"Edelweiss Financial Services Limited Full Year FY'16 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Edelweiss Financial Services FY-'16 Full Year Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should anyone need assistance during the conference call, they may signal an operator by pressing '*' then '0' on their touchtone telephone. Please note that this conference is being recorded. I now hand the proceedings over to Mr. Salil Bawa of Edelweiss Financial Services. Thank you and over to you sir.

Salil Bawa: Thank you, Margaret. Good afternoon to all of you and thank you for joining us today as we discuss Edelweiss Financial Services Audited Consolidated Financial Results for The Year FY-'16.

Speaking with you today are Rashesh Shah -- Chairman Edelweiss Group; Himanshu Kaji -- Executive Director and S. Ranganathan -- Chief Financial Officer.

Following the reading of Safe Harbor provision, I will hand over the call to Rashesh for his Opening Remarks. Thereafter S Ranganathan will take you through an Overview of our Business Performance and the Financial Numbers, this will be followed by Q&A Session. Our Press Release, Financial Statements and Annual Investor Presentation for FY-'16 have been circulated and also available on our website, www.edelweissfin.com. Certain statements that may be made or discussed at this conference call may be forward-looking statements that may be tentative. These need to be reviewed in conjunction with the risks and uncertainties that the company faces. We have outlined these risk and uncertainties in the last slide of 'Investor Presentation' which has been circulated and is now also on our website. Investors are requested to please refer to that slide.

I will now hand over the call over to Rashesh.

Rashesh Shah: Thank you, Salil. hello! good afternoon to all of you. I am sure you have had a chance to look at our Annual Results for FY-'16 which was announced on Friday has shown a fair amount of growth. All the businesses have scaled up, we have been able to strengthen the balance sheet and also invest in the hard and soft infrastructure of the company. What I am truly happy about is the 18-quarters of consistent growth in profitability that we have been able to show because as many of you may remember from 2008 till 2012 we re-engineered and reworked the business model to move away from capital markets only to a broad-based diversified Financial Service business, very much like a bank diversified business model which got executed by FY-'12 and from FY-'12 to FY-'16 the last 4-years has been consistent growth for us. FY-'16 we had revenue of Rs.5,316 crores and we have profit after tax of Rs.414 crores, which was a growth of 26% over the previous year. What we internally look at much closely is the profit after tax excluding Insurance because as many of you know we are investing in our Insurance subsidiary but the capital for that is ring-fenced and a large part of the capital has been provided by our partner, Tokio Marine. So though we get the profit and loss aggregation in that from cash flow and other requirements there is no extra onus on Edelweiss. So profit after tax excluding Insurance is 519 crores which is a very robust 36% growth.

What I am truly very happy about is we have achieved the Return on Equity (ROE) excluding Insurance for this year of 18.6% as compared to 15.6% for the last year, so fairly good jump in ROE and that is what we have been driving towards, in fact in the 4th quarter, our consolidated ROE is now14.5% and the ex-Insurance is now more than 20% for the 4th quarter. We have an asset base of Rs.32,000 crores our entire balance sheet size and we have been able to increase our long-term funding on the liability side as well as diversify the sources of funds. We also as part of the liquidity risk management increase our liquidity cushion to now Rs.2,900 crores, so this is almost 8% to 8.5% of our balance sheet asset base size. So we do try and maintain very healthy liquidity cushion for any emergency needs.

As many of you know, friends, our long term strategy on diversification of the business lines across Credit and Non-Credit businesses have been going forward and idea on this was to eliminate our quarter-on-quarter profit volatility as well as build in the stability, scalability, and sustainability in the business and we do believe that this entire diversified Financial Services business that we have followed is almost like a bank model and eventually as and when NBFCs graduate to bank, this is the ideal model that we think an NBFC should follow.

We also feel India continues to be Credit starved though we are seeing that there is not much Credit growth but overall there is still a lot of segments where Credit is still not easily available and hence we do think that any bank or financial services company which has an ability to cater to this segment will be able to find credit growth and we have seen the private banks, the NBFCs both Wholesale and Retail have been on an average able to clock between 20 to 25% growth in this year also. So this entire hypothesis about there not being enough Credit growth is also not true when you look at the private sector banks and the NBFCs.

In our case we have in the last 4-years used Credit as a major growth driver and currently 65% of our balance sheet is Credit and almost 70% of our profit comes from Credit. Even in Credit there are three main business groups we have is – Corporate Credit which is a Wholesale part of our Credit book, Retail Credit which is the Individual Retail client based Credit business we have and the Distress Credit which is part of our ARC and this we are actually 80% of our total credit exposure book that we have. On this we have had a fairly healthy growth. Obviously, Retail and Distress is growing a lot faster than Wholesale because Wholesale is an older business and has now got fairly good critical mass.

On the Non-Credit side is what I am the most optimistic about. Though in this year also a large part of the profit growth came from the Credit side of the business. We have achieved a lot of growth in the Non-Credit side of the business which will hopefully result in growth in the coming years. In Asset Management, Wealth Management as well as Capital Markets businesses we have invested significantly as well as grown the assets under advice; in our global Wealth Management business the assets under advice are now more than Rs.28,000 crores and we have seen a healthy growth in that in this year. Even in our Asset Management business, as you would have known acquired the JP Morgan Asset Management business, we acquired the schemes of that, we expect to close that in the next 3 to 4-months but even that acquisition increases our AUM and the client footprint that we have. Along with that we have quite a few funds in the pipeline – we have our AIS business has also had a healthy growth in this year as well as its capital markets though the last year was not very high activity from Capital Markets point of view, Broking volumes were down, even investment banking was slow, we have been able to grow and maintain our market share in various segments and going forward these three segments are very optimistic about in the next 3 to 4-years. Even on Agri, value chain business has been growing healthily and we see that is a new business which over the next 5 to 7-years will give us a lot of opportunity to provide value-added services as well as Credit for the Agri sector.

