Conference Call Transcript

Edelweiss Financial Services
Q3FY12 Results

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Corporate Participants

Rashesh Shah
Chairman

Himanshu Kaji
Executive Director

S. Ranganathan
Chief Financial Officer

Shailendra Maru
Head, Stakeholder Relations

Questions and Answers

Moderator: Ladies and gentlemen good day and welcome to the Edelweiss Financial Services Unaudited Q3 FY12 Earnings Conference Call. I would now like to hand the conference over to Mr. Shailendra Maru of Edelweiss Financial Services. Thank you and over to you sir.

Shailendra Maru: Thank you, Marina. Good afternoon to all of you and thank you for joining us today as we discuss Edelweiss Financial Services' unaudited consolidated financial results for the third quarter of FY12 that ended 31st December 2011. Speaking today with you are Rashesh Shah, Chairman, Edelweiss Group, Himanshu Kaji, Executive Director, and S Ranganathan, the Chief Financial Officer. Following the reading of Safe Harbor provision, I will first turn the call over to Rashesh for his opening remarks. Thereafter Ranganathan will take you through an overview of our business performance and financial numbers, followed by Q&A session.

The press release, financial statements and an earnings presentation for this quarter have been circulated and are also available on our website www.edelweissfin.com.

Certain statements that may be made or discussed at the conference call maybe forward-looking statements. These needs to be reviewed in conjunction with the risks and uncertainties that the company faces. We have outlined these risks and uncertainties in the last slide of our earnings presentation which has been circulated and is also available on our website. Edelweiss has obtained all market data and other information from sources believed to be reliable or its internal estimates although its accuracy or completeness cannot be guaranteed. I will now turn over the call to Rashesh.

Rashesh Shah: Thank you, Shailendra, and thanks to all of you for being on the call. On behalf of Edelweiss, I want to welcome you for our Q3 earnings update. As you would have seen from the results we have been able to clock a 22% growth in revenue and 12% growth in PAT on a QoQ basis. As you know Q3 has been a challenging and tough quarter for capital markets and the Indian economy as a whole. Whatever little bit of growth we have got on a QoQ basis we have been able to eke out because of the diversification that we have tried to bring into our business and we have been investing a lot in efficiency and productivity enhancement for the last couple of years. So the current bottom-line is slightly better on a QoQ basis, but on a YoY basis, obviously, it reflects the challenging environment that we have had all through Calendar '11. Though there are some signs of improvement in India from liquidity, interest rate, inflation point of view, we do believe we have another two or three quarters to go until the environment becomes favorable to growth and capital markets again. But overall if you see our results, we have had total revenue of Rs. 455 crores and a profit after tax of Rs. 29 crores. The reason for our top-line growing fairly rapidly is that we have a lot of new businesses that we are investing in, which are not yet contributing to profitability because they are still trying to get to scale, and second, the Capital businesses have become more and more important for us. Our Capital businesses which are mainly Credit and Treasury and Interest-Bearing businesses have now started contributing 82% to the top-line versus only 18% coming from the Fee and Commission part of the business. We are becoming slightly more capital-oriented as agency businesses have come down as a result of the lack of activity in the environment as well as the fact that we are scaling up our capital base.

As you know, in Edelweiss we now have six strategic businesses and I'll give you a little bit of highlight on each of these six businesses. The first one is the Credit business. The Credit business scaled up a little bit in this quarter and we now have a book of 3100 crores out of which 520 crores is the housing finance book; the focus here remains on Portfolio Management, Client Servicing and Risk Management. We have been very cautious given the environment. Along with that this business has had a stable quarter but not a great quarter also because of the liquidity crunch and the high interest rates that still prevail in India.

Our second business, the Capital Markets business includes Brokerage, Wholesale and Retail as well as Investment Banking. It has continued to struggle in this particular quarter. One of the reasons the Fee and Commission income has fallen even on a QoQ basis is that the Capital Market businesses have had a very challenging environment, broking activity was down; investment banking was almost at a standstill. We have focused on a couple of things on the Retail side, Anagram, what we call "Edelweiss Financial Advisors", the integration is over and now we are just making sure we can eke out some more efficiency because of the integration. And on the Wholesale side, we are investing a lot in our client coverage and the research products and we have come out with a couple of innovative research products in this quarter. Along with that our client coverage on Investment Banking has also been growing in this quarter. But obviously, the activity is very low in the Capital Markets.

Our third business is the Commodity business. As you know, we have been one of the leading importers and financiers of Gold in India with a large distribution set up. An integration is happening between the physical part of Commodities and the financial part of Commodities and we believe that as more and more financialization of the Commodities business happens, it will bring some amount of volatility in the prices, but a lot more importantly, it will bring a lot of efficiency through the market discipline that will get imposed and the investments that will happen. The supply linkages, the price discovery mechanism, standardization of assets, all of that is now going on in the Commodity business. We do expect this to be a very important business for us in the coming years, and we are currently evaluating all structural options for this business and we will come and update our investors in the coming quarters as we finalize how to structure this business in such a way that it can scale up as per the opportunities that are there.

Our fourth business is the Housing Finance business which is scaling up as per plan. We now have a Housing Finance credit book of 520 crores. We just started operations in Hyderabad and we have now covered six cities in India. As you know we started this about a year ago and we have been gradually adding about a city every quarter and now we will start scaling up even faster as we go forward.

Our fifth business is the Asset Management business, with both the Wholesale Asset Management which is the wholesale Alternatives business as well as the domestic asset management company. We have total assets of about $380 million in the Wholesale side and about Rs. 575 crores average AUMs for Q3 on the AMC.

The final business, the sixth business that we have recently started is the Insurance business. We started this in August last and it is scaling up fairly well as per plan. We now have 22 offices in 15 cities and about 530 personal finance advisors for this business.

Overall, we have focused a lot on execution, a lot on ensuring that all the six businesses we have are getting sufficient resources and oversight so that they are able to capitalize on the business opportunities that they are into. We have also invested in Infrastructure, we also focus a lot on risk management, technology and all these investments have been made in the last few quarters and we continue to focus on that.

