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Conference Call Transcript

Edelweiss Capital

Q3FY11 Results

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Corporate Participants

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Chairman

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Questions and Answers

Shailendra Maru: Thank you Rochelle. I am Shailendra Maru, Head of Investor Relations at Edelweiss. Good afternoon to all of you and thank you everyone for joining us today as we discuss Edelweiss Capital Limited's unaudited consolidated financial results for Q3FY11. Speaking today with you are Rashesh Shah, Chairman, Edelweiss Group and Himanshu Kaji, the Chief Financial Officer.

Following the reading of safe harbor provision, I will first turn over the call to Chairman Rashesh for his opening remarks. Thereafter Himanshu will take you through an overview of business performance and the financial numbers. Then, we will open the lines for questions. The press release and an investor presentation on our third quarter results have been circulated and are also available on our website www.edelcap.com.

Certain statements that may be made or discussed at the conference call may be forward-looking statements based on current expectations of the management of Edelweiss Capital Limited or any of its subsidiaries and associate companies. Actual results may vary significantly from the forward-looking statements contained in this conference call due to various risks and uncertainties. These risks and uncertainties include the effect of economic and political conditions in India and outside India, volatility in interest rates and in the securities market, new regulations, and government policies that may impact the businesses of Edelweiss as well as its ability to implement the strategy. Edelweiss has obtained all market data and other information from the sources believed to be reliable or its internal estimates, although its accuracy or completeness cannot be guaranteed. Rashesh…

Rashesh Shah: Thank you Shailendra and hi everybody. First of all thanks for being on this call. Its good to have all of you back. We have given out the results on Friday for the third quarter and I am sure you would have had a chance to go through the results and the investor presentation that we have sent out.

First in terms of the financials for the quarter, as you would have seen, we have total revenue of Rs. 445 crores which is what we call gross revenue. We have interest cost of Rs. 175 cr and since our credit business is growing very fast, we have now, as you would have seen in the presentation, also started calculating total revenue minus interest cost to come up with net revenue. This is because interest cost, as with all the banks, should be going above the line. So 445 minus 175 has been net revenue, that is Rs. 270 crores whereas the net revenue for Q2 was Rs. 255 crores. Out of this Rs. 270 crores of net revenue, the agency revenues are Rs. 135 crores and the net capital revenue, which is the total capital revenue minus interest cost, because all the interest cost is for the capital revenue, is also Rs. 135 crores. So we have almost 50-50 breakup between net agency and the net capital revenue and we would like to maintain that as we go forward.

For comparison purpose in the last quarter, our agency revenue was Rs. 144 crores and the net capital revenue was Rs. 111 crores. The profit after tax for this quarter is Rs. 62.3 crores which is 23% of the net revenue of Rs. 270 crores.

Now to give you some color on the business, first on the broking side. As you would have seen and as you understand the industry, it has not been a great quarter for the broking business. October was good, but after October there was a slowdown in activity, sentiment, the markets were down, all of that. Also on the broking side, options are still the main growth engine and as you know yields and profitability on options is not as high as in the cash side of the business. Our institutional broking business is still steady state. We keep on expanding our research and sales coverage, new client acquisition and all. And on the retail side, we are investing into growing the business including Anagram plus our Edelweiss.in. We have over 300,000 customers and we would want to add about 100,000-150,000 every year and we will continue to invest for that.

On the treasury side it has been a steady quarter. Yields have gone up as the short-term rates have also gone up, the treasury yields and the short-term rates have a high degree of co-relation. So there is no real increase in spread as such. Spreads has been maintained. The opportunity side has gone up and so we have added Rs. 3 to 400 crores to that book as compared to the last quarter.

On the credit side, it has been a good quarter. There has been good opportunity on the steady state book as well as on the episodic opportunities. The spreads have been stable. The LAS book is the one that has come down a little bit. We have seen a marginal scale down of about Rs. 100-150 crores on that book, mainly because of risk and liquidity reasons and the market environment. So overall a steady book. As is our continuing policy, whenever we see risk and liquidity issues, we have been very early to scale it down and apply the brakes.

On investment banking, it has been a steady quarter. We have done quite a few deals, but a lot of deals have been for smaller amounts except for the MOIL IPO which was a large IPO that we did.

Even on the fixed income business, it has been a steady quarter. Good amount of transactions have been advised by us and on asset management, steady quarter again. We continue to invest into starting couple of new funds and growing our AUM on that. Our focus continues to be on investing in the retail capital markets. In another 3 months or so we will complete all the integration of Anagram and it has been about 3 quarters so far. Our idea was to take 3 to 4 quarters to complete integration of Anagram. In this quarter, we also started housing finance and are scaling it up. It is still early days, but is a promising business for us and we continue to invest and scale that up.

For insurance business, as you would have seen, we have got the R1 approval and we are now going towards getting an R2 and R3 approval and we hope that by August or September we will start our insurance business.

On the balance sheet size, marginal scale down. We have also started looking at NPAs and provisioning and we want to go towards reporting and managing NPAs and provisioning the way it has been done with the banks and other credit institutions because our credit business is growing and we will adapt those standards as we have started with this quarter.

