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Conference Call Transcript

Edelweiss Financial Services

FY13 Results

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Corporate Participants

Mr. Rashesh Shah
Chairman

Mr. Himanshu Kaji
Executive Director

Mr. S. Ranganathan
Chief Financial Officer

Mr. Shailendra Maru
Head – Stakeholder Relations

Moderator: Ladies and gentlemen good day and welcome to the Edelweiss Financial Services unaudited Q3FY13 Earnings Conference Call. Please note that this conference is being recorded. 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 Unaudited Consolidated Financial Results for the third quarter FY13 that ended 31st December, 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 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. This will be followed by the Q&A session. Our press release, financial statements and earnings update for this quarter have been circulated and are also available on our website www.edelweissfin.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 uncertainties that the company faces. We have outlined these risks and uncertainties in the last slide of our earnings update 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. We announced Q3 results, couple of days ago and I hope all of you have had a chance to look at the investor presentation.

The brief highlights have been that we had a total revenue of Rs, 540 crores in this quarter, compared to 454 crores for the same quarter last year, which is up 19% and the profit after tax for this quarter is 46 crores as compared to 29 crores for the last year for the same quarter which is up about 56%. Overall for the first three quarters we have clocked profit after tax of 128 crores in this year which is equal to the whole year profit of the last year FY12.

If we remove insurance, because as you know we are tracking our performance ex-insurance as we are still in the investment phase on insurance, our YoY profit after tax growth is approximately 66% and our return on tangible equity excluding insurance is 11% in this quarter on an annualized basis. So overall we had about 5 quarters of sustained growth, five quarters ago we were 26 crores and from there we went to 29-39-40, now 46 crores PAT. So overall we have shown consistent improvement in the profit after tax on a quarterly basis for about 5 quarters now. As quite a few of you know we had embarked on building our diversified set of businesses after 2008 and we have now completed that, because all the businesses are fairly placed. The plans are in place, the management teams are there. The capital has been allocated and from now onwards for the next few years our focus in going to be on efficiency and growth in each of these businesses because each of this business is now going to become a very strong growth engine for us. We have also improved our efficiency and productivity, our cost to income ratio excluding insurance which was 76% one year ago is now 67%. So there has been an improvement in cost-income ratio also. As you know being a largely advisory agency business their cost-income ratios are high and even now capital markets have not come back; as and when it comes back we expect the cost-income ratios to improve even further.

Overall our retail business has continued to scale us as per expectation. We are eking out lot of execution efficiencies and operating cost structures. We have strengthened the entire resources at the liability side of the balance sheet as you would have seen in the presentation and we now have a fairly matched ALM profile and we have equal dependency between market and Bank borrowings now. Our burn in the new businesses is reducing significantly and overall all the businesses have been steady. Broadly as you know we have four businesses. the first and the biggest now is our credit business, which now has 6549 crores of assets which have grown about 13% Q on Q. This credit has retail finance business, which is about 1400 crores, and the wholesale business. The asset quality has been maintained. Our net NPAs are still below 0.1%. So we are still very focused on maintaining asset quality especially in an environment where there is an overall pressure on asset quality for all financial institutions.

Our retail businesses have expanded the operating foot-print; we now have almost 400,000 customers of the retail businesses. Our alternative asset business is steady; we have 6 funds which had an AUM/AUAs of $600 million equivalent. Our insurance business has scaled up as per plan. We have issued about 4400 policies in Q3 and we have about 2500 agents now on the ground. We have a strong and liquid balance sheet. If we exclude our cash and cash equivalent of G-Sec and FDs and the borrowings that we have against them, our gearing is about 2.77x and we have strengthened the entire borrowings side of the liabilities.

Basically all the business building blocks are in place; we are enhancing our risk management capability and adding more technology because we do think that it is a good time to invest in much stronger and a very robust risk management system.

