

Conference Call Transcript

VIP Industries

Q3FY11 Results

January 28, 2011 | 3 p.m. IST

Corporate Participants

Mr. Dilip Piramal
Chairman

Mr. Manoj Tulsian
CFO

Questions and Answers

Niket Shah: Thanks Vivian. Good afternoon everybody. We at Edelweiss Securities are extremely pleased to hold this call for VIP Industries, Q3 FY 2011 quarterly results. I would like to offer my sincere thanks initially to the management especially to all the participants who are sparing their valuable time. Joining on the call is Mr. Dilip Piramal, Chairman, VIP Industries, and Mr. Manoj Tulsyan, CFO, VIP Industries. I will now hand it over to Mr. Piramal for a brief description of Q3 results. Over to you, Dilip Ji.

Dilip Piramal: Welcome everyone. We have had a very good quarter and consolidated sales have gone up to INR 200.4 Crores from INR 167 Crores, a growth of 20% over the previous corresponding quarter of the previous year. What is noteworthy and what requires some explanation is that our PAT has been INR 30 Crores. It is higher than our profit before tax; profit after tax is INR 30 Crores, INR 2.5 Crores higher than the profit after tax and which was INR 14.8 Crores last year. So I would first like to explain how this has happened. We at VIP Industries have a wholly owned subsidiary called Carlton Travel Goods in the UK and it has another subsidiary but the other subsidiary is not operational, so only Carlton Goods is the wholly owned subsidiary whose accounts are part of the consolidated accounts. In the year 2008-2009, Carlton Travel incurred a loss of about INR 28 Crores and which was reflected in the consolidated statement that year. This year was financed entirely by VIP Industries because Carlton Industries did not have any other borrowings and its share capital was only about INR 1.5 Crore. We waited last year to see if any of these losses could be recovered but the business climate in Europe where Carlton Travel Goods is operating is very bad and we have now come to the conclusion that these losses are not going to be recovered because we continue to make very small losses even today, very small and so we had a restructuring of our operations basically to minimize these losses and we will be watching for a while. Our strategy is to watch for a while and then we will decide what we want to do in the future. So it is very sort of play safe strategy and basically we do not want to lose money now. We have reduced the sales to some extent but we want to play it safe. So this year we have to write off this money in VIP Industries and that is what we have done in this quarter. So if you see the standalone profit of stand alone accounts of VIP Industries, there is no profit because this INR 28.5 Crores is written off and there is a very nominal profit of INR 3.1 Crores. What happened in the consolidated accounts there is no impact because the write off in VIP Industries is the write back in Carlton Industries, so the two entries are getting offset. Just to remind you that in 2008-2009 we had taken the loss in the consolidated accounts, so that loss has already been booked in the consolidated accounts and now by booking it in VIP Industries we will not repeat it. We cannot repeat it in the consolidated accounts and so that has no effect in the consolidated accounts. However, we are getting a tax write off of this loss in VIP Industries, so that is why there is a tax credit of INR 9 Crores and that is reflected in the consolidated accounts and that is why the PAT

is INR 30 Crores and in this quarter there is a INR 2.5 Crores actually tax credit, a negative expense. I trust this is clear to everyone.

On the sales side we have done quite well. We have grown by 20% and our profitability is also growing and ours is a fairly simple operation as you might have remembered from our last meeting and we are continuing to do quite well. Our soft luggage is growing very rapidly, hard luggage is growing at a very small pace, but the soft luggage is the most profitable part of the business and I think we are on a good track. The other point is that obviously there will be no cash flow adjustment because of this write off because we incurred the loss in 2008-2009, that is when we lost the cash, so write now there is no adverse cash flow impact but the tax credit which we are getting is real tax credit, we will pay less tax to that extent. I now invite questions.

Vivian: Thank you. We will not begin the question and answer session, anyone who wishes to ask a question may press * and 1 on their touchtone telephone. If you wish to remove yourself from the questioning queue you may press * and 2. Participants are requested to use only handsets while asking a question. First question comes from the line of Sai Anjali from Capital Market. Please go ahead.