Overall on the outlook for the market, we do think 2011 will not be an easy year. The broking pain will continue for at least another 2 to 3 quarters. There is absence of growth in the market place with increased pressure on cost and yields coming down. It is universal for the whole industry and we expect to see this for the next 2 or 3 quarters. After that, we will start seeing some consolidation and uptick happening. In the next 3 quarters, we will continue to invest in scaling up our broking business. For the current year (CY11), we think FII flows will be between USD 15 to 20 billion, so it will be a come down from the earlier year, but it is still going to be good because in the second half, we expect reasonable flows from Indian institutions like insurance companies as well as the mutual funds. So basically all in all, we see slight headwinds until the first half of the year, but the second half of the year should see some reasonable consolidation and uptick in the business. We will continue to invest in the businesses ensuring that we invest in growth as well as some amount of profitability as we go along. Along with that, I will hand over to Himanshu who will give more color on the performance for this quarter.

Himanshu Kaji: Thank you Rashesh. Thanks everyone for joining us on this conference call. I will first touch upon the third quarter numbers and then spend some time in giving you some color on the business overview and also share some of the matrices which you generally track.

Our total revenues for the third quarter were Rs. 445 crores, up 93% year-on-year and up 18% quarter-on-quarter. Our profit after tax was Rs. 62 crores, up 16% year-on-year and down 6% quarter-on-quarter. The Board of Directors have declared an interim dividend of Rs. 0.25 which is 25 paise per share on a face value of Re. 1 per share for the financial year 2010-11.

You would see from our numbers that our capital based businesses are now gaining traction. 70% of our total revenues in the third quarter and 66% in the 9 months of FY11 came from these businesses. In the capital based total revenue, interest income has been Rs. 238 crores, out of which, interest on the credit business has been Rs. 184 crores. The second revenue stream under the capital business is the income from treasury operations which was at Rs. 64 crores for the quarter. There is a marginal improvement in the yields in this quarter on the back of liquidity crunch and volatility.

Rashesh introduced the concept of Net Revenues in his opening remarks. For the third quarter, our agency fee and commission income have been at Rs. 135 crores and the capital base businesses have had net revenue, that is net of interest cost, of Rs. 134 crores. Thus the agency income and capital based net revenue have now contributed equally to our net revenue.

For the quarter, the agency fees and commission income at Rs. 135 crores has recorded a year-on-year growth of 57%. Out of this, Rs. 81 crores was our broking income, Rs. 27 crores was our investment banking fee, and the rest Rs. 27 crores is other fees including asset management, distribution, and other fees. Our agency income is scaling up well this year and in the first 9 months of this year at Rs. 372 crores, it has already overtaken the agency income earned in the whole of last year which was Rs. 350 crores. It now accounts for 34% of our total revenues for 9 months of FY11.

Our total cost this quarter has been Rs. 347 crores, a year-on-year increase of 124% and a sequential increase of 25%. Within the total cost, our operating expenses have gone up by 52% year-on-year, about half of these are incremental expenses on account of normal cost of Anagram. As you know, we started consolidating Anagram from mid July this year. Then we have spent about Rs. 8 crores on brand promotion this quarter. Carrying cost of our new office building, as we have mentioned in our previous call, and higher depreciation have also increased our cost. We hope to start occupying the building later in this quarter. These additional costs have affected our margins for the year. Our PBT margin for third quarter is 22%, 33% year ago, and PAT margin is 14% compared to 23% a year ago. With capital based business now contributing over two-thirds of our total revenues, the margins are getting aligned with those of the banking and NBFC industry.

Our PAT margin as a percentage of net revenue is 23% for the current quarter and it was 29% for the corresponding quarter last year.

Now turning to other data points which you normally track. The credit businesses continue to fair well as you would have seen in the last 4 or 5 quarters. Though the credit book has been scaled down a bit in this quarter on prudent risk management, we have had a number of large IPO financing opportunities in this quarter. Interest income from credit business is also now becoming more and more significant than the treasury income on the capital side of the business. Our steady state loan book size at the end of quarter was Rs. 2966 crores compared to Rs.3112 crores at the end of previous quarter. The slight reduction in the book that you see was due to a marginal scale down in our retail loan book by around Rs.100 crores. In addition, we had lower outstanding at the end of the third quarter in the episodic IPO financing book which was at Rs. 61 crores compared to Rs. 919 crores at the end of second quarter. As on 31st December, our steady state loan book comprises of whole sale loans of Rs.2120 crores and retail loans account for balance Rs.846 crores. The retail loans now constitute 30% of the book. With some large IPOs hitting the market, the third quarter presented good opportunity for IPO financing and we financed 7 IPOs including Coal India, Power Grid, and MOIL.

As we mentioned in our previous call, we avoid sector or industry concentration in our credit book. At the end of this quarter, the top 5 sectoral exposures are organized retail at 13%; infrastructure, media and entertainment, and real estate at 12% each; and IT and telecom at 9%.

