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Conference Call Transcript

Edelweiss Capital

FY10 Results

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Corporate Participants

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Chief Financial Officer

Shailendra Maru
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Moderator: Ladies and gentlemen, good day and welcome to the Edelweiss Capital FY10 Earnings Conference Call. At this time, I would like to hand the proceedings over to Mr. Shailendra Maru of Edelweiss Capitals. Over to you Mr. Maru.

Shailendra Maru: Thank you Rochelle. I am Shailendra Maru, Head of Investor Relations at Edelweiss Capital Limited. Good afternoon to all of you and thank you everyone for joining us today, as we discuss Edelweiss's audited consolidated financial results for the financial year 2010. Speaking today with you are Rashesh Shah, our Chairman and Deepak Mittal, the CFO. We also have with us today Himanshu Kaji who will be introduced to you by Rashesh. Following the reading of safe harbor provision, I will first turnover the call to Chairman Rashesh for his opening remarks. Thereafter, Deepak will take you through an overview of our performance and financial model. Then, we will open the lines for the Q&A.

The press release and an investor presentation on our FY10 results are available on our website www.edelcap.com.

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Rashesh Shah: Thank you Shailendra and thanks to all of you for coming on this conference call. I am sure everybody has had a chance to go through the results that we announced on Friday. Before we start on the details of the quarterly and the annual performance, I just want to make an announcement about a key management change in our team out here. Deepak Mittal, our CFO, whom all of you know, is now going to take responsibility of our life insurance JV with Tokio Marine. He will go there as the CEO and Himanshu Kaji, who is our currently our COO, will also take on additional responsibilities to be the CFO. So from first of June, Himanshu will be acting as the CFO.

Now to give you the highlights for FY2010 consolidated results, we have recorded total revenues of Rs. 978 crores which is a 9% growth on a YoY basis. Our fee and commission is Rs. 350 crores versus Rs. 244 crores for the last year which is a growth of 44% on a YoY basis. Our interest income for this year is Rs. 339 crore versus Rs. 331 crore, which is a small growth over last year. Our profit after tax comes out to Rs. 229 crores which is a 23% growth YoY and our EPS is Rs. 29.37 and, as you would have seen, we have been able to keep the profit before tax margins at 34% for the year. We always aim to be around 35% plus or minus a few percentage points and we have been able to maintain that. For the Q4, we have the total revenues of Rs. 262 crores and profit after tax of about Rs. 52 crores.

The Board has recommended a final dividend of Rs. 3 per share. As you may know, we had given interim dividend of Rs. 2 earlier. So our annual ordinary dividend for the year works out to Rs. 5. In addition to this, as the company is completing its 15^{th} year of existence, the Board has also recommended a special dividend of Rs. 5 for this year. So after the approval at the AGM, we will be disbursing the final and the special dividend.

My colleague Deepak Mittal will take you through the financial results for the quarter and the year in a lot more color, but I will just highlight the environment and the highlights for the year for us.

Overall, the environment is good and bad. I think internationally it is bad and as you look at India's specific view, it looks good. Even within the India's specific view, what we saw in the current year was that the first half was very good, very optimistic. Second half, partly due to the international cues, has been subdued. FII flows have been good, but they are also slowing down significantly. Indian institutional flows from insurance companies have become a lot more important in the current year. As all of you would have seen, suddenly market volumes have been good this year, but if you analyze it a bit more, all the growth has been via options. So if you look at the cash equities as well as the futures, there has not been a huge amount of growth and as the commission rates for options are very low, we have seen that in this year, especially the last 3 quarters, the commission pool, whether it is for retail broking or for institutional broking, has not grown. In the environment we are seeing good traction in credit businesses and bond businesses because with ample liquidity and the short-term rates being low, credit businesses and bond businesses have started doing well.

Broadly speaking for Edelweiss, we continued with the same approach that we have had for the couple of years now. We are investing in growth areas and also strengthening our existing areas. It has been overall a good year for the agency businesses, the client facing businesses; for example, investment banking has had a good year. In investment banking, we did 33 transactions for the year. For the last year, which is FY09, we had done only 9 transactions. So it is a fairly big scale up and especially for ECM and debt capital markets. The 33 deals are across ECM, M&A, debt capital markets, advisory.

We did about 11 QIPs in the year which is fairly good because QIP was the flavor of the year and along with that, we also did some fairly path-breaking deals which are very high profile ones like we were in the NMDC IPO and we also did one of the largest private equity transactions in India. We raised almost Rs. 1000 crores for Coffee Day Resorts from 3 large private equity investors. Rs. 1000 crores private equity transaction is a fairly large one in the Indian context.

