

Company Flash

16 May 2008 | 8 pages

EdelWeiss Capital (EDEL.BO)

Results

4Q08 Results: Positive Business Momentum

- **4Q08 profits up 121%; 18% ahead of estimates** — Edelweiss' 4Q08 profits at Rs826m were up 121% yoy (-11% qoq). Key positive surprise was strong qoq momentum in each major business segment (total revenues up 25% qoq) despite the challenging capital markets environment. While higher employee and other costs were partly an offset, it continues to invest in newer segments while leveraging its franchise in existing ones – distinguishing it from peers.
- **Brokerage and Investment banking** — Institutional equity volumes for the industry were relatively stable in 4Q08 (-2.3% qoq vs -32.2% for retail). Institutional derivatives volumes were even stronger (+2.5% qoq) – a segment where Edelweiss has a large share. Nevertheless, a +15% qoq revenue growth is significantly ahead of industry and suggests market share improvements.
- **Arbitrage and Trading** — 41% qoq increase in revenues a surprise and well ahead of estimates; and importantly, no apparent markdowns on the portfolio.
- **Financing Business** — Asset size has increased 12% qoq, though revenues have outshone with a 62% rise. Edelweiss is still building its financing business, and we expect continued strong growth in its asset base.
- **Received approvals for a domestic AMC** — Edelweiss has also received final approvals for a domestic AMC; we expect a formal launch shortly. Its alternative assets under management – a relatively stable source of revenues – have increased to US\$625m (from US\$550m in Dec07). Await further details post management call on Tuesday.

Sell/High Risk	3H
Price (16 May 08)	Rs794.95
Target price	Rs760.00
Expected share price return	-4.4%
Expected dividend yield	0.1%
Expected total return	-4.3%
Market Cap	Rs59,568M
	US\$1,395M

Price Performance (RIC: EDEL.BO, BB: EDEL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	405	15.54	-6.1	51.2	16.9	34.9	0.0
2007A	1,090	26.34	69.5	30.2	6.1	28.7	0.0
2008E	2,606	43.50	65.2	18.3	3.5	22.7	0.1
2009E	3,155	42.13	-3.2	18.9	2.9	16.9	0.1
2010E	3,982	53.16	26.2	15.0	2.5	18.0	0.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	51.2	30.2	18.3	18.9	15.0
P/E reported (x)	51.2	30.2	18.3	18.9	15.0
P/BV (x)	16.9	6.1	3.5	2.9	2.5
P/Adjusted BV diluted (x)	16.9	6.1	3.5	2.9	2.5
Dividend yield (%)	0.0	0.0	0.1	0.1	0.2
Per Share Data (Rs)					
EPS adjusted	15.54	26.34	43.50	42.13	53.16
EPS reported	15.54	26.34	43.50	42.13	53.16
BVPS	47.15	129.50	229.05	270.05	321.53
Tangible BVPS	47.15	129.50	229.05	270.05	321.53
Adjusted BVPS diluted	47.15	129.50	229.05	270.05	321.53
DPS	0.13	0.25	0.50	1.00	1.50
Profit & Loss (RsM)					
Net interest income	-28	-58	6	1,442	2,487
Fees and commissions	296	713	1,146	1,601	2,052
Other operating Income	1,259	2,871	6,410	7,603	9,129
Total operating income	1,526	3,526	7,562	10,646	13,668
Total operating expenses	-832	-1,788	-3,510	-5,381	-6,824
Oper. profit bef. provisions	694	1,738	4,052	5,265	6,844
Bad debt provisions	0	0	-50	-100	-150
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	694	1,738	4,002	5,165	6,694
Tax	-230	-646	-1,328	-1,714	-2,221
Extraord./Min. Int./Pref. Div.	-59	-2	-68	-296	-491
Attributable profit	405	1,090	2,606	3,155	3,982
Adjusted earnings	405	1,090	2,606	3,155	3,982
Growth Rates (%)					
EPS adjusted	-6.1	69.5	65.2	-3.2	26.2
Oper. profit bef. prov.	104.1	150.3	133.1	29.9	30.0
Balance Sheet (RsM)					
Total assets	3,511	12,687	35,245	48,908	67,052
Avg interest earning assets	4,039	7,456	22,674	40,204	55,766
Customer loans	700	2,616	12,316	22,316	32,316
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	3,511	12,687	35,245	48,908	67,052
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	1,784	5,823	17,159	20,230	24,085
Profitability/Solvency Ratios (%)					
ROE adjusted	34.9	28.7	22.7	16.9	18.0
Net interest margin	-0.70	-0.78	0.03	3.59	4.46
Cost/income ratio	54.5	50.7	46.4	50.5	49.9
Cash cost/average assets	35.7	22.1	14.6	12.8	11.8
NPLs/customer loans	0.0	0.0	0.0	0.0	0.0
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	0.0	0.0	0.7	0.6	0.5
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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Figure 1. Edelweiss Capital: 4Q08 Results – Key Highlights (Rupees Million, Percent)

