



“Edelweiss Financial Services Q1FY20 Earnings
Conference Call”

August 14, 2019

Moderator: Good day, ladies and gentlemen, and a very warm welcome to the Edelweiss Financial Services Limited Q1FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to the Edelweiss Financial Services management team. Thank you, and over to you.

Ramya Rajagopalan: Good afternoon, everyone. Thank you for joining us for our Q1FY20 Results Conference Call. We have with us Mr. Rashesh Shah - Chairman and CEO of the Edelweiss Group, Mr. Himanshu Kaji - Executive Director and Group COO, Mr. Rujan Panjwani - Executive Director and Mr. S. Ranganathan - President and Chief Financial Officer

During the discussions, we will be referring to the Q1FY20 Investor Presentation uploaded to the exchange and on our website. I would like to state that some of the statements in today's discussion may be forward-looking in nature and may involve certain risks and uncertainties. Please read the detailed disclaimers in our result documentation. With that, I would now like to invite Mr. Rashesh Shah to begin the proceedings of the call.

Rashesh Shah: Thank you, Ramya, and good afternoon to all of you. First of all, thanks to all of you for being on this call once again for this quarterly call. You would have got a chance to see the results that we announced a few hours ago and the announcement that we have made in the investment in our advisory business.

First of all, I think it goes without saying, this has been a difficult quarter. The last few quarters in India, because of various things that we all read about in the papers and experience it every day has not been easy but this quarter especially because of elections and post-election sentiment and overall slowdown. Because what happened in this quarter is the problem that was there lingering for a few quarters about liquidity and NBFCs, which has actually become an economy-wide issue. We have seen slowdown in demand across the board. We have seen risk aversion. We have seen people going more on standstill. So, it has been a difficult quarter. Our profits have come down. And if you see the numbers, large part, almost the entire all-in profit is due to increased credit cost. Credit costs have gone down in this quarter by almost 120 odd crores. Our average credit cost which used to be 100 to 125 crores per quarter until the last quarter. Now I think for this quarter, it has gone to about 250 crores. And we think for the next quarter or so, this will remain there and then come back to normal and I will speak about it as I speak about environment and outlook going forward.

I think our approach is that we have always told investors that what we see is what we will try and communicate. And after the last 3 quarters of liquidity crunch, first couple of quarters were okay. But now we are starting to see some cash flow related stress in asset quality. Good news is that a lot of this stress is not reflected in collateral values. Collateral values are still fairly stable. Our average collateral cover still remains at 1.8x the loan book. So, stress is coming because cash flows have become very tight and in the last quarter that has become exceptionally

more tight than they were even earlier. So, as a result of that, we have decided to very proactively provide and just ensure that we grapple with the environment. We can't change the environment, but we are grappling with the environment. And our current outlook is that this year will be a consolidation, clean-up year for the industry as a whole, but I am hoping that after March 2020, growth will come back for various reasons and we will speak about that.

So, again, to recap, what are we doing in this environment? First of all, it goes without saying, we are managing liquidity. As you would have seen from our investor presentation, we have reduced commercial paper to almost zero, very small amount of commercial paper we have. We have diversified our borrowings. We have made sure that we are more tenured. Our longer-term borrowings have gone up. So, we have made sure that our liquidity availability on that is also intact. And in spite of the liquidity constraint in the environment, we have ensured through various measures to keep our liquidity on an even keel. We continue to monitor liquidity looking at 365-day horizon and we will continue to do that. Once things stabilize, we'll bring down the 365-day horizon to 180 days, as we were earlier before the crisis. We used to maintain a 180 day horizon liquidity before the liquidity crisis started. Since it started, we have moved it to 365, and I am happy to say that we currently continue to manage it in that framework.

Second thing friends we are doing is, managing asset quality. There is a huge focus especially on ensuring that projects get completed because we are seeing that pricing is still stable in real estate. The key risk is projects not getting completed either because of lack of cash flow or lack of execution capability. So, we continue to be focused on that. As we spoke last time also, we have about 160 odd projects in our portfolio, out of which around 30-35 is where there is some oversight, intervention and focus required. And we are very actively executing that. We have a committee that I chair which ensures that we look at it project by project, which are all either becoming sticky or can become accounts under watch and ensure that those projects keep on moving forward, either by helping them raise last-mile funding, helping them changing developer, doing a set of other things to make sure that asset quality is maintained.

Along with that, wherever there is stickiness and all we have proactively stepped up our credit cost. As you would have seen, the fall in profit for this quarter has been because of the increase in credit cost. Our profits of last quarter to this quarter has fallen by approximately 100 crore in PAT and our credit cost has gone up by 150 crores. So, on an after-tax basis, the impact of credit cost on PAT is about 100 crores. So, that has been the real impact. We are also ensuring that we will maintain a strong balance sheet. In this quarter, we got equity in our credit business. As you know, we had announced equity raise in our credit business of \$250 million (~INR 1,800 crores) from CDPQ. Happy to say that the first tranche of that, which is 1,040 crores, came into our NBFC in May of this year. So, we have capitalized our NBFC.

With that, also happy that we have announced today equity raise in our advisory business. As you know, we have 3 businesses; Credit, Advisory and Insurance. And today, we have just announced that Kora management, which is a very leading Tech-oriented global financial services company investor, have been an investor in Edelweiss Holding Company for a long time, and they have now agreed to invest up to \$125 million in Edelweiss and our advisory

business. We are also planning to raise about \$200 million in our advisory business. So, Kora is the anchor investor. Along with Kora, we are talking to a few more investors and we're hoping that in next 8 to 12 weeks, we should be able to close this round. At the end of which, each of our businesses will be fairly independently capitalized.