So just to reiterate, our strategy has been synergistic diversification to enable us to become a broad-based and a large financial services company. For example, Commodity as an independent business is also part of the strategy. Our Credit business, Asset Management business, all of that are all in related Financial Services businesses where we can draw synergies of the Edelweiss platform and the resources and the financial balance sheet we have. But along with that each of the business also capitalizes on its own individual opportunities.

We think headwinds have been there. If I were to give a headline for how things are currently, the way we see it is they have stopped getting worse in the last three months or so though I do not think improvement is happening immediately. So we are seeing that the bottom of either 'V' or 'U' is getting formed. For the next couple of quarters at least we think the environment will still be sideways and should not become unduly positive in a hurry. But with RBI cutting interest rate, inflation coming down, the rupee being stable will lead to economic activity and industrial activity. May be 5 to 6 months from now we'll start seeing growth coming back.

I'll now hand it over to our CFO – S Ranganathan who will add more color on the financial and the business performance. Over to you, Ranga.

S Ranganathan: Thank you, Rashesh. Thank you everyone once again for joining on this call. Let me first discuss the key takeaways of Edelweiss Financial Results for Q3 FY12. Broadly, we have recorded a significant growth in the top-line and a reasonable growth in the bottom-line QoQ despite activity levels being subdued this quarter. This is a reflection of the diversification and the breadth that we have achieved in our businesses and efficiency enhancements that we have been constantly working at. However, the challenging operating conditions, our conscious decision to continue to invest in new businesses, investment in some assets that are currently not yielding but otherwise accretive and depreciation on the new office property have continued to affect our bottom-line. We have scaled up our Insurance business this quarter, which has also led to increase in our Q3 cost. Our profitability in Q3 needs to be viewed in this backdrop as it would be higher if increase in such costs is taken into account. We remain focused on our core strategy of building a diverse set of business as we have also discussed in our previous calls and are positioning ourselves for a long-term future growth.

On the business front, our Life Insurance business has expanded the distribution network. The build out of our other new business Housing Finance is on track as the book size has now crossed the Rs. 520 crores mark. The total credit book has recorded a growth and has crossed Rs. 3100 crores this quarter. The steady businesses have posted a stable performance by protecting market share and the growth business scale up is progressing as per our plan. Our Retail businesses under incubation also continue to grow in size.

Now, turning to our performance highlights. Our total revenue for Q3 FY12 was Rs. 455 crores, up by 22% over Q2 number of 372 crores. Profit after tax was 29 crores compared to Rs. 26 crores in Q2, which is 12% up QoQ. Our capital based businesses continue to generate a larger part of our revenue and now account for 82% of our total revenue for Q3 with Agency and Fee Commission accounting for the balance 18%. In the capital based revenue, Interest and Treasury income was Rs. 373 crores for the quarter. Credit businesses continue to generate 30% of the total revenue by way of interest. Taken together with other interest on working capital assets, our total interest income is now 65% of our total revenue for the quarter.

Agency businesses recorded Fee and Commission Income of Rs. 81 crores in the quarter compared to Rs. 89 crores in Q2. From the current quarter the Fee and Commission income figures in the consolidated financial statements are disclosed net of (i) service tax collected on the broking fee, and (ii) sub-brokerage. To that extent we have recast the revenue numbers for the previous period as well. The drop in Fee and Commission is direct fallout of the lower activity in the Capital Markets.

If you look at our net revenue for the quarter, our Agency Fee and Commission was 81 crores and the capital based business had net revenue of Rs. 140 crores. Now the capital based businesses contribute roughly 2/3 of the total net revenue.

Our total cost for the quarter was Rs. 409 crores compared to 331 crores in Q2, which is up by 23% QoQ. Our employee cost is marginally higher this quarter as we continue to selectively hire in our new businesses especially in the Life Insurance and Home Finance. Opex is marginally higher in Q3 due to cost associated with scaling up of Insurance and other new businesses, expense on conferences and fee on banking lines, etc. The financing cost is higher due to increase in borrowings and due to short-term rates being higher this quarter resulting in a blended cost of borrowing at around 10.1% for the quarter. With our new office building getting occupied the depreciation is also higher in Q3. These additional costs continue to affect our ROE and the margin. Our PBT margin is 12% and the PAT margin is 7% YTD. Our margins are under stress due to the cyclical headwinds and other factors that I have mentioned.

Turning to the business highlights; the Credit business continues to post stable performance. The total book was scaled up to Rs. 3117 crores by December 2011 compared to Rs. 2640 crores by the end of Q2. The Loan book comprises Wholesale loans of Rs. 2110 crores, Retail collateralized loans 490 crores with Housing loans accounting for the balance Rs. 520 crores.

We continue to be conscious about sector and industry concentration in our credit book. As at the end of the quarter the top three sectoral exposures in the book are Mortgages and Loans against Properties 17%, Real Estate 15% and Media and Entertainment 13%. The average collateral cover for the collateralized book is over 2.33x at the end of the quarter. We continue to be adequately collateralized though there has been some impact of volatility in the market in Q3 on overall collateral cover. The Q3 yields are marginally better at about 16.8% though the spreads have shrunk due to higher cost of borrowing this quarter. The asset quality on our book continues to be satisfactory. Our gross NPLs are Rs. 16.84 crores compared to 17.21 crores in the previous quarter. The gross NPLs are at 0.54% and the net NPLs just around 0.1% of the total book. Including the general provisions on the standard assets, our total provision cover on the NPLs is around 132%.

The Housing Finance business offers residential mortgages, loans against properties and lease rental discounting. We have extended the operations to Hyderabad this quarter and are now present in six major metros. The higher cost of borrowing continues to affect the spreads in this business also.

Edelweiss Tokio Life Insurance which launched its business in Q2 has a variety of diverse products covering Term Plans, Saving Options, Credit Protection and ULIP Fund. Its presence has now scaled up to 22 offices in 15 cities. Its distribution network has also been scaled up by taking the number of Personal Financial Advisors (PFAs) enrolled for the business development to over 530. We plan to scale up our presence through more offices and a large network of PFAs as we move forward.

