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# Conference Call Transcript

## Edelweiss Financial Services

### Q2FY12 Results

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*Corporate Participants*

**Mr. Rashesh Shah**
*Chairman*

**Mr. Himanshu Kaji**
*COO*

**Mr. S. Ranganathan**
*CFO*

**Mr. Shailendra Maru**
*Head, Investor Relations*

## *Questions and Answers*

**Moderator:** Ladies and gentlemen, good day and welcome to the Edelweiss Financial Services Unaudited Second Quarter FY12 Earnings Conference Call. Please note that this conference is being recorded. I will now like to hand the conference over to Mr. Shailendra Maru of Edelweiss Financial Services. Thank you and over to you sir.

**Shailendra Maru:** Good afternoon to all of you and thank you everyone for joining us today as we discuss Edelweiss Financial Services' un-audited consolidated financial results for the second quarter of FY12 that ended 30th September 2011. Speaking today with you are Rashesh Shah, Chairman, Edelweiss Group; Himanshu Kaji, Chief Operating Officer and S. Ranganathan, 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 which will be followed by the Q&A session.

The press release, financial statements and a results presentation for this quarter have been circulated and are also available on our website, www.edelweissfin.com. Please note that we have recently migrated to our new and improved corporate website, www.edelweissfin.com, keeping in with the recent change in the name of our company.

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 uncertainties that the company faces. We have outlined these risks and uncertainties in the last slide of our Q2 results 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 now turn over the call to Rashesh.

**Rashesh Shah:** Thank you, Shailendra and hi everybody. Thank you for being on this call. And I'm sure most of you had a chance to see the results and the investor presentation that we have sent out. As you can see our top line is flattish from a QoQ point of view from first quarter to second quarter but the profit after tax has gone down. Largely, the fall in PAT is due to the insurance rollout as we are spending more money on the insurance part. We have occupied the office building that was underway, so the depreciation on that is also coming. So insurance and depreciation account for almost 75% to 80% of the fall in PAT. Outside of that things were marginally worse from first quarter.

From an environment point of view Q2 looks a lot worse. But it wasn't all that bad on a going concern basis if you see on the established businesses. It was only insurance and the occupation of the building for which accounting depreciation has come into the Profit and Loss account which has resulted in the fall in profit largely. Overall, if you see the markets are fairly subdued. Especially August onwards there is a much larger sense of gloom and doom that has set in.

Capital markets actually had a fairly bad quarter but not as bad as it appears when you look at it. Our estimate is that it was about 8%, 10% worse than the first quarter. What hurt in this quarter has a lot to do with the interest tightness and the resultant corporate reluctance to borrow. The credit is slowing down as we are seeing, the kind of liquidity crunch which we are seeing in the market, and that is hurting more. So the credit markets are now starting to hurt all financial services companies a lot more than the capital markets as such. In our case our insurance roll out has started, and it is getting rolled out as per plan. But it is obviously as expected adding to the cost.

The way we are actually breaking up our businesses are in three groups, what we call, Wholesale, Retail and Insurance. Wholesale capital markets had a slightly slow quarter. Though broking and equity capital markets were dull, M&A and fixed income advisory has had a fairly okay quarter. Because of that you would see that our fee and commission have actually gone up 8% in this quarter. The other business under wholesale business is wholesale asset management which is on schedule, though it was a flattish quarter in the sense the AUM has not gone up. There are a couple of funds for which we are on the road and in the next 4 to 6 months we would expect to close at least another couple of funds. For treasury, this was not a very good quarter. The volatility in August brought down treasury yields. Treasury spreads are now about 140, 150 basis points. They used to be 200 to 250 basis points earlier. And our wholesale credit book has shrunk a little bit while the retail credit book has expanded marginally and the spreads are the same. But it has been a lot more hard work because of the constant increase in short term interest rates.

On the retail side, in the retail capital markets we have completed the Anagram integration and it has gone well. We would hope to see some efficiencies out of that as and when activity starts scaling up. On the retail credit, our housing finance book has grown in this quarter. We are now adding about Rs. 40 crore to 50 crore every month on the housing finance part. It still needs to get to about Rs. 1600 crore to 1800 crore to break even and we are currently about Rs. 350 crore, but it's going as per schedule. And retail asset management also had a reasonably okay quarter with AUM going up. Insurance is the third group of business we have, which is as I said earlier starting to scale up as per expectations.