On the broking side, it has been a good year. We have maintained clients' volumes and we have been able to maintain the market share also overall. Our treasury volumes have been lower as this business has been very subdued for the year. The only one part of our business which has not had a good year was the treasury because yields continue to come down. In fact, we started the year with treasury yields of close to 20% at a gross level and 14% at net level. Every quarter we have seen between 200 to 300 basis points fall in yield, and for Q4 the yields were about 11.3% and 7.4% gross and net. We started the year with Rs. 2000 crores book and we have ended the treasury book at only about Rs. 1100 crores or so. So yields have fallen and we have scaled down the book. On an average, total daily trading volumes were Rs. 4314 crores for the year and the client volumes were about Rs. 1650 crores.

All through the year, the client volumes have been fairly stable. It is the treasury volumes that have come down. For Q4 also the client volumes are close to Rs. 1650 crore, but our total ADT for Q4 is under Rs. 4000 crores.

In Institutional Equities, we have had a good year. We still maintained what according to us is the slightly higher than 5% commission share of the industry and, as you know, the IE commission pool has not grown. We have inched up our market share a little bit and we have ended the year as a whole at 5% odd commission share in the institutional equities business by our estimates. Our IPOs syndication business has also had a good year. We are now ranked second in the HNI category and fourth in the retail category across all the IPOs through the year.

Our alternative asset management business continues to start new products. In the last quarter, we had launched Edelweiss Special Opportunities fund and currently we manage close to about Rs. 1000 crores of AUMs/AUAs across the funds we have. Our credit business also had a good year. If you remember, we started the year with size of the book of Rs. 630 crores which we have ended the year at Rs. 1837 crores, so we almost have increased the book 3 times in the year. Actually in the first quarter of the year, the book had gone all the way down to Rs. 400 crores. So we have been able to scale up the book and we have also broad based the products within this book. The current Rs. 1800 odd crore book that we have has promoter funding, corporate loans, margin funding and NCD collateral backed loans. We did also ESOP financing for quite a few companies. So there is a huge expansion in the product range and along with that, we have been able to scale up the book. In the new year, we are going to add SME financing and housing finance also in the credit part of our business.

The final part of our income is the interest on FDs in the bank that we have because we maintained around Rs. 1500 odd crores for the working capital for our brokerage business and other needs. The FD yields have been falling because we have FDs which were issued about a year to 18 months to 2 years ago. For the last about 5 or 6 months as FDs have got repriced, we have been seeing yield falling in that also and there is a little bit of fall in yields still remaining, that is some of the earlier higher interest bearing FDs will still get repriced this year.

Our operating costs have been under control. Since we are in the investment mode and we are investing in 3 or 4 areas, we have ensured that the operating costs continue to be under control. Our operating plus employee costs have increased about 4% on a YoY basis. Overall if we see in the first half of last year (FY09), the costs were high and then we scaled them down especially as the crisis got under way globally. So in the last year, the first half operating and employee costs were higher and they fell in the second half. In the current year (FY10) exactly opposite has happened. In the first half, we started off with slightly more controlled Opex and employee costs and we have been scaling them up from the third quarter and the fourth quarter onwards. So if you see it on an annual basis, it looks almost as if we have been flat on operating cost and employee cost.

In this year we released a thematic report India 2020. Here, what we have tried to do is to try and see what India will be like in the year 2020, how will the economy look like, what will be the savings rate, how various industries will grow and so on. We studied about 5 or 6 countries around the world which have gone through the same evolutionary phase as India and we have made our estimates and this report has been a fairly interesting one. There is a strong response to the report and we continue to invest a part of our research capability into thematic report. A few years ago we had done our infrastructure report, if you recall. India 2020 is what we consider a highlight for the year.

Other things which we are scaling up are our organic retail broking in the online side www.edelweiss.in. We have now close to 48,000 customers in that and we continue to add between 4 to 5 thousand customers in the organic retail broking business.

Our Anagram acquisition is going as per schedule, integration is going on. We are awaiting statutory approvals from SEBI and exchanges which should come in the coming couple of weeks and we are expecting that this quarter onwards, which is first quarter of the year FY11, we will be integrating Anagram. All our fourth quarter numbers are without Anagram as of now.