The steady state loan book is adequately collateralized at an average collateral cover of about 3 times at the end of the quarter.

The interest income from steady state loan book in the third quarter was Rs. 123 crores. Given an average steady state book of around Rs.3000 crores, the yield works out to about 16.4% for this quarter. The yields are marginally higher as we have been able to pass on a part of the higher interest rates to our borrowers.

The asset quality of our credit book continues to be satisfactory with gross NPLs at Rs.33 crores equal to 1.1% of the book. We continue to make a general loan loss provision on non-episodic standard assets at 50 basis points. Our total provision cover on NPLs including this general provision is now at 70%.

Our housing finance business has been launched in Mumbai and we plan to extend it to Delhi and NCR in the fourth quarter. We continue to look for expanding the credit book especially retail book.

The average treasury book size for the quarter was about Rs.1550 crores with gross yield of 16.6% and net yield of 10.8%.

Now turning to our agency businesses, we had a strong quarter especially in investment banking and retail distribution. We handled 10 deals across ECM and advisory and 4 deals in DCM. With this, we have had 40 deals in the first 9 months of this year compared to 33 deals in the whole of last year. We have also strengthened our market position in the equity capital market, which is comparatively a young business for us as we entered into it only 4 or 5 years ago. We are now ranked first in ECM deals for calendar year 2010 by number of issues below Rs. 400 crores as per Prime Database. We continue to have strong presence among both public and private sectors and mid to large corporates. The deal pipeline continues to be strong. Our corporate bond syndication desk continues to be a major player in debt market and is ranked third both in Commercial Papers placement and also in short-term bonds placement by amount in 9M of FY11 as per Prime Database.

In Broking businesses, our total average daily volumes for the quarter have been Rs.5558 crores compared to Rs.5388 crores for the previous quarter. This gives us a market share of 3.7% for the quarter compared to 4.4% in quarter 2. Our market share is 4% for 9 months FY11. As we discussed in our previous calls, a higher growth in options volume in the market is leading to a lower market share. Out of this ADV, the client broking volumes this quarter were Rs.2902 crores, similar to Rs. 2894 crores in the previous quarter. Our broking yields for the client transactions are marginally better at 4.3 bps for this quarter. It was 4.25 bps in quarter 2. Our research, which provides strong support to our broking business, now covers 185 stocks over 20 sectors covering over 70% of the market cap. During the quarter, we had our annual India Conference at Hong Kong and Singapore which facilitated close to 650 meetings among over 80 investors and 40 Indian corporates.

At the end of the quarter, our AUMs/AUAs under alternate asset management business are at USD 348 million equivalent, up from USD 321 million equivalent in quarter 2 FY11.

Now to cover our retail businesses, Edelweiss continues to build retail businesses both in retail broking and IPO distribution. We currently have 309,000 clients through our portal www.edelweiss.in and also through Anagram. We continue to add new clients at a healthy pace. Our internet portal now also offers the facility of investment in mutual fund units online. We have also launched mobile trading on BSE and NSE. As on December 31st 2010, we have 327 own offices and 33 franchise offices. Out of these, 330 offices, together with over 1300 sub-brokers, cater to retail broking.

On the distribution side, Edelweiss has emerged as a leading player. For the calendar year 2010 as well as 9 months FY11, we are ranked first in the HNI category with 16% market share and are ranked third in the retail category with 9% market share in total amount mobilized in IPOs as per Prime Database. As a broker, we are also ranked first in both HNI and retail category in the IPO of MOIL with a market share of 21% and 16% respectively. During the quarter, we handled 9 IPOs mobilizing subscription of Rs.21,400 crores.

The focus of our domestic asset management continues to be on the broad basing of the product portfolio and building investment track record. AUMs at the end of the quarter were at Rs.178 crores under 4 equity and 6 debt schemes.

Now turning to our balance sheet, our total balance sheet size at the end of the quarter was around Rs.8150 crores compared to Rs.8900 crores at the end of September. The reduction in Balance Sheet size has been more or less due to the lower outstanding in IPO finance at the end of third quarter. Our total group net-worth including minority interest now stands at Rs.2791 crores, and excluding minority interest it stands at Rs.2305 crores. Our borrowings at the end of the quarter have been Rs. 5387 crores. This implies a gearing of 1.93 times including the minority interest. The bank fixed deposits and other bank balances were Rs. 2360 crores at the end of the quarter. Our balance sheet continues to be strong and liquid.

Our average cost of borrowing for the quarter has gone up to about 9.4% reflecting the current market conditions. The return on average assets is 3.8% annualized. Our reported return on average net worth is 11.1% annualized. However, adjusting the networth for the amount of funds lent to Employee Trust and investment for purchase of BKC building as well as the impact of borrowings for the BKC building on our P&L until we occupy that building and surrender the existing leases, the adjusted return on average networth would come to about 13.5%.

