



“Edelweiss Financial Services Limited Q4 FY17
Earnings Conference Call”

May 18, 2017



MANAGEMENT: **MR. RASHESH SHAH – CHAIRMAN AND CHIEF EXECUTIVE OFFICER, EDELWEISS GROUP**
MR. HIMANSHU KAJI – EXECUTIVE DIRECTOR AND GROUP CHIEF OPERATING OFFICER, EDELWEISS GROUP
MR. S. RANGANATHAN – PRESIDENT AND CHIEF FINANCIAL OFFICER
MS. RAMYA RAJAGOPALAN – HEAD, CORPORATE DEVELOPMENT
MR. SALIL BAWA – HEAD & SENIOR VICE PRESIDENT, STAKEHOLDER RELATIONS

MODERATOR: **MR. VARUN DIVADKAR – CDR INDIA**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Edelweiss Financial Services Limited Q4 FY17 Earnings Conference Call. As a reminder, all participant line will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing ‘*’ and then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Varun Divadkar from CDR India. Thank you and over to you, sir.

Varun Divadkar: Thanks, Inba. Good afternoon, everyone. And thank you for joining us on the Q4 FY17 Results Conference Call of Edelweiss Financial Services Limited. We have with us today, Mr. Rashesh Shah – Chairman & CEO, Edelweiss Group; Mr. Himanshu Kaji – the Executive Director and Group COO; and Mr. S. Ranganathan – President and Chief Financial Officer. We also have with us from the stakeholders’ team, Ramya Rajagopalan – Head, Corporate Development; Salil Bawa – Head and Senior Vice President, Stakeholder Relations and Samridhi Deorah.

Before we begin, I would like to state that some of the statements made in today’s discuss may be forward-looking in nature and may involve certain risks and uncertainties. The detailed statement in this regard is available on the Q4 FY17 Investor Presentation that has been sent to you earlier.

I would now invite Mr. Rashesh Shah to begin the proceedings of the call.

Rashesh Shah: Hello, and good afternoon to everybody. First of all, thank you for being on this call. Good to have all of you back again, hope you have got a chance to see the results and the investor presentation that we have given out.

The highlights of the results are: on an annual basis, FY17 has been a good growth year for us. All around growth, both our credit businesses and the franchise businesses, they witnessed healthy growth. As you would have seen, we have clocked revenue of Rs. 6,634 crores for the year, which is a growth of 25%, while profit after tax after on consolidated basis has grown to Rs. 609 crores, which is 47% growth, excluding insurance, because we still continue to be in the investment phase on insurance. We have a profit after tax of Rs. 719 crores, which is a growth of 39%. So, this again caps almost five years of good growth for us. Over the last five years we have grown at an average CAGR of about 38% now. And one of the interesting things has been that our balance sheet has grown much slower. So, we have shown non-linear growth in profitability in this period. We have grown our balance sheet at almost approximately half the pace of growth of profit, so whatever has been the asset growth, our profit growth has been twice of that. And that underscores our credit plus franchise business model, because neither we are a pure credit company nor we are a pure agency advisory company, we have a good mix of both the businesses. And as you would have seen, even in this year almost about slightly under 70% came from credit and the remaining 40% came from the non-credit, which is franchise and the balance sheet management unit.

So, overall, we have now an asset base of Rs. 38,700 crores. For the fourth quarter, our ROE is almost equal to 22%, that is annualized ROE for the fourth quarter. So, now our old target of being in the range of 20% to 24% is getting achieved, and we still think that 22% to 24% is where we want the average going forward. We have said earlier also, we hope to continue our 25% to 30% PAT growth rate in the coming years.

For the asset base of Rs. 38,700 crores we have a group gross net worth of Rs. 5,288 crores and overall our credit businesses had a good growth year. As per our stated strategy, there was much higher growth in retail credit, our retail credit business grew at 48%. Distress obviously had a good year, because as you would have seen last year there has been a lot of activity in the ARC, so our ARC has grown more than 100% this year and the corporate credit book has grown at only 15%. And as you can see now, out of our total credit book, corporate is about half of it, retail has become 33% and distress credit is about 17%. Both distress and retail are growing fairly rapidly now, so we do feel that by 2020 we will achieve our stated target of retail being 50%, corporate being about 35% and distress being the remaining 15%, and that is where we are going towards. In the presentation, we have added some more annual data which gives you more granular details about our businesses and their profitability. So, you would have seen that in our credit business, we are now at 18% ROE and 2.1% ROA overall.

Our franchise business made a profit after tax of Rs. 193 crores which is very good growth over the last three years. And our treasury balance sheet management unit had about Rs. 719 crores. Overall, the franchise business operates at a 73% cost to income ratio, if I remember correctly, a year ago we were almost 80% cost to income ratio. So as we are getting scaled, we are obviously getting our cost to income ratios more under control. What also has been is, on the franchise business, our Wealth Management assets under advice have grown by almost 100% in this year, we were about Rs. 29,500 last year and we have crossed Rs. 60,000 crores in this year. So, we have a fairly good growth in our Wealth Management business.

Similarly, even in Asset Management business we now have total assets of almost Rs. 18,000 crores, out of which Rs. 11,000 crores is alternative and approximately Rs. 7,000 crores is in the mutual funds. So, fairly good growth rate.

