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Conference Call Transcript

Edelweiss Capital

Q1FY12 Results

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Corporate Participants

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Chairman

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COO

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Questions and Answers

Moderator: Ladies and gentlemen good day and welcome to the Edelweiss Capital 1st Quarter FY12 earnings conference call. I would now like to hand the proceedings over to Mr. Shailendra Maru of Edelweiss Capital. Thank you.

Shailendra Maru: Thank you Rochelle. I am Shailendra Maru, Head of Investor Relations at Edelweiss Capital Ltd. Good afternoon to all of you and thank you everyone for joining us today as we discuss our unaudited consolidated financial results for Q1 FY12. Speaking today with you are Rashesh Shah – Chairman, Edelweiss Group, Himanshu Kaji – the Chief Operating Officer and S. Ranganathan – the Chief Financial Officer. Following the reading of Safe Harbor Provision, I will first turn over the call to Rashesh for his opening remarks. Thereafter Ranganathan will take you through an overview of our business performance and the financial numbers. Then we will open the lines for Q&A.

The press release and an investor presentation on our Q1 FY12 results have been circulated and are also available on our website www.edelcap.com.

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

Rashesh Shah: Thank you all for being on this call. As you would have seen from our results, this has been a tough quarter overall. Of course I do not need to highlight it as you must have seen that in the newspaper articles and everything else about how the state of affairs in the capital markets has been. If you see our results, one of the key reasons for the earnings drag in this quarter is that we have seen a Q-o-Q fall and a Y-o-Y fall. The Q-o-Q fall has been mainly because in this quarter capital market activity has been very low. Broking volumes and investment banking have been almost standstill. So if you see our fee and commission, there is a Rs. 30 crores drop Q-o-Q. And second, which is very specific to Edelweiss, is that we commenced our insurance business in this quarter, so we have infused 300 crores of capital in the insurance entity and then there are other operating costs. So, in this quarter the capital market slowdown as well as the insurance commencement have been the reasons for the earnings coming down. On a Y-o-Y basis obviously a year ago interest rates were much lower, so the spread was higher by almost 100 basis points and because of the rise in cost of borrowing as I've spoken to you in the earlier conference calls, our spread has contracted from close to 500 basis points to 400 basis points. And about a year ago, we did not have Anagram. So when you compare Y-o-Y, the first quarter last year was without Anagram and now it is with Anagram. And on the Anagram front, as we have reported, we are almost close to the completion of the integration. Things have gone well; a lot of our people have gone into Anagram and as we move to the new office, all the Anagram employees will also move in there. Anagram is now called Edelweiss Financial Advisors.

The good thing in this quarter, if any, has been the capital businesses have done well. We have been able to scale up our treasury income as well as our interest income. There was some increase in profit due to the capital business but obviously it was not enough as compared to the fall in profit because of the capital markets and the insurance investment.

As you look at this quarter results, one other thing that should stand out and we are actually going to be sharing some more information on that, is that couple of years ago we embarked on the strategy of diversifying our total revenues and profits. And if we compare this quarter with 12 quarters ago, which means Q1 of FY09, our equities were 75% of the total revenue that time, now only about 36% of our total revenue comes from equities across broking, trading, arbitrage all of that put together. The contribution from equities as an asset class thus has come down from 75 to 36%. What we call the credit and the fixed income part of the business, which is the other asset class, which was 17% two years ago, is now 44%. So credit and fixed income has grown from 17 to 44%, and commodities which was 5% two years ago is now 15% of the overall revenues. So we have significantly brought down total contribution to our revenue from equities in favor of credit and fixed income and commodities. And this is one of the key highlights as we now expand our housing finance and insurance business. The diversification will be even more stark going forward and on a long-term basis we want to have almost equal amount of our total revenues coming from all these asset classes and businesses - equities, fixed income, commodities, insurance and housing finance.

The other key achievement in this quarter has been that our insurance business has just commenced. We have got all the approvals, we have started selling policies a few days ago and though the current market environment for insurance is also not very easy, we do feel very positive about the start that we have made and the team that we have hired. On a long-term basis, we are very positive of the opportunities in the insurance space. If you remember from the earlier calls, we think currently about $40 billion a year goes into the insurance sector from the household savings and we think over the next 5 or 7 years it should be closer to $100 billion. So this is one of the big opportunity space and we're starting in a difficult environment but it will be a good start.