	4Q08	4Q07	YoY %	3Q08	QoQ%	Citigroup Investment Research Comments
Fee and Commission Income	1,445	748	93.3	1,250	15.6	Healthy QoQ growth a positive surprise, higher than industry growth (-2.3% qoq for institutional volumes). Likely market share gains
Arbitrage and Trading (Securities / Derivatives)	1,343	458	193.2	950	41.3	Strong show, despite the volatile markets - and importantly no markdowns on proprietary positions
Income from Investments and Dividend	168	64	163.3	370	-54.7	
Interest Income	1,086	57	1797.7	670	62.0	Strong revenue growth - is building its financing portfolio - expect proportion of interest income to increase
Income from Operations	4,041	1,326	204.6	3,232	25.0	
Other Income	17	32	-47.5	3	431.3	
Gross Total Income	4,058	1,359	198.6	3,235	25.4	Overall strong growth in revenues - ahead of estimates and notable in a difficult capital market environment
Interest expense	(829)	(74)	1026.9	(673)	23.2	Cost of borrowings relatively easier – a combination of increased capital and relatively abundant liquidity / easy rate environment
Net Operating Income	3,228	1,285	151.2	2,562	26.0	
Employee Cost	(824)	(319)	157.9	(480)	71.7	Sharp rise QoQ due to a) an increase in no. of employees and b) higher than estimated variable pay
Operating Expenses	(939)	(374)	151.5	(645)	45.6	Sharp rise again – likely a reflection of continuous investments in the business
Pre-Tax Profit	1,466	592	147.4	1,437	2.0	Robust operating performance - a contrast to peers and the operating environment
Tax	(526)	(220)	139.8	(473)	11.2	Tax rate slightly higher than previous quarters
Minorities	(114)	1	NM	(40)	187.4	
Net Profit	826	374	120.8	924	-10.7	15% ahead of estimates - operating performance stronger for all major segments. Overall a positive surprise reflecting its strong franchise
EPS	11.02	7.43	48.3	13.38	-17.7	
Shareholders' Funds	18,467	5,815	217.6	17,498	5.5	
Book Value Per Share	246	130	90.3	233	5.5	
Revenue Mix (% of Total):	4Q08	4Q07	Bps Δ YoY	3Q08	Bps Δ QoQ	
Fee and Commission Income	36	55	-1941	39	-303	
Arbitrage and Trading (Securities / Derivatives)	33	34	-61	29	373	
Income from Investments and Dividend	4	5	-56	11	-730	
Interest Income	27	4	2254	21	604	Significant increase in proportion of financing income - expect continuing increase in share as asset build out still in early stages
Other Income	0	2	-197	0	32	
Total Income	100	100	0	100	0	

Source: Company Reports and Citi Investment Research

EdelWeiss Capital

Company description

Edelweiss, founded in 1995, started as a niche investment bank that focused on private-equity syndications. It was co-founded by Rashesh Shah, MD and CEO, and Venkat Ramaswamy, ED and Co-head - Investment Banking. Edelweiss has over the years built a diversified product offering in the institutional segment through broking and investment-banking services, backed by a strong treasury and arbitrage trading portfolio. Edelweiss also offers financing against shares, asset and wealth management, and insurance broking. It operates its various businesses directly and through various subsidiaries, which are consolidated under the parent.