Capital Markets had a good year. Capital Markets has also done well and overall, all three parts of our franchise business have started doing well. Asset Management broke even in this year. For about six to seven years we have been investing in this business and now we expect that good growth will start here too.

Insurance also had a good year, insurance has been maintaining a steady growth rate, our overall premiums have grown at 42% for this year. And as per plan, we are in the fourth year of the insurance rollout and we think we need another four more years for breakeven, and by 2021-2022 we expect to hit breakeven in that business.

Some of the other things we have done this year is we have strengthened the balance sheet, we have increased the liquidity cushion that we have, we now carry almost Rs. 4,000 crores plus

of liquidity cushion which is more than 10% of our balance sheet. And we think this is the heart of building a very strong balance sheet. So, not only do we have an ALM that matches well, over and above that we have a 10% of our balance sheet available as liquidity cushion on an overnight basis.

Our long-term liabilities have now become more than 50% of our total liabilities, which has grown a lot in the last four years. So we have used this liquidity environment as well as our own modern franchise to strengthen that. We currently have a group capital adequacy of 17% and debt to equity of 5.2, excluding treasury assets.

So overall, fairly good. And we are also very heartened by the current model we have which is the on-balance sheet and off balance sheet, the credit and the franchise model. And in that we have almost \$24 billion of assets on and off balance sheet, almost Rs. 156,000 crores of assets that we advise, manage, control, out of which only Rs. 38,700 crores is on the balance sheet, Rs. 117,000 crores is off the balance sheet in the AIC business, in the Wealth Management business, in the Asset Management business, and in the Custody business.

So, overall, fairly good growth and our diversified portfolio approach continues. In the annual performance slide we have also given some more data on that. There is a slide 23 which shows that the structured collateralized credit contributed to about 15% of our profits, wholesale mortgages contributed 22%, retail mortgages contributed 6%, SME/agri is another 9%, distress is 13%, Wealth Management is 10%, Capital Markets is another 15%. And our treasury and balance sheet is another 10%. So we have a very well diversified business and I think so many engines have started firing that we feel fairly positive for the growth prospects for the next seven to eight years. And I think from now to up to 2025, we do think that India is growing fairly well, India should become a \$5 trillion GDP country, and that growth will be reflected in growth in financial services.

We expect that in financial services, most of the asset classes, most of the business opportunities will double every four to five years. So whether it is bank credit, whether it is bank deposits, whether it is assets under management, whether it is Wealth Management, we think everything will double every four to five years going forward in India for the next few years at least. And that is an opportunity that we are harnessing when we have a good mix of business.

We also have a strong leadership team, we invested a lot in technology and infrastructure this year. And as we always said, our main focus continues to be on cost management, risk management, people management and client experience. And as long as we can focus on these things, we do think this growth should be available to us, we have to continuously execute on that.

So, along with that, thank you very much to all of you for being on this call. I will now hand it over to my colleague, S. Ranganathan – our CFO, to give more granular details on the performance.

S. Ranganathan:

Thank you, Rashesh. Let me quickly take you through the Q4 Earnings Update. In Q4, we recorded quarterly PAT of Rs. 170 crores, registering a YoY growth of 40% against Q4 FY16 PAT of Rs. 122 crores. As Rashesh mentioned, ex-insurance ROE for the quarter stands at 22.2%. Our total revenues for Q4 FY17 is Rs. 1,945 crores, up 26% year on year. Consolidated PAT for the quarter was about Rs. 170 crores, from Rs. 122 crores in Q4 FY16, up 40% year on year. Ex-insurance profit after tax of Rs. 212 crores as compared to Rs. 155 crores in the previous year, up 37%. However, the balance sheet grew only by 20% year on year to Rs. 38,667 crores.

This is how our main businesses have fared this quarter:

Credit business PAT grew year on year by 25%, corporate book grew by about 15% while the retail book grew by about 48%. Distress asset credit also showed significant growth. Franchise business PAT grew year on year by 159%, this segment includes fee based businesses, namely Wealth Management, Asset Management and the Capital Markets. Our operating efficiencies have improved as well, the ex-insurance cost to income ratio for the quarter was 51% as against 61% in Q4 FY16. Credit cost again remains well under control. The GNPA was at 1.59% and the NNPA 0.6%.

Overall, to sum up:

Our corporate book is covered 2.3x and the LTV on the retail book stands at 45%. Consolidated ROA for the quarter stood at 1.7% and the ex-insurance at 2.7%. Consolidated ROE for the quarter stood at 16.1% and ex-insurance ROE at 22.2%.

Now, let's look at the individual heads of income:

Our fund based income grew 7% year on year to Rs. 1,223 crores in Q4 FY17. Fee and commission at Rs. 481 crores in Q4 FY17 grew by 135% year on year.

Our Life Insurance business continues to be one of the fastest growing Life Insurance companies in the industry and recorded a gross premium of Rs. 205 crores during Q4 FY17, a growth of 35%.

Coming to the costs:

Our headcount stands at 6,972 as on 31st March 2017, compared to 6,227 a year ago. This has led to a year-on-year growth in the employee cost of 25%. We are making significant investments in our key growth areas to build scale in our operations. OPEX grew by 20% year-on-year, which is in line with the revenue growth of 26%. OPEX growth is mainly led by higher advertising expenses, legal and rental costs, especially for growing businesses like agri, value chain business, retail credit and Life Insurance.