The coming couple of quarters, we do see them as challenging because the slowdown in economy activity and the high interest rate scenario, forget about the global gloom and doom that is anyway there, but these two are actually hurting activity more as such. Though our expectation is that capital markets should not get worse. A lot of pain is already in there, so hopefully it should not get worse from what we have seen in the first and second quarter of the current year. Credit scale up should ideally start after interest rate stabilization happens. We think it may be another 3 to 4 months as inflation start coming down, at least RBI will hopefully pause if not cut interest rates and that should be a good opportunity for scaling up the credit book because we do know a lot of corporates and the promoters who are not currently borrowing and waiting for some interest rate stabilization to happen.

Insurance, we will keep on rolling out. The Tokio Marine partnership is going very well. They have deputed additional people out here to help with the entire roll out.
We are basically waiting for inflation and interest rate scenario to improve. At the same time we continue to invest in our retail growth business and also focus a lot more on execution efficiency, so there is a lot of stuff going on in the company to eke out more and more efficiency. The relocation to a common office building should give us some amount of efficiency from productivity and other point of view over the next few quarters. So fairly disappointing quarter overall, but the way the environment has been this was expected and compared to first quarter, second quarter has been just slightly worse overall for the industry. For us, coincidently, the insurance scale up is happening at the same time and that is why the numbers are also reflecting that. Having explained that, I will hand it over to my colleague, Ranganathan, our CFO, to add a lot more color to this. Over to you, Ranga.

**S Ranganathan:** Thank you Rashesh. Thank you, everyone again for joining us on the conference call. Let me first discuss the key takeaways for Edelweiss for Q2FY12. Broadly speaking, despite growth stagnating in the market, we continue to preserve our top line given the extent of diversification that we have achieved in our business. However, the operating environment turned even more challenging this quarter. In addition, our conscious decision to continue with the build out of our new businesses, investment in some assets that are currently non-yielding and the depreciation on the new office property have affected our bottom-line. But the good news is that despite these factors the impact of environmental factors has been contained and our core operations continue to be strong.

On the business front, our Life Insurance business has commenced operations this quarter and is already present in 14 cities. Our plans of scaling up the recently launched Housing Finance business in FY12 are also on track as we have now extended the operations to Ahmedabad, Pune and Bangalore in addition to Mumbai and the NCR. Other retail businesses which are under incubation, also continue to grow in size. The steady businesses have posted a strong performance.

Now, turning to the performance highlights. Our total revenue for Q2FY12 was Rs. 385 crore, flat over Q1, and our profit after tax was Rs.26 crore, down 21% QoQ. Our capital-based businesses continue to generate a large part of our revenue and now account for nearly 3/4th of the total revenue of Q2. In the capital based revenue, interest and treasury income has been Rs. 276 crore for the quarter. The interest income from credit business continues to be a significant revenue stream accounting for almost 30% of our total income. Our agency businesses had a reasonable quarter in line with the industry and recorded a fee and commission income of Rs. 105 crore in Q2. Both broking and investment banking continue to witness declining activity levels. As mentioned in our previous calls, with the higher contribution coming from capital based revenue, the concept of net revenue is becoming more and more relevant to us. For the quarter our agency fee and commission have been Rs. 105 crore and the capital based businesses had a net revenue of Rs. 104 crore. This agency income and capital based net revenue thus contribute almost equal to the net revenue at the net revenue level.

Our total cost this quarter was Rs. 344 crore, up 2% QoQ. We have completed the relocation of all the businesses from Express Towers and Sion to our new office building and nearly 1200 employees now operate from Edelweiss House. We have already surrendered entire leased space in Express Towers and Sion offices, though there was some overlap in the second quarter. The savings on the lease rental has been offset by the depreciation on the new office building. Our employee cost is marginally higher this quarter, as we continued to selectively hire for our new businesses, especially Life Insurance. We have also passed through the profit and loss costs for building new businesses with an eye on the future growth. We are still in the investment phase and will continue to be so for about a year or so. These additional costs continue to affect our ROE and the margins.