In Q3, the overall capital market activity inched up a little bit higher but it has not yet resulted into an increase in the revenue pool as we look at all the capital market players. Credit growth continues. There is still a lot of demand for credit especially the corporate loans and the collateral loans that we cater to. And overall in this quarter, liquidity has been fairly comfortable, inflation has been inching down and we do expect inflation to inch down may be 6.5% by the first half of the current calendar. We are hoping that RBI will cut rates. We are seeing a strong FII inflows and what we are seeing overall, not just in India but even internationally, slowly the de-allocation from fixed income to equity is happening. In the last couple of years, all investors have been over-invested into bonds and the switch from bonds to equities is starting to happen and that will be good for capital markets in India. Overall we still remain cautious on the macroeconomic parameters though we are positive on inflation. We think the current account gap and the fiscal gap are the two key issues to worry about especially current account gap because we have seen that exports are not growing and for a country like India with 4-4.5% current account gap, if at all it is there then it should be bridged by FDI. So if we open up FDI and more FDI comes then we are comfortable, else if we are more dependent on the portfolio flows, our fear is that overall rupee will be under pressure.

Having said that we do expect to continue the same trend that we have embarked on another 4-5 quarters because we now have a clear plan on growing the businesses and improving our efficiencies on a quarter on quarter basis for the next few quarters and all said and done we expect more of the same what we have done for the last 5-6 quarters to continue for the next quarters. Now over to Rangnathan.

S. Ranganathan: Thank you Rashesh. I will first discuss the highlights of our financial performance and then give you a business update.

Key takeaway of our performance this quarter is the sequential growth in our bottom-line in each of the five quarters including this quarter, despite the environment continuing to be challenging. The consistent growth in our PAT is the result of diversification of businesses, execution efficiencies and the cost control that we have been constantly working on. In fact our profitability excluding insurance is much higher, while the cash burn in our insurance business is as per plan. The burn in other new business is also reducing progressively.

On the balance sheet front we continue to strengthen the liability side and reduce our dependence on short term borrowings. Maintaining a healthy ALM profile continues to be a key focus area for us.

Coming to our Q3FY13 results, our total revenue for the quarter is Rs. 540 crores compared to 454 crores for Q3FY12, up 19%. Profit after tax for the quarter is 46 crores compared to 29 crores in the Q3FY12, up 56%. Excluding the impact of insurance business, our net profit for the quarter would be Rs. 61 crores which is 66% higher than the corresponding number in Q3FY12. This has been possible as our core business operations are robust. Slide #6 on our earnings update indicates that our return on equity ex insurance is already around 11%. I am also happy to inform you that in the nine months of the current financial year we have already achieved a net profit equal to that of financial year 12.

Among the individual heads of income, interest and other capital based income for Q3FY13 is up 18% year-on-year and up 5% quarter-on-quarter. While the growth in interest income was due to scale up of our credit book, it is partially offset by reduction in the bank FDs. At the same time we have been able to maintain our spreads in the credit and treasury book this quarter, compared to the previous quarter as our cost of borrowing has also fallen by a similar percentage.

Agency fee and commission for Q3FY13 is up 8% year-on-year and up 4% quarter-on-quarter. It is higher for the second quarter in succession reflecting a higher activity level; of course overall growth in fee and commission income continues to be subdued due to a challenging environment and industry revenues remaining static. Premium on Life Insurance Business, which is still in a nascent stage, was Rs. 10.4 crores this quarter compared to 6.3 crores for the previous quarter.

Within our total cost the OPEX this quarter is higher by 6% year-on-year and up 5% quarter-on-quarter. This quarter the change in the actuarial reserve on account of life insurance business, which passes to the P&L as an expense, is higher by about 4.2 crores and the advertising cost have been higher by around 2 crores QoQ. Against a growth of 6.2 crores in these two heads, you will notice that the net growth in overall Opex is only about 4.4 crores, The increase is thus compensated by efficiencies achieved in other heads of OPEX. We are therefore able to keep a tight control over our costs. I expect that with the scale up of our insurance business the expense passing through the P&L on account of the additions of the actuarial reserve will be higher and hence we are actively looking at showing this item of expense separately going forward in the earnings update to present a meaningful comparison of the OPEX.

Our employee cost is higher by 40% year-on-year and 17% quarter-on-quarter as we have continued to build branch infrastructure for our new businesses especially life insurance and retail finance and hire new recruits for them. Our employee strength stands at 3,661 as on 31st December, 2012.