Our credit business will have its own investor and its own capital structure. Advisory business will have its own structure and capital availability and the insurance business already has that. So, that allows us to make sure that each of these 3 businesses can continue their growth path going forward.

With this capital raise in this quarter, our gearing has already come down to 3.7x. So, about a year ago, we were at about 5.2x, our gearing has come down to 3.7x. With this capital raise and a few other things, we are doing, we are expecting our gearing by the end of the year should be around 3.2 to 3.3x, which would be one of the most conservative gearing in the industry. What it does is though in the short-term, it does bring down our profitability and ROE because of low gearing. If you look beyond March 2020, this allows us to have a lot of headroom for growth. We do think that growth will come back for this year, the first half is going to be challenging. Second half will be more consolidation and recovery. And then post March 2020, FY'21 onwards, we think growth will come back. And at that time, if you have enough equity, a lot of headroom for growth, you will be able to capitalize on that.

As you would have seen in the presentation, our diversified model that actually helped us a lot in this quarter also. And Slide 14 highlights that our wealth management, asset management business & capital markets have contributed to almost 31% of the profits. ARC has contributed to more than 45% of the profits. So, overall, I think our profits on our noncredit businesses, essentially even retail credit has done well. It has been the corporate credit where we have stepped up the credit cost and taken the hit on profits as a result of that. So, if there is one area, which accounts for the falling profit, it has been credit costs in the corporate credit book, which, friends, as you all know, for the last few quarters has been an area of concern and watch. And as we always said that when we start seeing any early signs of stress, we will proactively provide. The good news is that what we call, pre-credit cost PBT, for last year was about 2,530 crores. This year, first quarter is 537 crores, which on an annualized basis comes to 2,100 crores. So, our pre-credit cost PBT is robust enough to take some extra hit due to credit cost without impacting the balance sheet or without impacting anything else. The only impact is the earnings for the year, which, as we said, in FY20, if you can take some pain in the P&L and strengthen the balance sheet and keep yourself ready for growth post March 2020, that would be a good outcome in this environment. So, I think pre-credit cost or all our cost income ratios and everything else is fairly stable; except for credit costs, everything is very stable. And we do feel that credit cost is a passing phase because we have to go through this pain given the environment and what has happened over the last 3 quarters. We do think that it may continue for a quarter or 2, but post March 2020, things should come back to normalcy on credit cost and with coming back of growth, things should look better. Our Asset Management, Wealth Management, ARC business continue to grow. So, the diversified model even in this quarter has been underscored very well at Asset Management, Wealth Management, even insurance had a good quarter.

On retail credit, we continue to grow in a very small way, keeping liquidity in check. Our corporate credit, as our old plan has been that we slowly scale back this book on our NBFC and build in Asset Management format, and a lot of actions we have taken and we are taking will help us go towards that objective.

In terms of outlook, I have stated, I think FY20 will be a tough year for India as a whole. We are seeing it. I think in my 30-year career, this is one of the toughest phases that I have seen from economic slowdown, global headwinds, liquidity, risk aversion, all of those have come together. But history has also showed us that this doesn't last for long. It looks very intense and very painful when it is there and we are at that point as of now. I do think, by the end of first half, this sentiment and environment should bottom out. We should crawl back to normal in the second half and go back to growth. And this will partly happen because RBI has been cutting rates, liquidity has been eased off. And this started off in February, and we have seen that it takes about 5 to 6 months after the rate cuts and the liquidity injection to start and for its effect to be felt on the economy. So, if this started from February, we think August, September onwards, things will bottom out and should start improving.

But the next few quarters are very important and you have to keep a close watch on the economy. I am also hoping that government has been very cognizant of this, and they have promised to take some action either a stimulus package or start spending on projects from government's own coffers also. But I do expect and hope that government will also take some action.

What will happen post October is the base effect will also take into account because October last year onwards is when the slowdown started. So, even the Y-o-Y growth numbers will start looking slightly better and a combination of all this liquidity, rate cut, government action, years of base effect should start getting back some of the animal spirits that we are hoping for.

I think, by March 2020, real estate should also bottom out. We are starting to see early signs of good projects having good demand. Pricing is also starting to stabilize. The current problem in the industry on real estate is the projects which are stuck, projects which are not able to go forward either because of lack of execution or lack of funding. But the good news in that is the projects which get stuck are not inventory that is available so that will also reduce supply in the market, along with the fact that for last 1 year, no new projects have been launched in a significant way. So, the scale back of supply that we have been waiting for last 4, 5 years has started to happen. And I do hope that by March 2020 onwards, the demand-supply equation in housing starts becoming more positive and that should improve pricing and sales volumes also. So, I think still the next 3 quarters, some pain will be there, but hopefully, things will start improving.

I am also happy to announce that we have raised equity in our advisory business. This is a start of getting an outside investor and putting independent governance in that business, what we call EGIA, which is Edelweiss Global Investment Advisors. This business comprises of our ARC business, our Asset Management business, our Wealth Management business and our Capital Market business. So, these 4 businesses which account for more than about 50% of the profits

are housed in EGIA and having an investor like Kora to be the anchor investor and hope that some other investors with whom we are in conversation, we will close this. We will also allow us to strengthen and showcase this business as a standalone independent vertical for growth for us.