In our Alternative Asset Management Business, we continue to have AUMs/AUAs equivalent to US$380 million. Our Mutual Fund manages five equity and six debt schemes with an average AUM of Rs. 575 crores for Q3. It now has an active base of over 5700 investors with a distribution network comprising nearly 3000 distributors. The focus of our domestic Asset Management continues to be on broad basing the product portfolio and building investors track record.

Turning to our Capital Markets businesses, in Investment Banking despite actual deal closures remaining relatively slow, we handled two deals in ECM & Advisory and seven deals in the Debt Capital Markets. We were the sole financial advisor for sale of 14% stake of Siemens in the Bangalore Airport Authority and also closed a PE deal in this quarter. We have now executed 26 deals across ECM, Advisory and DCM in the nine months of FY12.

We continue to be a major player in the Corporate Bonds Syndication and are ranked overall 'Sixth' taking commercial papers and bond issuances together in the nine months of FY12 with a 16% market share. We are also ranked 'Fourth' in the CP Issuances in the same period as per 'Prime Database.'

Brokerage Business -- In the challenging environment where market ADVs and especially cash ADV were lower, our total Broking income for Q3 is Rs. 40 crores compared to Rs. 50 crores in the previous quarter. Broking income now accounts for 9% of our total income for Q3 2012. Our total average daily volume for the Q3 was Rs. 4850 crores compared to 5300 crores in Q2, that is a slide of about 9%. Out of the total ADVs the client broking volumes has gone up marginally at 2622 crores compared to 2540 crores in Q2. The Broking yield on client transaction continues to be under pressure and it is about 3.6 basis points this quarter on a gross basis compared to 3.8 basis points in the previous quarter. It is 2.4 bps on net basis.

The scale up of our Retail business continues. We now have over 364,000 clients through our online portal www.edelweiss.in and through the offline model compared to 354,000 in Q2.

The treasury and related asset book size at the end of the quarter was Rs. 5300 crores. The gross yield on this book for the quarter is 13.5%. As the average cost of borrowing for us during the quarter was about 10.1%, it gives us a spread of roughly 3.4% on the Treasury and related assets. Returns were marginally higher this quarter on the back of market opportunities and hence allocation to this book was higher. Treasury allocation continues to be a function of liquidity management needs, capital requirement of other businesses and opportunities available in the market. The allocation to commodities and its contribution to the top-line is increasing, as we consider it to be the next asset class with big opportunities in India. We thus see it emerging as an independent business within our group soon.

Finally, turning to our balance sheet, our total balance sheet size at the end of the quarter was around Rs. 11,300 crores. The total net worth of the group now stands at 2,878 crores. Our borrowings at the end of the quarter have been Rs. 8,409 crores, implying a gearing of 2.92x, with an inclusion of minority interest in the total net worth.

Taking forward our commitment to be more transparent in the data and information that we disclose about our operations, this quarter we have included a slide on the duration of our 'Assets and Liabilities' from a liquidity profile perspective in our 'Earnings Presentation'. I'm sure it would satisfy the demand of some of our stakeholders who wanted to have a look at our ALM. You can see from the slide that we have a positive cumulative gap in each of the durations. In addition we have unutilised bank lines which are not reflected in the ALM liquidity profile. The ALM data thus reinforces the fact that we continue to have a strong and liquid balance sheet.

The levels of sundry debtors, sundry creditors, loans and advances continue to be in line with our operations. The details of the current levels have been given in the 'Earnings Presentation.'

To sum up, despite the current headwinds affecting the Financial Services sector our business performance has held its ground and the financial performance is improving due to focus on internal operating metrics and higher efficiencies. However, the margins continue to be under pressure for the reasons mentioned earlier. We continue to invest in enterprise functions like Risk Management, Technology and build leadership strength besides instilling cost centricity across the organization. We remain focused to our core strategy with a planned build out of new businesses in Life Insurance, Asset Management and Housing Finance. The investment in incubating these businesses is likely to continue for about a year more, which will position us for future growth. With this I would like to conclude and will be happy to take your questions.

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 Lokesh Mallya from Birla Sun Life Mutual Fund, please go ahead.

Lokesh Mallya: Just a question on the ALM. If we look at Slide 9, we have Treasury Assets worth 1,242 crores. And later on we have mentioned that we have Treasury Assets worth 5,300 crores. So how does that actually add up?

S Ranganathan: The Treasury Assets are comprised of the commodity book, the debt or the fixed income portion including GSecs, the fixed deposits and the equity portion. So that is the total of 5,300 that I was mentioning to you whereas in the liquidity profile we have tried to break it down and give you each of them separately. 1242 includes only the commodity and the equity book.

Rashesh Shah: Actually, if you see here the Treasury Assets are mainly the equity market assets in a very broad sense and if you see the other ones which are G-Sec, Bonds and Fixed Deposits, part of those are also in the Treasury Assets, because Treasury business uses all these assets.

Lokesh Mallya: So if I add up FD, G-Sec and Treasury it comes to more than 6,500 crores.

Rashesh Shah: Yes, but all of these are not used for Treasury and all G-Secs are also not used for Treasury. So this Slide 9 classification is only for the Asset/Liability duration from a liquidity profile perspective, it is not from a business orientation.

Lokesh Mallya: You are saying that you are apportioning a certain part of FD as Treasury Assets?

Rashesh Shah: Yes. Commodity business also uses FDs to open LCs for import of commodities. FDs are also used for the Broking business and for other businesses.

Lokesh Mallya: So I would be right in including G-Sec and Bonds in the ALM statement as well as Treasury Assets plus the balances Fixed Deposits used for market related purposes?

Rashesh Shah: If you ask us broadly we have not split this way but maybe we can start giving that from the next quarter. About half of the G-Sec and Bonds can be Treasury Assets because all G-Secs are not for Treasury only; we use G-Sec for our corporate liquidity management also. FDs are used by Commodities business, by the Broking business, by the Corporate for liquidity management as well as by the Treasury business. So again I would suggest use Slide 9 just to get a handle on what is the structure of the assets and liabilities, and not how the businesses are using those assets and liabilities.