Our PBT margin for the quarter is 11% compared to 13% in the previous quarter. The PAT margin is about 7% compared to 8% in the first quarter of 2012.

Now, turning to our business highlights. Edelweiss Tokio Life Insurance has commenced its business this quarter. We already have a variety of diverse products covering term plan, savings options, credit protection and ULIP funds in the market. Its presence has been scaled up with the opening of 19 branches in 14 cities in the first quarter of operations itself. ET Life has also appointed over 350 Personal Financial Advisors (PFAs) for business development. We plan to scale up our presence through more branches and larger network of PFAs going forward.

The Housing Finance business, one of the new businesses we have, reached nearly Rs. 350 crore level this quarter. It offers residential mortgages, loan against properties and lease rental discounting. We have extended operations to 5 metros and plan to extend operations to a number of major cities in the country.

In our alternative asset management business we now have AUMs/AUAs equivalent of over $380 million. Our mutual fund manages eleven equity and fixed debt schemes with an AUM of Rs. 470 crore by September 2011. During the quarter a new select mid cap fund and an FMP fund were launched. It now has an active base of over 5,000 investors. The distribution network has been strengthened by building a force of nearly 3000 distributors. The focus of our domestic asset management continues to be on broad-basing the portfolio and building investment track record.

The credit business continues to post stable performance. Steady state loan book was at Rs. 2640 crore in September 2011 compared to Rs. 2600 crore in June 2011. The volatility in the market, November 2010 onwards has made us focus more on risk rather than pursue an aggressive asset growth. The loan book comprises of wholesale loans of roughly Rs. 1800 crore and retail loans including housing loans account for the balance. Total retail loans constitute over 30% of the book. We continue to avoid sectors and industry concentration in our credit book. At the end of this quarter, the top three sectoral exposures in the books are Mortgages and LAP 13%, Media & Entertainment 12% and Real Estate 11%. The loan book is adequately collateralized with an average collateral cover of over 2.7x at the end of the quarter. The Q2 yields are flat around 16.6%. We have, however, improved our spread for the book as cost of borrowings this quarter is marginally lower. The asset quality of our credit book continues to be satisfactory. Our gross NPLs are Rs. 17.2 crore compared to 14.6 crore in the previous quarter. The gross NPLs are equal to 0.65% and the net NPLs are 0.20% of the total book. Including the general provision on standard assets our total provisions cover on the NPLs is around 109%. We are more than adequately covered on the NPLs as the primary collateral cover itself on them is about 1.3 times. Taking the collateral cover and the provisions that we hold, the total cover available on the gross NPLs is about 2.4 times.

The treasury and related asset book size at the end of the quarter was around Rs. 4900 crore. The gross yield on this book for the second quarter is 10.9%. The average cost of borrowing for us during this quarter was 9.3% which gives us a spread of roughly 1.6% on the treasury and related assets.

Now, turning to over capital market businesses; in investment banking while the pipeline for the deal continues to be strong, actual deal closures have been extremely slow. We executed two transactions on the ECM and advisory side and seven transactions in DCM in Q2 compared to total 8 transactions in Q1. 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 bond syndication and have improved our overall rank to fourth taking commercial papers and bond issuance together in the first half of 2012 with 18% market share. We are also ranked fourth in CP issuances as per Prime Database. During the second quarter we placed NCDs and bonds for PFC, REC, HUDCO and SBI Global Factors.

**Brokerage business:** Broking industry continues to face strong headwinds as you are all aware of. Cash volumes are declining, futures are flat and options are increasing, putting pressure on yields. There was a net FII outflow in the second quarter. The industry broking revenue pie is also shrinking. In this challenging environment our total broking income for Q2FY12 is Rs. 67 crore compared to Rs. 72 crore in Q1 of 2012, a de-growth of roughly 7%. Broking income accounts for 17% of our total revenue for the quarter. Our total average daily volumes for the second quarter have been Rs. 5305 crore compared to Rs. 5188 crore for the previous quarter, a growth of 2%. The market ADV has risen by 9% in the same period; hence our market share is 3.6% for this quarter.