We are planning to raise about \$200 million in this business. \$75 million is the anchor investment from Kora, which can increase, but we want to keep it at \$75 million and keep headroom for other investors to also come in. It will take us another 4-5 months to put the structure in place with all the businesses folding under Edelweiss Global Investment Advisors. And by December, we hope the structuring should be over. Kora investment is a convertible structure as you would have seen in the release that we have given and we have an expected midpoint of the conversion at 8,000 crores, which is going to be equal to 10x PE of 2021, the price earning of this business in 2021. This business in this quarter had made close to 160 crores of pre-minority PAT and close to 130 crores of post-minority PAT. So, even annualized of that, it is a 500-600 crore PAT business now. We are hoping that in the next couple of years, it should be 800-900 crores PAT, so 10x of that will convert at about 8,000 crores is the midpoint. There is obviously a 20% up and down on that, which is what we have kept to align investors' interest in our interest. We do feel this is a fair structure convertible, which allows investors to have also some protection. And for us also, we have some upside. It is a convertible structure, but a compulsorily equity convertible. So, this is equity and it will help us in strengthening the balance sheet as we go forward.

So, friends, along with that, I do not want to spend more time. I want to leave a lot of time for Q&A. Thank you once again for being on this call. And again, as we keep on communicating to our stakeholders, we are doing everything we can to manage the environment. In this tough environment, we as an organization and as a balance sheet end up becoming stronger and do look forward to growth post March 2020 onwards because India has always been a growth story, and whenever we have phases like that, it has seemed very depressing when the phase is going on. But if you look across the valley, there is a fair amount of optimism that has always been there from growth point of view in India and I still continue to believe that, that growth is ahead of us, which is set to navigate the next 3 quarters, which can be a bit more trying and maybe some turbulence out there. But we have already seen turbulence for last 3 quarters. So, the next 3 quarters may not be much more tougher than those. So, thank you once again for that and we will open it up for Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Sachit Khera from Smart Equities. Please go ahead.

Sachit Khera: I had a quick question regarding the bond investments on the insurance book. Actually, I wanted to confirm if there were any bonds of DHFL or Reliance Capital or any of the capital groups on the insurance books? And if so, what is the provisioning that the insurance business has taken already?

Rashesh Shah: Historically, we have always been hesitant to talk about individual accounts because I think it shows up in the results alone. I would say that we will have some investments, our insurance business is very small. And whatever is there as per the norms we would have provided, not only for any troubled group, but as whatever is the mark-to-market, it has gone through the P&L. We have provided that on a very conservative basis, and we will continue to do that. The numbers will not be large because we are a very small insurance company. So, it can be 10, 20, 30 crores here and there, if we have to provide even going forward. So, they are not large numbers. But again, we have always maintained that we do not talk about individual accounts. We talk about it at a portfolio level.

Sachit Khara: And also sir I wanted to know about the stress level in your Stage 2 book because I was looking at the annual report and there was a lot of movement from Stage 1 to Stage 2. And considering that, obviously, you talked about stress in the real estate sector, but also in your SME sector, do you see any chances of major slippages coming from the Stage 2 book overall going forward?

Rashesh Shah: The Stage 1, Stage 2 keeps on going up and down, I should say that across the board. Stage 1 and Stage 2, not only for us, but for everybody, are going up. We are monitoring it very closely, but the buckets keep on shifting especially on the wholesale side where Stage 2 can get normal regularized there, because the interest payment and cash flows are delayed by 20, 30, 40 days here and there. But I would say that overall, you should expect a little bit of change in Stage 2, Stage 3, but our current Stage 2 that we have is equal to what it was Stage 2 a year ago. The numbers are the same, broadly of Stage 2. Now what is Stage 2 a year ago before all this started may have gone up in one quarter and come down in another quarter. Overall as I said, we are anticipating a little bit of increased stress largely related to cash flows because we are seeing that cash flows are getting very challenged for everybody, for all customers and every day. And as a result of that, we are proactively stepping up our credit cost. We do expect our credit cost, which is to be in the range of about 100 to 125 crores a quarter, for this quarter has been 250 crores. I think it will remain that for the next quarter or so. And this year, we may have credit cost in between INR 700 to 800 crores, but that should be all. We have done all the stress testing. We have looked at all the accounts. We are not seeing any increase in stress from what was SMA 1, 2, 3 quarters ago, it is the same SMA 1, 2 or 3 quarters ago, which has now been resulted in stress. The good news is that this has been going on for 3 quarters. So, you know what is there, and it can be 10%-20% up and down, but not a lot more than that.

Sachit Khara: So, I'm not very familiar with your Wealth and Asset Management business. So, I wanted to ask you prima facie in the mutual fund distribution business, does Edelweiss get impacted in any significant way regarding the commission long tails that were made, the regulation change?

Rashesh Shah: It does impact partially on the Wealth Management business, but our mutual fund distribution income as part of Wealth Management topline is very small. We are much stronger in distribution of bonds, which has become a very profitable activity right now and everybody is trying to raise bonds in structured products, in alternate funds, in equity broking, all of those are much larger sources of income than the mutual fund distribution. If you look at all the mutual

fund distributors, we are relatively smaller as compared to other wealth managers also. So, impact obviously is there, but it is very minor for us in the Wealth Management business.

Moderator: Thank you. The next question is from the line of Renish Bhuva from ICICI Securities. Please go ahead.

Renish Bhuva: Sir, couple of questions. One is on the provisioning part, which is like INR 250 crores this quarter. So, if you could just breakup this provision between wholesale and retail book?