The financing cost is up 13% YoY this quarter due to total borrowings being higher at Rs. 11,007 crores compared to Rs 8,409 crores at the end of Q3FY12. Higher finance cost due to higher borrowing was partially offset by lower interest rate year-on-year. However on quarter-on-quarter basis our financing cost is flat as a result of improved liquidity this quarter leading to softening of rate**s**. Our blended cost of borrowing is around 9.9% in Q3FY13 compared to 10.1% in Q2FY13 as well as Q3FY12.

To sum up the discussion on the P&L, our focused approach towards improving efficiency and productivity is leading to a sustainable growth in profitability. At the same time the strategy that we have constantly followed in the past by building a set of diversified businesses is reducing volatility in our results even though some of the businesses continue to face tough operating conditions for a prolonged period of time.

Now coming to our balance sheet, the total net-worth of the group stands at Rs.3,004 crores; excluding the intangibles like goodwill, loan to our employee trust and deferred tax asset our tangible equity stands at Rs.2,671 crores. Our total borrowings at the end of the quarter are Rs. 11,007 crores. Our total assets include G-Secs and FDs of about 2,681 crores against which we have back to back borrowings and excluding these G-Secs and FDs from the total borrowings, our net gearing at the end of the quarter is a reasonable 2.77x. If you will please see the larger picture for the last one year, the effective balance sheet side has grown by Rs.2,724 crores, the borrowings by about 2,598 crores, and in the same period our credit book has grown by roughly Rs.3000 crores. Broadly the entire year-on-year growth in the balance sheet size or the borrowings has been on account of the scale up in the credit book. Our sources of borrowing at the end of the quarter include debt market, basically mutual fund of Rs.3,966 crores, bank lines of Rs. 3,688 crores, corporate, insurance and others Rs. 1,547 crores and asset specific borrowing, that is CBLO, of Rs. 1,806 crores.

Our asset side mainly comprises of credit portfolio of Rs. 6,549 crores, FDs of 2,781 crores, G-Secs of 1,884 crores, bonds, commodities and others of Rs. 940 crores, insurance assets of 482 crores and corporate assets of 1,375 crores at the end of this quarter.

Coming to our ALM position – You will see that we have reduced our dependence on debt market from 54% as on 31st December, 2011, to just 36% as on 31st December, 2012, and this is on an enhanced borrowing base. At the same time the contribution of the bank lines has gone up from 27% to 34% during the same period. Increased bank lines have provided us with a stable longer term liability. We have, thus strengthened our liabilities profile by diversifying our sources of borrowing. We continue to ensure that we have a matched ALM profile. We maintain an overnight liquidity cushion of around Rs.500 to 700 crores to meet any unforeseen requirement.

Now finally turning to our business highlights – the credit business scale up continues. The total credit book stood at Rs. 6,549 crores by end of Q3FY13 compared to 5,773 crores as at the end of the previous quarter. The average collateral cover on the collateralized book is around 2.74x. The Q3 yield from the overall book is at around 16.2%, lower by 20 basis points this quarter compared to the previous quarter. Since the average borrowing cost has also fallen by 20 basis points quarter-on-quarter; we have been able to maintain the spreads. The asset quality on the credit book continues to be satisfactory with gross NPLs at the end of the quarter at 0.41% and the net NPLs at 0.10%. We carry adequate provisions on the NPLs. ECL Finance, our NBFC, has a capital adequacy ratio of 20% as on 31st December, 2012. The Retail Finance Business, which includes mortgages, LAP and SME finance, continues its steady growth. The book has now reached 1,395 crores spread across 2,000 clients. Average LTV on the book comprising of residential mortgages and LAP is around 56%. We were a leading debt arranger in the country with a market share of around 9.5% in quarter 3 compared to 8% in quarter 2. We continued our foray into public issues of debt by being a lead arranger of the NCD issues of Muthoot Finance this quarter. As you would recall we had earlier managed public debt issues of Shriram City Union and IIFL in Q2. We have also handled 8 other DCM transactions this quarter for the large and reputed clients like REC, PFC, HUDCO, Tata Capital Housing Finance, Tata Capital Financial Services, Bajaj Finance, and Syndicate Bank. Our Fixed Income Advisory business also handled one transaction taking the total number of DCM transactions this quarter to 10.