However, out of the total ADV, the client broking volumes this quarter were higher at Rs. 2540 crore compared to Rs. 2350 crore in the previous quarter, a growth of roughly 8% which is in line with the market growth of 9%. The broking yield on client transactions continued to be flat at about 4 basis points this quarter. Our research continues to provide a strong support to our broking business covering 186 stocks across 20 sectors.

Edelweiss continues to build the retail businesses. We currently have over 3,54,000 clients through our portal, www.edelweiss.in and through the offline model compared with 339,000 in Q1. While we added new clients at a healthy pace, the focus is also on activating a larger percentage of the new additions. As in September end we have 261 own offices and 47 franchisee offices. We have also ramped up the network of sub-brokers and authorized persons to over 4000 in over 500 cities by the end of this quarter to help us expand our retail broking footprint.

Finally, turning to our balance sheet, our total balance sheet size at the end of the quarter was around Rs. 10,900 crore about the same as at end of Q1FY12. Total net worth of the group now stands at Rs. 2,845 crore. Our borrowings at the end of the quarter have been Rs. 8,050 crore implying a gearing of 2.83 times with the inclusion of minority interest in the total net worth. Out of the cash and bank balances of Rs. 3222 crore, the amount of bank fixed deposits was just over Rs. 3000 crore at the end of the second quarter. The bank FDs along with liquid mutual fund investments provide us the required working capital as well as impart the desired liquidity to our operations. The level of sundry debtors as at the end of September 2011 is Rs. 303 crore compared to Rs. 1,558 crore as of end of June 2011 and Rs. 3,587 crore as at the end of March 2011. Similarly, sundry creditors have moved down to Rs. 965 crore from Rs. 1,649 crore on June 2011 and Rs. 4,353 crore as at March 2011 as per indication given in our previous two calls. The total loans and advances as on 30th September 2011 were Rs. 4,100 crore including a credit book of Rs. 2,640 crore. These were Rs. 4,150 crore as on June 2011 and at Rs. 5,061 crore as at March 2011.

Going forward, despite the current headwinds affecting the financial services sector, we remain focused on our core strategy with the planned build-out of our new businesses of Life Insurance, Asset Management and Housing Finance for future growth. Our investment phase will continue for about a year or so from now. We are also focusing on improving efficiency in cost consciousness in this difficult period. We started business and product diversification three years ago and are now more than half way through, wholesale to retail, capital market to financial services. As you know products usually have a larger correlation with the environment and the market, hence business diversification insulates us from that. We are now looking to gaining scale. With this I would like to conclude and we will be happy to take your questions.

**Moderator:** Thank you sir. Ladies and gentlemen we will now begin the question and answer session. The first question is from Pankaj Agarwal from Ambit Capital. Please go ahead.

**Pankaj Agarwal:** If I look at your balance sheet your loans and advances have remained more or less constant sequentially, even your borrowings have remained constant sequentially. But if I look at your net interest income in fund based income, it has gone down sequentially. Any particular reason for that?

**S. Ranganathan:** Your question was the interest income has gone down. Now, if you look at the first sheet where we talk about the financial results. The fund based income includes the treasury income also in addition to interest income. If we breakout the interest and the treasury separately, you will find that NII has improved by about Rs. 7 crore in Q2 compared to Q1 as interest expense is lower in Q2.

**Pankaj Agarwal:** Even it is like overall if your borrowings have remained constant and your brokerage volumes have remained constant, right, I believe the working capital for brokerage would have been almost similar versus last quarter. So the funds which are available to earn any kind of interest income would have been similar on a sequential basis and as the rates have gone up sequentially, slightly higher, I believe the interest rate should have been higher in this quarter.

**Himanshu Kaji:** In September quarter we did not have any episodic income. If you see our interest expense also has gone down. The quarter before we had a small amount of episodic income as well expense and therefore average book size has resultantly got adjusted. The numbers you are seeing are end of the quarter numbers.

