Edelweiss
Ideas create, values protect

Conference Call Transcript

Edelweiss Financial Services

FY12 Results

May 17, 2012 | 4 p.m. IST

Corporate Participants

Mr. Rashesh Shah
Chairman

Mr. Himanshu Kaji
Executive Director

Mr. S. Ranganathan
CFO

Mr. Shailendra Maru
Head, Stakeholder Relations

Questions and Answers

Moderator: Ladies and gentlemen, good day and welcome to the Edelweiss Financial Services audited FY12 earnings conference call. I would now like to hand the conference over to Mr. Shailendra Maru of Edelweiss Financial Services. Thank you and over to you sir.

Shailendra Maru: Thank you Marina. Good afternoon to all of you and thank you for joining us today as we discuss Edelweiss Financial Services' audited consolidated financial results for FY 12 that ended 31st March 2012. Speaking today with you are Rashesh Shah – Chairman, Edelweiss Group, Himanshu Kaji – Executive Director and S Ranganathan – the Chief Financial Officer. Following the reading of Safe Harbor provision, I will first turnover the call to Rashesh for his opening remarks. Thereafter Ranganathan will take you through an overview of our business performance and the financial numbers. This will be followed by the Q&A session.

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

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

Rashesh Shah: Thank you Shailendra. As you would have seen we came out with the results yesterday.

Let me just give you color on the 4th quarter as well as on FY 12 numbers. The 4th quarter was an improvement over the earlier three quarters. From a capital market's point of view and from an overall economic activity point of view, the 4th quarter was the only quarter in the last year where there was some relief which has also shown in the results. Overall for Edelweiss even on the agency business there was some uptick in the 4th quarter, but as all of you are aware, from April - May onwards again the slowdown has started and the market volumes and the capital market activity as well as even interest rates have not been as favorable from April - May onwards. Overall FY12 was one of the hardest years for financial services, I would say almost all segments of the business whether it was NBFC, whether it was broking, investment banking, and asset management had a lot of headwinds.

Overall, the high interest rates as well as the low capital market activity were the two key reasons for this. Our effort in the last year was, since we couldn't do anything about the environment and the headwinds, we focused a lot on basically improving the business efficiency. So we have been working on bringing down the cost income ratio, we worked very hard in making sure we had investment and productivity, efficiency as well as infrastructure. We also improved our market share in most of the business segments we are in. We also invested a lot in risk management ensuring that in the hostile environment of last year there was no risk event.

Given all that, our total revenue for the year was Rs. 1671 crores as compared to Rs. 1429 crores in the earlier year. So there is a 17% uptick in total revenue. However, the profit after tax is Rs. 128 crores for the year which is compared to Rs. 233 crores for the last year, which is down almost 45%. An absolute amount from 233 to 128 is a fall of about 105 crores. Broadly, for your understanding, out of these 105 about 45 is accounted by the capital market activity both wholesale and retail, as well as investment banking on the capital market side because our revenues on capital markets fell by more than 120 crores which led to a pre-tax hit of about 70 crores and profit after tax fall of about 45 crores as compared to FY 11.

Insurance also had an impact on PAT because of two reasons - the 300 crores that we invested in the insurance business as well as the actual operating loss on the insurance business which is about 18 crores for FY12. Combined effect is about 50 crores impact at an after tax level just because of the commencement of the insurance business. This is as per plan and as you know we have started this business along with Tokio Marine who along with us have capitalized this business sufficiently for this operating burn that we will take on. So it is as per plan but it happened in this year because we infused the capital in April '11. So about 45 crores accounted for by capital markets and another 50 crores accounted for by insurance. Another 22 crores is the depreciation which has gone up out because of the new office building that we have occupied because earlier we had not capitalized the building and hence that 22 crores change has been for that in FY12. So if we add up the three, it accounts for almost 110 to 115 crores fall broadly because of this.

Having said that, we are hoping that capital markets will come back and we are also investing a lot in efficiency. Insurance is an ongoing burn that will continue to stay but as other businesses are growing it will get offset by that. Office building depreciation has hit this year, it will be there every year but it won't increase much. Going forward we still have challenging environment.

On the business front, what we have tried to achieve is now we have five clear business segments. The first business segment is the credit segment, where we have both wholesale credit business and the retail credit business. This collectively now has a 3900 crores asset base out of which almost about 2800 is wholesale and approximately 1100 crores is retail. It is a good business. We estimate that this business broadly gives us about 19% pre-tax ROE. It is higher on the wholesale side which is about 21-22% and slightly lower on the retail side because of the investment and the size of the book and the early stage of the business.

The second business cluster we have is the capital market and the asset management cluster, where we have broadly about 800 crores of capital invested for all the businesses in the capital market and asset management. This business has made a very small pre-tax profit this year and effectively has been almost flat.

Commodities is the third segment which as we spoke in the last call has been growing fairly rapidly and it has currently accounted for almost about 59 crores of pre-tax profit in this year. Our total capital employed in this business is about 1300 crores and it gives us a pre-tax ROE of about 20%. So this business was stabilized and we think it will stay in this range and will grow by 25 to 30% every year.