We also just got an award as a Super Brand. We have invested quite a bit of effort and resources in building the brand in the last year as we're getting ready for our retail expansion and the insurance expansion. And we just got this award of one of the Super Brands in the financial services space, in fact the award ceremony is today in the evening. So it has been another good highlight for us.

On a long-term basis, if I see the trends and where we are in the market and the outlook, this quarter has been, as I said earlier, one of the hardest quarters we have seen. And one of the reasons it was a very tough quarter is because there is a significant conflict between the long-term and the short-term in this. All of us are very happy when the long-term and the short-term are both in sync, either both are equally bad or they are both equally good. Currently the short-term is very bad but the long-term still gives us a lot of confidence in terms of India growth and the savings pool growth and how the savings will get converted into investments. And our larger strategy has been to focus on the process of how a lot more savings get converted into good long-term investments via capital formation.

Our housing finance, insurance and all those opportunities that we have gone after is basically concomitant with that. We think the growth in household savings in India, which has been about 14 to 15% a year in Rupee terms, is going to be the genesis of opportunities in the financial services space. So we stay committed to that but the short-term headwinds are very severe, all of us are feeling it on an everyday basis. In the short term what we're seeing is a shrinking pool. Our estimate is that in this quarter the broking commission pool, both retail and wholesale, has shrunk by around 20 to 22%. investment banking pool has shrunk by almost 50% even on a Q-o-Q basis. Obviously there is increased cost in April, salaries got revised upwards. Increase in salary costs and other costs as well as the fall in the margin because of competition - in short-term almost everything is looking very bad. We think it will continue for another couple of quarters.

Though in this quarter we have seen the worst, it may continue to be like that; hopefully it will not get worse than this. But if we look forward 3-4 quarters from now especially FY13, we feel a lot more positive because we are hitting rock bottom in terms of shrinking revenue and profit pools, increasing cost pressures and lower margins. We have tried to add that in our investor presentation. In the last three years, we have tried to either maintain or grow the market share. And we have been able to achieve that in all the products and the businesses that we are in. In our retail broking business we have increased the market share. On the institutional business we have been able to maintain the market share. Investment banking, we have been able to grow our overall market share. So overall, we feel comfortable with the same even if the market itself is shrinking, we are able to maintain market share or grow the market share.

We have also invested a lot on efficiency. The kind of activity volume you would have seen in the top line growth, in a couple of years it is almost close to 100%. So the top line has grown by almost 100% which obviously results in a lot of activity but if you compare the Opex and everything else vis-à-vis the top line growth, we have improved our efficiency significantly, through automation, and training and investing in systems and processes.

And thirdly we invested a lot in organization building - in the leadership development. It is that leadership talent pool that we have, which allows us to expand and grow the top line. Now we have to go forward focused on getting the bottom line which will happen when the shrinkage starts to stop and we start getting back into the growth phase for our capital market sector and the other businesses we are in.

Broadly as I said, we're focused on the diversification strategy. We have another 2-3 years to go in that and from where they were couple of years ago to where we are now, we feel happy about it.

So overall these are the four plans on which we are focusing: ensuring that we are growing and maintaining the market share, ensuring that we are improving our efficiency on almost all the parameters, focusing on organization building through leadership and fourth is on diversifying all the businesses that we have because we do think that will not only reduce risk and volatility but also increase growth prospects as we go forward.

Having said that, as we are all aware the coming couple of quarters are still going to be tough. The key indicator for all of us to watch is inflation because as long as inflation remains high, we will all be sure that the interest rates will be high. As long as the interest rates are high, alternative investments outside of equities will look a lot more attractive for investors and as long as interest rates are high corporate earnings will slow down.

So if you see the combination of slowing corporate earnings and more attractive investment options for investors, we do think that the equities and the capital markets for the next couple of quarters will still face headwinds. Otherwise in this there will still be opportunities to consolidate. Having gone through this quarter, we do think the stronger players will only get stronger through the year. It may not get reflected in their quarterly numbers and the P&L. But we should expect that the stronger players will get stronger, hopefully some consolidation will happen in the industry and we are starting to see some early signs of that, some shakeout, some consolidation. And we're hoping that it should present an opportunity for us to grow as we go along.