Rashesh Shah: So, I don't have the exact breakup in front of me, but I would say out of INR 250 crores, INR 200 crores will be wholesale, broadly. It is largely on the wholesale side.

Renish Bhuva: Okay. And so broadly, again, within wholesale, largely towards the real estate book? Or it would be, let's say, between Structured & Wholesale

Rashesh Shah: Both. We treat it as one common book, now as call it corporate credit, so it will be across the two of them.

Renish Bhuva: So, sir, broadly when you're guiding for a INR 700-800 crores kind of a provisioning for this year, it is fair to assume that we have done, let's say, account-by-account analysis of our watchlist or let's say, top 20-top 10 exposures. And we are pretty confident of maintaining this guidance for the rest of the year?

Rashesh Shah: Yes, we have gone account by account. It has taken a lot of time and effort. But yes, it is not just a broad percentage of book number, it is account by account bottom up calculation. And as I said, there might be 10% here and there because that is unexpected in the environment. But all the stress testing and the calculations we have done, this seems to be a good estimate.

Renish Bhuva: So, sir, now moving on to my next question is on the wealth business. So, in this quarter, particularly, our revenue is down 20% Y-o-Y despite our AUA up 11%. So, it reflects there is a sharp decline in the yield to AUA. So, what explains this?

Rashesh Shah: Largely, activity. As you know, April was a slow month and then even June because of the environment and couple of credit events that happened, a lot of activity has come down. This quarter was much more muted activity across the board; even in capital markets, brokerage volumes, all of that was about 10%-20% lower across the board. The good news is, in the advisory this is more cyclical. The way Advisory business has always worked for the last 10 years, whether it is capital markets, wealth management, asset management, within a year, there is 1 great quarter, 1 bad quarter and 2 average quarters. And that is how it has always been across the last many years. Because this is the kind of, what I call, quarterly volatility in the advisory, strong capital markets related businesses, but it's not structural, it's more cyclical. And already, we have seen some activity coming back in this month. So, overall, I think if you would have seen capital markets, IPOs, everything has been muted in the last quarter. So, it's just activity led, there is no other change.

Renish Bhuva: Sir, last question on the Opex side. So, this quarter, we have seen a 20% sequential decline in the Opex. So, number one is, what explains that? And the next question, which is a follow-up to that in PPT, we have maintained something about making more investment towards technology and processes. So, I'm just wondering, despite our cost-to-income at 50%, and in a couple of quarters back, we have talked about the operating leverage, then why we are making again investment on the technology or processes?

Rashesh Shah: See, I think what's happening in financial services, and especially as you go in more and more retail, like whether it's retail wealth management, whether it's retail credit, technology is becoming not only important from scale and growth point of view, but also from a cost efficiency point of view. So, costs have come down because we have some operating leverage like when you say, you look at wealth management and other activities, when the topline comes already some part of compensation also gets calibrated, so there is an operating leverage that you have a little bit in the business that allows you to manage, the up and down in the topline on the advisory businesses. All businesses, I think the reason Opex has come down also because our headcount is getting more calibrated, and we are using technology to become more and more efficient. And so the way you should look at is technology investments are replacing people investments. So, your headcount or your people costs will come down, your tech costs will go up. And in the long term, that is more scalable, more efficient for all financial services and will ultimately improve your cost income ratio. And more importantly, customer experience also. So, I think entire financial services industry will be in this transition, where if your tech cost is X and your people cost is Y, your people costs from Y will come down, but your tech cost from X will go up.

Renish Bhuva: Right. Sir, sorry, just the last question. So, in the retail and wholesale finance business after adjusting for CDPQ's entire investment, what will be your holding in these 2 business?

Rashesh Shah: In the credit business because they have invested in one holistic credit business, everything is in that only wholesale credit and retail credit. They have a convertible structure, they will own anywhere between 14% to 18% as per the conversion formula that we have agreed depending on the profit and ROA at the time of conversion.

Renish Bhuva: Right. And this is purely so entirely in the ECL Finance?

Rashesh Shah: Yes, it is in the credit business in ECL finance, yes.

Renish Bhuva: And what about the wealth side. I mean, let's say, if we have to assume that Kora again will be converted a predefined formula, then what will be our share in the wealth business going ahead?

Rashesh Shah: So, assuming we do the complete round of \$200 million that we want to do Kora is the anchor investor with \$75 million, we're talking to other people for the balance amounts. And I know \$200 million will be about INR 1,400 crores. And as I said, our conversion pre-money expected is about INR 8,000 crores. It's a convertible structure. But 8,000 is the middle point and 10,000 is the cap on that. So, at 8,000 crore, you can calculate 1,500 will be slightly under 20%, about

17%-18% is what they will also. So, in both the businesses, we will end up owning at least 80 plus percentage equity after both these capital raises also.

Renish Bhuva: So, the Global Advisory will include wealth, capital market, ARC and asset management, right?

Rashesh Shah: Yes.

Moderator: Thank you. The next question is from the line of Shubhramshu Mishra from BOB Capital Markets. Please go ahead.

Shubhramshu Mishra: My first question is with respect to your corporate credit. So, out of the 162 projects in wholesale mortgage, I want a little more flavor, how much are under construction? And how many of them would be in MMR? And how many of them would be in NCR? And how many of them would come up OC or get cleared in FY20? That's my first question.