The fourth business is the Treasury business which is an old business where we now instead of just doing arbitrage, we have expanded the scope to basically handle asset liability management, liquidity management and the balance sheet control because as in the last one year the balance sheet has grown. So we have now expanded the treasury function from just arbitrage to also managing liquidity and balance sheet and interest rate sensitivity and asset liability risk and all. But this is a very liquid book. It has about 5700 crores of assets out of which almost 5000 crores are very liquid which is made up of G-Secs and bank deposits and bank CDs and bank bonds. Being highly liquid it doesn't earn a lot of money but if we get a spread of between 1 to 1.5% over our cost of capital in this business but it also allows us to be very liquid and especially try and be efficient on both capital deployment as well as liquidity management.

The fifth business group is insurance business which we started in the current year. The total capital in this business is about 520 crores out of which 300 crores has been infused by us and the balance at this stage has been infused by Tokio Marine. They will keep on investing more and more and we are obviously awaiting the increase of FDI hopefully from 26% to 49%. Insurance which has earnings on 521 crores and it would have expenses also, had a pre-tax loss of about 18 crores.

Finally, we have our corporate and unallocated segment which is the infrastructure assets as well as some corporate assets. We have an almost about 1000 crores including office building and other infrastructure assets that we have and this is the capital which is deployed in the corporate sector. So, this year onwards we will now see ourselves as these five clusters of Credit, Capital Market and Asset Management, third Commodities, fourth Treasury and fifth Insurance. And the good news is the Credit business and the Commodity business have scaled up and stabilized well. Our Treasury business is business as usual though we have expanded the scope.

Our Capital Market and Asset Management business had a fairly difficult year but it's a good steady ongoing business for us. Out of the total revenues of 1671 crores, almost 435 crores came from capital market and asset management part of the business. So it still accounts for about 25% of our overall revenues and broadly our capital market business being cyclical will come back.

In each of these five businesses there are existing businesses and growth businesses, like credit has Wholesale Credit which is very profitable and Retail Credit which is a growth business. Capital markets - Wholesale Capital Market is doing well, Retail Capital Market we're investing. So each of these five clusters have its own set of established businesses and growth businesses but on the whole they are all giving us like I said 19% pre-tax ROE on credit businesses, 20% pre-tax ROE on commodities business, about 14% pre-tax ROE on our Treasury business and about 4% on capital market and asset management because this was not a good year for them.

So overall all these business segments are now independent businesses which have grown on their own. Outside of that as I said going forward we expect this year to be challenging, we think the next 18 months in India are not going to be easy given what is happening on Rupee as well as the inflation front. Though we expect a little bit of relief on interest-rate front as RBI will may be give another 25 to 50 basis point cut in this year. We have now each of these businesses where the leadership is established, capital is allocated and we are now seeing ourselves as a five business conglomerate as each of these businesses are now becoming the growth engines for Edelweiss. The reason we have done this is basically we wanted to achieve diversification and growth because we needed risk diversification from the volatility of capital markets as we have said in the earlier calls. So by FY12 we have now achieved that, all the businesses are there, now the idea is to grow each of these businesses. So with all of our original strategy has been achieved through a very hostile and fairly bad environment of FY12 and as I said largely the results were impacted by insurance and capital markets. Along with that I will hand it over to Ranganathan to give some more details on our financial position.

S. Ranganathan: Thank you Rashesh. Let us first discuss the key takeaways of Edelweiss performance. Broadly we have recorded a growth both in the top-line as well as in the bottom-line quarter on quarter on the back of a higher capital market activity level. In fact Q4 was one of the best quarters for the agency businesses as we recorded higher fee and commission income this quarter compared to the previous three quarters. However FY12 was otherwise an average year for most of the businesses due to challenging environment. During the year we continue to grow our top-line with our established businesses holding their ground. This was possible due to the strategy of synergistic diversification that we have consciously pursued in the past in our businesses. At the same time FY12 profitability was impacted due to an overall low capital market activity during the year, high interest rates, planned burn due to insurance investment and depreciation on the new building. Despite the challenging environment our market share and productivity parameters have shown an improvement.

On the business front we have scaled up all our established businesses and we have also stabilized most of our businesses during the year. We also launched the insurance business in the 2nd quarter of FY12. While our core business model is in place now and we are positioned for a profitable growth as the headwinds abate, investment in scaling up of our new businesses will continue for some more time. This will continue to affect our bottom-line at least in the short-term.

Coming to our financial year 12 result, our total revenue for the year is Rs. 1671 crores compared to Rs. 1429 crores in financial year 11, up 17% and profit after tax for the year is Rs. 128 crores compared to Rs. 233 crores for financial year 11, down 45%. For Q4FY12 in particular our total revenues for the quarter is Rs. 479 crores compared to Rs. 454 crores for Q3FY12, up 6% QoQ. Profit after tax for the quarter is Rs. 39 crores compared to Rs. 29 crores for Q3FY12, up 32% QoQ. Among the individual heads of income, agency fee and commission is up by 20% in Q4 over Q3 as the fourth quarter was a good quarter for capital markets. However the full-year agency fee and commission is down by 23% as a result of overall lower activities in the capital market compared to the previous year. Interest and Treasury income for the financial year 12 is higher by 30% due to scale up of our credit growth from Rs 2644 crores on 31st of March 2011 to 3956 crores at the end of this year. This year we have a new income head to report by way of premium on life insurance business which was launched in Q2FY12. Our new business premium for FY12 was Rs. 11 crores.