Volumes have gone up to Rs. 33,379 crores from Rs. 27,773 crores, reflecting a scale up in our operations. There has been a marginal increase in the finance cost, however the weighted average cost of debt for the quarter is 9.5% and the NIMs have remained strong.

Coming to our balance sheet:

We have taken quite a few steps to strengthen our balance sheet. Our consolidated capital adequacy at the end of quarter four was 17.01%. We continue to have a matched ALM and liquidity profile over the short-term and medium-term. New lenders from insurance companies, pension and provident funds in addition to banks' mutual fund and retail subscribers have added to our diversified sources of borrowing. Post our last call, we have successfully raised masala bonds of the value of Rs. 500 crores from international market, and saw that diversifying our lender base. The debt-to-equity ratio, excluding treasury assets, stands at 5.2.

Coming to the credit business highlights:

Corporate credit books stood at Rs. 27,608 crores at the end of Q4 2017. The credit book continues to be in structured collateralized credit and wholesale mortgages. This book is very well risk managed and we have avoided undue sector as well as industry concentration. The asset quality continues to be under control with gross NPA at 1.59% and net NPA at 0.6%. The total provision cover stands at 87%.

Our retail credit book, comprising of Housing Finance, Loans Against Property, SME, Loan Against Shares and Agri and Rural Finance, continues to grow rapidly. At the end of Q4 2017 retail credit book was Rs. 8,952 crores, which is up 48%. Capital deployed in Distress Credit business stands at Rs. 4,781 crores with an AUM of Rs. 39,500 crores. The cost-to-income ratio on Credit business stands at 30% for the Quarter 4, 2017.

Coming to our franchise business, which comprises of Wealth, Asset Management and Capital Markets:

Wealth AUM doubled during the year and stands at Rs. 60,300 crores as of end of Q4 2017. We continue to have a good mix of product and advisory solutions for customized needs of our clients. As our Asset Management business grows, we are happy to share that the AUMs have grown from Rs. 5,000 crores to Rs. 18,200 crores as of March 2017. During this period, we have successfully integrated the JP Morgan and Ambit Alpha acquisitions. Our Capital Markets business continues to be a pioneer and market leader.

Insurance:

Gross premium in the quarter has gone up by 35% to Rs. 205 crores. Insurance is trailing as per plan. ETLI has a net worth of Rs. 733 crores. We are also happy to report the embedded value in our Life Insurance business at Rs. 1,012 crores as on March 2017.

This completes our Q4 review. And now I leave it back to the CDR team.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Vishal Modi of Maybank Kim Eng Securities. Please go ahead.

Vishal Modi: Sir, my first question is on your Wealth Management business. So, we have seen some bit of improvement now and our cost income has now come down to 76% from 88% odd level last year. So, what is the desirable level that we are looking at, maybe at 65% or so and probably at what timeframe do you think this will come down to that level?

Rashesh Shah: See, I think the long-term target on that is between 60% to 65% and that is comparable with the global best practices in cost to income terms. And we think we are two years away from that, so we should I think slowly and steadily get there over the next two years.

Vishal Modi: And sir, in terms of composition of assets, is it largely distribution or do we have some other aspects such as advisory or custody, etc?

Rashesh Shah: See, custody assets we have given out separately, we do not count that in Assets under Advice and Wealth Management. So we have another Rs. 4,700 crores custody assets, so we have actually broken that away now and assets under advice are mainly in Equities, Mutual Funds, Structured Products, Alternative Funds, and high-yield bonds, all of that put together. So it is actually very well-spread out, there are different categories and different kinds of asset mix in that.

Vishal Modi: And we will continue to see this business scale up, probably the growth rate would be a bit less because of the base has increased. But do you think two, three years we will probably be able to grow at 35% - 40% kind of level for the AUM?

Rashesh Shah: See, the good thing about both Asset Management and Wealth Management is that there is organic growth because the assets also appreciate. So the average if you see, a 10% to 12% asset appreciation in both Asset Management, Wealth Management is there for everybody. And then there are fresh assets coming in. So to give you an idea, our estimate is that the current assets under advise for the whole Wealth Management industry is close to about Rs. 700,000 crores odd business – Rs. 700,000 crores to Rs. 800,000 crores, which is close to about \$120 billion to \$130 billion in India. If you look at most of the other countries which have gone through this development phase, I think our long-term idea is that it ends up being somewhere between 40% to 50% of our GDP. So, to give you an idea, you are supposed to be 50% of GDP even now, it should be \$1.2 trillion, which is currently of only \$120 billion. So, we do think that as GDP grows, like to give you an idea, US assets under advice of Wealth Management industry is 85% to 90% of the GDP, we are expecting in India it should be 40% to 50% of GDP over the next eight to ten years. So, we do expect that not only it will grow with the GDP growth but also the percentage of GDP will grow from currently what we think is only about 5% of GDP to at least 40% of GDP over 10 to 15 years, I do not think this will

happen overnight. And given that, when you do the math, I think expecting a 30% growth of this industry over the next five, seven years, we do think it is possible, but it will require building a platform, a range of products, a range of services, even investing in technology is becoming very important, customer experience and all. So, I think you need a whole range of this, but the industry opportunity is there and I do not think there is doubt that it will grow 25% to 35% in the next five years.

Vishal Modi: Second was on our balance sheet management unit which is like now 15% of total and it has come down from around 19% last year. So, do you think there is a bit of scope to go down further or we are willing to keep it at around this level to maintain the liquidity?