Rashesh Shah: So, I think broadly MMR and NCR should be about two-thirds of the portfolio broadly. But again, in MMR also it's more outskirts of Mumbai rather than the Island city of Mumbai. So, on 80% of the inventory is below INR 1 crore and where the apartment value is below INR 1 crore, which is a fast-moving item. And what was the second question, sorry?

Shubhramshu Mishra: How many of them are under construction?

Rashesh Shah: Largely they're all under construction, at various stages of construction, but all of them are post approval. 100% of the projects are RERA compliant, largely housing, and almost 80%-85%, the sales have already started.

Shubhramshu Mishra: Right. And out of these 162 projects, how many would come up for OC in fiscal 2020?

Rashesh Shah: I don't have that number off hand. But I don't know, a lot of this works on partial OC and scaling up, but I would say at least about a third of them will be OC in this year and another maybe a third will be OC. Actually, quite a few of them may already have OC by now. But of the ones which do not have OC, my guesstimate would be about a third will be OC in this fiscal year and another one-third will be in FY21-22.

Shubhramshu Mishra: Right, sure. And my next question was with respect to your wealth management assets under advice, the market movement here is negative 2,000 crores versus your asset management, where your market movement is barely 15 crores. So, how do I read into your wealth management, has there been some write-down? How do I read this negative 2,000 crores of wealth management asset?

Shubhramshu Mishra: This negative 2,000 is the fall in market value. So, when you say market movement, it's like if you're holding equity shares and the equity prices come down, the market movement has reduced the value of your portfolio.

Shubhramshu Mishra: So, it's largely related to market movement equity price, right? My simple question is that if I look at the market movement as a percentage of opening AUM for wealth management versus market movement as a percentage of opening AUM in asset management, both of them are drastically different. So, how do I read both the numbers?

Rashesh Shah: So, the way to look at market movement is this is just the impact of the market change. So, for example, if you are a wealth management customer of ours and you have equity stock of Rs. 100 with us and that because just the market came down, the 100 became 85, there will be a market movement of minus 15. So, the way you look at asset management and wealth management is you look at 2 factors, what is the net new money, the new clients or the existing clients who brought in fresh corpus with you. That is called the net new money. And the existing corpus you have, existing assets under advice you have, the impact of change is just the market movement, which is more the passive part of it is what you calculate in the net market movement. So, the way to look in wealth management is we had 1,06,000 crores of AUA at the start of the quarter. On that corpus, the market movement either equity markets or currency or whatever other market changes that have happened, that would have resulted in a reduction of AUA by 2,000 crores. But we have also brought in 2,600 crores of new clients who have come into this. In an upward market, the market movement can be positive also. But this quarter, obviously, I know most of the asset classes have come down in value. The same thing is in the asset management. But asset management business is a different business, wealth management is a different business. So, in asset management, the corpus we have was 37,000 crores. Had we not got any new money this same 37,000 crores would have fallen by 15 crores just because of the change in indices and the market values in this quarter.

Shubhramshu Mishra: And you gave a credit cost guidance of 700 to 800 crores, is that a correct number?

Rashesh Shah: Yes.

Shubhramshu Mishra: And out of this, what would be your additional provision that you would be doing over the regulations?

Rashesh Shah: Actually, now we are all in Ind-AS calculation. So, Ind-AS, there is no calculated provision. It is your estimate of expected credit loss. In Ind-AS, you calculate ECL or you mark down your impairment, you take it on your portfolio. So, now we have all moved to an ECL model where the auditors have to agree to saying this is the expected credit loss after looking at collateral values and expected time to liquidation and recoveries and all that. So, there is no regulated formula any more.

Shubhramshu Mishra: So, it's all as per ECL and there is no additional provision above the ECL calculations? That's correct?

Rashesh Shah: No. The way it works is you calculate ECL in that way. So, if you want to be conservative, you calculate ECL in a conservative way. If you want to calculate ECL in more optimistic, you do that. There is generally nowadays no provision for doing an additional provision above ECL.

And even if you do that, your ability to use that in the future gets very bad. So, most of the auditors and everybody wants to say, ECL, you want to be conservative, take 10% more and provide, but that is also called ECL.

Shubhranshu Mishra: Sure, sir. Can you just tell me what would be the change in the PD and LGD estimates for this calculation?

Rashesh Shah: It's actually account by account. Obviously, Stage 1 and Stage 2 is a standard one. There is a different one for wholesale real estate some projects rather than for wholesale real estate advanced project is different, early stage project is different, structured is different. So, our Stage 3 PD is always 100%, right. Stage 2 PD is average of, about 55% to 60% of the wholesale book and close to 80% in the SME book and close to 10%-20% on other collateralized book. So, as I said, this is very book-by-book. So, we have some 18 categories in that. So, I am not able to give you an average. But I think Stage 1, our LGD is usually between, for wholesale book is about 20%. For Stage 2, also it is about 25%. And for Stage 3, it is 26%-27%.

Shubhranshu Mishra: And how have they changed from third quarter FY19? That would be my last question.

Rashesh Shah: I think it inched up a little bit by maybe 2-3 percentage points. As I said the moment, it's not the change in PD and LGD, it has been the movement that has happened between Stage 1 and Stage 2.

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

Anitha Rangan: I have a few questions here. So, the first thing is on the liquidity front. In your Q4, you have given some details as to your overall liquidity was INR 10,100 crores which is now INR 8,800 crores. Out of that in Q1 you mentioned that your bank lines which was like INR 2,300 crores it is reduced now to INR 1,500 crores. So, one, why is the bank line reduced? And two, has your overnight liquidity also reduced? I think what you used to call as FDs used to be like 3,000 crores, is that what is 1,600 crores or the 1,600 crores includes the bank line as well? Just wanted some clarity there.