I would now hand it over to my colleague Ranganathan, our CFO, to take you through the details on our performance this quarter.

S Ranganathan: Thank you Rashesh. Let me dwell on the key takeaways for Edelweiss for Q1 FY12. Broadly, we continued to achieve revenue growth both on Y-o-Y and Q-o-Q basis, thanks to the extent of diversification that we achieved in our businesses. However, challenging operating environment and our conscious decision to continue with the investments in incubating new businesses, about which we have also spoken in our previous calls, have affected our margins and returns. But the good news is that despite these factors we have continued to maintain our market share or even increased it in some of our businesses.

On the business front we are happy to note that our life insurance business has received the final approval from IRDA and was soft-launched this month.

Our plans for scaling up our recently launched housing finance business in FY12 are on track and we have now extended the operations to Pune and Bangalore in addition to Mumbai and the NCR. Our other nascent retail businesses also continue to grow in size.

We are happy to share that the Edelweiss brand has been adjudged a Business Super Brand 2011 recently in the third edition of the Super Brand India by the Council of the Business Super Brands in India, comprising 10 eminent personalities from corporate India.

Edelweiss has also recently won 2 awards at the CMO Asia Award 2011 at Singapore. Edelweiss Absolute Return Fund has won awards for the best marketing campaign of the year, as well as the award for the best brand excellence in the BFSI sector.

Turning to our performance highlights, our total revenue for Q1 FY12 was Rs. 396 crores, up by 2% Q-o-Q, and our profit after tax was Rs. 33 crores, down by 23% Q-o-Q. Our capital based businesses continue to generate a larger part of our revenue and now account for nearly 75% of our total revenue for Q1. In the capital-based revenue, interest income has been Rs. 235 crores for the quarter. Interest income from credit businesses continues to be a significant revenue stream, accounting for about one third of our total revenue.

Our agency businesses had a subdued quarter in line with the industry and recorded a fee and commission income of Rs. 97 crores in Q1. Both Broking and IB sectors continued to witness a slower activity level. With a higher contribution coming from capital-based revenue, the concept of net revenue is becoming more and more relevant for us. For the quarter our agency fee and commission has been Rs. 97 crores and the capital-based businesses had net revenue of Rs. 114 crores. Thus the agency income and the capital-based net revenue contribute more or less in a balanced manner at the net revenue level.

Our total cost this quarter is Rs. 344 crores, up by 7% Q-o-Q. Within the total cost, our operating expenses have remained unchanged at Rs. 93 crores compared to Q4 FY11. Carrying cost of our new office building has added to our cost as we have mentioned in our previous calls. We have already moved a number of businesses to our new building and hope to complete the relocation in the second quarter. By now already 1055 employees have moved to the Edelweiss House, our new office building and another 150 are due to move in the next couple of weeks. We have already surrendered the entire leased space in the Express Towers and a substantial part of space in our Sion office.

We have also passed cost for incubating new businesses through the profit and loss account. We are still in the investment phase and will continue to be so in this year. These additional costs continue to affect our ROE and the margins. Our PBT margin for the quarter is 13% compared to 17% in the previous quarter. The PAT margin is 8% compared to 11% in Q4 FY11. With the capital based businesses now contributing nearly 75% of our total revenue coupled with the impact of continuing investment, the margins are considerably lower currently.

Now turning to our business highlights – you will be happy to know that Edelweiss Tokio Life Insurance has received the necessary approvals from IRDA and we have made a soft launch of the business in July. We already have a bouquet of five diverse products in the market with five branches of ET Life. The company has also been capitalized with additional Rs. 500 crores in the first quarter by both the partners. We plan to scale up our presence through some more branches and build a network of personal financial advisors going forward.

The housing finance business that we launched in the second half of the last year has now crossed Rs. 185 crores level. We have extended the operations to Pune and Bangalore in addition to Mumbai and NCR. We plan to scale this up going forward, as well as extend operations to a number of major cities in the country.