For the insurance, our R1 application has gone to IRDA. We are awaiting approval on that and the process is going smoothly. There is a 30 men project team on that which we are now scaling up and getting ready to launch the business hopefully after 3 quarters. We recently got an approval for housing finance from NHB and we will be starting housing finance soon. Our distress assets business has also been scaling up and we have strengthened the team. We continue to see quite a bit of interest in commodities - bullion and fixed income though these asset classes are much smaller than what equity is as of now, but we are seeing good growth rates in all these asset classes. We are investing in retail, we are investing in asset management, we are investing in our HNI wealth management business, but at the same time we are keeping a strong eye on costs and ensuring that we do not get too carried away with costs.

I will now hand over to my colleague Deepak for the update on the financial and other operating parameters.

Deepak Mittal: Thanks Rashesh. Thanks everyone for joining us on the call. I also welcome Himanshu as our next CFO. I guess most of you would have gone through our fourth quarter numbers and the full year numbers and also through the presentation which we have circulated. So what I will do is that I will briefly touch upon the numbers, but will spend more time giving some of the data which all of you track and also share some of the business overview we have. Some of this may overlap with what Rashesh has already covered.

Very quickly, if I look at the fourth quarter, the key takeaways, first is very strong uptake in fee and commission revenues while broking has been reasonably stable, but we have had a very strong quarter for the investment banking business which had 17 transaction closures in this particular quarter. We continued to scale up our financing book and this is reflected in the growth in the interest income, and, as Rashesh also covered, there has been a drag on arbitrage and deposit yield which continue to be very low given the liquidity and the market environment. This has in fact impacted our income from the treasury assets. Overall, if you look at the results what it clearly shows is our ability to invest in growth of new business initiatives and at the same time continue to get growth in our existing large businesses.

Looking at the numbers for the full year, our total revenues were INR 978 crores, up from Rs. 900 crores for the last year. Profit after tax for the year was Rs. 229 crores, up from Rs. 186 crores last year and diluted EPS of Rs. 29.37 per share, up from Rs. 24.28 for the last year. Our total operating cost for the year, and in this I include both the operating expenses as well as the employee compensation, was Rs. 438 crores for the year compared to Rs. 420 crores for the last year. That marks an increase of 4% YoY. However, the interest costs went up from Rs. 135 crores to Rs. 194 crores for the year. We have maintained profit before tax margins of 34% and PAT margin of 23% for the year.

Coming to some of the segmental revenue highlights for the quarter, our fee and commission income has gone up to Rs. 117 crores, which is up from Rs. 86 crores in the third quarter. For the full year, the fee and commission income has gone up to Rs. 350 crores from Rs. 244 crores for the previous year. The broking income was stable across the four quarters and was Rs. 56 crores for this quarter. And it was Rs. 215 crores for the full year, which for the last year was Rs. 170 crores. The fee income other than the broking income, which includes investment banking, asset management, and other fee income, was Rs. 61 crores for the quarter, up from Rs. 31 crores for the last quarter and for the full year was Rs. 135 crores, up from Rs. 74 crores for the last full year. The income from treasury operations for the quarter was Rs. 34 crores on an overall book of Rs. 1200 crores, and for the third quarter the same number was Rs. 61 crores and the book size was around Rs. 1700 crores. Also this quarter saw some amount of allocation away from the equities arbitrage to fixed income and commodities and part of the income reflection on treasury book would also have been on the interest income line. The income from the treasury operations for the entire year was Rs. 246 crores on a book size of about Rs. 1600 crores.

If you look at this particular quarter, the gross yield on the treasury assets was around 11.3% on an annualized basis and the net was around 7.4%. For the full year, the same numbers were 15.3% for gross and 10% for the net returns. The interest income for the quarter was Rs. 108 crores; the last quarter number was Rs. 74 crores. The interest income includes both interest on loans as well as on our working capital assets which include bank FDs and other debt instruments. For this quarter out of the Rs. 108 crores of income, Rs. 58 crores of interest income was on what we call the steady state loan book which averaged for the quarter at Rs. 1475 crores implying a gross yield of 15.7%. Last quarter, the average loan book size was around Rs. 800 crores. So we have almost doubled the book on a quarter-on-quarter basis.

The interest income on the working capital assets for the quarter was Rs. 46 crores on an average book size of Rs. 2300 crores implying a yield of 8.04% and in addition to this, there was Rs. 4 crores interest income on episodic lending. For the entire year, the interest income was Rs. 339 crores versus Rs. 331 crores for the last year.