Turning to the Capital Market and Asset Management business, in Investment Banking the deal closure continues to be slow. We, however, handled IPO of CARE Ratings this quarter. The pipeline continues to be strong. I am happy to inform you that one of the transactions executed by us in March 2012 namely the IPO for MCX was recently adjudged "The Best Mid Cap Equity Deal of 2012" by The Finance Asia Magazine, Hong Kong.

On the broking side our total ADVs (Average Daily Volumes) for the quarter was Rs. 5,600 crores compared to Rs. 6,175 cores in the previous quarter. While we recorded higher client volumes of Rs.3,120 crores within the overall ADV, lower treasury volumes resulted in a reduction in the overall ADVs. Our market share was 3.2% this quarter. Although the market also recorded marginally higher ADVs this quarter; it has not resulted in any increase in the industry revenue. The broking yield on client transactions on a gross basis is marginally lower at 3 basis points this quarter, compared to 3.1 basis points in the previous quarter.

Our Retail Broking Business now has 3,97,800 clients through our online portal www.edelweiss.in and through the offline model. We continue to add new clients in this business at a calibrated pace.

In our Alternative Asset Management Business we have AUMs/AUAs of over USD 600 million equivalent at the end of the quarter including Structure Product portfolio of about 880 crores.

Our Mutual Fund managed 10 equity and debt scheme with an average AUM of Rs. 242 crores during Q3. It now has an active base of 8,000 investors having added about 900 clients this quarter.

Our Commodities Business continues to build it focuses on sourcing and distribution of bullion at 12 centers to over 400 clients. It is also scaling up the agri commodities business. This business has assets of Rs.2,084 crores at the end of this quarter.

Our Insurance Business continues to scale up this quarter. It earned a premium of Rs.10.4 crores having issued about 4,400 policies this quarter compared to Rs.6.3 crores premium and 3,600 policies during the previous quarter. During the quarter, it has expanded its operations to 6 more large cities and now has 45 offices in 35 cities. The agency channel build up continued with the number of personal financial advisors reaching to 2,478 compared to 1,845 as of September 2012. The cash burn in this new business is also as per plan.

The treasury book size at the end of the quarter is lower at 2,711 compared to 2,906 at the end of the previous quarter with reduction in FDs. The gross yield on this book for the quarter is 11.1% giving a spread of about 1.2%. We generally look at a spread of 1-2% on this book as its composition now mostly includes G-Secs, FDs and bonds which are used for liquidity and balance sheet management. Treasury allocation continues to be a function of liquidity management needs, capital requirement of the businesses, and opportunities in the market.

So sum up, we continue to implement our core strategy of synergistic diversification in financial services and de-risk the business model. The scale up of the new business of Life Insurance and other retail businesses is on track while the operations of the wholesale businesses remain robust. With the business diversification phase nearly over, we are now focusing on improving efficiencies and productivity. Given the strength of Edelweiss, we are confident that when growth returns soon, we will be able to fully translate the upside into a solid business performance.

With this I would like to conclude and will be happy to take any questions from you.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. The first question is from Vinay Shah from Reliance Mutual Fund.

Vinay Shah: This is a bookkeeping question. If I see the December '12 presentation, the credit book as on March '12 is around 4,785 crores. If I refer the March '12 presentation that was around 3,956 crores. So there is some difference of 800 crores. So is it because of some reclassification or what is the thing?

Shailendra Maru: Actually Vinay that is the reclassification which we did in the second quarter of this year and we had also mentioned about that in the earnings call then. We used to have a lot of credit substitute, loans given to the corporates by way of non-convertible debentures or other instruments, which as per accounting terminology are required to be classified in the balance sheet as investment. But they are actually akin to credit instruments and therefore we reclassified them in the second quarter in the credit book and we have reclassified the March number also to give a comparable number.

Vinay Shah: The second question is what will be the arbitrage booked as on December '12?