Within our total cost, our employee cost is higher by 12% quarter on quarter and 15% for the full year as we have continued to selectively hire for our new businesses, especially life insurance and home finance. Overall we added about 460 employees in the financial year taking the headcount to 3108. Operating expenses is flattish in quarter 4 over quarter 3 and up by 13% in financial year 12 due to costs associated with scaling up insurance and other new businesses. The financing cost is flat quarter on quarter and our blended cost of borrowing is around 10.3% for the quarter.

With the new office building getting occupied, the depreciation is also higher. Full-year depreciation has doubled from 20 crores in financial year 11 to about 42 crores in financial year 12.

Even though we achieved a 17% growth in top line for financial year 12, there is a drag on profitability due to one, challenging environment because of the capital market activity being significantly lower and interest-rate being higher in financial year 12, number two, our conscious decision to invest in incubating new businesses, in the life insurance and retail platform which includes broking, Housing finance and asset management, three, certain investments, which are currently non-yielding although on a long term basis accretive and four, depreciation on our new office property. Collective impact of these at profit after tax level as mentioned by Rashesh, is in the range of about 100 crores. Further the capital based businesses contributing 80% of our total revenue and agency businesses accounting for 20%, the margins are more in line with those of the banking and NBFC industry.

I may add that the financial statement for this year March 31st 2012 are prepared as per the revised Scheduled VI under the Companies Act 1956. Previous year's figures have been redrawn to conform to the current year's classification.

Now turning to our business highlights, the credit business includes collateralize loan, housing finance and fixed income agency businesses. The total credit book was total Rs.3,956 crores by the end of financial year 12 compared to Rs.2,644 crores at the beginning of the year, a growth of over 45%. The book comprises of wholesale loans of Rs. 2,797 crores, retail collateralized loans of Rs.383 crores, with housing loans accounting for the balance Rs.776 crores. The retail loans constitutes close to third of our book. We continue to avoid sector and industry concentration in our credit book. As of March '12, the top 3 sectoral exposures in the book are mortgages and LAP 20%, real estate and construction 16% and media and entertainment 10%. The average collateral cover on the collateralized book is over 2.64 times at the end of the quarter. The Q4 yield is marginally higher at around 17%. With the average cost of borrowing at 10.3% in the Quarter 4, the spreads have been maintained. The gross NPLs are 0.57% and the net NPLs are just 0.17% of the total book. The total provision cover of the NPLs is around 116% including the general provision on standard assets. The housing finance business continues to build scale and has now reached 776 crores compared to 116 crores at the beginning of the year. We conduct this business in 8 major metros so far and plan to expand our presence in a few more metros in the financial year 13.

We continue to be a leading debt arranger in the country and are ranked overall sixth largest private debt arranger, taking CP, bonds and NCDs together with a market share of 14.3%. We are ranked fifth in commercial paper insurance with a market share of 10.4% in financial year 12 as per Prime Database. We had a good year in this business at the total number of DCM transactions handled by us in financial year 12 was 30 as compared to 22 in the previous year.

Now, turning to our capital market businesses; in investment banking we handled three transactions across equity capital market and advisory in the 4th quarter. These include the IPO of MCX amounting to 663 crores, QIP of DCB and rights issue of Gayatri Projects. With this the total number of ECM and advisory transactions in the financial year 12 rose to 10. Impact of weak investment confidence in the country is clearly visible in this business.

Broking business, as I mentioned earlier Q4 was a good quarter for capital markets businesses. Our total average daily volumes for the 4th quarter was Rs. 5,980 crores compared to Rs. 4,850 crores in Q3, a growth of 23%. Out of the total ADV the client broking volumes this quarter were higher at Rs. 2,850 crores compared to Rs. 2,620 crores in Q3. Broking income accounts for 9.2% of our total revenue for the financial year 12. The broking yield on client transactions improved to about 3.7 basis points this quarter on the gross basis compared to 3.6 basis points in the previous quarter. On a net basis the yield is 2.4 basis points.

We continue to build scale in our retail businesses and we now have over 3,72,000 clients through our online portal www.edelweiss.in and through the offline model, compared to 3,25,000 at the beginning of the year. We are happy to share that Edelweiss has been rated as the Best Advisory Broker Asia in the recently declared World Finance Exchanges & Brokers Awards 2012.

We continue to consolidate our leading position in the industry as an IPO broker. Edelweiss has emerged as country's largest IPO broker for financial year 12. We were the second-largest in financial year 11 as per the total amount procured. We are ranked number one in the QIB category with a market share of 4.8% and ranked second in retail and HNI categories both with a market share of 7.8 and 10.5% respectively, giving us an overall first ranking for financial year 12.