Moderator: Thank you. The next question is from Vikrant Khadilkar from JP Morgan.

Ravi Ratanpal: Hi, Ravi Ratanpal here. My question is on your Credit book. You have a total exposure to Real Estate around 15% of your total credit book and 8% on Infrastructure. So what kind of exposures are these? Can you elaborate on the same?

Rashesh Shah: It is a usual industry wise exposure where you have the underlying collateral also. Our average collateral is between 2 to 3 times. It can be either shares and/or the hard assets in those companies. When we said Real Estate and Infra these are the companies and sectors. So in Real Estate exposure the collateral can be shares of a real estate company, it can be hard assets in Real Estate, and the same thing in Infra, where we usually take a combination of liquid and some illiquid asset. Largely it is liquid and our average collateral cover is more than 2.5X on the liquid side.

Ravi Ratanpal: So how is this credit exposure different from promoter financing?

Rashesh Shah: Because it is not always promoter financing. Very often we give loans to operating companies also, but we take liquid collateral from either the company or the promoters. So if a company has promoted another company and he is the sponsor of that, we might give credit to the underlying company and take the collateral from the sponsor or the holding company.

Ravi Ratanpal: So basically it will be some stake in the holding company, right, if it is shares?

Rashesh Shah: No, it would not be stake, it will be collateral. We need to differentiate between stake and collateral. Stake would mean that we are investing in that company and we do not invest in these companies. We take liquid and illiquid collateral against the loans that we give because we are not a bank and we do not have handle on the cash flow of the creditor companies. It is actually very important for us to have some sort of collateral against the credit that we extend. A large part of the credit also very often goes to the operating company, and so it is not always promoter funding.

Ravi Ratanpal: When you say shares of the company and how it is different from a stake? Because you just mentioned that Real Estate and Infrastructure you have some shares in the company?

Rashesh Shah: When you say stake we mean that we have invested in the company. We do not invest into these companies; we take the shares as collateral against the loan in pledge.

Ravi Ratanpal: Okay, so it is again different way of looking at it. And what would be the size of these companies? Are these companies listed or unlisted? What will be the average size of the company if it is listed? If it is not then what is your average loan value given to these companies?

Rashesh Shah: When we say liquid collateral we will always mean that these are listed companies collateral because liquid for us means listed in the market. As I said a large part of the collateral we have is listed and basically, liquid collateral. These companies are usually mid corporates.

Ravi Ratanpal: And so far have you seen any kind of stress specifically in the Real Estate and Infrastructure on your credit exposure?

Rashesh Shah: We have also reported our NPAs. We are not seeing stress as of now, but we have a very stringent underwriting process. So we will look at the cash flow and even if it is a loan for one year or two years we just ensure that it is not overextended. So if you have a strong underwriting process and good quality collateral then you should be able to manage stress. But it is also a function of economy and the underlying clients, but we are not seeing stress as of now.

Ravi Ratanpal: And what will be average duration of this credits, the loan given to the underlying companies?

Rashesh Shah: Approximately a year is an average, it can be anywhere between six months to 24 months.

Moderator: Thank you. The next question is from Nidhesh Jain from Espirito Santo.

Nidhesh Jain: My question is regarding the Broking business. If I calculate the net yield, there is a sharp decline in the Broking yield on that basis QoQ. So what are the reasons for that?

Rashesh Shah: Analysts usually enjoy looking at yields and all that! To be honest with you we look at profitability because to give you an idea, to do cash business at 5 basis points yield is also actually unprofitable versus even if you do an option at 0.5 basis point yield. The options business is fairly profitable on the automated algorithmic trading side. In the last 5 to 6 months, we have extended direct market access and other facilities to our customers, where on that particular business the yield maybe down but it is still profitable from an overall cost structure point of view. So as we are seeing higher volumes in options, higher volumes through algorithmic trading, direct market access and all of that, we should not just look at yield but we should also look at where the yields are coming from. Cash may have a higher yield but may have a lower profitability. To just give you the perspective our yields have fallen by 0.2 basis points from the last quarter. So actually our overall experience is now that the yields may fluctuate a little bit here and there because if there is a higher or lower F&O mix versus cash mix it can change a little bit, but overall I do not think yields are falling very sharply. So even this quarter it is only 0.2 basis points fall over the earlier quarter.

Nidhesh Jain: On the gross basis the fall is only 0.2 basis points but on a net basis, if I calculate net yield adjusted for a service tax the fall is around 0.7 basis points?

Rashesh Shah: No, it is about 0.3 or 0.4 by our calculation even on net basis.

Moderator: Thank you. The next question is from Ritesh Nambiar from UTI Mutual Fund.

Ritesh Nambiar: Just wanted clarity on one of the statements which you mentioned that the Treasury Assets earn you around 13.5% annualized yield. Is that excluding the advances?

Rashesh Shah: Yes, our capital is broadly divided into our credit business, our capital businesses and the FDs and other working capital we have. These are the three categories. So when we say Treasury Assets it currently includes commodities, the fixed income assets as well as the equity assets. Related assets include the FDs and other working capital assets.

Ritesh Nambiar: Could I get a rough breakup of all the three? Because if I reduce the cash component, the FD rates are nowhere close to that level and the debt book which you have including the G-sec may not yield you so much. So where is that extra yield coming from, 3-odd per cent?

Rashesh Shah: As I said, it includes the arbitrage activities, it includes the commodities business where we import against LC, we earn a spread on that on the financing of that also, so it is an aggregate 13%. There are various segments which give you 11%, some give you 14%, and some give you 16, 17%. it is an improvement. We used to average between 11.5% to 12% in the earlier quarters. As Commodity prices have gone up, as the volatility and the spread even in Equity markets have also gone up, the arbitrage opportunities have expanded, so this 13% is weighted average yield on that.

Ritesh Nambiar: Okay, it includes no upfront fees or --?

S Ranganathan: No.

Ritesh Nambiar: And what is the extent of profit in it?