In our alternative asset management business, we now have AUMs/AUAS of $370 million equivalent. Our mutual fund manages 4 equity and 6 debt schemes with an AUM of Rs. 407 crores by June 2011. The AUMs were Rs. 155 crores as on March, 2011. The focus of our domestic asset management continues to be on broad-basing the product portfolio and building investment track record.

The credit business continues to fare reasonably well. Steady-state loan book was at about Rs. 2600 crores in June 11 compared to Rs. 2644 crores in March 11, Q-o-Q de-growth of about Rs. 45 crores. The volatility in the market from November 2010 has made us focus on risk leading to a slight de-growth in the book. The loan book comprises of wholesale loans of roughly Rs. 2000 crores and retail loans including housing loans account for the balance. The total retail loans constitute 20% of the book.

We continued to avoid sectors or industry concentration in our credit book. As at the end of this quarter the top three sectoral exposures are infrastructure 18%, real estate 14% and organized retail 11% of the loan book. The loan book is adequately collateralized with an average collateral cover of three times at the end of the quarter. The Q1 yields are marginally higher at 16.8%, as we have been able to pass on a part of the interest rate increase to our borrowers. The asset quality of our credit book continued to be satisfactory. Our gross NPLs are Rs. 14.6 crores compared to Rs. 11.6 crores in the previous quarter. The gross NPLs are equal to 0.56% and the net NPLs are 0.10% of the total book. Including the general provision on standard assets, our total provision cover on the NPLs is around 127%.

The treasury book size at the end of the quarter was higher at about Rs. 1800 crores compared to Rs. 1250 crores in the previous quarter. The gross yield for the first quarter is marginally higher at 13.3% compared to 12.8% in the previous quarter.

Now turning to our capital markets business. In the investment banking while the pipeline for the deals continues to be strong, actually deal closures have been very slow. We handled 3 transactions in ECM & Advisory and five transactions in DCM in quarter one, compared to seven transactions in Q4 FY11. These include rights issue of Rs. 457 crores of Karnataka Bank as sole lead manager, Open offer of IL&FS Engineering and Construction Company and NCD/bond issues of IRFC, REC, PFC, L&T Finance and Mahindra Finance. With the efforts of our coverage group we continue to have strong presence among both public and private sectors as well as mid and large corporates. We continue to be a major player in the corporate bonds syndication and are ranked second in commercial papers issuances in Q1 FY12. Overall we are ranked sixth among the debt arrangers in the country as per Prime Database.

Brokerage business: Broking industry continues to face strong headwinds as all of you are well aware of. Our total broking income for Q1 FY12 is Rs. 72 crores compared to Rs. 77 crores for Q4 of FY11, a de-growth of about 7%. It accounts for 18% of our total revenue for the first quarter of 2012. Our total average daily volumes for Q1 have been Rs. 5188 crores compared to Rs. 5855 crores in the previous quarter, a drop of roughly 11%. The market ADV has fallen by about 14% in the same period. This gives a market share of 3.8% for the quarter, slightly better than the previous quarter where it was 3.7%. Of the total ADV the client broking volumes for this quarter were Rs. 2350 crores compared with Rs. 2600 crores per day in the previous quarter, a drop of 10% in line with the industry.

Our equity broking commission for the quarter is Rs. 59 crores down from Rs. 69 crores in the previous quarter, a drop of 14%. Since the clients' ADV has fallen 10% and the broking commission has fallen by 14%, our broking yield on client transaction is lower at 4 basis points for the first quarter compared to 4.2 bps in Q4. Lower cash volumes and competitive pressures in the market are leading to the fall in the yields in the industry. Cash volumes in the market in Q1 are 12% lower than what they were in Q4 2011.

Our research continues to provide strong support to our broking business covering 203 stocks across 21 sectors. Edelweiss continues to build retail businesses both in the retail broking and distribution. We currently have over 3,39,000 clients through our online portal www.edelweiss.in and through the off-line model. We continue to add new clients at a healthy pace - roughly 14,000 clients were added in Q1. By June end we had 263 own offices and 33 franchise offices. All of these offices together with over 2000 sub brokers and authorized persons network cater to the retail broking clients.