Some other data points which some of you normally track, in investment banking we have 17 closures in this quarter and 33 for the year. These include M&A advisory, private equity syndication, equity capital markets, and debt capital markets. Some of the key deals closed this year include QIPs for Allied Digital, Development Credit Bank, Bajaj Electricals, Usha Martin, and Karnataka Bank, IPOs of Man Infra and United Bank of India, FPO of NMDC, which was the third largest public market offering in India, private equity placement of almost $200 million for Coffee Day Resorts and sale of Excel Telecom on the M&A advisory side.

We also now have a strong presence across corporate debt and bond markets. Some of the key transactions which we did included a syndicated term loan for Bhoruka Power, a project finance loan for Jal Power Corporation and we were joint arranger for bond issues for large clients like Steel Authority, YES Bank, REC, PFC, Power Grid, State Bank.

Overall, on the ECM market, we were ranked number two in QIPs by number of transactions and overall third in the ECM space (QIPs+IPOs/FPOs+Rights) again by number of transactions as per Prime Database.

Now coming back to some of the data points on the brokerage business. On the client segment, our average daily trading volumes were Rs. 1647 crores and the broking yields for the fourth quarter were 5.67 basis points and for the full year 5.5 basis points. Our total ADT for the full year was Rs. 4314 crores which gives us an overall market share of 4.54%.

As Rashesh has covered, the treasury part of average daily volume was much lower in the fourth quarter out of the overall ADT of Rs. 3913 crores. As Rashesh has also covered, there has been certain amount of shrinking on the commission space because of sharp increase in option volume.

Coming to the research side, we are now covering 170 stocks across 18 sectors and we have released a marquee report "India 2020" which has got a strong positive response across both corporates and investors as well as from policy makers.

The year ending steady state loan book size was Rs. 1837 crores as compared to Rs. 1033 crores at the end of the previous quarter. Our total balance sheet size was Rs. 5184 crores, out of which our total equity net of minority was Rs. 2257 crores, while our borrowings were Rs. 2714 crores. Average cost of borrowing for the quarter was around 7.3%.

Just to cover some of the other key business updates, we now have almost 48,000 retail clients, this is on our organic Edelweiss broking platform and we continue to add 4 to 5 thousand clients per month. On the IPO syndication side, we ended the year ranked number two on the HNI category and fourth on the retail category by amount mobilized in IPOs. On the alternative asset management side our total assets under management or advice are almost Rs. 1000 crores. On the domestic asset management side, we have 4 equities and 6 debt schemes. We expect to finish acquisition of Anagram and get all regulatory approvals in another 2 or 3 weeks. We submitted our R1 application for the insurance joint venture and also got approval from National Housing Bank on Edelweiss Housing Finance which will start forming an important part of our credit business. With this, I would like to conclude the opening remarks and open the lines for Q&A.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from the line of Pankaj Agarwal of Execution Noble. Please go ahead.

Pankaj Agarwal: How is this Rs. 51 billion of your balance sheet distributed on asset side?

Deepak Mittal: On the assets side roughly around Rs. 1100 crores will be on the treasury asset side at the end of the quarter, Rs. 1837 crores will be the loan book, and working capital assets were around Rs. 2000 crores. The corporate and fixed assets will be another 250 crores.

Pankaj Agarwal: And your recent property transaction of Rs. 410 crores. How it is going to impact your profit and loss account and balance sheet?

Rashesh Shah: Broadly, I think it will be neutral because of whatever is the lease rent we are currently paying. The property is about 240,000 square feet and we are currently using about 100,000 or so square feet in 3 offices in Mumbai, Indiabulls, Express Tower and Sion. Out of this Rs. 400 crores our equity contribution may be Rs. 50-60 crores and the balance we will borrow. So whatever is the cost of capital, it will be equal to the lease rental that we are currently paying. It will almost be neutral from that point of view, and what is currently lease rental costs will get converted to interest costs, but we will own the property. The other half we may lease out and it can be used for future growth after 3-4 years, so half will be used by us and half could be leased out.

Pankaj Agarwal: But it is in FY11 that you will be paying both interest as well as your lease rentals right because it will take at least some time to move to the new property?

Rashesh Shah: Yes, there will be a 3-4 months overlap.

Pankaj Agarwal: Okay and coming back to your financing portfolio, how much of this Rs. 18 billion is promoter financing?

Rashesh Shah: Approximately about Rs. 1000 crores is promoter funding, margin funding is another Rs. 250 crores, all these are approximate numbers because they change every day, another Rs. 250 odd crores will be the corporate loans, then we have ESOP funding and others.

Pankaj Agarwal: How big is this promoter financing market?

Rashesh Shah: It keeps on varying and the average tenure for this market is also only about 18 months or 3 years in that range and there is on-shore market and there is an offshore market also. So if I do not count the offshore market, the onshore promoter funding size is about Rs. 25,000 crores or so.