Rashesh Shah: Our long-term estimate is that this will be between 10% to 15% of the balance sheet, because as you see a part of that is also the liquidity quotient that we carry which is also currently about 5% to 6% of the entire balance sheet. So, I do not think it will go below 10%, but I think 10% to 15% is what we aim to keep it at.

Vishal Modi: So that should add to some bit of ROE improvement because this is a bit of a drag so to say, right?

Rashesh Shah: Yes, but again, this is not an asset that you are investing in for returns, it is also liquidity management and liquidity cushion and all. But you are absolutely right, I think as the percentage comes down the ROA, ROE will improve.

Vishal Modi: And sir, lastly on the provision line in credit business has seen a bit of increase this quarter from Rs. 140 crores, so what was this specifically?

Himanshu Kaji: So, broadly as far as provisions are concerned, they are really in line in terms of the percentage and the book that we have and some linkage that has been created. But what is more important to see is that most of the provisions that we have made or the NPAs that we have, we have an asset cover available on this which is in many cases more than 100%. From a loss given default on this, it is actually much lower than the provisions that we have made. And I had written back even this year reasonable sum on the fee and we assume that will continue.

Vishal Modi: So we have made something which is higher than regulatory requirement?

Himanshu Kaji: Yes, we always do that.

Vishal Modi: So for example, nine months it was like 179 and in fourth quarter itself it is 140, so that would include some bit of higher than required provision as well?

Himanshu Kaji: Yes.

Moderator: Thank you. Our next question is from the line of Jinal Fofalia from AlfAccurate Advisors. Please go ahead.

- Jinal Fofalia:** I have a couple of questions. First question is, in your credit business we saw cost to income reducing significantly by 30% in fourth quarter. So, what was the reason for it and if you can guide for FY18 as well?
- Rashesh Shah:** See, as we always maintain, the cost to income ratio will come down as the scale goes up, because especially in retail credit we had invested quite a bit of in opening branches and customer acquisition. So overall, we are now at 36%, I think if I remember, a year ago we were at around 40% or so. We think in the long-term, given the mix of businesses we have, corporate, retail and distress, retail which has housing will go up faster. We should be able to average around 30% over the next two to three years. So, if we can bring this 36% down to 34% next year and then 32% and then 30% by 2020, it would be as per plan.
- Jinal Fofalia:** Sir, second question is, in your wealth and AMC business what was the net profit in FY16 and FY17 and if you could also guide for FY18 as well?
- Rashesh Shah:** It will be hard to give guidance on FY18. FY17, we used to give this along with the BMU part of it, but for this year our total profit is Rs. 193 crores on this franchise businesses what is Asset Management, Wealth Management and Capital Markets. My guess is about last year the total number on this was about Rs. 73 crores.
- Jinal Fofalia:** Rs. 73 crores has gone to Rs. 190 crores, right?
- Rashesh Shah:** Yes, it is actually more than 100% growth because Capital Markets have grown but more than that Asset Management has grown. As I said, in Asset Management we have broken even a year ago, and we were investing money in that business.
- Jinal Fofalia:** So, sir, this is including your wealth, AMC and Capital Markets combined?
- Rashesh Shah:** Yes, so in the presentation this is Slide #21, we have given the breakup of this for this year, Rs. 71 crores, Rs. 7 crores and Rs. 115 crores, between wealth, Asset Management and Capital Markets.
- Moderator:** Thank you. Our next question is from the line of Bobby Jayaram from Falcon Investments. Please go ahead.
- Bobby Jayaram:** Rashesh, to your point about how the assets under management are going to increase with increase in GDP, have you considered the impact of DIY ETF investing where the investors simply bypass all the asset investors?
- Rashesh Shah:** Your voice is fading out, can you repeat please.
- Bobby Jayaram:** My question was that when you talked about assets under management increasing with increase in GDP, did you factor in the impact of direct ETF investing by investors as we move along?

Rashesh Shah: See, earlier I was talking about the Wealth Management industry. And I would just like to clarify that we classify Wealth Management and Asset Management as separate parts of the business, the Wealth Management is the advisory part and the Asset Management is the manufacturing part. My understanding would be that the ETFs will have a lot of impact on the Asset Management economics going forward, but on the Wealth Management side it will be another product that you will offer to your customers. But what you are seeing in India is that increasingly as these are coming down, as more assets are moving away from bank deposits and real-estate into other financial assets, we are seeing a lot of appetite for high yield bonds, collateralized bonds, alternative funds, structured products and all of that. And along with that we are also seeing a fair amount of demand for margin funding, for IPO financing, ESOP financing and all of that. So actually, on the Wealth Management side we are seeing that the portfolio is a lot more important than any one particular product or asset class as such.

Bobby Jayaram: So you are not talking specifically about the actively managed unit growth? Do you have any actively managed unit costs under your Edelweiss brand?

Rashesh Shah: Yes, so if you see our Asset Management part of the business, we have a mutual fund and we have alternative assets. Now, alternative assets are largely focused on credit opportunities in India, we are the leader in private debt in India and we think private debt is a new big emerging asset class. If you see, a lot of alternatives in India are either in the hedge fund category or in the private equity category, there are very few in private debt category, so we have taken leadership position in the private debt category. Our assets under management is the Asset Management part of the business, the manufacturing part as you call it, there will be mutual funds and we have alternative assets.

Moderator: Thank you. Our next question is from the line of Dhwanil Desai from Turtle Capital. Please go ahead.