Finally, on Insurance: We have been able to grow. In this year our gross premium has grown by 61% in this year and also our partner, Tokio Marine, infused Rs.527 crores for 23% stake, in a way they have valued the insurance company at close to on a post money basis of Rs. (+2,100) crores and now they have a stake of 49% in that business and Edelweiss continues to own 51% of the business, for our 51 we have up till now infused about Rs.350 crores and Tokio Marine has infused close to Rs.1,000 crores. We currently have about Rs.900-odd-crores of cash on hand in this business. So it is a very high equity infuse business and we think for the next few years it is adequately capitalized for allowing us to grow at a fairly good clip in the coming years.

On the JP Morgan deal – there were some clarifications required by some analysts: We have not yet closed the deal, we will close the deal in the next 3 to 4-months. We are awaiting SEBI approval on that. What we have done is acquired the schemes of JP Morgan and we are not buying the company, we have acquired the schemes of JP Morgan, and we will merge that schemes with us. Along with that we have also taken over the management team of JP Morgan especially investment management team where we see that there were some very high quality individuals and investment competence that was there and we are very happy to augment our team with the JP Morgan team and we sincerely look forward to the integration very soon.

We have also recently signed agreement with a global IT major for technology business transformation for Edelweiss for two key businesses – our Global Wealth Management business and our Insurance business where we are undertaking about 15 projects across these businesses where we will spend close to Rs.100 to 175 crores over the next 5-years is what we expect. It is a fairly major investment for us but we think technology is going to be a significant game changer in the coming years.

We are very happy to say we have won a few awards in this year including Most Valuable Brands, Most Promising Brand, Best Private Banking Solution as well as the Bull of the Year Award.

Finally, we continue to focus on five areas: Profitability: We have shown fairly good growth in the last 5-years

Scalability: We feel all our businesses -- Asset Management, Wealth Management, Retail Credit – all of them have a lot of headroom to grow because we are still very-very small from the addressed market point of view.

Third item has been Sustainability which with the diversification we have, and the quality of businesses we have and the leadership and the breadth and depth of management team, we do feel our businesses have become significantly more sustainable.

We invested a lot in Management Quality; hired a lot of senior people, manage our attrition rate and invested a lot in training and development in this year.

The last item of focus for us has been Governance. As you would have seen from the investor disclosure to investor communication we keep on upgrading our standards when we constantly investing in trying to give more and provide more and more color to the investors and all stakeholders in our businesses, and on that we will be happy we have been very fortunate to get a lot of feedback from you and suggestions on what more we can do so that all of you can understand our business a lot more.

So these five areas are what we continue to focus on Profitability, Scalability, Sustainability, Management Quality and Governance. Truly invest, we do think that in the coming year there might be volatility because of the global factors, we think some issues around China and Britain exit and all those will continue to be there, global deflation is a big risk but in the India side we feel the macroeconomic stability we have achieved -- Thanks to Government of India, Finance Ministry's effort as well as Reserve Bank of India will continue. So we think inflation will be stable, we think the other macroeconomic parameters will also be stable, and we expect that the issues such as bank NPAs are also going to come to an end in the coming year. So we think FY-'17 will be the start of the comeback year for India. We may not see immediate growth because we still see demand is weak in India but we are hoping that the government's spending and good monsoon in the second half we should see some positive traction on that. The asset quality cleanup that has been happening thanks to the AQR process by RBI is overall good for the economy and has been good for us for our ARC business also. We are seeing a lot more opportunities to work closely with banks in helping resolve NPAs by reviving a lot of companies through financing restructuring as well as by operating restructuring, but also to focus on recoveries and we think the next 3-4-years there is going to be a huge focus on recovering of the NPAs that we have brought in the last 2-3-years. We have found that an average NPA takes about 3-4-years from acquisition by an ARC to a substantial recovery on that, and a lot of assets we acquired in '14-15 are now getting ripe for recovery and we expect for the next 2-years a lot of our focus in ARC is also going to be on revival and on recoveries of the NPL assets.

Finally, we are happy to announce that we have joined hands with the Indian Olympic Association to become the principal sponsor for the 2016 Indian Olympic team going to Rio and our Insurance company Edelweiss Tokio Life Insurance has provided Life Insurance Cover of Rs.1 crore to every athlete who is going to Rio for 2016 -- This is the first time any company has provided Insurance to the Olympic Athletes and we are very proud to have this opportunity.

So going forward, we remain cautiously optimistic, huge focus on risk management. We do think that this year there will still be risk because of market volatility as well as the fact that India growth is going to be slow to come in the first half. So any company will have to be cognizant of the long term opportunity and the short-term challenges on risk management and volatility go ahead and that is going to be our strategy in the coming quarters.

Thank you very much. Now I will hand it over to my colleague, S Ranganathan, to give you more color on the "Year's Performance."

S Ranganathan: Thank you, Rashesh. I welcome all the participants once again and thank everyone for joining us on the conference call for discussing the FY-'16 Performance.