In our alternative asset management business in the fourth quarter we launched EW SBIH Crossover fund in joint sponsorship with SBI Holdings, Inc of Japan with a total commitment of USD 100 million by the sponsors. We now have AUMs/AUAs equivalent to over USD 570 million at the end of the year compared to USD 360 million at the beginning of the year. Our mutual fund manages five equity and seven debt schemes with an average AUM of Rs.370 crores for Q4 and now has an active base of over 6000 investors. The focus of this business continues to be on broad basing the product portfolio and building investment track record.

As we indicated in our previous calls, commodities has emerged as an independent business for Edelweiss. We have started this business about three years ago to diversify our asset classes; it focuses on sourcing and distribution of bullion and Agri commodities. While Agri commodity business is in a build out stage, we believe with increasing financialization of commodities in India it will present large business opportunities going forward.

Edelweiss Tokio Life Insurance which launched its business in Q2 offers diversified products to meet the basic needs of the customer on education funding, wealth accumulation and enhancement, living with impaired health, income replacement and retirement funding. It also offers group products for credit protection and life protection. Its presence has been scaled up to 31 offices across 22 cities. The number of personal financial advisors has also gone up to 825. We plan to scale up our presence through more offices and larger network of PFAs as we move ahead.

The treasury and related asset book at the end of the quarter was Rs. 5,700 crores. If consisted of fixed deposits and government securities worth 3,900 crores, bonds 1,100 crores and other treasury assets of roughly 700 crores. The gross yield on its book for the quarter was 12.8% giving us a spread of 2.5% on this portfolio. Treasury allocation continues to be a function of liquidity management, capital requirements of other businesses and opportunities in the market.

Finally turning to our balance sheet, our total balance sheet size at the end of the quarter was Rs. 14,545 crores under the revised format. The total net worth of the group now stands at Rs.2,875 crores including minority. Excluding goodwill, loan to our employee trust and deferred tax assets, our net tangible net worth stands at 2,542 crores. Our borrowings at the end of the quarter have been Rs. 10,414 crores implying a gearing of 3.6 times with the inclusion of minority interest in the total net worth. The liability of 10,414 includes government securities and FDs which are highly liquid and financed back-to-back. Adjusting their liability, the actual liability is Rs 6,500 crores implying a gearing of roughly about 2.3 times.

Coming to our ALM position, our short-term borrowing from mutual funds stand at Rs 3,387 crores at the end of financial year 12 compared to 4,373 crores at the end of Q3. Our bank borrowings at 3,810 crores now account for 37% of the total borrowing. We have thus been able to diversify our sources of borrowing and reduce the dependence on short-term money market borrowings in the fourth quarter as we had indicated earlier. On the asset side we have diversified asset profile with about 50% of the assets being highly liquid. Taking our commitment to keep enhancing the disclosures levels, we have enlarged the discussion on our assets and liabilities in the quarterly earnings update and hope that this would help you in understanding our balance sheet structure in the true perspective.

To sum up, while Q4 has been a good quarter, the environment continues to be challenging. However our market share and productivity parameters have shown good improvement. We are optimistic about growth coming back in the latter half of FY13, hopefully aided by inflation and interest rates coming down by then. But macroeconomic indicators and global scenario have the potential to derail the growth. We have stabilized most of our businesses. Our growth and new businesses are in the investment phase but the operating parameters are robust. We are investing in risk management system, technology and other key enterprise functions to strengthen the backend. We are de-risking the business by reducing volatility with the help of diversification and building scale. We have remained focused on our core strategy with the planned build-out of new businesses of life insurance, asset management and housing finance for future growth. All the building blocks are in place for us and we are positioned to grow as the headwinds abate. With this I would like to conclude and we will be happy to take questions from you.

Moderator : Thank you very much. Ladies and gentlemen we will now begin the question and answer session. The first question is from Rahul Vekaria from Axis Mutual Fund.

Rahul Vekaria: On slide number 13, you were explaining the funding profile. So that ASB is an asset specific borrowing, could you just brief on what does it suggest in terms of the pie-chart?

Rashesh Shah: Large part of this is government securities which are funded in the CBLO market as part of our interest-rate management and asset liability management. We do participate in the CBLO market and so this ASB is basically repo like borrowing against G-Sec.

Rahul Vekaria: Any insurance borrowing or debt market I understand should be your CP book?

Rashesh Shah: A couple of insurance companies have bought the CPs also but in this chart they come under the retail and corporate umbrella and not under Debt market.

Rahul Vekaria: Would you please give number on the same?

S. Ranganathan: It is included in the retail & corporate 15% borrowing in the pie chart (slide 13) for FY12. The total borrowings from the insurance companies and corporates is roughly around 900 crores.

Rahul Vekaria: And the next borrowing chart (slide 14) also suggests that close to 70% of your borrowing is now maturing under a year. So is this the obvious thing that we are looking to do or do we have some numbers - what per cent of liabilities are we trying to manage in a period of less than a year?