Dhwanil Desai: I have three questions, first is on the insurance side, I think we are one of the large entrants and we are one of the smallest players in the insurance sector and if we look at the industry in India it is in the consolidation phase. So, given our smaller scale and since we do not have any large bancassurance channel, so how do you see the potential of this business and what are the headwinds or challenges that you see given your scale and the distribution channel that we have opted for?

Rashesh Shah: See, many insurance companies which are there in India, a lot of them are promoted by industrial groups or business groups, which are not core financial services companies, they do not have the same focus. For us insurance is a complete portfolio buffering to our customers. Whereas on long-term basis, what we want is when we have a customer we want to provide a home loan to him, we want to provide insurance to him, we want to provide all the other investments as well as borrowing products to him, both ours and third party. So on that basis we think insurance is first of all a core business model, it is not an opportunistic diversification or a JV that we have done to just exploit the opportunity. We do think on a long-term basis this is going to be the key vehicle for savings to investments getting converted. What we have felt

in India is that there is a lot of savings but they have not been historically converted into investments and we need vehicles like Capital Markets and all, we think insurance will do that. **What we have focused a lot is on the par and non-par product and through the agency channel.** And if you see, agency channel is slightly more expensive but is a very sticky long-term channel. The way to understand this is an agency channel in insurance is equal to CASA in a bank, and we have grown fairly well, we are growing at 35% to 40% every year over the last five years where insurance industry has not grown much. And our focus is on very high quality products for really meeting the needs of the customers sold through a very strong agency channel. You are right that Banca is very important, we also have a Banca relationship, which is a small one but has actually been growing fairly well. Banca is good to sell ULIPs while agency is very good to sell par and non-par products, what are called the traditional products. And we think traditional products on a long-term basis have a lot more sustainable value creation for our customers, and that we are focusing on. In the last four years in spite of the industry not growing much, we are as per plan and we have a very well capitalized balance sheet, we have invested a lot, our branch productivity is one of the highest and our whole emphasis on this again goes back to same thing, can we manage cost, can we manage risk, can we understand the customer needs and provide the right products, and is this an industry which is growing. And on insurance our estimate is that even if you can get 1% to 1.5% market share eventually, it is a good profitable opportunity for you to play, and we do not think there are too many players in India by the way. I think the real serious players are only about 14-15 in India, and there also a bit consolidation may come down to much fewer in the long-term. And we think that a country like India can support between 20 to 25 insurance players eventually.

Moderator: Thank you. Our next question is from the line of Devansh Lakhani from NVS Brokerage. Please go ahead.

Devansh Lakhani: Actually, my question was also on the Life Insurance part only. First question is, where do we stand in terms of our leadership in Life Insurance, like what is our ranking in terms of private sector Life Insurance?

Rashesh Shah: So, we actually divide the whole industry in four categories, four comparable peer sets. So one is what we call the old bank backed insurance companies which are obviously ICICI, HDFC, SBI and all of them. Then we have old non-banks which are people like Aviva and Max and companies like those and then we have new bank backed like India First rather and others and new non-bank which is AEGON Religare, Pramerica, Future Generali, all of them. So they are about six in this category which are started post-2008 and are non-bank backed. In that we have been actually growing faster than most of the others on a four-year basis and we are now actually either second or third ranked in this base, but we see that if you can maintain this 30% - 35% growth, we should be coming to the top about 13-14 rank by 2020 for the industry as a whole and in the top ten rank by 2025. That is the path on which we are going. But along with that there are two other parameters we focus on very aggressively, and in that for the industry as a whole we are in the top four or five currently, one is on branch productivity which includes even agent productivity. And the second is on persistency and on persistency also we have now consistently been very high up in the industry ranking, because we think along with

your size of the premium that you collect every year and the growth rate you show, the persistency as well as the branch productivity are two very important factors.

Devansh Lakhani: And the second question is, sir, we are still I think loss making on the insurance side, so when do we think that we will at least start turning profitable in terms of the profit after tax on the insurance side? Because I think the overall business is a bit lagging, which is generating a bit of loss. So if you could just throw some light.

Rashesh Shah: I think there are two points I would like to answer your question in, one is, we expect to have an accounting breakeven by 2022 and an embedded value breakeven by 2020. So, the first important milestone is to get **alluded value** breakeven and then to get accounting value breakeven. And here what we have done is because we have a partnership with Tokyo Marine, though we are making a loss because of the investments required, a large part of the capital has come from our partners. So the way we have structured the deal is it is a ring-fenced entity and the capital has come from the partners, so though accounting wise it gets aggregated in our earnings because we own 51% of this, almost three-fourths of the capital has come from our partner. So we have also structured it financially well enough that the financial burden is not largely falling on Edelweiss shareholders, so we own 51% of that.

Devansh Lakhani: We hold 51% of the JV basically, right?

Rashesh Shah: Yes.

Devansh Lakhani: So, I think you said two-third of the capital has come from Tokyo Life...

Rashesh Shah: Three-fourth of the capital.

Devansh Lakhani: And we own 51%, so how does that correlate?

Rashesh Shah: Our partners have come at a premium, so if we have invested Rs. 10 a share, they invested Rs. 30 a share, for example, just to simplify. So we have capital the company at Rs. 1,350 crores, Rs. 350 crores has gone from Edelweiss and almost Rs. 1,000 crores have come from the partners.