As usual, let me start with the "Financial Highlights" and then go on to give you "Business Update". This is the 18th quarter since FY-'12 that we have recorded a consistent growth in our performance despite challenging environment in parts of this 5-year period. The profitability that you see today is a result of our long-term strategy of synergistic diversification. Our total revenue for FY-'16 stands at Rs.5,316 crores, up 36% compared to FY-'15. Our net profit for FY-'16 is Rs.414 crores, up 26% over FY-'15. PAT excluding Insurance stands at Rs.519 crores compared to Rs.381 crores for FY-'15, that is up 36%. Our operations and capital efficiency has improved and our ROE excluding Insurance for FY-'16 is 18.6% compared to 15.6% in FY-'15 that is up 300 basis points. The consolidated ROE for Q4 FY-'16 is 14.5%. We continue to strengthen our balance sheet by tapping into long-term liabilities and reducing our dependence on short-term borrowings, at the same time exploring newer lenders. Liquidity Management continues to be a critical focus area for us and will continue to be so. Edelweiss is now Rs.32,000 crores asset company with group gross net worth at Rs.4,372 crores.

Let us now look at the Individual Heads of Income:

Our Fund-based income grew 36% to Rs.4,218 crores in FY-'16 reflecting growth in the Credit book. Agency Fee and Commission at Rs.697 crores in FY-'16 is up 22% year-on-year. Life Insurance business continues to be one of the fastest growing insurance companies in India and recorded a gross premium of Rs.310 crores for FY-'16, growth of 61% year-on-year.

Looking at the Cost:

Our headcount has gone up to 6,227 in FY-'16 compared to 5,555 at the end of FY-'15. We have hired for future growth as also for scaling up the Agri Services Credit and Insurance businesses. This has led to the higher employee cost, which is up 24% to the increased levels of operations as well as higher advertising, legal and rental costs stepping up of provisions especially for growing businesses like Agri Value Chain, Life Insurance and OPEX has increased with the business. As spoken previously, we have also been significantly investing in setting up Agri Value Chain business and Credit businesses, which has resulted in higher profit margin. Although there is a marginal reduction in the blended rate of borrowing at 9.9%, higher borrowings have resulted in increased finance cost which is up 43% in FY-'16. Borrowings have increased from Rs.23,540 crores to Rs.27,773 crores for the year FY-'16, reflecting a scale up in our operations.

Coming to our Balance Sheet:

We have taken quite a few steps to strengthen it. Our consolidated capital adequacy at the end of the year was 18%. We have increased the liquidity cushion to Rs.2,900 crores which is roughly 9% of our balance sheet as at the end of March '16. We have matched ALM and liquidity profile over the short-to medium-term. We have securitized around Rs.350 crores of Credit portfolio. New lenders from insurance companies, pension and provident funds in addition to banks, mutual funds and retail subscribers have added to our diversification in the sources of borrowing. The overall debt-to-equity ratio stands at 6.35 with excluding treasury assets it comes out to 4.95x.

Now turning to Credit Business Highlights:

The total Credit book stood at Rs.20,014 crores at the end of Financial Year '16 compared to Rs.15,036 crores at the end of FY-'15, a growth of 33%. The average collateral cover in the Credit book is 2.1x. We continue to enforce prudent risk management policies to ensure that our capital is always preserved. As a part of this policy we avoid undue sector and industry concentration in the book.

Our NIM in this business is 6.8% for the year which is marginally higher compared to last year. Similarly, our spreads are at 5.5% compared to 4.9% previous year. Cost-to-income ratio for the Credit business stands at 44%. The asset quality in the Credit book continues to be under control with gross NPLs at the end of FY-'16 at 1.4% and the net NPLs at 0.47%. Our provision cover including the standard asset provision stands at 88%. Our Retail Credit business continues to grow steadily. Retail Credit comprises of Housing Loans, Loans Against Property, SME and Agri Finance as well as Rural Finance and LAP. At the end of financial year '16 the book size of Retail Credit was Rs.5,700 crores, which is up 41% from Rs.4,065 crores at the end of the previous year. Our Credit book also includes loans of Rs.1,900 crores to Edelweiss Asset Reconstruction Company. Our ARC with a portfolio of roughly Rs.27,000 crores continues to be a leading ARC in India. We are excited about the ARC opportunities as it helps in releasing productive assets for the nation's economy and reduces the burden on commercial banks.

Coming to Non-Credit business:

Our Broking side our Agency ADB for the clients was over Rs.5200 crores in FY-'16. The Broking yield on client transactions continues to be around 2.5 basis points on a gross basis. Investment banking handle 100 transactions in FY-'16 with a good traction in pipeline. The client base of Edelweiss Group across its diversified businesses is over 8,87,000 at the end of FY-'16. In addition, our depository participants maintain over 3,03,000 DEMAT accounts. Wealth AUAs are around Rs.29,500 crores including the Broking and Advisory Services. In IPO Distribution, we are Ranked Number One in Retail and HNI Categories. There is a 40% increase in our Global Asset Management business which has an AUM and AUAs of roughly Rs.32,000 crores at the end of FY-'16. Fixed Income Advisory business continue to be Ranked First in Public Issue of Bonds in FY-'16 by being lead arrangers to 14 issues. Edelweiss was the only arranger to be mandated as lead arranger to all the public tax-free bond issuances conducted in this year.

Our Insurance business continues its planned scale up with a growth of 61% in its gross premium during the year. The focus of this business is to constantly improve the performance. I am happy to inform that Edelweiss Tokio Life Funds have been rated top performance by Morningstar with most of the US ULIPs being in the top docile. During the year, Tokyo Marine increased the stake in the Insurance JV to 49% by infusing Rs.527 crores for 23% stake.

To sum up:

We continue to implement our core Strategy of Diversification in Financial Services while improving Efficiency and Productivity. We are confident that going forward we will maintain our track record of consistent growth in profitability and improvement in the business parameters.

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

Moderator: Thank you very much. We will now begin with the Question-and-Answer Session. The first question is from the line of Jyoti Khatri from Monarch Networth. Please go ahead.

Jyoti Khatri: The growth on the Credit book side has been pretty strong at around 33%-odd. How do we see the growth panning out for the next fiscal and in the medium term and what would be driving the growth?