Rashesh Shah: So, I think the bank lines will keep on going up and down depending on our utilization strategy also on that. There are pros and cons of keeping bank lines unutilized versus utilized. Our current tendency is to use them, so that at least they are regularly used from bank to bank because even the bank lines are over 8 or 10 banks. Overnight liquidity now we actually made it very fungible because just keeping overnight liquidity mutual funds especially liquid funds is what we used to keep. And FDs, now FD rates have come down, even the mutual funds and all, liquid and all, there has been a lot of upheaval. So, we have started keeping a lot of that in what we call treasury assets. So, our overnight liquidity what we need is only about 1,000 crores, but we still keep about 2,000 to 3,000 crores of overnight liquidity. And a lot of that, we have moved into things like arbitrage, things like G-Secs, things like even the loan against shares book, which can be liquidated in 30 to 60 days. So, we are using this opportunity to ensure that our cash is slightly more efficiently used, rather than just kept idle in liquid fund. When yields were high enough, I

think liquid funds and FDs were okay. Now we are trying to be slightly more efficient. Because overnight liquidity appears to keep about 4,000 to 5,000 crores. Now we don't need that much money because our balance sheet and our short-term, most importantly our high overnight liquidity was we had a lot of short-term commercial paper and other short-term repayments due. A lot of our short-term requirements have gone away. We have hardly any commercial paper. So, as the commercial paper has gone away, the need to keep overnight liquidity has also come down. And it is then inefficient to keep a lot of money just in liquid funds or FD, we would rather keep it in G-Secs especially at times like this when interest rates are coming down. So, we can earn a higher yield on that. So, what we internally monitor is our liquidity available in 120 days. And we obviously, internally have overnight bucket, 1-day bucket, 7-day bucket, 30-day bucket and all that. Then we look at our obligations and keep on calibrating according to that.

Anitha Rangan:

And second is your overall ECL provision from Q4 to current is like increased from 815 to 836 crores. But what you said is like you've taken a material write-off about 250 crores. So, that has actually come as a part of write-offs or provisions because here, it's not showing up in a material way.

Rashesh Shah:

It has largely come from mark-downs and write-offs and impairment, a lot of our credit is also held as bonds and all that because some of the loans we give are in bond form and under Ind-AS, even things which are non-NPAs, you have an option to mark them down, even when they are not NPA. See, what has happened in the earlier NPA regime, which was the Indian GAAP regime. In the NPA regime, you have to call something NPA and only then you can provide against it. In the new Ind AS regime, you can mark down even a non-NPA, either a bond or a loan. So, we have, as we said, very proactively started marking down and taking the impairment because now we move away from provisioning approach to a more impairment and expected credit cost approach. So, that is what we have done in this quarter. So, you may not see the provisioning going up from an NPA categorization point of view. But ECL has gone up or total credit cost has gone up because we have taken impairment. If you see our P&L accounts, there is financial instrument impairment that we call it. So, that is actually a more prudent way of doing it because you don't want to wait for somebody to become an NPA and then provide for it. You want to sometimes provide even before it becomes an NPA, if you think this is a sticky account. And it's account in the watch. So, I expect with Ind-AS, slowly and steadily in a year or 2 the NPA terminology will go away. Unfortunately, because banks have not moved to Ind-AS, only NBFCs have moved to Ind-AS. All of us are toggling between NPA and expected credit cost. But I think the more elegant way, the more prudent way to look at it is look at it from the expected credit cost point of view, which is not related to NPA at all. In fact an overdue account after 30 days, even if it's SMA 1, you may want to start providing against it. Because you are now saying that is an expected credit loss, I may have on that. So, I think in Ind AS, now the regime is going to change and we are following that.

Anitha Rangan:

Just a couple of more questions. In your liquidity analysis, you are talking of fresh borrowing of almost 2,000 crore each in Q3 and Q4. So, what is your thought process behind, like, what

sources of borrowing will you access in Q3, Q4? Will it be banks or market or retail borrowing? Can you throw some light there?

Rashesh Shah:

So, it will be largely banks and retail and then maybe a little bit of NCDs with mutual funds and insurance companies. So, if you go back until last year, we were borrowing about 4,000 crores of what we call the long-term money every quarter. So, even if you see the last year's second half, which was a very sticky and very dry quarter. First half of the year, we raised about 8,000 crores. 7,800 crores in the second half of last year. So, our average has been about 4,000 crores a quarter. For the last 3- 4 years, we have been conservative, and now we have brought it down to 2,000 crores a quarter, which includes bank lines as well as retail NCDs and all that. And that even in the first quarter, we've been able to keep up with that. So, we think 2,000 is a very conservative number in this market environment and that is what we are currently projecting. Our idea is to be conservative. If you are able to raise more, we will obviously step up on disbursements and scaling up again. But as I said, I think our current approach is that from now to March 2020, we will be more consolidation, liquidity management, asset quality management, take the pain in P&L kind of an environment and you become ready to grow post 2020 onwards. And we don't want to grow in a hurry, unless we clearly see that environment has stabilized.

Moderator:

Thank you. The next question is from the line of Aditya Jain from Citigroup. Please go ahead.

Aditya Jain:

Sir on the Stage 3 loans, if you could help us understand, is all of the increase in Stage 3 loans related to loans, which are now 90 days past due? Or is there also some conservative tagging of Stage 3 based on stress that you're seeing in the particular account?