Rashesh Shah: As I said, 13% is the yield and our cost is about 10%. We actually look at the spread like our Credit business gives us about 5% spread; our Treasury gives us about 2 to 3% spread on an average. If you compare it with any bank, it is fairly similar to the spreads that the treasury of a bank also gets.

Ritesh Nambiar: Okay, and the second part on the minority profit distribution, why this quarter there is a dip compared to Q2?

S Ranganathan: That is because of the insurance scale up. There has been a loss on the insurance side. So 26% of that goes to the minority.

Rashesh Shah: There are only two areas where we have significant minority investors; one is on the credit side - ECL Finance where we have Government of Singapore which owns 8% of that company and then we have the Insurance business. The Insurance business has been scaling up and the operating burn in that business has started to happen. As we have mentioned, as you see results of this quarter you should factor in the fact that there is an increase in the operating cost on the Insurance side as we scale up. It is approximately 8 crores. So the minority share on that is what has happened in this quarter.

Moderator: Thank you. The next question is from Lokesh Mallya from Birla Sun Life Mutual Find.

Lokesh Mallya: Could you give us a break-up of the Treasury Assets into arbitrage and prop? And just a second question as well, you have Loans and Advances of 4520 crores, of which I believe 3120 crores is the credit book. What is the balance?

Rashesh Shah: On the first one, this allocation in Treasury is very dynamic and changes frequently. So if you look at our Treasury Assets, it is broadly 3,000 crores. We should expect about 1,000 to 1,500 crores in the Commodities and Gold import business, because at any point of time we are importing Gold and selling and holding inventory on that. The inventory is always hedged and we do not take any Forex or price risk on that. We do invest in working capital for the business and earn a spread on that. Now, we have about 400 to 500 crores on the Equity arbitrage. Another between 700 to 1000 crores on the fixed income on the Corporate Bonds and the G-Sec. On that also we hedge the interest rate risk and we earn spreads on that. So broadly 3000 average you should look at in these three businesses, but in any particular month it can go up or down by 300 to 400 crores very easily. Then there are the FDs which are used by Treasury and Commodities which take the total to about 5300 crores.

S Ranganathan: On your questions on the Loans and Advances, predominantly as you rightly said the financing business takes care of the chunk of that, 3100 crores. Apart from that it is a combination of several items like Advance Tax that we have paid, the MAT credit that is available to us, the Edelweiss Trust share loan that we have given and the ICDs that we have placed, the Service Tax credit that is available to us, loans to associates, Deposits with Exchanges and deposits for the premises that we have. So it is a combination of several things.

Lokesh Mallya: How much would be ICD?

S Ranganathan: ICD is roughly 270 crores.

Moderator: Thank you. The next question is from Vijay Shah from Reliance Mutual Fund.

Vijay Shah: If you can share the market share in Institution and Retail broking? In the September quarter presentation it was around 4.5% on the

Institutional side and 1.2% on the Retail side.

Rashesh Shah: The market share is broadly the same in this quarter also. By our reckoning we have an average of around 4.5% on the Wholesale broking side and between 1 to 1.5% on the Retail side by revenue.

Vijay Shah: The other question is the investments have decreased QoQ from 1530 crores to 700 crores. So what major chunk has gone from the investment book?

S Ranganathan: Nothing has gone from there. It is just a classification issue. Some of them have been shifted to stock-in-trade. These were classified earlier as current investment. The auditors believe that the right place should be in stock-in-trade.

Rashesh Shah: I don't think from performance point of view stock-in-trade or investment for a business like ours should make any difference. It may make a difference from an Income Tax point of view, but from a normal P&L point of view whether you are holding some corporate bonds as an investment or you are holding it in stock-in-trade, they are both the same. Accounting wise also they are the same for us, from the profit point of view. So any accountant when he changes classification, he could be keeping in mind the Income Tax rules.

Vijay Shah: So this would largely justify the increase in the net current assets by 1,000 crores QoQ?

S. Ranganathan : Yes.

Vijay Shah: The other thing is, if we see the ALM this quarter, which is a very appreciative thing from an investor perspective. Just wanted to know one thing; right now, as we are going on the fund-based model, the liability profile which appears today is largely skewed toward the short-term maturity. So once we grow forward more on the Fund-based or Housing Finance business, how do we plan to extend this maturity profile?

Rashesh Shah: Yes, it is an important question that we have also been grappling with. But if you see our assets and liabilities, one of the things that we strongly emphasize is that the asset profile drives the liability profile and the liability profile also drives our asset profile. So we have tried very hard to keep both in sync. Our asset profile is also at a short end because of the Treasury Assets and all the FDs we have. So as the asset profile starts extending higher than two years, we are also working on getting the liabilities commensurately. So, currently, since we have a fairly large equity base the stress is not high. For the next six months to a year, given the large equity base we have and the scale up in the Housing Finance to be another 1000 crores only in the coming year, we have already tied up commensurate liabilities for that. So if you see on the Slide, where we have given the Asset/Liability profile, actually we have a positive cumulative gap for all the periods that are there, which I am sure you will agree that it is very unusual. So we have a little bit of room on that and we are also working on getting other liabilities which are of three years and five years going forward.

Vijay Shah: I was looking from that perspective. Suppose, if we are looking for an incremental book of 1000 crores in the Housing Finance business, then the total book maybe at FY13 could be around 1500 to 1800 crores, and we have corporate assets and investment of 1100 crores. So these largely occupy the net worth for themselves.

Rashesh Shah: Yes, but again as I said, our asset profile will also drive the liability profile that we create. So we will not continue at the same liability profile and just extend the asset profile. We will change both of them in sync with each other.

Vijay Shah: So do we have any NHB funding as of now?

Rashesh Shah: We are evaluating that. We are already in conversation with them. But I can assure you the fact that we have started giving out this statement every quarter, we do want all of you also to keep us in check and keep on asking us so that our asset/liability profile remains in sync and it does not go out of hand.

Moderator: Thank you. The next question is from Pankaj Agarwal from Ambit Capital.