Sai Anjali: Hi, this is regarding sales. Is it possible for you to provide a break up of it as in like soft luggage hard luggage and then the other segment like premium, mass economy, is it possible to give?

Dilip Piramal: No, it does not serve any purpose and I think by giving all this we are unnecessarily giving market related information, which only our competitors will benefit, but I would say overall I can say that soft luggage sales this year, about 60% of our overall sales is soft luggage and 40% is hard luggage.

Sai Anjali: Okay, this is for the quarter is it?

Dilip Piramal: For the quarter as well as for the year.

Sai Anjali: But is there any particular segment that is big for you? Can you at least possibly broadly draw a line?

Dilip Piramal: I will give you that. The one feature of VIP is that we are present in all segments. We are at the moment bit small in sort of super premium segment where Samsonite is quite strong and where we had the Delsey product so far and we discontinued Delsey since November and we have launched our own brand Carlton and we hope to get much larger market share in this segment. But this is a very small segment, otherwise VIP is present in all the mass premium that is our main segment where VIP is very strong. VIP is very strong in the mass premium that is sort of sweet spot we make good percentage of our profits in this segment and this is both in hard and soft luggage and we are the only branded player in the economy segment with our brand Alfa and that is a slightly smaller segment though it is an economy segment and its share to the profitability is also relevantly smaller. I just want to add something more about the market. I would like to add regarding the market that in the current year we introduced the short-haul premium range called Shuttle, we introduced it in this last quarter and that has met with very good

success. We also launched advertising of our Alfa Boxer Upright bag, which also met with very good success. Our products are getting good success, very good acceptance, all our new products and that is the reason for the good sales growth also.

Vivian: The next question is from the line of Eric Ritter from Nezu, please go ahead.

Eric Ritter: Hello Sir I am calling from Hong Kong. I wanted to know if you can tell me whether the overseas operations are you completely closing it down or reducing the scope because next year we would not see the impact and then any colour though on your sourcing cost for the soft luggage, recently cotton and polyester prices have been very, very strong, I wonder if that is affecting you at all?

Dilip Piramal: No as far as our overseas sales are concerned we have two large markets one is the Middle East that is West Asia. The UAE basically where we have good brand equity, VIP brand has good brand equity and we sell both VIP and Carlton there and that market is doing quite well. The other major market for us, the European market, which is mainly a Carlton market and the European market has been quite troubled and it is here that we are following the very sort of play safe policy. So we have controlled our sales to some extent and now we will not be doing distribution which we were doing earlier ourselves in the UK particularly and we were doing direct distribution in Holland and Belgium and UK but we will now be selling through distributors, so our chances of making losses are quite limited. It is not going to reduce our sales substantially but it might not increase our sales also in the short term and we will watch the market, our strategy is to watch the market for a year or so may be next year or so and then depending on market conditions we will decide whether we want to expand further, continue the same way or even close down. Right now, it looks that we will have to watch and wait for a while that is what it looks at the moment. As far as our supplies from China is concerned there is pressure, upward pressure but not too much, not as much as we were anticipating and I think it is fairly okay but now they will be closing for their Chinese New Year in February and that is the time after which they come back with new prices and all that like a beginning of a new year and we are sort of anticipating price increases ranging from 5 to 10%. We were doing that, we did that last year also, and things were not as bad, let us see how it turns out this year.

Eric Ritter: How much of the soft luggage is sourced from China versus India?

Dilip Piramal: Almost everything but let me tell you that is sort of trend of the entire world, today I think China would be providing 97% or 98% of the soft luggage to the entire world including the unorganized sector in India.

Eric Ritter: Can I just ask what do you think is the normal growth rate for soft luggage versus hard luggage?