Pankaj Agarwal: So do you have any targeted market share in this segment?

Rashesh Shah: No, because we have seen in credit businesses aiming for market share, as we have seen globally also what happened in the last two years, isn't a good idea. So our approach has been as long as risk return is good, it is a good quality credit, good quality collateral, and we are comfortable with the counter party, then we will do it whether we have 3% market share or 4% market share or half a percent market share, we do not care about that.

Pankaj Agarwal: Have you seen any NPAs on this book in this year?

Rashesh Shah: No, there haven't been any NPAs. In fact, our average collateral cover has fluctuated between 2.5 times to 3 times. So for every Rs. 100 crores loan the collateral value we have whether through up market, down market, has been between 2.5 times to 3 times of that.

Pankaj Agarwal: Okay and there was a jump in your operating expenses on quarter-on-quarter basis. So both employee cost and operating and other expenses were up on Q-on-Q basis, is this a new run rate or some one time items in this quarter?

Deepak Mittal: Partly half and half; some of it is definitely increasing cost as we are continuing to build new businesses. Also, fourth quarter had overall reasonably high level of business activity more so in the agency businesses. So if I were to look at it, may be half and half.

Pankaj Agarwal: Okay, great, thanks a lot.

Moderator: Thank you Mr. Agarwal. Our next question is from the line of Manish Shukla of Deutsche Bank. Please go ahead.

Manish Shukla: My question is on life insurance. Now you are trying to venture into life insurance at this stage when the growth outlook for the industry has clearly taken a beating plus there are a lot of regulatory headwinds there, so just wanted to understand your thought process behind venturing into life insurance at this stage?

Rashesh Shah: Our approach in all this is that these are 8-10 years kind of horizon businesses. So even if they are short-term headwinds, and in fact our experience in the past has been, though they are not always true so I must was qualify that, our experience has been that you start businesses when there is uncertainty, when there are structural changes going on in the industry, as long as on a long-term basis you are fairly optimistic about the industry. We think in India given the way household savings are growing, the way investment especially household savings are being channelized into long-term investments, insurance will be a very critical product in that and for us, we see insurance as adjacent to capital market and large part of the business is also asset management in that sense. So we have to be in that business if we take an 8 - 10 year view on our industry. Short-term headwinds are there in every industry.

Manish Shukla: But structurally, would you agree that the industry has moved to growth rate more in the range of 12 to 15% from what we have been seeing for a long time?

Rashesh Shah: Our estimate of growth rate is about 18 to 20% and given the size that India is and the GDP growth rate that we expect, we think 18-20% is not something we consider very aggressive. So even at 18-20% growth rate, this is an exciting kind of market.

Manish Shukla: What is your estimate of the capital contribution required over the next 2 to 3 years from Edelweiss for the venture?

Rashesh Shah: For the first about 5 years, we are estimating that Edelweiss will invest close to about Rs. 100 odd crores every year. We expect about between Rs. 500 to 600 crores over the first 5 years starting one year from now because we will start the business only 3 quarters from now.

Manish Shukla: Thank you. Those were my questions.

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

Viraj Gandhi: Just wanted to clarify on a few data points. First thing is that if you take average daily turnover of less than Rs. 4000 crores for this quarter, the average for the full year comes out to be around 4250 which according to us is around 4350.

Deepak Mittal: The average daily volume for the year is Rs. 4314 crores.

Viraj Gandhi: What is the exact average daily turnover for the last quarter?

Deepak Mittal: For this quarter it is Rs. 3913 crores. For the last quarter it was Rs. 4700 crores. The number of trading days varies from quarter to quarter.

Viraj Gandhi: If we back-calculate as far as our yields are concerned, then it will turn out to be around 5.1 basis points. I think the brokerage income out of Rs. 117 crores is around Rs. 52 crores for the fourth quarter?

Rashesh Shah: For the fourth quarter it is closer to Rs. 56 crores and the yield is coming to 5.67 basis points.

Viraj Gandhi: We are targeting a higher growth rate from our financing income now where we are trying to scale up our loan book from 1800 odd crores to around 2500 to 2700 by the next couple of years. I just wanted to know broadly how are we going to fund this - will it be from the cash that we are holding or will it be from the borrowing side only because the interest expenses have gone significantly in this quarter?

Rashesh Shah: We are not making any forward looking statements in terms of how we will scale up the credit book, but obviously we have enough equity. Our equity base currently is about Rs. 2500 crores. And altogether, current borrowings are only Rs. 2700 crores. So we have quite a bit of room to borrow and scale up the asset book.