Rashesh Shah:

I would guess Stage 3 is higher than NPAs. If you are asking that question that Stage 3 is not equal to NPA, it will end up becoming higher than NPA in the new ECL regime that we are following. So, to answer the question, yes. Stage 3 has accounts, which are non-NPA also, but we classified them as Stage 3.

Aditya Jain:

Okay. And since you mentioned coverage, so if you see Stage 3 coverage now at 47%. So, is there a target level of coverage that you would see going forward? Or is this a stable level? And related to this, is the guidance of the full year credit cost. So, that basically assumes an increase in Stage 3 loans? Or does it assume an increase in coverage on Stage 3?

Rashesh Shah:

I think it will not be increased in coverage because our approach has been that to calculate the real loss given default, not the formula loss given default. If you calculate the real loss given default on stressed accounts, usually on collateralized, even wholesale credit or even retail credit, it has been between 10% to 20% has been your real loss given default on collateralized credit. So, we estimate worst case will be like home loans and all your actuals loss given default about 10% to 15% on delinquent accounts. So, our approach has been that if you can target about 50% for the collateralized wholesale loans that is conservative enough because it is actually in our estimate twice of what the actual experience has been for the industry as a whole. So, if the industry thinks our experience about 25% as real loss given default having a provision coverage of 45% to 50% is a good approach to have. The same thing was on home loans, I think a 20%-

25% provision coverage is a good thing. On SME loans especially unsecured, we currently write off everything on 120 days. So, we take 100% as write-off on the unsecured loans. So, on unsecured, I think you should take 100% write-off after 120 days is our approach. On collateralized wholesale and other relative portfolio being at 40 to 50 provision coverage is a good thing. And for home loans and all being at 10% to 20% is a good conservative provision coverage ratio.

Aditya Jain: Got it. And that's helpful. Then just one clarification. So, in the notes to account there is a 35 crore favorable net gain on fair value change due to high court judgment. So, what does this refer to?

Rashesh Shah: This was an old investment we had made, which we had written off. This was a 10-year-old investment, but about 5 years ago, we had written it off completely. And we have filed a case for recovery on that. The court case has gone in our favor. So, auditors insisted that since the probability of recovery is high, we should take it into the P&L.

Moderator: Thank you. The next question is from the line of Mahrukh Adajania from IDFC. Please go ahead.

Mahrukh Adajania: How much of your residential real estate loans would be under moratorium?

Rashesh Shah: So, we have no interest moratorium at all in most of the cases because what happens on the repayment is not under moratorium, it is linked to cash flow payments of the project as we expect the project sales and project cash flow to come about. Sometimes you have an escrow account, where you get 10%- 20% of that. So, where we expect that there is going to be a cash flow related stress is what I was saying earlier, we are starting to classify them, call them Stage 3 even before they become NPA and start to provide for that. We are also proactively in at least a few cases where we expect it that the project will not be able to throw out the cash flows as contracted. We have proactively 3 months, 6 months ago, gone and got an additional investor or some last mile funding on that project to make sure that cash flows are because what you see is the only reason cash flows are getting impacted in a project if the project gets stuck. So, we have not allowed any project except for a couple of projects, which are stuck as of now. We have made sure that all projects which are in our portfolio continue to move forward. And as long as they continue to move forward, the moratorium doesn't become a big issue for us. And we look at 180 days out. In the next 180 days, where are the repayments going to be due and how they will come. And if you see any problem in that, either we arrange for funding and ensure that we don't have an issue on that or we provide and even after that if it becomes NPA, then we still have to provide. So, either it becomes Stage 3 or it becomes NPA after that. But we try to proactively avoid that. We have not done too many structures where there is a onetime bullet repayment at the end of 3 years and all because it is not just an ALM issue, it's also a very big risk issue. So, we make sure that our repayments are linked to project cash flows and we stress test very aggressively.

Mahrukh Adajania: Okay. And just on your ARC business. I mean, anyway resolutions are very slow and they've slowed down even further. So, how does one cope with that? Because that's eventually going to have an impact on ARC valuations.

Rashesh Shah: When you say resolutions are slow, it is partly true and partly not as everything else in India because we are looking at only NCLT. I would say that almost two-thirds of the resolution in ARC happens outside of NCLT because NCLT is only one more true of dissolving accounts. A lot of accounts are getting resolved outside of NCLT either through asset sales or through a new strategic partner or a OTS, a onetime settlement and all that. So, actually, the one way to look at it is recoveries. So, last year, we did total recoveries about 7,000 crores. This year first quarter, we already done about 1,000 crores plus. Quarter 2 will also be like that. And the big one this year is Essar Steel which is another 8,000-10,000 crores, which definitely will happen in this year. So, this year, we are expecting about 12,000 to 13,000 crores of recovery. So, if you look at our AUM, which is about 40,000 odd crores, a year before that we did 3,000 crores of recovery, year before that was 1,000 crores of recovery. Last year was about 7,000 crores of recovery. This year, we are looking at 12,000 to 13,000 crores of recovery, which means in 4 years, you would have recovered almost about 25,000 crores on a 40,000-odd crores AUM. So, I think recoveries are looking fairly good. So, don't look at only NCLT. Of course, Essar Steel is a headline case and that has truly got delayed by at least 3-4 quarters according to me. But outside of that, we have quite a few other resolutions last week. Alok Textile has got cleared also. So, there are resolutions happening, unfortunately because of Essar Steel, we think they are slow. So, I think it is slow, but they are a lot of non-NCLT things which are also getting resolved.