Rashesh Shah: Hardly any. As you know the arbitrage business has gone away over the years and now if you see a large part of what we call the balance sheet management group, a lot of that is FDs in the bank as well as G-Sec and bonds. So may be about 100 odd crores or so.

Vinay Shah: So is it pure hedge kind of thing or what will be there as a part of activities of this book?

Rashesh Shah: It is basically the way you have it in a bank, you basically manage your liquidity because you constantly have inflows-outflows and there is a bit of mismatch. So you basically do what we call liquidity and balance sheet management.

Moderator: Thank you. The next question is from Chandan Gehlot from Deutsche Asset Management.

Chandan Gehlot: Just wanted to know about your credit book. As we are seeing, in Edelweiss the credit book is continuously growing, vis-à-vis if we are looking at the markets and other participants, everybody is now very cautious on the capital market books. They are very cautiously increasing the books. So I just wanted to figure out why we are growing above the markets?

Rashesh Shah: See, one is we had a much smaller base and as you know our capital adequacy is still around 20% in our NBFC. Over a year ago we had lot of equity and on a smaller base. As you know Retail Finance Book is the new business, so it has almost gone up by more than 100% in the last year. So it is a combination of the normal growth of the wholesale business and the added growth of the Retail Business and as I said even overall our gearing is only slightly above 4 and if you remove the cash and cash equivalent we have 2.77x gearing. So we have a reasonable amount of growth there. We are very conscious of the credit quality and the asset linked issues, but as you know almost all of our credit is collateralized, so we don't do unsecured loans on the wholesale side and as a result of that we have been able to maintain our asset quality and risk issues under control.

Chandan Gehlot: No again my point is like I had seen couple of other large NBFCs, which are reducing the exposure to particularly like wholesale financing side, but still what we are seeing at Edelweiss is that the book is continuously growing. So don't you see any pressure coming in, I mean the kind of environment we are operating?

Rashesh Shah: No. As I said not in the market where we are operating and the risk and the underwriting culture we have, we do think the entire asset quality should get easier over the next few quarters, Calendar '12 was one of the worst years. But if RBI cut rates, if at all economic condition improves then hopefully credit condition will also improve. But we have a very strong risk and underwriting control and as I said ours is very collateralized book. So if we see stress we always have the option to liquidate the collateral and get the money.

Chandan Gehlot: And what is our current year policy for the NPA recognition. Is it 90 days or is it 180 days?

Rashesh Shah: 180 days.

Chandan Gehlot: And subsequently when the new regulation comes in and if we need to maintain 90 days DPD what kind of an increment could we see in the NPA level?

S. Ranganathan: We will report the data as and when that happens. But we have started doing it on a parallel basis by computing it. It should be about 1.4 crores as the incremental NPAs from 180 days to 90 days DPD. That means over and above 26.8 crore of declared NPAs on 180 days basis and then also our gross NPA percentage will just be 0.43%.

Moderator: Thank you. The next question is from Ravi Mittal from BNP Paribas.

Ravi Mittal: What is the average yield for our wholesale finance book and separately for retail finance book?

Rashesh Shah: On an average approximately we get spread of about 500 odd basis points over the cost of funding. Our current cost of funding is close to 10%. So about 15 is the yield on the wholesale credit side and on the retail we get a spread of about 180 basis points approximately. So that is about 11.8 or so.

Ravi Mittal: Sir I was not able to understand because our average yield on the overall credit book is around 16.2%, so with almost 30% of the portfolio with the retail kind of thing, so I was just thinking how is the 16.2% being calculated?

Rashesh Shah: Over and above this you also have other parts of the loan book like LAP, Credit substitutes, SME finance, LAS etc, some of which have a higher yield so as to give the average of 16.2%.

Ravi Mittal: How much of our portfolio have we sold so far in this current financial year?

Rashesh Shah: We don't disclose that currently but we have a policy to originate and sell down.

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

Shailendra Maru: Thank you Rashesh, Himanshu, Ranganathan and thank you Marina and thank you everyone for joining us on this call. In case you have any other further question, please feel free to contact us directly or drop me an email at shailendra.maru@edelweissfin.com. Have a great day ahead.

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