**Pankaj Agarwal:** Episodic in a sense some kind of one-time interest income or--?

**S. Ranganathan:** IPOs and other financing business which are opportunistic.

**Rashesh Shah:** The ideal way to look at it is interest income minus interest expense. That should usually give you a good handle.

**Pankaj Agarwal:** So that was also like it was down from 110 crore to 100 crore, so there is a sequential decline of around 10 crore in that?

**Rashesh Shah:** No, treasury and interest income has gone down from 288 crore to 276 crore which is about 12 crore and the interest cost has gone down from 184 crore to 176 crore which is about 8 crore. So it is a 3-4 crore gap which is due to lower treasury income.

**Moderator:** The next question is from the line of Arun R. from SBI Mutual Fund. Please go ahead.

**Arun R.:** Can I have the breakup of the debt, Rs. 8,049 crore is the current debt, how much is the commercial paper outstanding now?

**S. Ranganathan:** Roughly about Rs. 4,500 crore is the commercial paper which is outstanding.

**Arun R.:** And remaining would be?

**S. Ranganathan:** Remaining would comprise of bank finances and non-convertible debentures.

**Arun R.:** So how much is long-term out of this 8,049?

**Rashesh Shah:** Broadly about 4,500 is short-term, another couple of thousand crore would be on the medium term, about a year kind of and the remaining would be on long-term. What we want you to do is to see on the asset side also. If you see broadly out of 11,000 crore of assets we have over 3,200 crore of FDs and balances with banks, which are used for working capital, used for liquidity cushion, used for brokerage business, treasury business, all of that. We also have the treasury and related assets of about rs. 3500 crore, which are also short term in nature, a maximum duration of one month. So we have close to about 6,700 crore of it, you see cash and cash equivalents broadly. Usually, we try to keep the bank deposits and treasury assets fairly close to or over the short-term commercial borrowing we have. Then some medium-term borrowings, one year or so, we have is usually close to the credit book we have. Our average credit book tenure is about 13-14 months and our credit book is about 2,600 crore. From that if you take out housing finance, you will look at the wholesale credit book which is close to about 2,000 crore and that matches with what we call the medium-term borrowing. And finally we have equity of about 2,800 crore which is going into more of the illiquid assets.

**Arun R.:**And other thing is from investment book and stock-in trade, how much would be proportion invested in debt instruments or unlisted instruments? So whatever is listed equity out of it if you remove what is the remaining portion there?

**Rashesh Shah:** Actually we don't give that breakup as of now quarterly, because it is all going into consolidated number.

**Arun R.:**And then just one last thing. Can you give me some idea on the 'Other Loans and Advances'? So total loans and advances is Rs. 4,100. Out of which 2640 would be the credit book. Remaining 1460 what does it include?

**S. Ranganathan:** It is a combination of several things like advance tax paid, advances to State Agencies for import of gold, investment in inter-corporate deposits, advances to business associates, Exchanges and other loans and advances such as loan to our Employee Trust which are sitting there.

**Arun R.:**And the deposit with stock exchange and advance tax could not be substantial I believe?

**S. Ranganathan:** It could be substantial, it also includes the trust share that we hold on behalf of the Employees Trust Shares of roughly about 200 crore.

**Arun R.:**How much is the ICD you mentioned?

**S. Ranganathan:** About 80 crore.

**Arun R.:**And this is to which entity, if you can disclose?

**Rashesh Shah:** Actually I do not think on this call we are ever allowed to disclose counterparty and clients.

**Arun R.:**Ok. No problem. But there is no loans given in this loans and advances. Because in the annual report you had receivable for financing business as one item in loans and advances and then you had loans given. So this does not include anything of the loans given.

**S. Ranganathan:** Nothing of that sort. All client loans are under receivable from financing

**Moderator:** Thank you. As there are no further questions from the participants, I would now like to hand over the conference back to Mr. Shailendra Maru for closing comments.

**Shailendra Maru:** Thank you, everyone for joining us. In case you have any further questions, please call me or send me an e-mail at shailendra.maru@edelcap.com. Thank you very much and have a great day.

**Moderator:** Thank you. On behalf of Edelweiss Financial Services that concludes this conference call.