Investment strategy

We rate Edelweiss shares Sell / High Risk (3H). We believe the stock is fully discounting the company's favorable positioning, high growth rates and strong

management. Stock-market volumes have declined more than 50% from their peak in October 2007, and remain volatile. We expect global uncertainty to exert continued pressure on stock-market volumes, and are therefore cautious on extrapolating past growth rates and valuations. We expect FY09E industry volumes to slow 5-10% from a high base. While volumes should remain cyclical and volatile in the near term, we expect growth to normalize to 15-20% in the longer term.

Valuation

Our target price of Rs760 is based on a sum-of-the-parts valuation. We use 18x FY09E EPS - a 20% premium to the current Sensex multiple of 15x - to value its brokerage and related businesses (Rs424), 2x FY09E BV for its financing business (Rs182), and 1.5x FY09E BV for its arbitrage trading business (Rs154). We accord a premium to the brokerage/related businesses to factor in Edelweiss' strong business growth and management record. To better capture the asset-heavy nature of the capital-intensive financing and arbitrage businesses, we use a P/BV approach. We value the financing business at 2x FY09E BV, largely in line with our target multiples for other similar financing businesses, after factoring in its risk-reward profile, growth potential, capital-market dependence and wholesale funding model. We use a lower multiple for arbitrage trading than for the financing business to reflect the former's lower return profile and challenges in scaling up without a corresponding increase in market breadth and volumes.

Risks

We rate Edelweiss shares High Risk, though our quantitative risk-rating system, which tracks 260-day historical share-price volatility, suggests Speculative Risk due to the stock's short trading history. We prefer High Risk to Speculative Risk because Edelweiss is diversifying its revenue profile from purely brokerage and arbitrage to financing and wealth management, and the company has a good track record. However, its revenues continue to be closely linked to capital market growth and volatility. Upside risks to our target price include: a) stronger-than-expected growth in brokerage volumes; b) higher-than-expected returns on the treasury portfolio; c) further infusion of capital/faster than estimated growth in the financing portfolio; d) a decline in interest rates; e) forays into other businesses, including retail brokerage; and f) regulatory changes.

Appendix A-1

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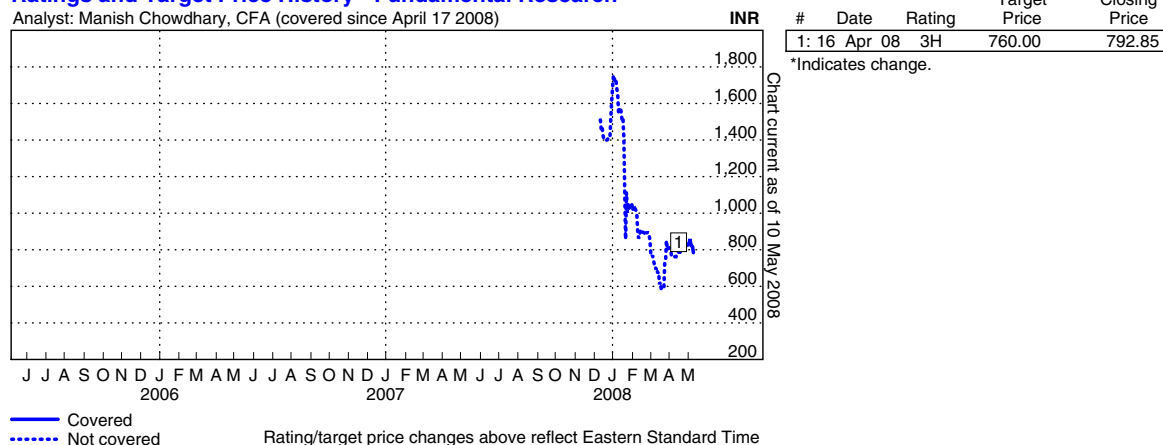
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Analyst: Manish Chowdhary, CFA (covered since April 17 2008)



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