Rashesh Shah: I would just like to go to the slide after that, slide 15 gives you the asset and liability profile. If you see in every bucket we have a fairly balanced asset liability profile. We have worked hard on this to make sure that our asset and liability profile on slide 15 gives duration wise profile. So if you see the three slides, two important takeaways: one is our assets and liabilities in every segment has got fairly matched and the important thing on slide 13 is that our dependence on the debt market and mutual fund market has gone down and it will continue to go down in this year (FY13) also. That is a part of our articulated strategy and we have been implementing that.

Rahul Vekaria: In coming to our credit book on slide 23 our wholesale book is close to 2800 crores, so what would that be majorly comprising of if I were to breakup into a large part or something?

Rashesh Shah: A large part of this is basically corporate loans, collateralized loans to promoters and all of that. It is a business we have been doing for last four years, it's sponsor financing, it is corporate loans but it's all collateralized. Our collateral cover is over 2.5x on that and in spite of the market in the last four years being fairly volatile we have been able to manage risk on that fairly well. We have also given an industry wise exposure, it is fairly broad balanced and it is across various industry sectors.

Rahul Vekaria: Our credit book has grown by close to 850 crores so where are you seeing the growth coming from in the credit book?

Rashesh Shah: In FY12 a large part of the growth came from the retail book, we did not aggressively grow wholesale book. So if you see our retail housing finance book this is up by almost 600 crores in this year.

S. Ranganathan: 660 crores.

Rahul Vekaria: Just to understand, as every year the real estate market is pretty highly priced, so where are you seeing these disbursals, which region or which part are you seeing the disbursements towards the housing loans, where are you seeing this growth coming from?

Rashesh Shah: We are in 8 metros and though you are right that there is a slowdown but if you see the actual data in FY12 the housing loan market and the LAP market both of them have been close to 240,000 crores disbursement. So it is still a very large market and lot of disbursements are happening. So our aim was to try and get about 600 crores in this year. This business is currently not profitable because of the cost of branches and the customer acquisition and all that. Our estimate is when we hit 2000 crores on this housing finance and the retail financing book after which it will start becoming profitable.

Rahul Vekaria: Does retail finance have any unsecured lending?

Rashesh Shah: No.

Rahul Vekaria: And the credit book do we have any exposure to any builder loans, the real estate portion, within it is the builder loans?

Rashesh Shah: We are having a total of about 16% of total loans to this sector, which includes loan against shares, against property, against collateral, all of that. We have a couple of construction loans of almost constructed properties; we don't do any credit against raw land or undeveloped property. If an office building is almost completed, we might give a loan against it. But it will be not more than 5% of the overall book.

Rahul Vekaria: Any pressure there on that book?

Rashesh Shah: No actually we haven't seen any pressure on that.

Rahul Vekaria: Going ahead any ideas to venture into the gold loan business as well?

Rashesh Shah: Gold loan business is not on the agenda as of now.

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

Nidhesh Jain: My question is regarding your commodities business, so given that there is a pressure on gold demand, what is your outlook on your commodity business. Also your commodity business will be dependent on the prices of gold, so what is your outlook on that?

Rashesh Shah: In the last year we had a higher proportion of gold import business and we are now seeing that because of the increase in gold import duty and the price itself and the rupee getting devalued, the rupee price of gold has been going up. Consumption is already slowing down. Our estimate is that last year India imported almost 800 tons of gold for consumption and this will fall to about 600 tons in the current year (FY13). So we will see a 25% fall in the gold import. It has started happening from December onwards itself so the 4th quarter already captures that but we have expanded our product range to cover agri commodities and others also. So we import some of the pulses and we are starting edible oil also. Our idea is that we want to be a financial intermediary providing client facilitation services especially in areas where India is a large importer and consumer, because our ability to source, get good credit lines, import and distribute, will give us some efficiency. We expect to make about 17 to 18% return on a gross level in this. So think of it almost like a trade financing or a credit financing book for the trade which gives you 17-18% return for all this. We are expanding the product portfolio from gold to Agri commodities.

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

Ritesh Nambiar: Just one clarity, regarding this 18 crores loss in insurance which you have booked last year, your transaction with Tokio Marine was capital protection. So how is this getting adjusted to the reserves?

S. Ranganathan: It is capital protected in a different sense, in the sense that whatever they have paid us is in the form of equity and share premium. So their contribution has been purely routed through the balance sheet while the burn in the insurance company is routed through the profit and loss account because that's how the accounting would be.

Rashesh Shah: So to answer this in other way, we have no capital protection from them. The current structure of the deal is that they invest money at a premium so broadly if we have invested money at Rs. 10 they would invest it at about Rs. 30, it is actually a formula based price but broadly it will be a Rs. 30. So they come in at a premium and our estimation has been that the premium that is coming into the business is equal to the expected operating burn over the years.

Ritesh Nambiar: And what is that sir?

