating impact on our cost of fund. On the asset side, the yields will begin, the composite yields will start rising, and therefore, overall spreads will improve. And that gives positive momentum to profit.

Unidentified Analyst, [100]

Right. Okay. And like your branches, you've increased from 150 to 200 over the last year. Where are you expecting to take your branch network to? And how much costs does that entail further, considering the kind of growth we've seen in costs for the 50 branch network expansion?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [101]

It is something that will be discussed by the new management as they share with the markets their strategy.

Operator [102]

We will take the next question from the line of [Rahul Saraf], individual investor.

Unidentified Participant, [103]

Can I ask you to have some words on the share price, which will definitely continue to be falling from last [1 year], today or [onwards].

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [104]

I don't have any words to share on the fair share price. I mean, it is for the markets to decide. I don't want to get into a discussion on market dynamics. I can only share with you what this management can only share with you, what is within our control, which is operations and the P&L and the balance sheet and business during the year.

Operator [105]

Your next question is from the line of [Aditi Shah] from Vikram Advisory Services.

Unidentified Analyst, [106]

Sir, just as a follow-up, so am I correct in understanding that in the next 1 or 2 quarters, you would be taking a provision of INR 280 crores to make this 90%?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [107]

No. So we are not making additional provision to get to 90%. What will happen is that, actually, this is an important point to clarify. We'll get to 90% by reducing the stressed book itself.

Bipin Gemani, IDFC Bank Limited - Interim CFO [108]

[Like only 1 percentage is in advances].

Unidentified Company Representative, [109]

(inaudible)

Bipin Gemani, IDFC Bank Limited - Interim CFO [110]

Trade will come down.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [111]

[As today]. Do you understand that?

Unidentified Analyst, [112]

Yes.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [113]

So (inaudible) we don't know that the stress hasn't come down. The denominator's coming down.

Unidentified Analyst, [114]

Okay, okay. And sir, on a stand-alone basis without Capital First, do we have any internal targets of what the year-end profitability as for the full year should look like?

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [115]

It should look much better.

Unidentified Company Representative, [116]

Than the last few years.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [117]

(inaudible) yes. I mean, we don't normally give a forward guidance on this kind of things, but you should be able to tell from the quarter-on-quarter gross issue. If you remove the one-off, you'll be able to get some sense of that.

Operator [118]

Well, ladies and gentlemen, that seems to be the last question for today. I would now like to hand the conference over to the management for the closing comments.

Rajiv Behari Lall, IDFC Bank Limited - Founder, MD, CEO & Director [119]

Well, thanks again. This has been a challenging few quarters. But just to reiterate, it is with some satisfaction that we have come to where we are in terms of cleaning up the book and creating the foundation for the retail bank and diversification and such like. I am hopeful that the merger will get done this quarter, before the end of the financial year, and look forward to a continued engagement. And thanks once again to all the team that have helped us get us to this point. Thank you.

Operator [120]

Thank you very much. Ladies and gentlemen, on behalf of IDFC Bank Limited, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.