Finally turning to our balance sheet. Our total balance sheet size at the end of the quarter was over Rs. 10,900 crores compared to Rs. 10,800 crores as at the end of financial year 2011. The gross net worth of the group now stands at Rs. 2811 crores. The same excluding the minority interest of Rs. 238 crores is Rs. 2576 crores; this was Rs. 2440 crores in March 2011. The growth in the net worth in Q1 is mainly due to the retained earnings and addition to the reserves and surplus due to the premium paid by our JV partner in the life insurance subsidiary, which is book value accretive for the investors in ECL. The effective net worth of the company excluding the goodwill and investment in employee trust shares is Rs. 2265 crores as on June 2011.

Our borrowings at the end of the quarter have been Rs. 8110 crores. This implies a gearing of 3.04 times including the minority interest in the tangible net worth. Out of the cash and bank balances of Rs. 3063 crores as on June 2011, and the amount of bank fixed deposits was just over Rs. 2900 crores. The bank FDs along with liquid mutual funds investments provide us the required working capital as well as impart the much-needed liquidity to grow our operations. The level of sundry debtors as of June 2011 is Rs. 1558 crores compared to Rs. 3587 crores as at the end of March 2011. Similarly sundry creditors have moved down to Rs. 1280 crore from Rs. 3984 crores in the same period as we had indicated in our Q4 call. The total loans and advances as in June 2011 are Rs. 4150 crores including the credit book outstanding of Rs 2600 crores. These have also come down by about Rs. 900 crores.

You will thus see that the business and in the product diversification which was started by us 3 years ago, we are now more than halfway through. This included transition from wholesale to retail and capital markets to financial services. Products, as you know, usually have a stronger correlation with the environment and the market. Hence, our business diversification insulates us from that. Now we are getting the scale.

To sum up, while we continue to scale our established and mature businesses, we are continuously investing in building out new businesses. We also continue to look for the opportunities to expand in the financial services segment and at the same time in the current difficult environment the focus is on achieving incremental improvements in efficiency and cost control.

With this I would like to conclude and we will be happy to take your questions.

Moderator: Thank you very much sir. Our first question from the line of Lokesh Mallya of Birla Sunlife Mutual Fund.

Lokesh Mallya: Hi, my question is on the sundry debtors and creditors. As I understand, it reflects the gold business that you are into, basically where you buy gold from the canalizing agencies and sell it on to jewelers. It was a large amount as on March 31st, as you mentioned earlier 3600 crores of the debtors, 3900 on the creditor's side and it has come down significantly. What is the reason for this and secondly also if you could throw some light on how the 1800 crores of treasury assets are stacked up across various asset classes in terms of fixed income commodities, equities, etc.?

Ranganathan: You are right about the numbers, what we said that it had come down from Rs. 3500 odd crores. To answer your question, yes we did mention about the business of bullion in the last quarter and there were some opportunities which are available closer to the end of March 2011 and we did that which eventually led to the increase in the debtor's number and the creditors' number. Of course there was not much of an impact on the net current asset level. Now this was an opportunity which was available at that point in time, and it was on a 90 day credit period, that's completed and those have come down to a reasonable level. We didn't have such kind of opportunities as of June, so it is sort of business as usual now.

Lokesh Mallya: So, is that something that is going to follow as a trend, the amounts are going to come down. As I understand it is a margin business, which is pretty stable?

Rashesh Shah: Yeah, actually these are opportunistic things that are available in the market and what we saw last year, because of the huge interest in commodities, there was a lot of demand out there. We had capacity, so we imported on credit and sold on credit against LCs. But without taking a lot of risks, the margins were fairly small in that. It is a small spread business and the risk is also fairly low. So as we see the opportunities, we try and capitalize on that, subject to risk and capital utilization being low.

Lokesh Mallya: Okay and could you throw some light on how the treasury assets components are like, 1800 crores?

Himanshu Kaji: By and large it is broadly divided between equities and commodities, 50-50.

Lokesh Mallya: So fixed income which used to form a quite a large chunk is not a part of this?

Himanshu Kaji: It is a part of the working capital assets of the treasury.