Rashesh Shah: I had mentioned it a couple of calls ago and it is adjusted for exchange rate and all, but broadly over five years Edelweiss is expected to infuse about 500 crores into that business while Tokio Marine will infuse approximately 1100 crores in that business. So they will infuse about 600 crores more and we're hoping that they will own 49% if allowed under the FDI rules and we will own 51% by that time. We have some other fallback structures which have similar economics if the FDI increase does not come about, but broadly the premium is about 600 crores, which is equal to the expected burn over the first five years in the business.

Ritesh Nambiar: But that is yet to be utilized as I see because if it would have been done there wouldn't be any loss that minor 18 crores odd loss wouldn't be seen in this year?

Rashesh Shah: No it would be there because for an example the capital comes at a premium into the insurance company so it is on the balance sheet. So even if they invest money at a premium the operating P&L will still get consolidated with our P&L as well as you should account for the fact that currently we own 74%. So this gets consolidated at 74% in our financials. So even if from a cash flow wise we are protected because of the higher share premium has come into the balance sheet, but from a P&L point of view it is still routed through the P&L.

Ritesh Nambiar: Currently how much you have roughly invested of the 550 crores into this venture?

Rashesh Shah: We have invested about 300 crores and they have invested approximately 240 crores as of now into this business. We have capitalized this fairly aggressively because we wanted to be one of the most capitalized companies so that we're not really drawing money on a quarter to quarter basis but there is an upfront capitalization. Also the interest that you earn on this extra capital offsets part of the burn. So like for example if the FDI limit is increased from 26% to 49%, then Tokio Marine will infuse additional about 200 crores which will also help in reducing the operating burn because you will earn from return on that capital also. So our strategy has been to have the premium which offsets the operating loss expected as per the plan or capitalize this as early as possible from our side and from the partner side so that the extra capital also offsets part of this burn.

Ritesh Nambiar: What is your expectation of a break even because within five years I suppose you're expecting a breakeven pretty soon or how is it?

Rashesh Shah: We expect to break even after the sixth year, so seventh year is currently expected to be breakeven. As you would have seen the industry is going through a big structural change which is an advantage for us because we don't have any legacy cost structure. To give an idea first year though we spent only 18 crores, the budget and expense was supposed to be a lot higher. So we are able to manage this with a much lower cost because the industry has become a lot more cost-efficient.

Ritesh Nambiar: Secondly on your treasury assets side, 12.8% gross yield which you have reported, just wanted a breakup because I'm just curious whether you're getting deposits at higher rates, how is it?

Rashesh Shah: It's a combination of assets which has 4-5 categories. We have some G-Secs and we also hedge our interest rate so there is also little bit of IRF management in that. Along with that we have FDs in our books against which we also borrow. We also have our cash futures arbitrage business that you are aware of, we also have some trading in corporate bonds, a very small amount. So the yield is a static yield that you earn on the assets as well as some spreads that you earn in your trading also. So overall we compare this with the treasury of a bank and as we have seen most of the bank treasuries make anywhere between 11% to 14% yield on their treasury assets and depending on what their cost of capital is, the spread can be anywhere between 100 basis points to 300 basis points. For us at 12.8% we estimate that our spread is about 250 basis points.

Ritesh Nambiar: Going ahead how should we in fact perceive your balance sheet to look like because based on your current way of reporting it just seems to be bulge from 10,000 crores, it is near to 14,000-15,000 crores. So should we estimate any further upside from in this business because of this leveraging and commodity business?

Rashesh Shah: As you have seen what we have been doing is commodities will have its own financing because it is more like asset financing. The 14,500 you are seeing, you should take about 1200 crores out of that which are current liabilities as it is basically back-to-back funded. So we see our actual balance sheet outside of current liabilities as 13,300 out of which also we take out the G-Secs and the FD and the repo part of the assets because these are fairly liquid and partly opportunistic and partly our interest-rate management and liquidity management strategies. But it can go away in a quarter depending on how the interest-rate moves and the liquidity requirements move. We also have almost 3000 crores of equity. So our current borrowings are about 6500 crores which is split almost equally between the bank and the mutual fund market. So overall I wouldn't expect the balance sheet to grow a lot. We would reallocate capital from say treasury business into credit business because we think credit will grow. But as we are growing the housing finance book, we will borrow more from banks and NHB and others. So increasingly we will go more and more towards the businesses being able to borrow from their own sources of financing rather than the mutual fund market.

Moderator: Thank you. The next question is from Tamalika De from ICICI Securities.

Tamalika De: My question is there has been a reclassification in fee and commission income in Q4, can you give the reason for this reclassification, earlier it was 80.7, 76.9 now?

S. Ranganathan: It has been predominantly driven by some direct expenses relating to broking which have been netted off from those income.

Tamalika De: You mean sub-brokerage expenses?

S. Ranganathan: That's correct.

Tamalika De: Can you tell me the percentage of sub-brokerage expenses to the total, this sub-brokerage business that you have?

S. Ranganathan: It ranges anywhere between 40% to 50%. But we also have lot of direct business and in an aggregate around 35 to 40% should be the component on the retail broking.