Moderator: Thank you. Our next question is from the line of Dhwanil Desai from Turtle Capital. Please go ahead.

Dhwanil Desai: Two more questions. First is on the Wealth Management side, if you look at comparable peers, the typical yield on the **(Inaudible) 40.27** is around more than 90 bps - 95 bps, so where do we stand on that? And on the **chain** business, typically what we are seeing is that as the operating leverage kicks in and the product market expands, we now have EBITDA margin in the range of 50% - 60% of the comparable peer set, **so do we think that we are on the growth** and is that a right number to have in mind in terms of steady state margin profile that we can have for Wealth Management business?

- Rashesh Shah:** I think on a long-term basis we expect yield to average between 70 basis points to 80 basis points and your product mix can change every quarter a little bit, so because the yield is more like an output variable. And as I said earlier, we do expect that 25% - 30% growth is achievable. It is actually possible, the market opportunity is there. And our idea is, I think there are different market segments, we are focusing on what is called the OPDO market which is owner-promoter-director-officer market and with a lot of the new wealth, many emerging entrepreneurs, emerging wealth, especially from executives and others is where a lot of our offerings go there.
- Dhwanil Desai:** So, in terms of margin profile do you think that 50% - 60% EBITDA margin is something which is achievable or is that kind of different considering the product mix or the market that we are addressing now, any views on that?
- Rashesh Shah:** So, the yields according to us should be averaging about 70 basis points to 80 basis points and your cost to income ratio will be between about 60 basis points to 65 basis points. So, I think having a pre-tax margin of about 35% on that should be possible and the post tax margin should be about 25%. Our estimate is that both on Asset Management and Wealth Management, on a long-term basis for scaled up players, for players who have some scale, profit after tax should be between about 20 basis points to 25 basis points of AUA or AUM. So if you have Rs. 100,000 crores of assets under advice or management, you should be able to make a profit of about Rs. 200 crores in a year.
- Dhwanil Desai:** And sir, second question was on the cost to income ratio. I think we have a key target of having a cost to income ratio **ex-insurance** on consolidated basis below 50% and Q4 FY17 we are already at around 51%. So, are we nearing a stage whereby most of the leverage for cost optimization has been utilized and will be reaching steady state in maybe a year or year and half from now?
- Rashesh Shah:** No, I think if we look at our cost to income ratio on credit, which is a 36% as I said earlier. We want to be averaging at about 30% out there. And if you look at the franchise business, our cost to income is about 73%, and on that also we eventually want to be at about 65%. So, I think we have 4% to 5% on an average of cost to income that we need to bring down.
- Dhwanil Desai:** So, below 50% means maybe 400 basis points or 500 basis points below 50% is what we are targeting?
- Rashesh Shah:** Yes, I think good industry practice should be around 45% to 47% and as we do the math, I think it is achievable. If you see, today I think HDFC Bank is at about 45%. So a good bank which has a diversified portfolio of businesses with both franchise and credit businesses, I think around 45% is a good industry practice.
- Moderator:** Thank you. Our next question is from the line of Sandeep Patel of Hornbill Capital. Please go ahead.

Sandeep Patel: Sir, just one question on the insurance side. I just wanted to ask whether the foreign partner in the insurance business has an option to increase its stake at any preferred price or any pre-decided formula?

Rashesh Shah: No, I think our understanding with them is that it will be a 51-49, we will be 51% and they will be 49%. And on a long-term basis we have invested Rs. 1,350 crores. Before 2020, we expect to capitalize that company by a further Rs. 650 crores, so we will eventually go to a Rs. 2,000 crores capital infusion. And on that remaining Rs. 650 crores also the same formula will apply, we expect that we would invest about Rs. 150 crores odd and the remaining will come from the partners.

Moderator: Thank you. Our next question is from the line of Raj Chalimeda of Elevation Capital. Please go ahead.

Raj Chalimeda: I wanted to know, if you can throw some light on the agri credit business. How do you see this business shaping up over the next three to five years and what kind of growth do you expect to see here?

Rashesh Shah: As you know, we have spoken about it on earlier calls and the approach to credit business building is to identify a vertical, our credit opportunities which we think we can scale it up to Rs. 8000 crores to Rs. 10,000 crores over five to seven years on an average. And the idea should be because at that size we get good enough opportunity, it is the right size of opportunity for us to capitalize on that. So, on that basis we identified agri credit as one new growth opportunity where the competitor intensity is low. Obviously, a lot of complications are building on that business but that is what we like, because it will take us a few years, we have been doing this for two years now. And the strategy we are following on this is: can we build a warehouse management business first which acts as risk management and a collateral management capability for us. Because in agri credit, one of the biggest issues has been not the opportunity but how do you manage the collateral risk. So, we said let us set up a warehouse management business where we can have the goods in our control, in our warehouses and when the goods are in our control we can give the customer credit against that. So, we do not do third party credit against assets in third party godowns, we only give credit on assets which are in our warehouses. And on that basis, we have built almost a **Rs. 1,000 crores book**. It is still in incubation phase, I think it will take up to one more year after which we will start scaling this up. There are a lot of teething problem, operational problems and technology investments that we are making in this to just iron out the entire back-end, the processes and practices. And we think eventually over the next four to five years we can take this to a Rs. 8,000 crores - Rs. 10,000 crores book.

Raj Chalimeda: So, what is your experience so far with managing risk in the last two years?