Pankaj Agarwal: Sir, I was looking at the breakup of your Agency and Fee income. Your Broking income which was around 50 crores last quarter, it has come down to around 40 crores. So it is around a 20% sequential decline in the Broking income. So do you think it is purely because of dip in market revenue pool from 2nd Quarter to 3rd Quarter or you have lost some market share during this period?

Rashesh Shah: Broadly, our calculation on the market share is the same. You should see three things in this quarter; one is this quarter had quite a few holidays or at least there were quite a few days where foreign investors were not active, especially end November and December. Also if I remember there were only 60 trading days in this quarter versus 62. When you are in the Broking business you count every day in the quarter. So, given the Indian holidays and the International holidays which happened in this quarter, this quarter was slightly subdued. So by our calculation on the market volume as well as the commission pool, we have been able to maintain the market share both on the Wholesale and Retail side. And we have also crosschecked this with other Brokerage houses when they declare the results and we think this is broadly in sync with that.

Pankaj Agarwal: So it would be fair to say that between Q2 and Q3 the Brokerage revenue pool has come down by 20% for the entire industry?

Rashesh Shah: Yes. Also, you should keep one other thing in mind. Nowadays when all of us give Brokerage, this is Equity Brokerage and Commodities Brokerage. So you should keep that also in mind because you might see some quarters where Equity volumes may not have come down but Commodities would have come down. Anecdotal evidence is saying that on an average between 20% to 30% of Retail Broking now is Commodities and Currency-led. So you should also consider that because in this quarter by our calculation

Commodities also slowed down.

Pankaj Agarwal: So out of your Broking income, some part is Commodities as well as Currency Broking?

Rashesh Shah: Yes, though we are smaller than others, but as I said for the industry as a whole Commodities and Currencies is now between 20% to 30% of what is called 'Broking Commission Pool.'

Pankaj Agarwal: Only the Retail part, right?

Rashesh Shah: Yes only on the retail part because anyway Institutional Investors are not allowed in this.

Pankaj Agarwal: Okay and sir, your premium from the Insurance venture, is it going to some line item on revenue side?

Rashesh Shah: It will start coming from this quarter onwards. Since we are just scaling up, currently it's like a couple of crores here and there, it goes into other income. But it will soon be a significant item. So we will break it up either from the 4th Quarter onwards or the 1st Quarter FY13 onwards. For this quarter it is about 3 crores.

Moderator: Thank you. The next question is from Rahul Vekaria from Axis Mutual Fund.

Rahul Vekaria: My question is with regards to your Loan book. What percentage of our credit loan book of 3100 crores is wholesale?

Shailendra: 2100 crores is the Wholesale; about 490 is the Retail part and 520 crores is the Housing part.

Rahul Vekaria: So almost say, 95%-odd of our credit book is wholesale?

Shailendra: No-no, 490+520 crores that makes it about 1000 crores, which is 32%. So you can say that 68% is the Wholesale part of it.

Rahul Vekaria: Sir because I was reading the total credit book is around 3120 crores?

Rashesh Shah: So Wholesale is about 2100 crores out of 3100 crores and the remaining is the Retail.

Rahul Vekaria: Sir, can I get a breakup of the Wholesale book in particular into various sectors or anything that you have --

S Ranganathan: The sector wise demonstration is there in the presentation on slide no.27.

Rahul Vekaria: That is the whole book, right? If I only wanted the Wholesale book there in that case?

Shailendra: From there 17% mortgages that is 520 crores you can eliminate. Sense on remaining 2500 crores you can get from that pie chart.

Rahul Vekaria: On the Real Estate side, how are the projects, are we monitoring the projects towards which we are exposed to and are we seeing any stress there and how is it going out there in a particular sector?

Rashesh Shah: As we answered earlier, when we say real estate exposure, the collateral can be shares, the collateral can be office assets or apartments and flats. So it is a combination of liquid and illiquid. We generally prefer liquid assets and liquid assets are currently the larger part of the collateral cover that we have. We do not directly finance projects from the credit book. And as I answered for an earlier query, we are not seeing any stress in any part of that.

Rahul Vekaria: Sir, these are the Real Estate developers or builders, is it?

Rashesh Shah: It could be there, but it could be assets of an existing project that is already completed. So we might give it against the yielding asset also and they use that for a new project. We generally avoid Construction Finance and Project Finance in Real Estate.

Rahul Vekaria : Do you have any exposure in the Power sector?

Rashesh Shah: We would not have it at a project level at all. If we have it, we would have at our shares levels because we might have given money to a company that is investing in a Power project or we may have given against the shares of a listed power company. But we have no exposure to Power Projects.

Rahul Vekaria: Sir, what would approximately that amount be?

Shailendra: For Power sector the amount is actually not even worth coming into the top 10 sectoral exposure as you can see in the pie chart. So it is less than 4%. In fact it is around 2% of the total book of 3120 crores.

Moderator: Thank you. The next question is from Nischint Chawathe from Kotak Securities.

Nischint Chawathe: Can you talk a little bit about your strategy in the Commodity business? What you exactly plan to do? Whether this is going to be agency or prop or lending or a combination of these three, what is that you really expect from this?

Rashesh Shah: Broadly, Commodity business is what we call "Clients Facilitation Services" where we basically provide Import, Financing, and Hedging Services to our clients. We don't take any open prop position in any Commodities. So a large part of the profit that we make is a spread or yield on the assets and the working capital that we deploy. We currently import Gold for our customers. We sell to about 500-odd jewellers in India. We import and sell off-the-shelf and we provide hedging services and financing services for them. The other people who are in this business are all banks. Bank of Nova Scotia is one of the biggest one, then there is ICICI Bank, Axis Bank, who also provide similar services. Historically, Gold import, Financing, Hedging services all were provided by the Indian Banks. Now, we also provide that as the Indian Commodities Exchanges have come about. So, it is largely a Client Facilitation business. It is not a Prop business; it is not a Credit business in that sense. So we earn a spread on the working capital that we employ in the business.

Nischint Chawathe : And just try to understand this, how would you hedge your position?