Rashesh Shah: We think our Credit book now is about Rs.20,000 crores and our internal target is to grow it by about 20% a year which means we would add about Rs.4,000 crores of debt assets every year and we across the business lines we have A), we see enough opportunities on that, but even from the resourcing point of view we think with internal accruals as well as the headroom we have for the next 2-years there is enough capacity and opportunity to grow by about 20% a year, and as you would have seen internally our approach has been that we should grow at between 5% to 10% ~~basis points~~ more in profit after tax than the asset growth, so our internal target we can grow at about 20% asset growth on the balance sheet and grow by 25% to 30% in PAT terms and for the last 4-years we have been trying to arrive at that, we have had a much faster growth on the Credit book for the last few years because we had a lot of headroom because our Credit business has effectively started only about 6-7-years ago, but going forward we think if we can maintain 20% growth that should be healthy.

Jyoti Khatri: The Retail part would be growing at a faster pace than the non-Retail one, is that right?

Rashesh Shah: Yes, I think Retail will be the one because it is still only Rs.4,800 Crore book and there is a lot more headroom for growth and it is a newer business. So Retail is going to grow faster than the Wholesale book.

Jyoti Khatri: On the Credit book side, the PCR excluding standard asset provisioning is around 66%-odd, am I right there?

Rashesh Shah: The standard asset should be 25 basis points. So you can deduct that, yes. We always remind that since we largely do collateralized credit, even the provisions we have made, we still have the collateral with us and our historic experience has been that because there is collateral and the collateral is value, eventually recovery rates are much higher than what it is for normal credit, which is non-collateral part, and a lot of our collateral is fairly liquid which are the shares or real estate or cash flows which are escrowed in a particular entity. So it is easier for us to access the collateral and realize the value.

Jyoti Khatri: On the ARC side, you said that you are expecting sort of material recoveries to happen in next two years' time**.** So any rough estimate on how much like to happen in FY'17?

Rashesh Shah: We do not have an estimate as of now, as I said we have seen historically that usually 3 to 4-years is an average recovery time from the time an ARC acquires the asset because even when you acquire the first loan it takes you about a year to aggregate the remaining loans as well as work out a restructuring package with the company and then it takes about 2-years after that to start getting the first recoveries and another 18-months after that to get complete recovery. So usually 3 to 4-years is the time and as you know that we acquired a lot of our assets in calendar '14 and calendar '15, so we expect a lot of that recoveries to start from this year and go through '16, '17 and '18.

Jyoti Khatri: Also, asset side you are buying on the ARC book, is it coming at a cheaper cost versus average 50% discounts for the assets that you would have purchased in FY'14, FY'15?

Rashesh Shah: Actually after RBI changed the formula to 85:15 the pricing has become a lot more reasonable and competition has also come down because assume for the same amount of capital that in ARC is willing to put they can buy only 1/3rd the assets. So there is a lot more opportunity to pick and choose the assets that you want. This year also we bought fewer assets but we have been able to buy assets that we know what is the restructuring plan, what is the resolution plan and how will it go forward. So it is a lot more concentrated now in terms of how many assets you buy unlike earlier when it was 595 most of the sales were a portfolio that you were buying and in average portfolio we will have about 10 to 15 assets, now we are buying specific assets. I would agree with you the pricing has become a lot more reasonable.

Jyoti Khatri: Will it be possible for you to share the sectoral distribution of assets of ARC?

Rashesh Shah: We do not currently disclose that, it should be possible we just consider it and look at any RBI rules and all and then may be going forward we can incorporate that. We give it for the Edelweiss NBFC entire book that we have.

Jyoti Khatri: On the Life Insurance actuary side, if you can just throw some concrete thoughts on how do you see your business growing, how you are building on the franchisee and how is the cost likely to behave going forward?

Rashesh Shah: On the LIC side, we have a lot of focus on the organic agency part which we think is on a long-term basis the most stable, it is a lot more expensive to build, so the depth of the hockey stick is a lot more in organic agency as compared to bancassurance but we are focusing a lot more on organic agency through the branch network and we are selling a lot more of the traditional products -- the non-par and the par products -- the focus on ULIP has been much lower for us, and as you can see over the last 4-years though the Insurance industry has not grown much, we have been able to show reasonable growth in this business also.

Moderator: Thank you. The next question is from the line of Vishal Modi from Maybank. Please go ahead.

Vishal Modi: We plan a sustainable ROE of say between 16% to 18%. So can you throw some light on the drivers because our OPEX growth still remains high at 30%. So, will it be top line driven or cost controls because we are still planning to focus on investments in branches, technology and all, how do we see this trajectory in say two to three years and areas where we would like to improve?

Rashesh Shah: If you see the 4th quarter ROE consolidated already was about 14.5. So in a way we are not very far away from the target that we have set on a consolidated ROE because last 4-years we have been explaining consolidated versus ex-Insurance that is only to bring out the color but now that Tokyo Marine has already gone to 49% that itself has increased our consolidated ROE because earlier 74% of the Insurance loss was getting aggregated with our accounts, now only 51 we can aggregate into the account. So on that count itself there is increase in ROE which is shown in this quarter also and that should continue. As you correctly said, we have been investing money which is showing up in the expenses because as I said in our Wealth Management business, Asset Management and Capital Markets, we still operate at cost-income ratio which are much higher than what we think should be the steady state rate… we operate in this businesses at anywhere between 80% to 90% cost-income ratio and the reason for that is because we are investing in capacity building. So we still think that these are the businesses which are getting built out as we go along, but we see higher growth in that especially in Asset Management and Wealth Management in the next 2-years we will see the result of this capacity that we have built so the non credit business and aggregate is operating at a 76% cost-income ratio for this year, we hope to bring it down to somewhere between 65% to 70% cost-income ratio. So some efficiency will come from that and we have some headroom for growth in the balance sheet side also. So that will also improve our consol ROEs. So we think from current 14.5 on the 4th quarter to get to about 16-17 in the next 2 to 3-years is available to us.