Lokesh Mallya: Which is the net current asset, you are talking?

Himanshu Kaji: In the classification is of treasury assets, what we call treasury assets are equities and commodities. In addition to that we have treasury working capital asset which are fixed income related.

Lokesh Mallya: So in addition to 1800 crores treasury working capital assets are inclusive of the fixed-income?

Himanshu Kaji: Yeah.

Moderator: Thank you. Our next question is from the line of Sameer Kulkarni of Vantage Securities.

Sameer Kulkarni: I just wanted to know that you have entered into the housing finance, around 185 crore of book as on 30th June. So going forward, over the next two years, how do you see this book growing?

Himanshu Kaji: For the FY12, we expect the book to grow around Rs. 800 crores and for the next year we should be around Rs. 2000 crores.

Sameer Kulkarni: Sir, in the broking industry, we have seen the Indian players are downsizing or they are keeping the growth momentum at lower rate but at the same time the foreign brokerages are entering in the market. So how do you see the broking business growing over next 2 to 3 year?

Rashesh Shah: As I said earlier, there are headwinds in the next couple of quarters. If you add up the institutional commission and the retail commission, it is about Rs. 11,000 to 12,000 crore annual market which goes up and down by 15-20% every quarter. So, we will have an 80-20 rule on that, 20% of the brokers will control the 80% of the commission pool as you go forward. We do think that, it is not that all Indian guys are facing problem. Indian brokerage firms which are well-capitalized and which have a good product offering can get scale. The future in this business is going to be either you get scale in efficiency or you remain very small and you have a very small niche clientele who you cater. So the market will get polarized between large brokers who have scale and efficiency and small brokers who have a very niche clientele.

Sameer Kulkarni: Okay but as we are seeing that the cash volumes are going down, when do you see the volumes picking up, during FY13 only?

Rashesh Shah: The key in that is to keep on looking at inflation because until inflation comes down, until interest rates come down, equities will not be a favored asset class. As I said, inspite of that the commission pool is about Rs. 10,000 to 11,000 crores. It used to be about Rs. 14-15,000 crores, three years ago. So there is enough income for everyone out there. Obviously, costs have gone up, competition has gone up but if you have scale in efficiency, there is still a good business proposition out there and we do feel that in a couple of years when growth starts coming back, there will be good prospect in this industry.

Sameer Kulkarni: Sir, last point is, as you mentioned in the earlier conversation that the equities portion has come down from 75 to 36% and the Fixed Income has gone up from 17 to 44%, so how do you see this ratio panning out over the next 2 to 3 years?

Rashesh Shah: As I said, if you go back couple of years ago, we were largely an equity house, all our business was around the equity market and at that point we communicated to all the shareholders and investors and said that we will now diversify the business. So credit was the first one. So now equities is about 36%, fixed income and credit is about 44% and commodities is 15% and hardly anything from the housing finance and from insurance currently because they are both very new businesses. On a long-term basis we would like some kind of 20-20-20-20 rule that though the profitability will change from year-to-year across this asset classes but if you can achieve 20-20-20-20 at a net revenue basis, it would be a good achievement for us.

Moderator: Thank you. Our next question is from the line of Dipan Shankar from HSBC Invest Direct Securities.

Dipan Shankar: I had a question in particular related to the insurance business. Just to understand what is the product niche that we are offering which is not out there and how has the response been, given that the market share is the key thing and brand proposition is the main thing in this business, but LIC is still remaining the key player in this particular segment?

Rashesh Shah: You have asked a very existential question. In essence it says that why should anybody enter any particular industry, when there are already market leaders and established players. Yeah, our view is that in a country like India, we have currently about 30 odd insurance companies. We do think that the market pool is large and growing fast. As I said from $40 billion, we think it is going to go to $100 billion. Obviously LIC and a few other large players will still remain fairly well-entrenched competitors but the way the financial services usually works is, it is not winner take all kind of situation, unlike the technology business. Financial services all over the world are more what is called distributed oligopolies, which means that 20 to 25 large players and it is true with a lot of services business. Look at IT services or BPO. Since it is the financial services, we think there will be room for at least 20 to 25 insurance players in India. And we have studied other markets like Brazil, China, Indonesia and all, and a country like India according to us needs about 40 to 50 players out of which at least 20 to 25 will do well, 20 to 25 will struggle like in any other business. So there is going to be room, which will largely come out of growth. We are not saying we will have a completely new product because in this industry the product will get copied fairly quickly. So it is going to be that we have a go-to-market strategy, a market niche, we have our own clientele that we will cater to, and over the next couple of years we will have to show to all of you that our strategy has worked.