Rashesh Shah: We hedge the whole inventory in the exchanges because exchanges are fairly liquid. So if we have say 300 crores of Gold, we will hedge those 300 crores of Gold on the exchange and as and when we sell to a client, we unhedge that amount from the exchange.

Nischint Chawathe : In terms of specific commodities, you see a big opportunity in Gold is what I would infer?

Rashesh Shah: Gold was the first one we started. Our idea is that wherever there is an import required, where hedging is required, where there is a large client base who all wants to buy this commodity, there is scope for this business. Like, if you are a small jeweler in India who wants to buy say 100g of gold or 40g-50g of gold, it is very hard for you to import on your own and up till now that service of buying gold was coming to you only from either the banks or STC and MMTC. So, we are also providing this service now. We have a 4% to 5% market share of the Gold imports in India. Even now the canalizing agencies and the banks continue to provide a large part of the services in this.

Nischint Chawathe : Any sense, if you could share some numbers in terms of what kind of a market do you estimate and the kind of the contribution of this particular business to the revenue, or what you plan to take it to like? Some basic numbers to take it forward?

Rashesh Shah: See we are very hesitant to make any forward-looking statements because a forward-looking statement can be fairly injurious to your health and especially in an emerging area which is new! We have been working on this for the last three years and we have scaled up this business to a certain level. So, we will formulate a plan and as I said earlier, as and when we have a concrete plan which we can share with the analysts and the investors and the stakeholders, we will be very happy to share. But currently we don't want to make any forward-looking statement. As I said, this is one of the six businesses we have, and our current six businesses to reiterate are Capital Markets, Wholesale Credit, Housing Finance, Asset Management, Insurance and Commodities. Each one of them is now scaling up fairly well and we are executing on that. We are basically attempting this broad-based financial services model that we strongly believe in which is very execution-intensive, especially areas like Commodities, but we do feel that there is a lot of opportunity in that. Since the business is scaling up we have now started to share information. As it scales up more we will obviously give more color on this.

Nischint Chawathe: Sure, just one final touch point on this. As on date if I want to look at the current financials, I am assuming that this would be a part of others in the total income?

Rashesh Shah: Currently, it is a part of Treasury income because it is, as I said, spread income that we earn. For us cash futures arbitrage or Gold import financing business both are fungible with each other because they both earn x kind of yield and we basically see how the yield is. If the Gold business stops giving yield and the cash futures arbitrage gives higher yield, we will allocate more capital there.

Moderator: Thank you. The next question is from Rishendra Goswami from Locus Investment.

Rishendra Goswami: Just a couple of questions; one, on your Insurance business, how much have you put into the total capital of the Insurance business?

Shailendra: We have put in 308 crores of equity in that company and a total capital of that company is 550 crores.

Rishendra Goswami: And just to tell little bit on your Treasury business, how much of equity actually do you allocate to the overall Treasury operations?

Rashesh Shah: Currently, as we have said there are about 3000 crores of assets on that. Broadly, I would say 400 to 500 crores of equity. We don't have hard allocations because we have a consolidated equity base of 2800 crores. But I would assume about 400 odd crores of equity is allocated to that particular business, and in this quarter, as you have seen, we have earned total revenue of about 60 crores on that, broadly on a 3000 crores kind of broad asset at the end of the quarter. So if you want to allocate, you can take about 400 to 500 crores in that and similarly, we have about 500 crores allocated to our Credit business which is a 3000 crores book and then we have Insurance where we have invested 300 crores. So we have some allocations but they are not very hard.

Rishendra Goswami: The reason I was just asking this question is in terms of the Treasury business, where is this capital getting allocated from? Because you guys are kind of well allocated across your subsidiary.

Rashesh Shah: Actually, it is not entity-specific because entity business is fairly broad-based. It is like an activity which is being carried out for liquidity management, for efficiency of the capital, for yield enhancement and all that. So it happens in various entities, but if you look at consolidated, as I said we have 2800-odd crores of gross capital, and out of that we have some in Insurance, some in Housing Finance, some in Credit business, some in Commodities business and some in Agency businesses. So we have allocated but currently you should see this on a consolidated basis, we don't have hard allocations for any of the businesses.

Rishendra Goswami: So in terms of just thinking about the Treasury business overall, I know, it is not a hard allocation but how do you actually see it going forward in terms of what yields you get? Let’s say if you have to think about from an ROA prospective, what do you think is the ROA of that business overall?

Rashesh Shah: Overall that business will not ever give you more than 100 basis points of ROA on an after-tax basis if you were to calculate that. That 100 basis point has been true for banks and everybody else because, treasury is not a high ROA activity, it is your liquidity management, yield enhancement, efficiency kind of a part. So as you have seen in the last few years, as our other businesses have grown, as our balance sheet has grown, our treasury size has remained more or less the same because it is like an essential activity, you are not doing it only for return, but since you as a financial services company have to have a fairly liquid balance sheet. That liquid balance sheet is actually translated in your Treasury activity where you try to earn at least a return that gives you a small spread. Broadly, most of the banks and all of us, the spread we earn on our Treasury business will not be more than 100 to 300 basis points on an average. The spread that you earn is the yield you earn minus the cost of capital that you incur.

Rishendra Goswami: In terms of going forward, let's say as some of your other businesses scale up and those are capital-intensive businesses, be it on the Credit side or be it on the Insurance side, do you think the treasury operations would actually come down as you allocate more towards the other businesses?

Rashesh Shah: Actually, it may not shrink, but as a percentage of the overall it will go down. It has gone down over the last 3-4-5 years. Broadly you see most of the companies will have Treasury Assets between 10 to 20% of their overall assets. We have currently about 30-odd percent, so it will come down as the percentage of the overall book.

Rishendra Goswami: One data point in terms of the interest income that you have reported. How much of it is from your core lending operations versus your Treasury?

Shailendra: Approximately 135 crores would be from the core lending operations in Q3.

Rishendra Goswami: And rest would be from?

Shailendra: From the working capital assets.

Rishendra Goswami: Just one more question on the Wholesale Lending business. So this Wholesale Lending business that you have sounds more like an opportunistic promoter financing kind of thing. Is that understanding correct or there is more to it?