Vishal Modi: Second question is maybe to SR. The tax rate for the quarter particularly is quite high. So what led to this? Your outlook for maybe next year?

S. Ranganathan: If you look at the Insurance loss, this tax rate that you are seeing is cumulative of the Insurance. If you see the trajectory of the profitability of ETLI, the loss that we sustain in the last quarter was disproportionately larger than the previous three quarters. So this is primarily the reasons for the increase in the tax rate in the last quarter. But if you look at the year as a whole excluding Insurance, we are at about 33% which is the usual tax rate.

Moderator: Thank you. The next question is from the line of Anita Rangan from HSBC Asset Management. Please go ahead.

Anita Rangan: Just wanted to know in terms of your asset quality while the asset quality has been very good, want to know if there has been any pockets of your business which are like showing signs of stress especially on the developer side, on the real estate side and how you are dealing with the same?

Rashesh Shah: We are seeing some stress in cash flow; interest payments are going 30-40-days here and there and that has been fairly consistent for the last couple of years as we have seen across, I do not think it is any sector-specific, cash flows have always been a lot more stretched. On the real estate front, we are not seeing any stress because we do mainly Housing especially the ones which are post-approval projects. So in that we are seeing that the ability to sell at a particular price is still there. So like there is a project which originally was expected at 18,000 a sq.ft., if the price drops to 17,000 or 16,500, usually we have seen that the developer is able to sell and collect some cash. The only risk that remains in the developer side is always on completion. What was supposed to be a three year completion project ends up getting stretched to 4-4.5-years, so that is the only risk that we see, we do not see a lot of pricing risk on Housing projects and in most of the projects we have covered between 2-2.5x. So we do not take a lot of pricing risk on that but we do see some amount of completion getting stretched. But our internal estimates are that 12-18-months completion getting prolonged is nowadays par for the course and in underwriting we also adjust for that. Any project that get stuck for 3-4-years is where there is a problem in out of the entire portfolio we have, only a couple of them are stuck where the completion date has got prolonged by more than 3-plus-years, otherwise most of them are within that. In Housing sector, we do not see the pricing going up, we do not see pricing coming down, they are more or less flat and we see a fairly good price elasticity that whenever any project you drop the price by 5% or 10%, there is usually a fairly good demand pick up on that.

Himanshu Kaji: Also, we generally have escrow mechanisms on all receivables. So as long as there are sales and the past sales are giving that cash flows coming in, we generally do not see a lot of delay. Fairly that has been the experience.

Anita Rangan: Have you seen any difficulty in terms of like interest servicing, I think could be much easier because you have escrow, but what about principal repayments and all of that like do you see any challenge in servicing of that?

Rashesh Shah: We have not seen a lot of that, obviously, there are specific cases where it takes time. But what we are seeing is as long as the collateral is good… I want to remind that we are usually in collateral backed kind of loans, so they are asset bank. As long as the collateral quality is good and if you are covered by between 2-2.5x, lot of the borrowers are able to get refinancing or even liquidate the collateral and raise the money for repayment and when we do our underwriting we usually take the repayment also into consideration. So there is already a preplanned kind of an exit which is already envisaged that how will the repayment happen through refinancing or through liquidation of the asset and we also monitor that. So we do not only look at the interest servicing, we also look at the repayment at the underwriting stage itself.

Anita Rangan: In terms of the liquidity cushion which you have mentioned in your presentation about Rs.2900 crores, can you give a breakup of what portion would be like backed by assets which are encumbered and against which you have these liabilities against which you have these assets and breakup of what would be the off-balance sheet lines and the banking lines?

S. Ranganathan: Out of the total Rs.2900 crores we have something like Rs.1250 crores which is sitting in the balance sheet which is in the form of liquidity cushion. It comprises of several of the assets like liquid mutual fund, fixed deposits that we have and other liquid assets. Apart from that we have roughly about Rs.1700 crores of off balance sheet liquidity cushion…when I say off balance sheet in the sense these are all bank lines which we have not drawn, these are lines that have been sanctioned by the banks but we have not drawn them. So that put together is roughly about Rs.2900 crores. This firms as important part of our liquidity management tool and as we scale up we are looking to scale this number also up to roughly about Rs.4,000 crores by the end of next year.

Moderator: Thank you. The next question is from the line of Subir Sen from Birla Sun Life. Please go ahead.

Subir Sen: I just wanted to understand on the Wholesale book, you mentioned about the stress. Last four quarters have you seen the stress increasing/decreasing or it has been steady, if you see Wholesale book, there are different products segments like structured collateral, collateralized versus real estate versus promoter funding, have you seen difference in the level of stress between these segments?

S. Ranganathan: Overall I would say the stress has not gone up because even if you look at India the Wholesale Credit books of all the banks and everybody, our analysis has been that a large part of the stress that we are seeing in the banking sector also are the loans which were given between 2010, ‘11 & 12. So it is largely those loans which for the sector as a whole all creating problem. Even amongst those loans of ’10, ’11, ’12, large part are infrastructure or project related and to whether it end to the steel industry. So these are the ones which are a little bit under trouble. When you look at collateralized loan books of all the NBFCs and all the banks, there has not been any increase in stress in the current year including ours also. Some sector specific can be here and there like in the early part of the year a couple of power projects where our clients were there had a little bit of cash flow problem, but a lot of this are operating assets. So there are usually cash flows on that because we have not done any project funding, we have only funded either operating assets or again liquid collateral like shares and real estate.