Rashesh Shah: Actually it has been fairly good, our hypothesis on how to manage risk have come through. There are lot of operational issues, sometimes there will be rain and flooding and all those things will happen and you have to see the insurance claims and all that. The amounts are

fairly small, usually in each episode the amount is about Rs. 20 lakhs, Rs. 30 lakhs, Rs. 50 lakhs because these are spread over 400 warehouses all over India. So your per-episode risk is lower. We have not encountered fraud and mismanagement and all that which are other risks, but it needs a lot of investment in processes and technology and best practices and we have been investing it back. Fortunately, with RFIDs, and others there are a lot of technological answers which are possible, but you have to evolve with your own experience. So we are slowly and steadily investing in this business and our idea is that for another year, year and a half, we will iron out all these things. And once it is done we will scale it up, that is what we did with our ARC business. That is what we did with our retail credit business, we took three, four years to build the base, to build the foundation and once we had a good understanding of the customer, customer needs, our own underwriting origination capabilities, we were then able to scale up that business really rapidly.

Moderator: Thank you. Our next question is from the line of Atul Mehra of Motilal Oswal Asset Management. Please go ahead.

Atul Mehra: Sir, just one question on the general insurance foray that we have done. So, are we looking at inducting any partners here? And secondly, in terms of lines of business, which are the lines of business which we look at maybe in say three to five years? Are we looking at any particular lines in particular?

Rashesh Shah: I think our idea in general insurance is to focus on building a good online digital platform because we think, from all the study and market research we have done, that is a good opportunity. It is a lot more cost effective than the conventional GI business that you would build. And our idea is that this also builds our capabilities and our customer connects and all that, because in the long-term what we invest in customer acquisition, customer relationship management, branding and all, if you could spread it out over multiple products, the cost effectiveness goes up a lot. And in a lot of countries globally, insurance is sold in a combined basis, life insurance and general insurance. So, our idea is to do a lot of experimentation, be ahead of the curve on new emerging trends and opportunities and be more online and digital. We have no plans to bring in a partner immediately because here we want to evolve, we want to experiment because we think there is a lot of change happening in India on the ground in this industry as of now.

Atul Mehra: Right. And in terms of lines, any specific lines – may be auto or health or anything – that you would like to focus first in a way?

Rashesh Shah: Yes, actually, I think we are more customer-led than actually product-led in this. But to answer your question, I think auto and health are the two biggest categories in this and they are the biggest customer requirements also. The third is fire. But there is a lot more for the corporate sector; for individual clients, auto, health and home. What is called overall home insurance are the leads which are there.

Atul Mehra: And how much do we plan to invest in the first maybe next say one or two years?

Rashesh Shah: We expect to spend about Rs. 30 crores to Rs. 40 crores per year on this particular business, so not a lot of investment and a lot of that is OPEX. And that is because we now are at an average pre-tax profit of more than Rs. 1,000 crores a year. Actually, that is why we do not feel the need for a partner, I think it is affordable. In fact, I must here mention that we try and carve out about 18% - 20% of pre-tax profits for future investments. And I think all companies have to do this, all businesses have to do this. So, we estimate what our pre-investment, pre-tax profit is and we try and save 15% to 20% to be invested in new opportunities, technology and other things. Like in the last few years, we invested in Asset Management business, we were investing in the Wealth Management business earlier. So, we are constantly finding new opportunities to invest where we can spend **Rs. 20 lakhs**. Currently, we are still spending on every credit business and we are spending about Rs. 18 crores - Rs. 20 crores every year on building out that business. So, our idea is that if you can take Rs. 150 crores odd every year and invest it for future new opportunities, it does allow us to maintain current earnings at a good level, but also allows us a lot more growth and opportunities in the future.

Moderator: Thank you. Our next question is from the line of G. Vivek of GS Investments. Please go ahead.

G. Vivek: My query is regarding, how is our ARC business and the legacies in first of the few accounts like Bharati Shipyard which we are talking for long. And what have been the changes recently in the ARC business and **CLT**, insolvency loss and how does it appear for us in terms of opportunity size?

Rashesh Shah: So, in the ARC business as you would have seen we are now invested about Rs. 4,700 crores aggregate, and this is spread out over many accounts like Bharati Shipyard that you mentioned. Let me just give you the background on that, Bharati Shipyard was close to almost about Rs. 8,000 crores of total debt for the company, we acquired almost about 80% of the debt but we bought it at \$0.25 cents to a dollar. So, there was a \$0.75 cents haircut on that. **So, we totally have invested about, we bought about Rs. 1,800 crores of appreciation price there and our total investment on that is about Rs. 100 crores.** And against that we have fees of about Rs. 35 crores to Rs. 40 crores in a year. And for Bharati, slowly and steadily I think some of the incomplete ships are getting completed. They needed some immediate working capital, we helped them arranged that. We also tried to ramp-up the management team. We are looking at investing in repairs business now coming in, because repairs is becoming an opportunity. Actual ship building has slowed down, commercial ship building all over the world is not growing very much. But repairs and defense are big opportunities. So, I think it has slowly and steadily improved. I think the first two years, to make sure that things are not getting worse, and now in the last year we are starting to see some improvement in operations and completion of ships. And overall, I think all these things they take about four to five years at least, and very often about seven to eight years. But in an ARC structure, what happens is you put very little money, like in Bharati Shipyard out of Rs. 1,800 crores only about Rs. 90 crores was our cash invested. And against that Rs. 90 crores, you end up getting Rs. 30 crores - Rs. 35 crores of fees every year. So, your risk-reward is fairly well-balanced in that sense, though it is a Rs. 1,800 crores loan that you acquired, it is actually an Rs. 8,000 crores loan. You acquired Rs. 8,000 crores loan for Rs. 1,800 crores, but on that you put not more than Rs. 100 crores of your

own money. So, it is a fairly good risk-reward adjusted structure where you will get the upside. Bharati Shipyard, we feel confident even today, the asset value if you sell all the land and the shipyards and all, it is at least worth about Rs. 1,300 crores - Rs. 1,400 crores.