Dilip Piramal: You see luggage is such a small industry, so there is no such thing as a normal growth rate, what is happening is the growth rate and at the

moment we have become one of the very hard luggage manufacturers in the entire world. There are a few, in fact, as far as injection moulding hard luggage is concerned I think we must be making more than, I would not be surprised if our production is about 50% of the entire molded hard luggage production in the world. What is now gaining popularity internationally is what is called PC luggage, which is vacuum formed and not injection molded. This is sort of lightly technical and it is a big difference and PC luggage is more expensive than injection molded polypropylene luggage. So we are becoming quite large internationally in molded luggage and even in PC luggage and we see that as a very good opportunity for us in the future to supply hard luggage to the world like at the moment we make the entire molded hard luggage for Delsey worldwide though we have stopped distributing the product our manufacturing agreement is still on and we produce the entire injection molded luggage for Delsey for their requirements worldwide. So I think hard luggage is a good opportunity for VIP Industries as a company to virtually become the hard luggage factory for the world just as China as a country is the soft luggage factory for the world and I think we can get good sales in the future.

Vivian: The next question comes from the line of Krudent Chheda from Value Quest Research. Please go ahead.

Krudent Chheda: Congrats Sir on a good set of numbers. Just wanted to understand now the raw material of your soft luggage has increased.

Dilip Piramal: Which raw material?

Krudent Chheda: The luggage, which we source from China the cost has gone up, you said.

Dilip Piramal: No we are anticipating, it is not gone up so much as yet, but the Chinese New Year is in the first half of February when they close down their factories and they resume after that and then they start their new negotiations, so we are anticipating price rises.

Krudent Chheda: Then would we be able to pass on.

Dilip Piramal: Yes, quite easily, you see it happens to everyone, it happens to the entire our competition, Samsonite and all as well as the unorganized sector.

Krudent Chheda: Everyone sources from China?

Dilip Piramal: The whole world sources from China and as far as more particularly in India even the unorganized sector sources from China and we are the second largest buyer in the world today after Samsonite, so we get better prices than most of the people, so what happens to us happens to everybody else.

Krudent Chheda: If I am not wrong in last concall you said our operating margins will be around 18-20%.

Dilip Piramal: Our operating margins change every quarter depending on the sales, if the sales go up, operating margins also go up because your contributions go up, your gross margins go up and overheads remain more or less the same and this year, like this quarter our operating margins are 16%, so

as I said it changes from quarter to quarter.

Krudent Chheda: What kind of margins you think is sustainable, around 16-17 levels?

Dilip Piramal: Yes, these are sustainable.

Krudent Chheda: Sir, what will be your tax rate for the next year FY 2012?

Dilip Piramal: FY 2012 our tax rate should be about 22 or 23%, Manoj am I right?

Manoj Tulsyan: No Sir, next year actually, we are you know this is the last year we got benefit from Haridwar, from next year we will get 30% benefit on our Haridwar plant, so tax rate I think should be 27-28%.

Vivian: The next question comes from the line of Aditya Sood from Sunlam investment. Please go ahead.

Aditya Sood: Thanks for taking my question, Just can you elaborate how many new stores you would have added during the nine months period?

Dilip Piramal: I do not have it right before me, but I think we have added about 80 new stores, exclusive stores.

Aditya Sood: What is the store count right now cumulative?

Dilip Piramal: Overall we have about 9000 stores but 80% of our sales comes from about 1500 stores and out of these 1500 about 550 now are exclusive shops which sell exclusively VIP products and out of these 550, about one third are run by the company or even less, exclusive stores are about 500 now and 150 or so are run by the company.

Aditya Sood: Any colour on I mean to say company run store versus a franchisee, what is more profitable for you and what format do you expect?

Dilip Piramal: No for us they are both equal, we make very little profit on our own retail stores and in fact, means on the retail part of the store and in fact we open our own stores only when the dealer is not forthcoming. I would like to say this thing, this is a very unique part of the luggage business worldwide that retailing is very, very difficult because luggage is such a bulky item, you know one suitcase which sells for INR 4000 or INR 3000 occupies so much space 30 inches suitcase so the retailing expense is very high and that is why, if you see in the last 30 years, there is only one brand I can think of internationally, new brand which has entered luggage. What happens with this is that in India for example if a multibrand outlet a multi brand outlet, if a new comer wants to sell to MBO he will want a discount which is about 20% higher than what VIP is giving him. If we give him 25, he will ask a competitor to give him at least 35-40%, 40% at least. Now the competitor margins, he does not make that much profit, he makes about 10% profit, so he just cannot survive and that is why no new brands come in and that is why it works against VIP internationally also. That is why we have not been able to enter Europe or America in spite of being quite a large company, good company but our brand is not known there. So in Europe we are selling basically our Carlton brand. So this actually works in our

favor in India and that is why the only other brand in India which is in the organized sector is Samsonite which is a very well known international brand.