Subir Sen: If you can just clarify the point on leverage which you made as to what is the consolidated leverage and how is this figure different for your Retail book versus let us say your Wholesale book?

S. Ranganathan: If I look at the total consolidated balance sheet, the leverage ratio looks at 6.3, but as we have always talked about the treasury assets are sort of self-funded in the form of CBL or borrowings that we have. So the right way to look at our balance sheet is to remove the treasury assets because we are highly liquid and at the same time we are backed by CBLO. So what we internally do is and also encourage people to look at the leverage ratio without the treasury assets which is 4.9x. So at 4.9x we believe that there is still sufficient room for growth, we should be able to take some more debt in our balance sheet which will help us improve our balance sheet as we grow along.

Subir Sen: Would you be able to give some breakup of how much is the leverage in the Retail book versus Wholesale book?

Rashesh Shah: We have not been splitting that up between Wholesale and Retail because we are looking at the balance sheet as a whole because for Wholesale and Retail we largely calculate risk weighted average and capital adequacy of these entities. So we have been following that but maybe it is a good suggestion we should start calculating that and also focusing that going forward.

Subir Sen: Since you mentioned about the Wholesale book, any kind of restructuring that we have seen in this book in the last couple of quarters?

Rashesh Shah: We have not seen a lot of restructuring, as I said, we had a fund operating assets or we fund where there is liquid collateral. So we usually prefer instead of doing restructuring to either get the asset refinanced by somebody or to just liquidate the asset and recover the money.

Moderator: Thank you. The next question is from the line of Mishaal Chotani from Aditya Birla Finance. Please go ahead.

Mishaal Chotani: The first question was regarding the growth in the NPA on the base of Rs.196 crores which was there in FY'15, that has jumped to Rs.281 crores, so almost 50% growth. Would you be able to give some indication about which book it has come from and what do you see that going forward?

Rashesh Shah: On the NPA front, we have been very conservative in providing for that, as I said earlier, even where we have the collateral and as you know the last couple of years we had grown the book. So the growth in NPAs is more or less commensurate with the growth of the Credit book that we have had and we are now at about 1.4% of the gross NPAs which given that we have close to 7% NIM in our internal mathematics that we do on this kind of Credit risk/reward. Our estimate is that for 7% NIM up to 2% gross NPA and up to 75 basis points NNPA is what should be part of the equation. So we are currently at about 1.4% and our NNPA is about 45 basis points or so. So on that count we are fairly much within the tolerance levels that we have internally. We have been very conservative in providing for NPA even where we have the collateral because if there is some collateral which cannot be immediately sold but will eventually get sold and we will recover the money, we still prefer to classify it as NPA and start providing for that.

Mishaal Chotani: On which particular book are you seeing this NPA growth – is it on the certain corporate assets or certain real estate assets, if that continue some pinpointed view of that?

Rashesh Shah: Actually, it has been broadly on a pro rata basis because in almost every book including Retail, Housing and LAP, it has been more or less around this particular number only. So across all the books except obviously the distress book where there is no NPLs that we provide because we anyway buy the NPLs from the banks. It would be more or less fairly similar for both Wholesale and Retail book and even within the Wholesale the Corporate as well as the Real Estate Credit book. We have not seen any significance in any one particular segment of the Credit portfolio.

Mishaal Chotani: Could you give me some indication of the continued treasury loss that you are seeing on this book and that growth, how would that loss come and what is your strategy around that?

Himanshu Kaji: It is not a loss really, in fact, it is nothing but the way the accounts have to be presented. ECL Finance has a part of its liquidity and funding strategy. We borrow money on structured products which do not have any coupon. So these are mark-to-market and it is nothing but the finance cost relating to this structured product which is sitting here as a treasury loss. Actually, it is not a loss, it is an interest income sitting there.

Mishaal Chotani: So you are saying this is not a loss, this is just an accounting…?

Himanshu Kaji: Yes, as required by the accounting standards, any derivative product will have to be accounted or separately.

Mishaal Chotani: Regarding your growth in clients has seen almost of 4x jump, I think you are now 300,000 plus clients. So can you give a quick brief this 4x jump in client has come from which particular segment?

Rashesh Shah: All this is largely because we also do a lot of Insurance Broking as well as Rural Finance which is done through our Retail Finance book. So, these are usually large clientele very low value items and a lot of that goes to our book. So our clientele has increased a lot because of this and this is part of our long-term strategy to basically expand the client base as much as we can even if the ticket sizes are very small, so that on an ongoing basis we can do cross-sell and use this client base for basically building the Edelweiss franchise and relationship with them.

Mishaal Chotani: We have seen obviously as your Insurance is maturing, the persistency has dropped to 60%-odd. Are you seeing this now as a fairly standard or are you sensing that it will go down further and kind of mature at a certain level?

Rashesh Shah: No, actually, it would be other way. Our persistency has gone up and in FY'16 it has been 70%, we had gone as low as 48% a couple of years ago because in the early days of your Insurance business the new policies and you are experimenting with new channels and channel partners, usually persistency suffers as a result of that and it stabilizes. 70% we are fairly good even as compared to the industry. I think when we had a persistency rate of 48%, we were almost in the last 10% of the industry. 70% we are I think 8 or 9 as the rank in industry. So anything above 65% is normally considered good persistency and we are now at 70% which for a young company like ours it is a fairly significant achievement.

Moderator: Thank you. The next question is from the line of Sudhakar Prabhu from Span Capital. Please go ahead.