One final word about our higher levels of disclosures. As a responsible organization, we believe in accurate and consistent communication with our investors and other stakeholders. You would have noticed that during the past 2 or 3 quarters, we have continuously enhanced the quality of our disclosures. We have also been focusing on more discussion on businesses which are growing and are more relevant in the current context to Edelweiss. We hope this would also enable you to understand and appreciate our diverse businesses and our long-term strategy in the true perspective.

With this, I would like to conclude and open the lines for questions. Thank you.

Moderator: Thank you very much sir. The first question is from the line of Pankaj Agarwal of Ambit Capital. Please go ahead.

Pankaj Agarwal: First of all I would like to thank you for improving disclosure levels. I believe this should set new standards in terms of disclosures for the industry and I hope that other listed players take a leaf out of it and improve their disclosure levels. So a good job from the management on this front. Coming to your broking business, it seems your client broking volumes are flat and market share is down from 2.4% to 2%. So any specific reason?

Rashesh Shah: It is basically due to options. What we track Pankaj is our commission market share because as you know our estimate of the institutional brokerage is about Rs. 3500 crores for the year and retail brokerage about Rs. 8,500 crores. This is the total market commission pool for our internal use. But they are estimates, so we do not give it in the investor presentation. To be honest, just look at average daily traded volume in the context of what is happening in options and all that, it is not true because ultimately what you want to look at is your commission market share and our commission market share is steady. We have not scaled up our options business significantly and hence you will see the fall and if the options volumes go up even further, you will see it falling even further.

Pankaj Agarwal: But if you see the broking volumes quarter-on-quarter, it seems they were up 21% on both the exchanges and even if you take lower yield on options volumes, still it seems that for the entire industry the broking revenue pool should have been up around 10% sequentially. So do you think the entire increase in volumes have come from proprietary trade for the entire industry?

Rashesh Shah: No, if we look at the cash and the futures volumes, by our estimate from quarter 2 to quarter 3, both have fallen as a percentage. The aggregate has gone up mainly because of options. Options have had a large increase in this quarter in that sense.

Pankaj Agarwal: But I believe that even if they are low yield product, still they carry some value. Even if they are yielding one or two bps still if you see the quantum of jump in options volumes, it still comes to topline of the brokers. So if all the top-listed players are losing market share because of options, then who is gaining market share? Where are these volumes going?

Rashesh Shah: Our estimate is that a lot of options trade is actually market making and automated trading. Anecdotally we know a lot of large international funds as well as brokerage houses have very large options trading business or lot of the intraday trading. Jobbing and all have also gone into options because of STT. So we also try to understand exactly the same question that you asked me, and anecdotally we are getting the understanding that a lot of this is automated trading, algorithmic trading, market making, and all of that.

Pankaj Agarwal: And coming into higher share of options volumes, do you think it is a structural change in the industry? If you see 5 years down the line, do you still see options volumes consisting of say around 57% of total volumes?

Rashesh Shah: Hard to say because it is governed by STT rules and liquidity in the market and all that. But as you know our markets are fairly active trading oriented. There are a lot of intraday jobbers, a lot of the day trading, jobbing, market making, automated trading, especially automated trading. The two key catalysts for options trading in the market have been automated trading, & algorithmic trading, and the STT structure for options. These are the two main reasons that options have actually become so prominent. I cannot see in the future what all changes will happen, but you should assume that the active trading, the futures and options will actually take away a lot of the active trading part of that.

Pankaj Agarwal: And coming back to commission rates, I believe the blended yield has come down because of higher options volumes, but are you seeing pressure in individual segments as well especially cash delivery?

Himanshu Kaji: Pankaj actually our blended yield has gone up from 4.25 to 4.30 bps because as Rashesh was mentioning that for the market as a whole, the major jump has come on options while our sequential growth has been by and large well distributed.

Pankaj Agarwal: No, my question was more from the industry perspective. Are you seeing pressure on cash delivery yields as well?

Rashesh Shah: I do not think any more. Cash yields have stabilized. They have actually stabilized for the last couple of quarters. The fall in blended yield you are seeing is mainly because of the composition of options vis-à-vis the others, but for cash delivery and futures I do not think there is yield pressure that at least we have seen for the last 3-4 months.

Pankaj Agarwal: And going forward even like 2 years, 3 years down the line, do you see pressure on cash delivery yields or do you think they have already come to developed market levels?

Rashesh Shah: Hard to say. The market will get segmented in multiple parts. There will be execution services kind of a market where maybe yields will fall, and these will be your direct market access and automated trading. Then there will be the part which will have more like mid caps block trading and there will be a third part which will be backed by your standard research coverage, corporate access and all the ancillary services that you provide. So hard to take a view, but we have seen some stabilizing of the yields now. The pressure is not on yields, the pressure is now on the growth in the market and on the cost.

Pankaj Agarwal: And coming to consolidation in the industry, do you see it happening anytime soon or do you foresee it is being segmented over next 5-10 years again?

