"Edelweiss Financial Services Limited Q3FY20 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Edelweiss Financial Services Limited Q3FY20 earnings conference call.

As a reminder, all participants lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mrs. Ramya Rajagopalan – Head of Corporate Development. Thank you, and over to you, ma'am.

Ramya Rajagopalan: Good afternoon everyone. Thank you for joining our Q3 earnings call for FY20. We have with us Mr. Rashesh Shah – Chairman & CEO of the Edelweiss Group and Mr. Himanshu Kaji – Executive Director & Group COO. During the discussions, we will be referring to the Q3FY20 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 results 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 for being on this call. As usual, every quarter it is good to have a lot of you back with us to discuss how the quarter has been, how we see the environment going forward, and what Edelweiss' priorities and focus items are. In this current quarter – the quarter that got over – Q3, we had said that we will focus on strengthening balance sheet, managing liquidity, and reducing the wholesale book. We have continued on that. On our balance sheet, we strengthened our equity base and now the D/E ratio has come down to 2.9 times with a capital adequacy of 21.4%. This is largely due to some reduction in the assets but also equity infusions from Kora and Sanaka in our advisory business - EGIA, which came in this quarter. Also, in this quarter, sold down part of our wholesale book to our South Korean partners Meritz, and that also reduced the debt-to-equity ratio.

On the liquidity front, we have now more than 10,000 crores of liquidity which is about 22% of our total balance sheet size. We have always said that we are going to be between 15 and 20% and in the last quarter, we made repayments of about 5,000 crores, but overall, I think liquidity conditions have improved but we have also strengthened our liquidity in the meantime.

On the earnings front, this has been a muted quarter which is there. We had ex-insurance profit after tax of about 74 crores which has come down. Largely this has been due to elevated credit cost, both implicit and explicit, and as we have been guiding, I think credit cost has remained higher, and I will speak about it as we go along. But I think credit cost continues to eat into earnings as we go along.

Our wholesale book sell down, reduction of the corporate book, remains a key priority, and in this quarter, we did 1,000 crores of sell down. We plan to do a lot more in the next 2 quarters. In fact, we have announced it at the board level that we have decided to pursue these opportunities more aggressively. We will do 2 to 3 transactions of various parts of our wholesale book to sell down because currently our wholesale/retail mix which is about 50:50, we want to, in the next year, end up at about 70:30. For that, we will have to do aggressive sell down of the wholesale portfolio, and we are in discussions with investors on that. In order to do that, we have also announced that we will do a review of the ECL model and try and come up with a very transparent approach to this so that when we sell down the portfolios, we will be able to clearly demonstrate the pricing at which it is sold down, what is the ECL of the residual book and all of that because one of the things that has happened in the last 1 year for all us because an ECL regime is very different from an NPA regime. NPA regime is a lot more deterministic that something is an NPA and you provide on a formula basis. In ECL, there is a lot of forward-looking judgement that is there and what we have found is largely ECL calculations have been impacted by liquidity environment. Even today, whatever delta on ECL has been there, 80% of that can be explained away with liquidity and by selling down this wholesale book, we are also planning to generate liquidity which itself will allow us to make sure that we allocate liquidity for projects to be completed and manage ECL as a result of that because the ECL is largely getting impacted by whether you can provide liquidity to complete the projects or not, especially in real estate, and that is what our approach is going to be that we constantly make estimates of how much liquidity we will be able to generate, we will be able to give, we will be able to originate for those projects and based on that what the ECL is going to be. We plan to do this in the next couple of months and then do the portfolio sales of wholesale book on that basis so that there is very transparent pricing because we have been always asked that when you sell down your books, are you selling down the good book or are you selling down the NPA book and at what price you are selling down.

By doing this ECL model review and really showing the pricing in a transparent manner, we hope that we will be able to give comfort to all stakeholders, not only on the sell down but also on the ensuing book after that. We expect to do this in this quarter and our hypothesis of liquidity has improved in the last 3-4 months, but it is still a lot tighter in the environment and we are seeing more and more projects getting affected more by liquidity. The government has announced the last mile completion financing scheme which has been a fairly good development. We are hoping that by March, a lot of disbursements on those also start happening.

By selling down the wholesale book, we will be doing multiple things. We will change the composition of our credit business, we will generate liquidity to pump into completion of some of the projects. That's what we did in the Meritz deal. Out of the total money we raised, we kept part of it for completing those projects out there. We transferred about 7 projects into that fund and for the 7 projects whatever last mile completion financing was required also came from the fund. That allowed us to ensure that we could have clear visibility on last mile financing.