Viraj Gandhi: What is our cost of borrowing for the whole year?

Deepak Mittal: For the quarter was 7.3% and for the whole year was 7.8%.

Viraj Gandhi: This will be from my side right now, thank you.

Moderator: Thank you Mr. Gandhi. Our next question is from the line of Megha Gupta of Birla Sun Life Insurance. Please go ahead.

Megha Gupta: I wanted to check regarding your proposed move to begin financing SMEs as well as housing finance on the approval that you got from NHB. Given that traditionally you have been in the capital market related financing space, what exactly is the preparation and ground work that you have done to enter consumer financing and consumer facing businesses like these SME and housing and if you could give a perspective on what exactly are you venturing into while looking at SME Finance?

Rashesh Shah: We have been working on this for the last over 8-9 months and we have hired a few people, so the project teams are already in place and we been working on the strategy, the game plan, and all that; and as you know, now we have quite a few clients also with Anagram and with our broking business. So, our idea is also to cross sell to our clients on whom we have a very good understanding of their credit or at least their asset base and their credit worthiness. So we have been looking at that. We have been hiring people who are experienced in the business and our idea is to start slowly, scale it up gradually as with everything else. Our approach to all these businesses is to look at 4-5 year horizon and start small and then scale up once you have the grounding right.

Megha Gupta: Okay and the NHB license therefore would mean that you would have a 100% subsidiary which would be doing the housing finance and it would not be done through Edelweiss Capital?

Rashesh Shah: Yes, it will be.

Megha Gupta: Okay and lastly my question is on the Opex, what proportion of that would be variable?

Rashesh Shah: It keeps on varying, but depending on what you call actual variable because some are variable, some are semi-variable, but our estimate is about 40 to 45% of these expenses are fairly variable - they are like STT and exchange related costs. Even the interest cost that we have could be considered reasonably variable because we are borrowing on one side and earning on the other side.

Megha Gupta: I was specifically talking about the variable portion of your salaries etc. as well as the franchise costs if any?

Rashesh Shah: Salaries we are not breaking it up. On the franchisees, since we do not have a large retail business as of now, we do not have it, but going forward when we add Anagram, we will obviously have that and will break that up and give it.

Megha Gupta: Alright, so currently around 40 to 45% average. Total operating cost including salaries?

Rashesh Shah: No.

Megha Gupta: Only the OPEX.

Rashesh Shah: We are talking about the OPEX.

Megha Gupta: Alright, thank you.

Moderator: Thank you Ms. Gupta. Our next question is from the line of Pankaj Agarwal of Execution Noble. Please go ahead.

Pankaj Agarwal: Would you say that this drop in arbitrage yield is more structural or cyclical?

Rashesh Shah: Arbitrage has always been a function of 3 or 4 factors. One is optimism in the market especially from retail and HNI investors, which has been absent for the last 3 quarters almost as we are seeing in IPO business and others. Second is liquidity situation, how the short-term yields are. The short-term yields are currently about 4%, the arbitrage yields are 7.5 to 8% in the Q4. So they are correlated to the short-term yields, they are correlated to optimism in the market. They are also correlated to high volatility. If you see the last 8 quarter results, in the last year the first two quarters were good, even in the current year the first two quarters were good. Third quarter onwards and fourth quarter especially where there is complete absence of optimism with retail and HNI investors, people are not aggressively buying and along with that there is huge liquidity overflow in the system, yields are low. So given this, partly you could believe that it is structural as liquidity has eased but partly it is also cyclical as when short term yield goes up we have also seen arbitrage yield go up.

Pankaj Agarwal: Suppose going forward, if the situation improves in arbitrage business, how are we going to fund the arbitrage portfolio, suppose it goes from 10 billion to 20 billion or so.

Rashesh Shah: As you know, on the balance sheet we have currently borrowed only about 1.2 times. We have a current capacity to go up to 3 times also. So on Rs. 2500 crores we can theoretically borrow and go easily up to Rs. 7500 crores on the debt, but we do not intend to go all the way there. We have enough capacity on the balance sheet to borrow a couple of thousand crores and along with that, our internal accruals are also happening every month. So equity is going up and along with that, at least 3 to 4 thousand crores of additional borrowing capacity is available on the balance sheet easily.

Pankaj Agarwal: Regarding your core financing, what is the optimum level of leverage that you are going to see going forward?