Aditya Sood: Secondly can you elaborate what kind of hike you are expecting as far as raw material is concerned?

Dilip Piramal: As I said, in our case, well technically it is not raw material, it is finished goods which we buy completely finished goods and as I said we are expecting 5-10%. So it will vary, I think the increases will vary between 5 and 10, we were expecting the same last year but it did not happen so much, I think the prices went up by only about 5%.

Aditya Sood: Is there a lag in terms of passing on these prices to the supply chain?

Dilip Piramal: Today our lead time buying lead times are very long, so the lag is actually taken care of by sort of longer lead times and in fact because of these longer lead times we are carrying more stock. Our cost of losing sales is very, I mean the profits we lose on lost sales is very high whereas our carrying cost of extra inventory is not high at all, so we prefer to keep higher inventory and we do not have any risk of obsolete or non-selling items.

Aditya Sood: When do you effect a price hike in the market actually?

Dilip Piramal: See we usually have two price hikes in a year, on separate items. But one is done around March 1 or April 1 depending on consideration at that time, usually May 1 we do. And the other one is around October 1 before marriage season. So these two big seasons we see which products to increase prices, we do not do it all across, usually they are broken up in these two parts.

Aditya Sood: Can you throw some color on ladies handbags segment, which has been reported, you plan to enter?

Dilip Piramal: We have plans now, I think effectively, it will take us some time because again we are doing the same sourcing model from China, so in fact we will launch it sometime in the next fiscal year and the impact will start coming only in FY 2012-2013.

Aditya Sood: But how big is the market, how fast is it growing?

Dilip Piramal: The market is very big, we reckon it is about, see all these luggage handbags they are very small industries, so there are no very accurate figures and it does not matter, you know, we do not spend too much time on gauging that but it is I think generally the impression is that my handbags market in India is about seven to eight times larger than the luggage market.

Aditya Sood: And how much of it would be organized?

Dilip Piramal: At the moment there is nothing in the organized sector except in the very niche brands which are imported and which sell for 50,000 and all these Luis Vuitton is the top and you have Gucci and all these high fashion brands, there is nothing in the organized sector. I mean the biggest sales of a person, there are one or two brands which sell for INR 20 Crores or something, annual sales are INR 20 Crores but you cannot really call them very organized

sector. It is fairly I think for a good market where we can create our own brand and the distribution our luggage distributors would be I think would constitute about 60% of our sales of this product, our existing dealers themselves, so we have a ready made distribution outlet, all our dealers have been asking us for many years for handbags.

Aditya Sood: So right now there would be initially essentially importing from China and selling the handbags?

Dilip Piramal: Well they would not import it themselves, there are importers and all and many of them are doing that, they are selling handbags from the unorganized sector, so there is very good space for organized player like us to come in who can create a good brand and it looks a very lucrative market.

Aditya Sood: So when do you plan to test market or launch?

Dilip Piramal: In the coming year we will do it, we are recruiting people and once a CEO joins in for this business we will get, we have already identified the person, once he joins in then things will move faster. We already, the supply side is quite relatively easier because there are lot of suppliers in China and we have already recruited somebody there and because it is such a much larger market it was very easy for us to recruit. We have a very strong Hong Kong office for our luggage in fact that is one of our biggest strength, we have a very efficient outlet there.

Aditya Sood: It would be launched under the VIP umbrella brand name or?

Dilip Piramal: No, it will have to be a new name because this product is different. It has to be a more feminine oriented.

Aditya Sood: But what are you targeting in full year of operations in the initial year?