Rashesh Shah: See our institutional broking hasn't got any sub-broker element. In our retail broking I would estimate about 20 to 30 crores in that range would be the sub-broker expenses overall.

Tamalika De: This quarter you have shown a reclassification of the other income, that was in Q3 it was almost (-8) and Q4 it is 56 million so can you just bifurcate like what would this other income constitute of?

S. Ranganathan: This is driven by the new classification of Schedule VI wherein we are required to present it in a particular way. This predominantly comprises of delayed payment charges and other items.

Moderator: Thank you. The next question is from Arvind Subramanian from IDFC Mutual Fund.

Arvind Subramanian: My first question is on slide 13 on that diversified sourcing of funding, just to clarify, you had first said all your CPs come under the debt market 34% but then later you clarified that the insurance company portion comes under retail and corporate. So if you can just reconcile the two?

S. Ranganathan: The debt market is the 34% segment which comprises of borrowings from mutual funds - CPs and NCD put together, about 3,400 crores. Then there are some CPs which have been invested by the bank amounting to about 138 crores. That makes it the 34%. Then the second one is what we're talking about the retail and corporate. It comprises of about 900 crores which I just spoke from corporate and insurance companies. Finally 620 crores of the NLDs or the structured products, etc., that makes it about 1,500 crores, equal to 15%.

Arvind Subramanian: What kind of instrument would the retail and corporate 15% be?

S. Ranganathan: These are NCDs and CPs and structured products.

Arvind Subramanian: So CPs, NCDs and SPs is around 50%, so 35 plus 15 correct?

S. Ranganathan: That's correct.

Rashesh Shah: Actually the way to read slide 13 is not to look at it by an instrument but by source of funding so to clarify…

Arvind Subramanian: But capital market would be 50% if I read that correct?

Rashesh Shah: I don't think we see structured product as that because these are usually three year products and these are like NCDs. Of course they are equity linked instruments. We don't call them capital markets linked in that sense. Some of the corporate borrowings we have are more on a normal basis so I would say 3,400 and maybe another 400 to 500 crores could be insurance broadly so about 3500 crores from mutual funds and the banks CPs and another 400-500 crores of insurance so maybe 4000 crores, about 40%.

Arvind Subramanian: So this retail and corporate is entirely insurance or what are the other sources of fund from retail and corporate?

Rashesh Shah: Here we have three categories, 600 is what we call retail which are individual clients who have bought structured products or equity linked. Balance corporate and insurance is about 900 crores.

Arvind Subramanian: What would corporate be?

Rashesh Shah: It is about half and half broadly.

Arvind Subramanian: I'm trying to understand what is corporate I mean what you mean by…

Rashesh Shah: Corporates are ICDs or the deposits that we have got from some of the corporate treasuries who have parked money with us either as NCDs or as ICDs.

Arvind Subramanian: This banks which is 37%, this is entirely secured loans which you have raised or is there a portion of unsecured loans as well?

Rashesh Shah: It's against cash flow as well as against the assets.

Arvind Subramanian: Out of your total balance sheet what is the amount of assets which you can pledge as security to banks to raise funds given that they also have their limits in terms of loan against share or loan against property kind of securities against which they can lend to you.

Rashesh Shah: If you see our slide on the asset liability part, if you see our assets quite a few of them are pledgeable. But what happens with banks since they have different categories, there are some categories which they give against receivables and cash flows and some they give against assets. Usually banks prefer to give you loans against receivables and cash flow rather than against assets because their collateralized funding is a much smaller part. So even after this we would have at least another couple of thousand crores of assets which are not pledged or mortgaged to the banks.

Arvind Subramanian: You are talking about the fixed assets, your building…

Rashesh Shah: No I'm saying even the credit book and all that.

Arvind Subramanian: More than that we have receivables which you have already pledged for banks?

S. Ranganathan: If you look at our housing loan portfolio for example we have something like 776 crores of housing loans and oppose to that the borrowing in the housing finance entity is just about 90 crores. So that leaves us another 600 crores or so, leave aside some portion for the margin and all those things, that is about 600 crores ability to borrow in that particular entity. Then we have the NBFC where we have receivables, even though there maybe some restrictions from RBI on capital market exposure - leave aside that portion, after that we have ability to borrow another 900 crores in that particular entity.

Arvind Subramanian: It is an unutilized amount?

Rashesh Shah: Yes.

S. Ranganathan: Ability to collateralize and set up fresh limits that is what Rashesh was talking about, something like 2000 crores where we have the ability to further leverage ourselves.

Arvind Subramanian: Finally on your slide 15 on ALM, when you make assumptions on your asset maturity, is it on the contracted duration especially for loan against shares or is it your estimate of liquidity? Because there was confusion last quarter when you had put out the presentation. So when you all have build this up this time, is it on the contracted maturity of loan against share?

S. Ranganathan: Yeah it is on contracted maturity including fixed deposit and the credit book.

Arvind Subramanian: So everything as on contract, not on estimate?

S. Ranganathan: Yes.

Arvind Subramanian: Just on the same slide, what is the total assets and liability that was considered for this slide, the base amount within the entire balance sheet?