Rashesh Shah: At a consolidated level as I said we would want to be around 3:1 at the upper end may be after couple of years or after 3-4 years. In the core financing book for you to make sense with NIMs and yields something which is closer to 5:1 or 6:1 gearing will be optimal.

Deepak Mittal: For that you would need a more diversified asset base in terms of lending.

Pankaj Agarwal: What level of sustainable ROE can you expect from the financing business going forward, once you leverage like 4 to 5 times?

Rashesh Shah: Typically it goes up to mid teens to high teens. The yields on this particular book are usually about 15%, anywhere between 13 to 14 to 15% and your cost of borrowing is anywhere between 8-9%. So you get of 5%-6% NIM, then you take expense out of that and your net NIM at a pretax level should be about 4%, 300 to 400 basis point.

Pankaj Agarwal: So if you calculate, you would need at least 5 times of leverage to make an ROE of more than 15%, right?

Deepak Mittal: You also earn the ROE on your equity also, so you will get the base on that and this will also get added.

Pankaj Agarwal: Okay, thanks a lot.

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

Nischint Chawathe: Can you please highlight a little bit more about your retail strategy, I did get the point that you would want to have a more gradual approach, but how do you see the business over a medium-term, what would be the proportion of contribution of this business to overall Edelweiss. How largely do you see this portion the retail portion becoming for Edelweiss over a medium-term, more from a vision point of view rather than what you can really put on paper.

Rashesh Shah: I think it is an interesting question. We actually have not worked out clear quantitative annual targets that we can share with people, though we do have an internal plan. Broadly our growth strategy is to grow in adjacent markets. So our first entry in retail was through retail broking where we are in an organic business, then we acquired Anagram. The idea was we understood broking, but we did not have a retail customer base. So we have gone into that. The same thing we did in credit, we started the wholesale credit initially, then from wholesale we have started our HNI book through margin funding, ESOP financing and all that. Now as we are getting comfortable, there is a retail client base that is there, now we will expand into retail financing also.

Basically growth in adjacent markets where you are either changing a product or a customer base at a point of time. You are either familiar with the product or a customer base, like we are familiar with broking as a product and then we went after a new customer base in terms of retail customers. Now we are getting fairly familiar with the retail customer base and so now we are adding financing as a product where we know wholesale financing. Thus, if you are familiar with a customer base, then add a product for that. So our approach, and again these are all 3, 4, 5 year kind of strategies, in the first year we will get the theme in place, we will get our credit approach and all the methods in place and then scale it up as we have been doing in other businesses. So over 3 to 5 years, we need to also have retail financing as another business. Once we have established retail broking and financing, then the retail asset management will also be there. All of this is a part of an overall strategy of what we call growing through adjacent markets.

Nischint Chawathe: So now you are just trying to come slightly through a shorter term. I would not say what is the next move, but which is the sub-segment most exciting in the entire retail segment?

Rashesh Shah: We like all businesses. Our problem has been that we like all businesses, we have just been gradual. There is no a business about which we are most excited. Our retail broking has been very exciting. We have been investing in that for almost 3 years now. If you remember we started out 3 years ago with our retail brokerage, we set up the theme and now there is traction culminating with Anagram acquisition. Now we will start the housing finance business, but it will be slow. I can assure all of you that it would not have any impact for the first couple of years for sure. It will be slow. But again we are approaching all this business keeping 8-10 years of view because we need to build a client base and the product expertise and all. But we are excited about all businesses.

Nischint Chawathe: Okay that explains the point thanks.

Moderator: Thank you. Our next question is from the line of Paras Nagda of Enam Holdings. Please go ahead.

Paras Nagda: Your ROE from 28% in 2008 has gone down to 9% and 11% in 2009 and 10. So could you tell me the target for next 3 years, how will your ROE grow?

Rashesh Shah: Our aim is to keep on increasing ROE, though we have no target. If you study our annual report, you will come to realize that we have a little bit of excess equity. It was a good problem to have when there was a credit crisis going on in the world and the excess liquidity did help us in ensuring that we kept on investing in the business, but that excess equity is now acting as a drag on the ROE. On the whole, given the view we have over the next 8 to 10 years, we think it is a good problem to have. By our estimate, we have about 4 to 500 crores of extra equity than what we need for current businesses with the growth plan that we have. It is an expensive resource but good to have it. It just acts as a drag by may be 200 to 300 basis point on ROE, but our idea is to keep on growing it. ROE is also influenced by the growth of the agency business. It is influenced by the leverage on your balance sheet and by the efficiency of capital and yields that you earn on your capital and our aim will be to push each of them.