Rashesh Shah: It's not an opportunistic promoter financing. Historically we have studied this market very closely and the onshore market for what we call liquid collateralized borrowing. We may or may not call it promoter funding because promoter funding has a connotation and because very often a lot of this credit is to operating companies against maybe the shares of the promoters. Like I remember in the early days of Edelweiss, when we used to borrow money from banks, they used to take our shares as an additional collateral also. So, it is not funding the promoter. Very often it is also funding the company, but you get this additional collateral which is a security that you need. The Indian market size is between 50,000 to 70,000 crores as an annual book and there is an offshore market also, which is another between 40,000 to 50,000 crores, a lot of international banks also play into that. So collectively onshore and offshore is 100,000 crores kind of credit market. So it is not opportunistic, it is not that it is there for a couple of months and then goes away. It is a steady-state business because this is the liquid collateralized borrowing market that is there and it will only grow as people use their shares for M&A funding and a lot of others purposes. As M&A start happening, will see a lot more of that. This is how it has evolved abroad where private equity guys have also acquired companies and used the shares of the acquiring company against which they have borrowed money. So all that will happen as the economy evolves and the market also evolves.

Rishendra Goswami: Right, and who will be the other large players in this market, outside you?

Rashesh Shah: There are quite a few ones. If you are in the market and I'm sure as a good analyst you are keeping track of everybody, there are the other NBFCs, there is ILFS, there is IFCI, IDFC, all of them are there. People do it in their own sectors, in their own clientele, in their own comfort zone but everybody has been there. Birla has been there for a quite a few years and, all the NBFCs are there in some way or the other and everybody has anywhere between 1000 crores to 4000 crores as an average size of the book.

Rishendra Goswami: And just a last thing, you mentioned about market volumes moving more towards F&A and automated trade. Is that a significant chunk of your business now on the Institutional side?

Rashesh Shah: Our estimate is about 20% to 25% of the volume will be going there, and that is also an average for the market as a whole. When we speak to people in the exchanges and industry, the sense we get is about 20%-25% of the overall volume has started to move towards algorithmic automated direct market actions.

Rishendra Goswami: This is 20% to 25% of the entire market volumes across cash and F&O?

Rashesh Shah: Yes. It won't be very high on cash; it will be largely on the F&O.

Moderator: Thank you. The next question is from Lokesh Mallya from Birla Sun Life Mutual Fund.

Lokesh Mallya: Has there been any write-off in this particular quarter and what has been the amount?

S Ranganathan: No write-off, Lokesh. Only there have been some provisions that were created, that is all.

Lokesh Mallya: And just a part on the ALM statement. We have corporate assets which can be liquidated in three months 359 crores. What would that be?

S Ranganathan: It is not a question that it will mature; it just reflects an ability to mature it.

Rashesh Shah: For example, if we are having a three-year FD but we think in three months we can liquidate it, it will fall under three months bucket. This particular slide you should see only from the liquidity profile point of view, you should not see this from the utilization point of view. If we have to liquidate the assets and repay the liabilities, this is how the assets can be liquidated.

S Ranganathan: The ability to liquidate. If you see the fixed deposit, obviously, all fixed deposits may be for one-year because that's where the margins will be. But if you see some of the fixed deposits are put in the first month bucket, simply because whenever I need to liquidate the fixed deposit, I can go to the bank and get the money.

Lokesh Mallya: I'm just trying to understand what would be a corporate asset which is liquidable in three months? What could that be?

Rashesh Shah: Corporate also maintains its own assets from a liquidity management point of view, from an overall management point of view. And again three months is the liquidation time, it may not be the tenure of the asset.

Moderator: Thank you. Next question is from Paras Nagda from Enam Holdings.

Paras Nagda: I was noticing in your earlier presentation which you made. The income from Broking was close to 67 crores in Q2. What kind of re-adjustments have you done to arrive at? This I'm talking for the June quarter.

S Ranganathan: It’s not just for the June quarter, what we have done is in this quarter, we have netted off the service tax and the sub brokerage element from the total income, just to make it clinically more correct. So what we are required to do is re-state the previous quarter’s numbers also just to ensure correct readability.

Paras Nagda: So from gross broking you have moved to net broking by minusing service tax and sub brokerage, is that correct?

Rashesh Shah: You are right.

Paras Nagda: One more thing I wanted to ask is, at a PBT level, what kind of losses are there from Insurance and the other businesses which are still on a growth phase? Like on a 46 crores of PBT if I have to look on a steady-state, you mentioned around 8 crores of loss in Insurance, correct?

Rashesh Shah : You can attribute about 8 crores to Insurance.

Paras Nagda: Any other businesses like Housing Finance, Asset Management?

Rashesh Shah: Housing Finance and others are about a couple of crores every quarter. So a couple of quarters ago we had indicated that all the Retail businesses are broadly at that point, this was pre-insurance, although Retail businesses were costing us about 20 to 25 crores a year in terms of the profit which is reduced.

Paras Nagda: One more question, wanted to know on the consolidation in the Broking field, do you think the time is right for acquisitions, what are your thoughts on that?

Rashesh Shah: Consolidation will happen. I do not think consolidation will happen on the Wholesale Broking side because Wholesale business is not additive. Like if you’re doing business with an institution, just because two Wholesale Brokers come together the market share will not increase obviously.

But on the Retail side if I have let us say 400,000 customers and somebody else has 400,000 customers, and if they are integrated then you will have 800,000 customers. So we do think on the Retail side consolidation will happen, wholesale it will not happen.

Moderator: Ladies and gentlemen that was the last question. I will now like to hand over the floor back to Mr. Shailendra Maru for closing comments.

Shailendra Maru: Thank you Rashesh, Himanshu, Ranganathan and Marina, and thank you all for joining us on this call. In case you have any other questions please feel free to contact us directly or drop me an e-mail at shailendra.maru@edelcap.com. Have a great day ahead. Thank you so much.

Moderator: Thank you very much. On behalf of Edelweiss Financial Services that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.