Rashesh Shah: Consolidation may not happen on the wholesale side because you know one plus one will not be equal to two as each player has a certain amount of wallet share they can get from an institution. So one plus one may not become two on the wholesale side. On the retail side, we think consolidation will happen. The pain is starting to happen in the industry, but for consolidation to happen you also need consolidators and given the environment in the industry, we are the only ones who acquired Anagram in the last about a year. I haven't seen a lot of M&A activity, but on the retail side it should happen, you are right.

Pankaj Agarwal: And coming to the tax rate in this quarter, it was slightly higher around 34%. So any specific reason?

Rashesh Shah: All this goes from subsidiary to subsidiary. As you know, we have quite a few subsidiaries. Our insurance subsidiary is also now spending money, but obviously we cannot offset the insurance subsidiary operating burn with any other entity. So it is more of a consolidation issue and you will see a 3-4% swing in tax rate every quarter only because of entity reasons.

Pankaj Agarwal: Okay sir, thanks a lot.

Moderator: Thank you Mr. Agarwal. Our next question is from the line of Santosh Kamath of Franklin Templeton. Please go ahead.

Santosh Kamath: Rashesh, some information on the credit book. In the slide 20 you mentioned the minimum cover of 2.5x in the wholesale credit book. I think you did not mention the minimum cover in the retail book. Does it mean that you also hold some unsecured loans in the total credit book?

Rashesh Shah: No. On the retail side, because retail is a lot more LAS driven and margin funding driven, usually it is between 1.5 times to 2 times. But it also re-balances a lot faster. Wholesale is about a year, 18 months, 2-year kind of loans. Retail average is about 3 weeks or 4 weeks, but every retail loan is also at least 1.5 times to 2 times collateralized.

Santosh Kamath: So there are absolutely no unsecured retail loans?

Rashesh Shah: No unsecured loans. Even if the collateral falls and if there is a gap between the outstanding amount and the collateral, we take a view and if it is unrecoverable, we immediately add it to NPA and provide against that.

Santosh Kamath: Can you give me the breakup of the yield on the wholesale book and the retail book separately? You mentioned 16% yield.

Rashesh Shah: Wholesale is about 14 to 15 to 16. Retail changes because it is HNI driven. So it is anywhere between 11-12 to even 18% depending on client and other factors, but retail is hard to say.

Santosh Kamath: And you have to break the gross NPL again into wholesale and retail. Is there quite a different rate for both or kind of both on the same level of….

Rashesh Shah: To be honest with you, we actually have not broken it up that way. My guess would be these would be more or less same. We have not seen any extra stress on either portfolio.

Santosh Kamath: And one thing on the ALM, do you want to throw some light on the ALM of the entire credit book and the total borrowing of yours?

Rashesh Shah: Last quarter's borrowings, they are basically half under 3 months and half under within 3 months to a year. A large part of our credit book will be between 3 months to 18 months in terms of the remaining tenure on that, but we also have the treasury book and other assets which are even more short term. So if you add up equity and all that, we usually always have a reverse ALM problem - that is the average tenure of liabilities is higher than the average tenure on assets.

Santosh Kamath: On that comment, I need to ask something which we do not get to hear from a fixed income guy, but is there any chance of the equity buyback happening from the company to improve the capital structure?

Rashesh Shah: We would be actually very happy to consider that and we do debate that all the time. However, there is one regulatory constraint on the buyback. As per the rules, if you buyback you cannot have your gearing more in 2:1 for a year after the buyback and it just puts excess constraint on your holding company, the main company. It is only for that reason that we keep on evaluating it and then we are trying to find some structural answers to that.

Santosh Kamath: Thanks Rashesh, thanks a lot.

Moderator: Thank you Mr. Kamath. Our next question is from the line of Aashish Sharma of Enam Asset Management. Please go ahead.

Aashish Sharma: The question pertains to first of all on the loan book. You have given the consolidated borrowings at Rs. 5390 crores. If we have to actually value the financing book separately, can we know how much loan borrowings is for the NBFC book sir?

Rashesh Shah: See our credit book is about 60% of our total capital assets and the rest 40% is treasury book and you can split it in the same way. For us everything is fungible because we do not really do back-to-back splitting in that sense.

Aashish Sharma: So 60% of the total debt is pertaining to NBFC book?

Rashesh Shah: Yes it would be approximately that.

Aashish Sharma: And what guidance you are giving for the loan book now? There was a good traction in loan book in the preceding two quarters, this tapered off in this quarter. What is the guidance for 2012 sir?

Rashesh Shah: I would want to refrain from giving any guidance on that, but as I said we are growth oriented. We will look at opportunities, but as with any conservative credit institution, if the environment for liquidity and/or risk is not very positive, then you don't just go and pursue growth for the sake of pursuing growth. The current environment is uncertain because of all the liquidity, interest rate and other issues that you are seeing. We do have internal targets, but I would refrain from giving it outside.

Aashish Sharma: You have given a split for the interest income for Q3; can you give it for 9 months sir?

Rashesh Shah: Interest on credit book for 9M FY11 is Rs. 396 crores.

Aashish Sharma: And going forward, just wanted your sense on your plans for insurance and I think one of the media reports also mentioned that we are interested in getting a banking license, any updates or any plans as of now?