Sudhakar Prabhu: My first question is on your distressed asset which is around Rs.1900 crores. Would like to know what is the nature of these assets – are these Wholesale or Retail? Also, what is the total collateral or the book value of this asset?

Rashesh Shah: These are largely Wholesale assets, these are the assets we acquired in our ARC from the banks and as you know when we acquire from the banks we earlier used to invest 5%, now we invest 15%. So this amount corresponds to our investment when we buy an NPL from the bank. On an average we have bought NPL from the banks at about 45-50% of the gross value of the loan is what we pay and out of what we pay we now invest 15% as our own money. Against that we get interest on this money as well as we get fee as well as recovery incentive on handling the recoveries and restructuring of this asset. So collectively our estimate has been that you can earn about 17-18% yield on your investment, part of which comes out of interest income and part of which comes out of fee income as the ARC. So we treat this as the distress credit book or in other words our share of the distress credit book on which we expect to earn between 17-18% kind of yield in aggregate.

Sudhakar Prabhu: Are you taking any interest into your P&L now, what would be that percentage?

Rashesh Shah: It is on actual basis but as I said part of this comes as fees and part of it comes as interest and it varies from asset to asset; on some asset you make 12% interest and maybe another 4-5% comes by way of fees while the others where the fee is a much larger component in this. So if you see the addendum that we have said, it shows you the fee and incentive income and other operating income which is there in the profit & loss account of the ARC, today afternoon we have given individual subsidiaries profit & loss account also. So in that you will be able to see the fee and incentive income and the operating income. But the idea is to take the total income as the yield on the assets that we have created.

Sudhakar Prabhu: The gross NPA numbers of 1.4% which is mentioned in your presentation, on how many days do you classify this gross NPA -- is this based on 120-days or 150-days?

S. Ranganathan: 150-days norm, this year onwards it will be 120-days norm, but we do not see a significant difference as of now as the portfolio stands today.

Sudhakar Prabhu: My third question is on your leverage. You mentioned that ex of your treasury your leverage is around 5x. Just wanted to understand, at what maximum level would you be comfortable with in terms of leverage?

Rashesh Shah: As you know we all focus on capital adequacy and the risk weightage assets and all those parameters also. But just crudely I think between 6% to 6.5% is where we are comfortable, we would not want to exceed that.

Moderator: Thank you. The next question is from the line of Umang Shah from Emkay Global. Please go ahead.

Umang Shah: What would be the quantum of our Loan Against Property portfolio outstanding?

Rashesh Shah: We had that in the presentation where we have given the breakup; overall, my guess would be this should be about Rs.5,000-odd crores.

Umang Shah: This would be a part of structured collateralized credit as well as mortgage…?

Rashesh Shah: You see in the Presentation Slide #22, Rs.5347 crores is the Loan for Developers against Housing Projects and what you see in Mortgages it is Rs.2,641 crores, we will have some Retail, LAP also I would guess about Rs.1500 crores out of that should also be LAP but those are Retail LAP.

Umang Shah: My second question was regarding within our Retail segment we have a category called Rural Financing. Which are the products that we do under Rural Finance?

Rashesh Shah: We mainly do small ticket loans through some of the Microfinance entities and as I said our long-term idea in this is to build a clientele and understanding of those clientele so that we can eventually sell them home loans as well as Insurance and other investment products on a long-term basis. So, this is a small part of portfolio and we are ceding this for building large Rural Retail clientele which we think over the next three to four years will be good for at least being able to sell some other investment of Credit products too.

Umang Shah: Just a related question; would this be portfolio buyouts for us or these MFIs originated for us, how does that work?

Rashesh Shah: These are usually originated by the MFI in partnership with us. So we underwrite along with them. So there is a program that is jointly evolved. They do the origination work, but it is in our books and the clients are our clients. They also protect us on some kind of credit loss and all that. So, it is in partnership with the Microfinance companies.

Umang Shah: But basically these would be on our balance sheet, I mean, these would not be buyouts ideally so to say?

Rashesh Shah: No.

Moderator: Thank you. The next question is from the line of Jyoti Khatri from Monarch Networth. Please go ahead.

Jyoti Khatri: Your Housing Finance book, I think it is on 90 DPD, right?

S. Ranganathan: Yes, that is on 90 DPD.

Jyoti Khatri: So ex-Housing Finance it is 150 DPD?

S. Ranganathan: Yes.

Jyoti Khatri: You mentioned that the stress is not yet gone. So what is your assessment… how the asset quality should behave in FY'17?

Rashesh Shah: No, I think I said stress has not gone up, it has not gone down, I think the last couple of years, we are seeing cash flows getting stressed a lot and we expect at least for the first half of this year that to continue and we are cognizant of that but we are not seeing stress going up, if you see most of the stress in the banking industry also as I said earlier our projects which were funded between 2010 to 2012 and largely in the areas of steel, power and other infra projects. So any bank, any NBFC which has avoided those and especially the asset which got built after '13-14, there is not a lot of stress on those assets per se but interest servicing and cash flows for everybody in the economy are slightly stressed. So you would be very cognizant of that, but we have not seen things getting worse, in fact, things if at all have marginally improved in the last 4-5-months because from October onwards we have seen that things have been slightly improved but it is too early to say and hence we are hypothesizing that same thing will continue at least for the next couple of quarters.

Jyoti Khatri: In FY'16, had you seen any gaze that you would have liquidated the asset of the work….?

Rashesh Shah: We do liquidate from time to time, we do not disclose details on that, but I would say every year we would have liquidated 2-3-accounts for recovery of the money and that is an ongoing process and we have a fairly stringent risk management team that oversees that.

Jyoti Khatri: You are able to recover your entire amount, is that correct?