Dilip Piramal: Once our management is in place then we will do it more scientifically, it is very difficult to say but I sort of very broadly say that in five to ten years you must overtake VIP, luggage sales so it is a very broad thing but I mean at the moment that is what we can say this is a general feeling and VIP is also growing, VIP is growing quite well, so in five to ten years I want to have that business larger than the luggage business or at least equal to the luggage business.

Aditya Sood: Do you have dividend policy at this particular point in time?

Dilip Piramal: Yes, we have a dividend policy roughly we pay one third of our profits as dividend.

Aditya Sood: And is that expected to continue?

Dilip Piramal: Yes, so we announced a dividend of 30% now in rupees and in the second half, in the second time when we do it which was paid in July we do it in two goes.

Vivian: The next question comes from the line of Sagar Mehta from Dalal & Broacha. Please go ahead.

Sagar Mehta: Good afternoon Sir. Last quarter you indicated that our company

was planning to enter the hypermarket category via HyperCITY, Big Bazaar.

Dilip Piramal: No, we are already there, what I had said was that the products which we sell in these markets we will also sell in the general market, right now we are selling some products only in these markets, in the hypermarkets like Big Bazaar etc. but we will now introduce that same line in the general markets also.

Sagar Mehta: Sir, regarding advertising, advertisement expenses, what is the budget likely for this year by the end of this year?

Dilip Piramal: We are maintaining a 5% advertising expense, maybe let us see, next year we might increase it by 0.5% or so.

Sagar Mehta: This year you mentioned that 80 new stores have been opened, what would be the figure going forward?

Dilip Piramal: I think roughly the same thing, what next year we would like to do what I would like to do is increase the productivity of our existing stores, but I think new areas are also coming up in the country, new markets are also developing, so probably we will, 80 is only for the three quarters. We will be doing more.

Sagar Mehta: Sir, regarding the Jalgaon factory, any further strategy developed on the same?

Dilip Piramal: No, nothing it is a very small thing. We have a piece of land in Nashik which is not a factory but we have a guest house there and two, three years ago we were thinking of selling it for about INR 2 Crores and we thought it is a very low price. Now we are planning to develop that space ourselves for outright sale we will make homes, but that should give us a net revenue of INR 20 Crores. I mean most of it will be the land value, now the land is valued at about INR 15 Crores, so what I am saying is Jalgaon factory does not mean anything, we will get INR 2-3 Crores for that. But this small piece of land in Nashik will give us a much greater value, it will take about two to three years.

Vivian: Mr. Shah would you like to ask a few questions while participants join the queue?

Niket Shah: Yes sure, just wanted to know that any particular brand that you wish to advertise for the next year, I mean you have already started with Alfa, any new brand?

Dilip Piramal: Brands you have to advertise your existing brands so VIP and Skybag and Alfa, these three brands and Carlton we will do a little bit, we will have to sort of start advertising also, but that will be very small in the relevant niche areas.

Niket Shah: Sir any more capex likely in the hard luggage because you know something in the warehousing side or something in the PC side?

Dilip Piramal: Actually we have budgeted this year, which we have still not spent, Manoj.

Manoj Tulsyan: Sir actually both the projects have been initiated and we have

even ordered for the machines but since the payments have not been made that is why it is not reflected in your statement and also Niket to answer your question this year we are doing warehousing expansion which has been already informed as well as putting this line which will be together costing around INR 8.5 to 9 Crores both this together but in the next year we do not have any such plans because this will give us adequate capacity on the PC front.

Dilip Piramal: I think we have a terrific model where we do not have to invest in anything on manufacturing and nothing on the retail side also. I think it is too good to be true.

Niket Shah: Sir just one more question on the ladies handbag side that you plan to get in to. Does it mean that Sir once you start the ladies handbag business, get into lady handbags does it mean that you will grow at a much faster pace on a very higher plane that you have been continuously saying that you will be growing at 20% post ladies handbag segment you can go at 25% plus, do you think that is possible?

Dilip Piramal: Yes of course.

Niket Shah: So that growth we should see post FY 2013 only right.