Paras Nagda: Also the new business initiatives are all capital intensive like our insurance business. So in 3 years' time you will not be as overcapitalized as you are now?

Rashesh Shah: Well, we are also hoping that the over capitalization problem will continue because we will also have retained profits every year and as I already stated, in our insurance business the plan is to invest about Rs. 100 crores a year over the next 5 years. We are making about Rs. 230 to 240 crores annual profits. So it will come from there and the problem may not completely go away, but again as I said it is a good problem to have.

Given India opportunity and the opportunity in the financial services of India, there are two things I would not be unhappy with having extra. One is extra capital and the other is extra leadership and an extra good management team. So in the short-term, it will act as a drag and we should accept it.

Paras Nagda: Thanks a lot sir. All the best.

Moderator: Thank you Mr. Nagda. Our next question is from the line of Nilanjan Karfa of Brics Securities. Please go ahead.

Nilanjan Karfa: If I have to summarize what you had been saying over the last few quarters, you are growing Edelweiss most likely as seeding the business and then taking 4-5 years at least to grow in each of these businesses. Now what is happening is you are becoming a me-too player in each of these categories. So for example if I go back to mutual funds, you already have a license but you are not growing it. So may be over 4-5 years it will grow. The same thing is with insurance. The brokerage is mostly valued at 15x, most analyst would value at that, your business valuation comes most likely from the lending business, but as you are saying the ROEs are going to be mid teens so the valuation most likely there will be about say 1:2 x over period of time. And when you say you have an India opportunity, so how do you see yourself positioning Edelweiss in each of these businesses and which segment do you think will be growing forward and where do you want to excel? Which business part do you want to excel in?

Rashesh Shah: Again as I said, we are excited about all businesses. We do not think all this is actually me-too, though the products are similar. Like somebody making a car is also making a car, but all cars are different. So we approach asset management the same way, we approach broking they same way and we will hope that we will do it in insurance also. We will have differentiation in our approach. So the idea would be to create broad based financial services firm which can sell products to a common client base, have a good brand name and have good franchise. We have executed like that in institutional brokerage business which we started about 8-9 years ago. It was also what we call a me-too product then, there were enough institutional brokers Indian and foreigners at that time, but we have been able to create a leadership space in that and we have invested in research and all that and we have taken 8-9 years to arrive at that. The same thing we did in F&O.

Even our asset management business, it is only about a year old and we are investing in that and again as I said our approach is you cannot build these businesses overnight. Anybody who has tried to build a business overnight in a market like India has come a cropper. So we are very gradualist, we are very-very stead fast but our commitment has not wavered.

To give you an idea, our retail broking business started in 2008 when the world was in a complete crisis, then we went from 0 people of 100 people team. About 24% of our head count today is in the businesses which contribute 4% of our total gross revenues. 4% revenue has 24% of the people because we are investing in that and we do think that not only us but a lot of financial firms will be in investment phase for the coming may be a year to 18 months to may be 2 years.

I do not think there is a question on whether we invest or not. The question is how to invest and how to make sure that what you are investing strengthens you for the future.

Nilanjan Karfa: So if I have to build it out probably in the institutional part, do you think if you want to gain more market share then the incremental or the marginal expense will go up so high that you will not probably go and invest more into the institutional part?

Rashesh Shah: I would not agree with that. We have actually invested a lot in our institutional brokerage business. Every year it is also one of the key areas where we invested, like I told you we invested in a 2020 thematic report. It was almost 8 months of effort on this India 2020 report, almost 11 people worked on it for 8 months to come out with the thematic report which is not a quarterly earnings kind of a report. So we do invest a lot.

We invest a lot in automation. On institutional equities, if you have the kind of volumes we do in the expiry week, our peak volumes on client institutional brokerage business go to Rs. 3000-4000 crores. So we have been able to handle it. It needs a lot of technology investment, lot of automation investment. Algorithmic trading, and we have invested in that for our institutional clients. So we are investing and by our estimate say 18 months ago, we had 4% market share in the commission pool of institutional equities. We have now inched up to 5% odd or so and we would want to grow that.

The fact that we are investing in other businesses should not mean that we are not investing in current businesses. The current growth we are seeing but again we are being very-very careful about how we invest. Our institutional equity and investment banking had a good year. We are continually still investing into that. If you remember our history, we first started off by doing private equity advisory business 14 years ago and this year we closed another private equity deal, as I mentioned earlier, of Rs. 1000 crores. So we stuck to our original products, but we have also grown in the adjacent markets without abandoning the original focus.

Nilanjan Karfa: Okay, thank you sir.

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

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

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