Rashesh Shah: Yes, as I said, we have a collateral cover between 2-2.5x, so we usually recover and after that also if there is a problem we are not able to liquidate then we provide it in NPAs and it goes through the NPA book.

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

Nischint Chawathe: What would be the size of the Microfinance book?

Rashesh Shah: Currently, fairly small; altogether it is about Rs.450 crores across about 11 or 12 microfinance companies and here we usually as I said it is originated by the microfinance company but booked on our books with a program that is jointly developed for underwriting and we also have credit loss guarantee from the microfinance companies. So we are basically protected on both the counts. Along with that, largely, our attempt on this is to cross-sell our other products especially Rural Housing as well as Insurance and other products on that.

Nischint Chawathe: Your yield on this kind of a product would be…?

Rashesh Shah: I think it usually ends up being between 14% to 16% on this book that is the yield to us outside of what gets paid to the microfinance company for origination.

Nischint Chawathe: On your Wealth business, the average AUA per family works out to close to Rs.120 crores. Is that a right observation… what is exactly that you are doing here?

Rashesh Shah: When we said 250 families, it is largely the global wealth group only. When we are showing the assets under advice we have the HNI broking clients also in that. So overall the clientele number would be a lot larger so that 250 families is not directly commensurate with the Rs.20,000 crores of assets, Rs.25,000 crores or both the global wealth management assets as well as HNI broking assets that we have in our custody and all while the 250 families where we have the family wealth management mandate from those clients.

Nischint Chawathe: On the Agri-sector Credit, these are I believe more of Warehousing Finance and short-term facilities?

Rashesh Shah: Yes, we only fund goods in our warehouses and the reason we started the value chain business is so that we have control on risk and we will fund only goods in our managed warehouses, we do not do any third-party warehouse financing at all.

Nischint Chawathe: Income from this is not part of Edelweiss Commodity Services, it comes under the fund-based income I believe?

Rashesh Shah: Yes, it is a Credit book for us.

Nischint Chawathe: If you could give some color of the Rs.900-odd crores revenue in the Commodity Services business?

Rashesh Shah: All this was our Commodity Intermediate business including the Gold Imports and all the other Commodity businesses that we do, as we have said in the past, we are intermediaries in the physical part of Commodities also, so it is all that. But again, top line is also because Commodities is what we call capital-based intermediation services. So large part of the top line is effectively some kind of an interest cost or the interest income that you have and out of that interest income is about Rs.755 crores.

Nischint Chawathe: This is not a part of the credit income. It is shown separately?

Rashesh Shah: Yes, it comes as Commodity income.

Nischint Chawathe: How do you see the income composition changing for Edelweiss over the next few years because the contribution of the Credit business is increasing substantially?

Rashesh Shah: If you saw, in the current year our Credit businesses had an NII of Rs.1,200 crores while the Non-Credit had Rs.1,100-odd crores and this gap has been expanding in the last few years. So I would expect that currently we are about 57-58% Credit and 42-43% Non-Credit…I am excluding Insurance out of this. I would expect on the next four year basis, this should become about 75-25; 75 of the (NR) the net revenue should come from Credit business and the remaining 25 should come from the Non-Credit business.

Nischint Chawathe: In terms of the bottom line I guess in that sense it would be a lot more skewed towards the Credit?

Rashesh Shah: Yes, if you see currently our profit after tax on the Credit business is Rs.337 crores while the Non-Credit is Rs.182 crores, so it is about already one-third in some form, I think it should also become about 75-25. But having said that I think the growth in Non-Credit might be slightly faster for the next couple of years but as I said by 2020 we would expect 75-25 kind of a split.

Nischint Chawathe: Some of the Non-Credit segments that you are most excited at this point of time excluding the ARC?

Rashesh Shah: I think the ones we are most excited by our Asset Management, Wealth Management and also Capital Markets, because I think Capital Markets will have some sort of reversion to mean, as I am sure, you are aware like in our own case our Broking revenue now is the same that it was in 2008 and our Investment Banking is half about it was in 2008. So almost for 8-years, capital markets has not grown or some parts of markets have shrunk. So I do expect that over the next couple of years, there will be some reversion to mean on that count as well as the investments we have made in both Asset Management and Wealth Management, especially Wealth Management we feel very excited about because we have grown our assets under advice and now it is Rs.28,000 crores we think a significant size and we would expect to see significant growth on that. As I said earlier, we still are operating at a fairly high cost-income ratios in this business because we are still seeing ourselves in investment mode, we are building capacity, hiring relationship managers and all that, but going forward, we do expect cost-income ratios to come down and the top line to go up. So profit may grow lot faster because of that.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir, if you could share the yield on the Rs.20,000 crores Credit book and the Rs.32,000 crores balance sheet if you could divide it as your capital employed in Credit business, Non-Credit business and Insurance business?

Rashesh Shah: The entire Rs.20,000 crores Credit is there in the Slide #22 of the presentation that we have, out of the remaining Rs.12,000 crores, almost Rs.8,000 crores are the treasury assets and the Non-Credit assets and the remaining would be what we call Corporate assets which has Insurance investment, so about Rs.1,000 crores. Go to Slide #28, that gives you the capital employed in the Non-Credit business which is about Rs.11,000 crores and then go to Slide #32 which gives you the breakup of the balance sheet management unit and the remaining will be the Insurance assets that we have.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. As there are no further questions, I would now like to hand the floor over to Mr. Rashesh Shah for closing comments.

Rashesh Shah: Thanks a lot. I do hope to see you again when we have this conference call. Bye-bye. Good Afternoon.

Moderator: Thank you. On behalf of Edelweiss Financial Services, that concludes this conference. Thank you for joining us and you may now disconnect your lines.