Rashesh Shah: Actually no comment on that. As you know RBI said that they will come out with the guidelines for the banking industry. As and when the guidelines come, everybody in the business is going to study it and see whether it does present an opportunity or not. So that is the only comment I can make.

On the insurance, we have got the R1 approval and we are now going towards getting R2 and R3. The usual timeframe from R1 to starting the business is about 6 to 7 months. So we expect to start the business around August or so subject to final approvals.

Aashish Sharma: And what will be the capital requirements in initial 2 years?

Rashesh Shah: We will capitalize it with approximately Rs. 500 odd crores which will come from us and our partner in a predetermined split and they will put in more if the 49% approval comes in.

Aashish Sharma: That 500 crores will be for the initial 2 or 3 years I could assume?

Rashesh Shah: Yes, it should be good for 2 to 3 years according to us.

Aashish Sharma: Okay sir and all the best for the next quarter sir. Thank you.

Moderator: Thank you Mr. Sharma. Our next question is from the line of Shubhankar Ojha of SKS Capital. Please go ahead.

Shubhankar Ojha: Are we happy with our current level of ROE because I think the ROE has been depressed. If we look at your presentation and look at the last 10-year ROE numbers that you presented, last 6 or 7 years it used to be about in the region of 30% till 2008 and the last 3 years, it is hovered around 10%. So I am just wondering what is the management comment or vision or view on the ROE number going forward?

Rashesh Shah: ROEs are a function of your gearing of the balance sheet as well as the proportion of agency businesses which, as you know, are very high ROE oriented. We obviously are very keen to pump up the ROE, but there are two issues that currently are there. One is that in the last couple of years, the industry has been on an investment phase. Everybody in the industry has been diversifying and investing into new businesses. At the same time, the existing business segments are not growing and the margin pressure has been there as we have spoken and it has been like that in the last couple of years. There is a cyclical trend in the industry. It is unfortunate that the investment phase and the cyclical phase have coincided in the last 2 or 3 years.

We can also look at ROE from a relative sense point of view as well as from an absolute point of view. From a relative point of view, given all the investments that we are making and all the investments that Himanshu spoke about into infrastructure, into brand building, into retail businesses and all, we do not feel very uncomfortable, but we hope that relative to itself the base moves up. On an absolute basis, obviously nobody would be happy with the current level of ROE and we constantly want to invest into our agency businesses, mainly on the broking side, and on the asset management side, to scale up ROE. We also want to up our gearing, because as you know today we are geared only 2:1. Our equity base is about approximately Rs.2500 crores and our total asset base is about Rs. 7500 crores. So it is hard to really scale up ROEs with a gearing of only 2:1. As we scale up gearing and focus on the credit business side as well as we invest and scale up our agency businesses, the RoE should improve. As you would have seen from last year to this year, our fee and commission growth has been fairly interesting and we continue to grow in that and invest in that. In the next 3-4 quarters as the margin pressure, the cost pressure as well as the absence of growth for the agency businesses start to go away, we will hopefully start seeing upside on that.

Shubhankar Ojha: So what would be your number that we would target let us say over a 5-year period because one as you said it is function of the leverage, but even without the leverage even if we look at zero leverage situation, a company, typically a stable mature company, should be earning higher RoEs than what you have at present. Would you agree with that or no?

Rashesh Shah: I would not entirely agree because ROE varies from industry to industry as well as on what stage of the investment cycle you are. If you compare with a very steady state mature company that is not making investment, you are an analyst and you would have seen quite a few such companies, the RoEs could be higher. But companies do go through a phase of investing where their current ROEs may remain depressed because they are investing for the future of the business. Unfortunately in our industry, as I said, the investment cycle as well as the industry cycle have both coincided at the same time and we strongly feel that it is a good time to invest. There is some short-term pain, but if you do believe the India story, and if you think of the business over the next 5-10 years, things would improve. We are making investments in a calibrated manner, in a considered manner, and we are confident that a lot of this investments will come through and bear fruit in the future.

Shubhankar Ojha: And the second question I had was regarding the business of ECL Finance, the promoter funding etc. that you do. I was a bit confused about or rather wanted to clarify the manner in which we do it because on the face of it, we seem to be taking on a lot of these positions in our books. What I understand about the LAS business is that you typically pledge the share and you would give them a certain loan to value on the shares. But as we see a lot of deals that have got reported amongst the bulk deals and even if we look at your ECL's holdings in various companies, you have significant stakes in lot of these companies which are in your books. So can you explain that model to me how does it all get reversed, how do you handle which is apparently on behalf of the promoters, but how do you take it on your books? Do you have a back-to-back agreement with them to sell it back to them, how do you realize the profits and losses on those transactions?

Rashesh Shah: No, let me say that your understanding and information is not correct.....

Shubhankar Ojha: I am talking about the companies like Great Offshore you had as per Bloomberg, you have 48 million shares in K S Oils as you have reported holding in ECL Finance?

Rashesh Shah: I would refrain from speaking about any individual credit because it would not be fair….