Dilip Piramal: Yes. You will see it in FY 2013 also but the impact in 2012-2013 definitely we should, I cannot say, I would like to do at least INR 100 Crores that year but it is too early for me to say anything, let them work a bit more scientifically. I do some sort of back of the envelope calculations, I mean I tell my people including my daughter who is our MD that if 1000 stores do 1 lakh sales a month, you got INR 10 Crores a month. It is not difficult you know. I am not asking for any average of 1000 store, 1 lakh a month is not anything great average, not so easy, it is not that you will just do it, but what I am saying is 1000 stores 1 lakh a month average, some stores will do 5 lakhs also in Bombay, Delhi, some of the stores might do 50,000, so INR 10 Crores you get in a month and you do INR 120 Crores that way is not something out of the way but she does not want to commit anything and fair enough, you know let the guy come let them do all the work and if we can do 200 we will do 200.

Niket Shah: What is the distribution channel you will use initially, you will obviously use a VIP store or you will open new store?

Dilip Piramal: One is readymade store we will do, our existing stores, but you see the luggage sales are also increasing. So although handbags will not take so much space, but it takes space you know and today there is not so much of extra space but to start with it is easy, each store can give, even if they give 25% of their existing space I do not think it should affect the luggage sales also and this handbag is good enough, now again this is my personal feeling, all this has to be sort of verified, reiterated by the actual operating people but I feel that our existing luggage stores should give us about 60% of our sales and the remaining 40% should come from new stores which are selling only handbags because mind you handbags is a much larger business, there are many more retail outlets and it is a sort of item of casual purchase unlike luggage which a person buys only when he wants to use the luggage but a handbag that is the

beauty of this handbag business is that anybody I mean lady will have 10, 20, 50 depending on her economic status, it is an item of casual purchase.

Vivian: The next question comes from the line of Krudent Chheda from Value Quest Research. Please go ahead.

Krudent Chheda: Sir what will be your target market in ladies handbag?

Dilip Piramal: I am saying it is very difficult to put a figure and let our operating people once they are in place and you know it is a new business but very broadly as I said in 5 to 10 years I want it to become bigger than the luggage business.

Krudent Chheda: I wanted to understand would we be in the high-end category or the mass market like that?

Dilip Piramal: I think we will do exactly what VIP is doing, what we call the mass premium market, it is a mass market for the middle class, upper middle class and some segments of the upper class, and you know what is upper class, in middle classes I would say anyone earning up to about 10, 15, 20 lakhs but let us say even 15 lakhs a year starting from 3 lakhs a year that is the hardcore middle class, so that is the real sweet spot. Even in luggage where our sweet spot is 2000-3500 which product sell in retail at this price where we make solid 1000 rupees gross margin or even more 1200 on a product, so I think something similar may be because handbags are much smaller, so about 30% less than that these prices.

Krudent Chheda: Currently you have 150 company owned stores right and what is the capex close to?

Dilip Piramal: Company run, not company owned, these are all leased out, capex is very little 5-7 lakhs, we will write it off in two years.

Krudent Chheda: Do we plan to open any more stores in this year?

Dilip Piramal: Yes, this year also we are opening. Manoj, please remind me next meeting to have these figures, I forget to take these store figures, the latest figure, how many we have opened.

Manoj Tulsyan: But your numbers are correct.

Dilip Piramal: But I would like accurate figures.

Krudent Chheda: What are the plans for next year? How many stores do we plan to open?

Dilip Piramal: I am not familiar with the figure but it will be something similar only, about 120-150 let us see.

Vivian: Sir at this moment there are no further questions.

Dilip Piramal: Okay. See basically I would like to conclude by saying that our operations are quite simple and our real strength is our brand strength and we continue to strengthen and nurture and nourish our brand because the profit is in the brand and it is very difficult for a new brand to come in the luggage business as I explained to you earlier and we have to bring out good products

catering to all segments of the market and I think we are well on our way, we had some weak points but gradually in the last year and going forward also we will take care of these weak points in our product offerings and we are meeting with good success. Thank you.

Vivian: Thank you. On behalf of Edelweiss securities, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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