Moderator: Thank you. The next question is from the line of Subramanian Iyer from Morgan Stanley. Please go ahead.

Subramanian Iyer: So, a couple of housekeeping questions on the transaction. So, one is that I believe your fully diluted stake in the ARC business was anyway supposed to go to about 60% in a couple of years, given that CDPQ's stake was about to go to 25%. So, now post this transaction, does your residual stake in ARC go down to say around 40%, 45% odd? So, that was one. And the other question was that given that there's a capital infusion in the GIA business and that most of that business doesn't require cash as such. So, how do you plan to use that cash?

Rashesh Shah: So, a couple of things. I think the first one in the ARC business, we already have a 60% beneficial interest as of now. So, the way ARC holding is currently structured, 60 is with Edelweiss, 20 is with CDPQ on a fully diluted basis and 20 other old investors who are there because as you remember, when we started ARC, we had only 49% holding as per RBI rules. So, we had outside HNI investors who got the remaining 51%. So, a few of those are still at 20%. So, 20 is with old HNI investors. 20 is CDPQ. 60 is Edelweiss, but this ARC will become part of the Edelweiss Global Investment Advisors and will become subsidiary of that. And if we dilute, say, about 15% to 20% of that, the question you are asking is very important that our ARC holding, which is currently 60 can also get diluted by say about 18%, which will come down to 15. Our endeavor is to keep it at the beneficial eventually at 60%. The way we could that is we can buy out some of the other investors and buy 10% of that, so go from current 60 to 70 and then effectively get

diluted back to 60. We want to remain between 55 and 60 in ARC on a beneficial basis also. So, we will do because this, as I said, this will take about 5-6 months for the transaction to close. So, as on currently, our beneficial interest, which is 60 will get diluted down to the extent of the dilution in EGIA, but we will hopefully try and rebalance it by buying out some more stake in ARC and upping our stake to come back to 60% in the next year. It's more an intention. So, it's not something that we are sure that we will do it, but we will intend to do this. And we will use this capital, see, currently in the wealth management business, we need some amount of working capital for the wealth management business as well as for the margin funding business that has been there. Currently, the margin funding book of the wealth management is housed in our credit business, ECL finance. We would have seen that there is 4,000 crore ESOP financing book. We're the leader in ESOP financing, we see the market as fairly large. And even today, there is an appetite for another 3,000-4,000 crores in the market from our customers who have the need for that. So, once we raise this capital and this equity, this equity will also allow us to build some amount of ESOP financing in this business also. And on a long-term on a 3- to 5-year basis, we would like to do what is related to wealth from a credit point of view, which is mainly ESOP funding, margin funding inside the wealth business. So, we will slowly transition it out in the next 3 to 4 years. But even today, this additional capital will allow us to scale up the ESOP financing business, which is in huge demand. And we have almost 70%-75% market share out there. And we would want to maintain that market share.

Subramanian Iyer:

And if I may slip in 2 more questions actually. So, one was on the overnight announcement, the final guidelines that came out on the partial credit guarantee scheme by the government. So, any early thoughts on that? And if Edelweiss would be keen to, say, participate in that? That was one. And the other question is that what are your expectations from the co-lending arrangement that you have with some of the banks? And how do you expect it to scale up over the next couple of years?

Rashesh Shah:

See, you see we have a retail book the SME as well as the retail mortgage book, which is currently almost about 14,000-15,000 crores. So, we would like to use this scheme that will be announced to at least recirculate some of that because we have a strong origination engine. Our capacity is much higher than what we are originating currently given the liquidity situation and all. So, if we can release some capital and replough that into originating more, I think that will become a model. The good thing is in the last 9 months, we have not used asset sell down or securitization in a big way. So, the portfolio is still very available from that point of view, because a lot of you have eligible portfolio that you wouldn't find it as easy to use this scheme that is there. In the last 8-9 months, we have not done more than 500 crores of retail securitizations, so our book is fairly intact from the utilization point of view for securitization. So, we would definitely use it for a couple of thousand crores and use that couple of thousand crores to scale up the retail business. And the same, I think, going forward, co-origination is going to be a great opportunity, which is going to be usually 80-20, we don't think that structurally, most NBFCs will now become capital-efficient and not just scale up your book by 20%, 30%, 40% every year. I think you will have to pretty increase the flow business, get more fee income and use things like co-origination. So, your ROA should go up, but your gearing should come down for NBFC as a whole to maintain the same ROE. The part of the ROA going

up should come from higher fee-based or churn-based activities and that is the new model that we think will come up into play. And I think co-origination is going to be an important part of that. We also see co-origination opportunities on the wholesale side. So, we are seeing a lot of global players coming to us and say, wholesale is also very good risk reward business, has its own pros and cons. But wholesale on average gets you about 4% to 5% higher yield, with a 2% to 3% higher credit cost. So, from that point of view, wholesale is still a good risk-reward business. But given the environment and all, NBFC should not do a lot of wholesale business. But can you do it also under co-origination? So, I think co-origination will become a very capital-efficient strategy and will improve the fee and other income to improve your ROA without using the balance sheet very aggressively.

Moderator: Thank you. That was the last question. I now hand the conference over to the management for their closing comments.

Ramya Rajagopalan: Thank you everyone for taking the time out to listen to our call, especially ahead of this almost long weekend. Happy Independence Day. And we'll speak to you in the next quarter. Thank you very much.

Rashesh Shah: Thank you, everybody. Thank you, bye-bye.

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