Shubhankar Ojha: Koutons Retail or Era Infra etc.?

Rashesh Shah: I think there may be a slight misconception between what is pledge and what is on the books. In the promoter funding book or what we call the secured credit book, a pledge that is usually reported in the press is a pledge, it is not ownership of shares. But when you take the pledge as collateral as per Indian rules, you also have to report that. So I would strongly recommend you may be speak to Shailendra at length to understand how this business works.

Shubhankar Ojha: No I do understand this main business and the difference between the pledge and what exactly I am talking about. I am talking about when a share is pledged, if company is pledging their shares to ECL Finance, it would not change the shareholding pattern of the company whereas if the shares are being transferred to your DP, then the shareholding pattern of that company would change and that would reflect in Bloomberg or all these research media that we have access to. In fact I have Bloomberg in front of me right now and I am seeing. I do not think Bloomberg would confuse between the pledge and the actual holding in your……

Rashesh Shah: Only thing I can assure you in most of the examples you have given, they are all pledge, they are all collaterals. Sometimes we do move collateral to our own account for liquidity reasons or other reasons, but we do not have a principal position in the shares.

Shubhankar Ojha: That is all I wanted to clarify.

Moderator: Thank you Mr. Ojha. Our next question is from the line of Hiren Dasani of Goldman Sachs. Please go ahead.

Hiren Dasani: How would your cost of funds have moved during the quarter?

Rashesh Shah: In the earlier quarter it was close to 8.5 which has currently become 9.4%.

Hiren Dasani: 9.4% in the December quarter is it right?

Rashesh Shah: Yes, approximately 80-90 basis points increase in cost of funds.

Hiren Dasani: Do you increase the rates for your existing borrowers also?

Rashesh Shah: Almost all the credit book we have is on a floating rate. So if the cost of fund goes up, we do increase it on the credit side also. We try to maintain the spread and the spread has been the same in this quarter as it was in the earlier quarter.

Hiren Dasani: And so these are longer dated loans, but not on a fixed rate basis right?

Rashesh Shah: You are right, it is on a floating rate basis.

Hiren Dasani: And secondly the asset management fees, thanks for the additional disclosure in the fee side, this gives a greater granularity now. So the asset management fees, what is the source of the variation on a quarter-on-quarter basis. I think in the June quarter, it was almost 14 crores and now it has gone to 27 crores. So have we raised additional funds or how is it?

Himanshu Kaji: It is actually asset management fees and other fees. The other fees also have a retail syndication component which varies from quarter-to-quarter based on what IPOs we have distributed.

Hiren Dasani: So all the distribution related income will also get booked under this line?

Himanshu Kaji: Yes.

Hiren Dasani: Your increase in the operating cost on a QoQ basis from let us say Rs. 91-92 crores to Rs. 105 crores, is it largely attributable to the full quarter impact of the Anagram or is there anything else?

Himanshu Kaji: Partially that and actually we have also spent some more money on brand building compared to last quarter. We had also executed MOIL IPO, so there is some cost associated with that because we were the BRLM**.** So those are one-offs.

Hiren Dasani: And considering that rule about the buyback, is it fair to assume that it is kind of ruled out for us because of our even existing gearing is more than two times?

Rashesh Shah: No, I think it applies to the holding company. As you know, usually there is a rule of 2:1 for a normal manufacturing company, but it obviously is a problem for banks and NBFCs because of their gearing more than 2. But you can do it at a holding company if all the borrowings you do is at a subsidiary company level. So we are evaluating, but as I said even if you want to buy back for NBFCs, not just alone, all NBFCs will find it not very easy to buy back if you have a significant enough credit business also.

Hiren Dasani: Just wondering one of your listed competitors has just announced it started the buyback very recently. Are there any other restrictions also in the business side which can come if you announce the buyback?

Rashesh Shah: No, I think the gearing is the only restriction that is there.

Hiren Dasani: Okay great, thank you.

Moderator: Thank you Mr. Dasani. The next question is from the line of Viraj Gandhi of ICICI Securities. Please go ahead.

Viraj Gandhi: I just wanted to clarify on the interest income front, if you can just give me the break-up of interest from our loan book and from FD because there is a great jump here in this quarter on sequential basis while our book has gone down by around 200 odd crores on Q-on-Q.

Rashesh Shah: You are seeing the interest income increase also because of the episodic IPO funding interest income.

Viraj Gandhi: Could you please explain how income of 238 odd crores is broken up?

Rashesh Shah: Our interest income has three components, there is a loan book, there is a working capital interest, and there is episodic as Himanshu had enumerated in his presentation. We have had some IPO funding opportunities in this quarter - Coal India, Power Grid, and MOIL. So what you are seeing is a combination of all three in the interest income. The interest on steady state book and episodic book is Rs. 184 crore for the third quarter.

Viraj Gandhi: Can you just let you know our gross yield on the episodic book?

Rashesh Shah: We are not splitting it across three books in terms of that.

Viraj Gandhi: Rise in interest cost for this quarter – is it because you will be borrowing debt amount for episodic funding?