Dipan Shankar: Second follow-up question, what is the distribution strategy currently in the insurance business? Are we looking at tie ups largely in the initial phase or it will be all our own employees who would be recruited on the sales side and the cost indication of that for ramping up for the insurance business?

Rashesh Shah: The insurance sales are usually through four channels. The first one is called agency. Second is called the bank assurance, the third is through direct selling through Internet and your own sales force and the fourth one is through corporate agents and other alternative channels. We will focus on the first one, which is the agency channel because we do believe that the agency channel is the old world way of doing business. The way the industry is getting restructured, as it is changing, the power of an agency model is going to start to come back very strongly. We are putting our faith for the first three year on this channel. We will obviously ultimately have to use all of the four channels, but your first channel for us will be agency.

Dipan Shankar: And in which cities have the started the soft launch yet?

Rashesh Shah: We have started in Mumbai and the NCR area which are the easier ones and we have opened offices in these two places. We are starting in eight other cities very soon and will announce them through advertisement as we roll out those offices.

Moderator: Thank you. Our next question is from the line of Abhishek Soni of Canara Robeco Mutual Fund.

Abhishek Soni: My question is on the credit book composition, how is the composition like? How much is the capital market funding and the wholesale funding and everything?

Rashesh Shah: If you see our entire book, we are focusing on collateralized credit. Largely close to about Rs. 2000 crores, which is almost 75% of the book is collateralized with liquid collaterals which is shares. But a lot of them also are loans to companies but is collateralized by promoters shares also. Because we are not a bank, we do not want to do pure working capital loans and pure straight loans. We want to focus more on providing either the loans to the sponsors or the loans to the companies but they have to be collateralized. So our average collateral cover is almost 3x and a large part of this is liquid collaterals. We do take some secondary collateral which can be the real estate and all, but the primary collateral that we insist on is always liquid collaterals, whether it is a loan to the promoter or a loan to the company.

Abhishek Soni: So as you have said out of 2600, 2000 is on liquidable shares or some other sort of collateral, right? And what is the nature of the remaining 25-30%, 600 crores of it?

Rashesh Shah: You see, Rs. 2000 crores is the wholesale loans and the other Rs. 600 crores includes about Rs. 185 crores of the housing finance loans and the remaining Rs. 400 crores is margin funding and brokerage related business.

Abhishek Soni: So the 2000 is promoter funding sort of and the 400 is the margin?

Rashesh Shah: We do not call it promoter funding because as I said earlier we also give loans to companies which are backed by promoters' shares, like we do funding for infrastructure companies which are in project implementation stage but we do not want to take on the project risks, so we do give the loans to the infrastructure companies but we will take some shares from the promoting entities which has liquid collaterals.

Moderator: Thank you. Our next question is from the line of Lokesh Mallya of Birla Sunlife Mutual Funds.

Lokesh Mallya: Just a follow-up on your funding profile, how do you plan to diversify your funding profile going forward because as I understand quite a large part is dependent upon mutual funds and quite a lot in the short-term buckets? So what is the plan on that and what is the target leverage for the company going forward? Do you plan to keep the leverage at the current level or is it going to go up or down in the future?

Rashesh Shah: Out of the total borrowing we have about 65% comes from the mutual funds and the other 35% comes from the banks right now. Approximately 30% is from banks and five is from structured products and stuff like that. So broadly it is two thirds/one thirds. As we build assets which are non-capital market related like housing finance and infrastructure funding, we will actually increase the bank borrowings. Now recently retail bonds have also started becoming an addressable market. So as we diversify our businesses, our ability to source funding from the Indian capital markets and Indian banks will also grow. May be we can also go offshore because housing finance and infrastructure assets will also allow us to go offshore for borrowing as well as from Indian retail market from customers and retail investors.