G. Vivek: And the banks are willing to take the haircuts, I mean they were very hesitant, any change recently?

Management: Yes, actually in Bharati we have taken, in a lot of them we have taken on some. What has happened, the bank's haircut, the capacity haircut is a function of how much provisioning they have done. So, what will happen is when the AQR process happened in 2014-2015, the year immediately after that they had only provided may be 15% - 20% of the loan. But now just three years have gone by, in quite a few cases they have already provided 30% to 40% to about 50% of the loan. Because as you know, there is a NPA provisioning that goes on every year. So, we have seen that when a loan becomes an NPA, about third or fourth year after that the banks will usually provide enough to be able to sell it with a haircut. Our own acquisition has been very robust last year, our capital deployed has grown by more than 100% and this we find as a good opportunity. The idea here is to work in partnerships with banks and understand what structure works for them from their various needs point of view, what works for you from your risk-reward point of view and what is good for the company from a long-term sustainable debt and additional funding and revival of operations point of view. The only other thing I want to add is, most of the assets we have acquired are good operating companies which are financially broken and we actually specialize in that part that they are good operating companies because everybody thinks that an NPA means the company is closed down. Very often, more than two-thirds of the NPAs in the banking system are operating companies, operationally viable continuing operations, but are financially broken because they have too much debt or the bank's working capital limits have been slashed and all of that. So, the idea is to take these companies which are operationally robust and fix the financial part of it, which is the easier part. And almost 80% of the assets we have acquired fall in that category – operationally robust, financially broken.

G. Vivek: And sir, one last question is about, what is your take on the financialization of the savings in India and how long the tailwinds are expected to continue and how are we being impacted because of that?

Rashesh Shah: I think, this is an important question for all of us. But financialization of savings is one of the biggest trends that is going on. With the recent demonetization and all it is happening even more strongly, with inflation coming down a lot of savings which were going into hard assets have started coming into financial assets. Yields have come down and hence even in financial assets instead of bank deposits people are looking for alternatives, we have seen mutual fund SIPs going very well, the insurance industry also had a good year last year. So, I think, financialization of our savings, because as I said earlier, India had always been a country of savers but not a country of investors. And it was for a few reasons, one was inflation was high so it was easier to invest in hard assets than in physical assets, our financial system had not evolved as much, the reach was not there. But I think a lot of those things have now started

getting corrected. Inflation has come down, financialization is going up, I think availability of instruments, even the markets have been cleaned up, capital markets, the investor **predication** has gone up. All those chit funds and illegal pooling vehicles we use to see, SEBI has clamped down on them and brought them down. So, the formal financial services sector is now actually getting the benefits of that. So, I think this is a long-term trend. And as I said earlier about wealth management, you do a comparison on wealth management, asset management, bank deposits, everything. All these parts of the business will double every four to five years and this is what has happened for the last 20 years. To give you an idea, the bank deposits in India have doubled every four years in the last 20 years. It used to be Rs. 500,000 crores of bank deposit in 1995, we now have more than Rs. 110 lakh crores of bank deposits.

Moderator: Thank you. Our next question is from the line of Ajay Sharma from Flowering Tree Investment Management. Please go ahead.

Ajay Sharma: Sorry, Rashesh, I missed the point on general insurance, were you talking about broking or starting general insurance?

Rashesh Shah: Starting general insurance, we announced about five, six months ago, we have got the **ARC** approval and in a very small way, in a very controlled way, as I said, we want to build this as a digital kind of business. Because we see there is a lot of change happening and whatever market research we have done, we do think that even cross selling to your own customer base, understanding their specific need and especially in health and auto, there are some very good opportunities out there and our idea is to complete the portfolio. So, after this our portfolio is complete, we now have as I said, capital markets, asset management, wealth management, credit and insurance, these are the four verticals we have. And it completes our whole portfolio like any other bank, I mean we have always said that we want to be diversified like a bank but we are not a bank, we are non-bank, and this allows us to have a complete portfolio, which has a lot of effect on cross selling, up selling, common branding, common acquisition vehicle and all of that.

Ajay Sharma: Understood, I got it. And your balance sheet allows you to do it alone, that is the point you meant?

Rashesh Shah: Yes.

Moderator: Thank you. Ladies and Gentlemen, that was our last question. I now hand the floor back to the management for closing comments. Over to you, sir.

Rashesh Shah: Thank you very much and I again want to thank everybody again. As usual, I find this interaction very energizing, there are a lot of new perspectives coming in I think among the questions that have been asked we have covered almost all aspect of our business. And once again, if any of you have any individual feedback or you need information, feel free to contact us any time. And we look forward to interacting with you again very soon. Thank you and bye.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Edelweiss Financial Services, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.