S. Ranganathan: If you look at slide number 12, we will find the total assets as 13,289 crores, it is these assets which have been classified there for the purpose of ALM. The difference between 13,289 and 14,500 which is sitting in the balance sheet is on account of the current liabilities and various other things which have undergone a change because of the presentation requirement as per revised Schedule VI.

Arvind Subramanian: On the liability side you have drawn up the maturity for what amount?

Rashesh Shah: In slide 14 and 15, liabilities profile is for the entire amount of 13,289 including the networth of 2875 under 3+year.

Arvind Subramanian: Would it be possible going ahead if you could give up the breakup when you put out this ALM, just a request, breaking it into each classification that will be helpful.

Rashesh Shah: Yes. We will do that. Thank you.

Moderator: The next question is from Kajal Gandhi from ICICI Direct. Please go ahead.

Kajal Gandhi: If you can share more on the breakup of that commission and fee income because of the reclassification which is not possible to now break down.

S. Ranganathan: I'm talking about the yearly number.

Kajal Gandhi: Yearly is there in the presentation, we needed Q4 if you can share.

Shailendra Maru: Kajal I will give you quarterly number separately because they refer to four different quarters.

Kajal Gandhi: What is the employee base as of now?

Shailendra Maru: 3108.

Kajal Gandhi: On the OPEX side also since we have made some adjustments, what is the OPEX for the Q1 and Q2 if you can give?

S. Ranganathan: 73 crores and 83 crores but we will reconfirm it to you later on.

Kajal Gandhi: What is the broking yield that you have seen and have you seen any uptick in the cash turnover in the quarter because the market has seen something in that?

Shailendra Maru: Kajal as you can see from slide 28, there has been an improvement in the market share as well as the yield. The yield has moved up to 3.7 basis points from 3.6 in the 3rd quarter and for the full year of course there has been a drop.

Kajal Gandhi: What will be your commodity turnover on a daily basis, average daily commodity turnover?

Shailendra Maru: It is about 600 crores a day.

Kajal Gandhi: But the income is quite large because commodity brokerage doesn't seem to be giving so much of yield.

Rashesh Shah: The way to understand our commodity's business is not just the commodities broking business though we also do commodities broking. We are also importers of commodities like gold and Agri commodities which we distribute. So there is a combination of this physical part also, which is much larger so on that we earn a spread, we earn financing charges, and we earn distribution fees on that. So all of that put together is a commodity's total revenue. It is not broking only.

Moderator: The next question is from Chandan Gehlot from Deutsche Asset Management. Please go ahead.

Chandan Gehlot: My first question is related to the NIM on your credit wholesale book and the retail book. So what kind of NIM we are generating on that side?

Rashesh Shah: Broadly on the wholesale side we are getting about 400 to 450 basis points on an average and on the retail side it is about 120 to 140 basis points.

Chandan Gehlot: In terms of concentration, can you just give us the concentration on customer wise like top 10 customers how much do they contribute of your credit book?

Rashesh Shah: We don't have it off-hand but I would assume that out of our total book of 3900 crores, the top 10 will not be more than about 800 or 900 crores.

Chandan Gehlot: I just wanted to understand the quality of the collateral as you mentioned roughly the collateral is 2.5x. We just wanted to understand what kind of quality do we have generally because the reason why I'm asking, generally when we have the fixed assets or maybe the other particular asset against the loan. So there is a charge which is sometime the exclusive charge, sometime is the pari passu, sometimes is the subservient charge. So just wanted to understand what kind of quality do we have?

Rashesh Shah: More than 95% of the collateral is made up of liquid securities, can be shares, mutual fund assets, debentures. So large part of the collateral is liquid securities. Another 5% could be real estate asset where we have completely un-incumbered mortgage but no second charge and pari passu in that, including the housing finance book also where we don't do any pari passu charge, we will take the first charge.

Chandan Gehlot: What is your guideline for the housing finance figures for the next FY13 in terms of disbursement, in terms of geographical expansion?

Rashesh Shah: We currently are in 8 cities, we might add another 7or 8 cities in the year as we go along and our idea is to add about 1000 crores in the year but again it depends on interest-rate situation because housing finance is a kind of business you can step up and step down. But our idea is to be more calibrated on that because you also want to pick up the appropriate kind of business. So may be broadly 1000 crores but it can be a little bit here and there.

Chandan Gehlot: What kind of NIM margins we are earning on this business?

Rashesh Shah: As I said NII margins on housing finance is between 120 to 140 basis points. I don't think it will go higher than that so it will hover around the same range.

Chandan Gehlot: Lastly the question the gross NPA which is roughly 0.57% so broadly it is pertaining to wholesale business or retail business?

Rashesh Shah: it is largely retail business which is actually a retail business, on wholesale we have not had any major NPA. But no NPAs in housing book.

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

Shailendra Maru: Thank you Rashesh, Himanshu, Ranganathan and thank you Marina. Thank you everyone for joining us on the call. In case you have any other questions please do feel free to contact us at shailendra.maru@edelcap.com. Have a great day ahead.