To answer your other question, we want to go from currently what we have 3:1, by the end of the year we will most probably be at 3.5:1 and then we want to slowly add to may be 4:1 in a year's time, but a large part of that is adding housing finance assets and infrastructure assets.

Lokesh Mallya: Is there a plan to set up a separate infrastructure finance company?

Rashesh Shah: Yes.

Lokesh Mallya: Will that happen within this year?

Rashesh Shah: We do not want to insist on saying that, we have to build the book and then go for an accreditation. We have started building assets in a way that we are more conscious of the risk than the speed at which we can scale up that book. So we will do it slowly but even our infrastructure lending is going to be some specialized products for infrastructure sector, not a 5 to 7 years infrastructure loan and those project financing kind of a thing. As we get to that status, we will also explain more about the products we have. But we have identified some 3 to 4 key products that are required in the infrastructure sector from the credit point of view, which we think we can cater to, given our asset liability profile and build may be a Rs. 1000 crores book in the next couple of years.

Moderator: Thank you. Our next question is from the line of Vinay Shah from Reliance Mutual Funds.

Vinay Shah: When I was referring to the balance sheet, our investment has increased from 388 to 1284 Q-o-Q, so just wanted to have an update here, I missed your opening remarks, so first thing, can you share some colour here?

Ranganathan: Vinay, it is predominantly into the government security treasury bills. If you look at what happened in quarter 1, we infused around 500 crores into the insurance business. As we go along, there will be utilization of funds but to begin with these funds were deployed in the approved securities for the purpose of insurance business, those are approved by the insurance regulator. So that is where a large chunk of investments are sitting.

Vinay Shah: When we say we have infused Rs. 500 crores in the insurance business, earlier I understood that we were supposed to infuse 100 crores every year into the insurance business. And together 500 crores in 5 years, so is it that the investment of five years has been infused in same year?

Rashesh Shah: The Rs. 500 crores is a combined infusion by us and our partner Tokio Marine. But since we own 74% of that, it comes into our consolidated balance sheet. So it is 500 odd crore, out of which we have put in Rs. 300 crores odd and balance has been put by Tokio Marine into that and currently we have put all that money into treasury bills and approved securities rather than investing into other asset classes. The reason we moved away from the Rs. 100 crores per year kind of model is, one the 49% approval for JV partners has not yet been approved by the Govt. Currently our agreement with them is that when government approves 49% for foreign partners, they are willing to put more money to go up to 49. So we have invested a bit more currently for which they will be buying shares from us in the future. Along with that, given the income tax and the capitalization needs of that, we thought we will upfront capitalize the entity. But after that we may not need to infuse additional capital for another one or two years from now.

Vinay Shah: And the second thing is, I was reading in some news article that ECL Finance has acquired 2% stake in Redington India, so if the same is true then going forward will there be any strategy to acquire such kind of stakes or is this a strategic stake, can you throw some colour here also?

Rashesh Shah: We usually do not speak about any individual transaction but you see ECL Finance is in credit basis. I can assure you that it is not in any investment business. Very often what happens is even in promoter funding, we take the shares on our books for various legal enforcement reasons and all that. It is a credit position which has been converted into an investment position, maybe for a transitionary period it came up in our books and then it got converted into some kind of a funding deal.

Moderator: Thank you. Our next question is from follow-up from Abhishek Soni of Canara Robeco Mutual Funds.

Abhishek Soni: Just wanted to check on the leverage policy on the consolidated level and as well as what is the current capital adequacy ratio maintained at the ECL Finance level?

Himanshu Kaji: ECL Finance capital adequacy is 35% and at a consolidated level we are 3 times geared at this point in time.

Abhishek Soni: Do we have any prudent mark or some sort of internal ceiling to that number?

Himanshu Kaji: Yes, as we mentioned we are not looking at anything beyond 4:1 over a period of 1-1.5 years.

Moderator: Thank you. There are no further questions. Would you like to add in closing comments Mr. Maru?

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

Moderator: Thank you Mr. Maru. Thank you members of the management team. Ladies and gentlemen on behalf of Edelweiss Capital that concludes this conference call.