Rashesh Shah: As you have seen, our interest cost has gone up from Rs. 121 to 175 crores. Our overall credit book is the same. So you should assume that the increase in interest cost is mainly for episodic reasons.

Viraj Gandhi: And sir what kind of NIMs are we comfortable with on our loan book because now that we are trying the yields to be stable as good as any other financial institution. So what kind of NIMs should we look forward to in this business line?

Himanshu Kaji: As far as NIMs are concerned, we look at both gross yields and also the cost of borrowing separately. We want to see that our gross yields are generally steady. You would have seen it over last 2 or 3 quarters, gross yields by and large have remained steady and also our cost of borrowing, difference being in the NIMs which is fine. Actually it has been quite steady over a period of 2-3 quarters.

Viraj Gandhi: And sir one final question. We are seeing some pressure in increasing our market share because of the rising options volume. What is that one segment that as a group you are targeting to take our top-line growth in the coming 2, 3, or 4 years because options volumes are not expected to come down so significantly and cash volume segment is sluggish at this point of time. So another line item which you as a company as a strategy will be looking forward to as a growth engine for the coming 2 or 3 years?

Rashesh Shah: We have quite a few things that we are trying, but it will be unfair to disclose it at the moment. Whatever we are doing, we will achieve it and then we will disclose it.

Viraj Gandhi: Okay thank you sir.

Moderator: Thank you Mr. Gandhi. Our next question is from the line of Nischint Chawathe of Kotak. Please go ahead.

Nischint Chawathe: Thanks a lot for giving additional disclosures. Did you somewhere mention in the discussion that cash market volumes for Edelweiss have come down to around 10% on quarter-on-quarter basis?

Rashesh Shah: No actually the market cash volume has come down by 10%. For us it has been constant.

Nischint Chawathe: So what you are saying is you broadly moved in line with the market and in terms of growing the NBFC book, what are the primary constraints at this point of time, is it just liquidity from an ALM perspective or you believe that the current scenario will kind of result in some kind of NPLs in the system as such?

Rashesh Shah: I do not think there is any constraint as such. Your ability to originate good quality credit, and process it so that the risk return is also commensurate is the main one and we are just currently looking at the environment. There is a healthy pipeline. What I was trying to say earlier is that our approach is that we do not want to just grow the book for the sake of growing it. We will keep in mind the risk and liquidity conditions and evaluate it only accordingly.

Nischint Chawathe: Okay this is more liquidity from managing ALM?

Rashesh Shah: We expect liquidity to be tight for the next 2-3 months. So you do not want to grow very fast because any extra liquidity you want to have will always be at a premium. You want to keep some dry powder on your hands. From a liquidity point of view as well as from the risk point of view, we are always constantly evaluating and then scaling up the book accordingly.

Nischint Chawathe: And finally if you can just share some thoughts on the housing finance business and some plans - how do you plan to approach the business and at what yields, etc.?

Rashesh Shah: Housing finance is an interesting business. Our estimate is that there is going to be Rs. 200,000 crores of disbursements on housing finance in the current year and it will grow by about 20% a year for the next 4 to 5 years. If we take the next even 4 years, almost 10 lakh crores of housing finance loans are going to be disbursed. There are various market segments that are there in the housing finance business and we have identified a few market segments where we as a non-bank can have some competitive advantage in origination terms and processing terms because, as you know, origination cost is also a significant cost in housing finance business. Given that we have a retail business, and we do have some presence on the ground, we have worked out a strategy and our aspiration is to build a Rs. 4000-5000 crore book in the next 3 to 4 years. So given the size of the market, and a couple of segments that we have identified, we do think that there is good exciting business in that segment.

Also in housing finance, a lot of people say your NIMs are smaller than what they are for your wholesale credit business. But you should remember that the average tenure of the wholesale credit loan is between 18 months to 24 months while the average tenure on the housing finance loan is between 5 to 7 years. So on a wholesale finance even if you make 4 to 5 percent NIM while on the housing finance let us say you make between 2.5 to 3 percent NIM, if you calculate it on that basis and take some view, it is a fairly exciting business. But as with every credit business you have to be careful in how you scale up the business, what your credit underwriting policies are and we are cognizant of that.

Nischint Chawathe: When it comes to approaching the business, are you kind of trying to build the business more as a niche housing finance business or being kind of a more providing home equity kind of products or what is the broad thinking on that front?

Rashesh Shah: We are starting the business. Our product strategy or our customer segment strategy is not something that I would like to disclose on the call and you ideally want to speak about them after you have achieved that kind of growth.

Nischint Chawathe: Thank you very much.

Moderator: Thank you Mr. Chawathe. Ladies and gentlemen that was the last question and I will now hand the conference over to Mr. Shailendra Maru to add closing comments.

Shailendra Maru: Thank you Rashesh, Himanshu, and Rochelle. Thank you everyone for joining the call. In case you have any other questions, please feel free to contact us directly or drop me an email at shailendra.maru@edelcap.com. Have great day ahead. Thank you so much.

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