Thirdly, it allows us to step up on disbursements on retail, which we remain very excited about. The other parts of Edelweiss, the advisory business-EGIA, has now got independently capitalized. We have outside investors in that and that business continues to chug along well. It has had more or less business as usual quarter. Within EGIA business, ARC had a good quarter and advisory businesses had a decent quarter. So, we now run Edelweiss in 3 parts – there is a credit business, there is an EGIA business, and there is insurance business. The EGIA – advisory business – made a PAT of 151 crores for this quarter and they continue to chug along well. We have been very excited by that. By raising capital in that business, we have made it more and more independent and we have structured it in a way that they use their capital for their growth and they are not dependent on the NBFC or other parts of Edelweiss for their capitalization requirement.

In fact, one part of EGIA is the asset management that had a very good growth in the last quarter. Our asset management AUM had a 40% YOY growth mainly because of Bharat Bond plus other inflows that we got and we continue to remain focused on both the alternatives and the mutual fund part of the business. Overall advisory continues to give us a lot of growth expectations and we continue to invest in that.

The insurance business had a steady quarter. We will continue to invest in that as per plan and there is no significant change in approach or growth assumptions of those businesses.

Economic environment has seen some improvement. I think October was a U-turn and after October we have seen some improvement. It is still early days as people say, green shoots are there but I think it will take another couple of quarters for real growth optimism to start coming back. We remain conservative, we remain cautious, we remain focused on liquidity as the primary operating metric, capital adequacy, asset quality management. As I said, ECL is largely also dependent on liquidity now and we hope that we get that in order, and fourthly as I said, continue to invest in our non-capital-intensive businesses like advisory because they continue to show a lot of promise.

Along with that, once again, thank you very much for this for being here. We will now open up for Q&A and I do look forward to interacting with all of you.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. We will wait for a moment while the question queue assembles.

The first question is from the line of Avinash Singh from SBICAP Securities. Please go ahead.

Avinash Singh: A few questions. The first one on that credit cost because now we are in the journey of sort of degrowing the corporate or wholesale book, but of course in this process, the credit cost is coming and typically we are running closer to 200 crores a quarter. Given the environment and how it is turning out to be, how long can we expect this elevated credit cost to continue and what I chase apart from this liquidity over the last 2 years is, we were very very bullish on our collateralized credit or even on the developer book, but over the last 1 year or so, the book has started to show a lot of stress despite selling down reasonable portfolio and we are still sort of looking at elevated NPA. So, that is on NPA and credit cost trajectory.

And second one is now more from a group structure perspective that given that over the last 1 year, you have raised multiple tranches of equities and that had come at a different level. Now we have sort of a minority investor at different levels. You have within EGIA at ARC level, then we also have some investor at the overall holdco level and then separately in your credit business. This is sort of making the structure a bit complicated. So, is there a plan by which either you sort of demerge the businesses separately as some of the peers have done or looking to bring all these sort of strategic minority shareholder at the holdco level?

Rashesh Shah: Avinash, very important questions. As you said, ECL is currently running at about 200 crores a quarter and 800 crores a year largely on the wholesale book which is about 16,000 crores. On the wholesale book, we are running at a credit cost of about 4% to 4.25% of the book which is higher. Our original estimate was about half of that between 2% to 2.5%. So, credit costs have in a way doubled from the normal estimates. I would say a large part of this is because of liquidity. What we saw in the last year has been unprecedented liquidity crunch and it is affecting credit cost and this is not very easy to explain because we assume that credit cost should remain because credit cost gets impacted by environment and by liquidity. So, if you saw the bank NPAs that happened when a coal mine got canceled or steel prices came down, a lot of that was led by changes in the business environment or the conditions.

What we have seen in last 1 year is the liquidity has been impacting credit cost and things have not changed as much. A housing project is the same housing project. Even the pricing has not changed much but the project completion, projects are getting stuck for 20-30 crores which was not the case earlier. Earlier, money would come, even construction finance or money from home sales, from home loans and all would come. Everything has slowed down, and this slowdown still I would say about 75% to 80% of the projects are going along. So, they are able to manage and all, but the ones which have some headwinds coming in, the liquidity environment makes it very very hard for the projects to complete and we also have not been very keen to allocate and disburse more money from our balance sheet because we want to reduce the wholesale exposure and the real estate exposure. That is what our creditors and bankers have been telling us. As a result of that, we have not been equally fast in disbursing money. We have tried all these innovative things of raising money all of that to just make sure that liquidity is available for the projects which need completion.

I would say 80% of the increase in credit cost is purely liquidity led. Unless liquidity environment improves which I am hoping in the next 2 quarters, I think liquidity has improved, credit flow has not improved as much. Unless credit starts flowing and people are willing to give 20-30 crores for a project which is economically viable, which can be completed but is currently stuck for funds, I would say at least another 2 quarters it will remain. And that is exactly the exercise we want to do to make a reasonable assessment of the environment but more than the assessment of environment, make a reasonable assessment of the liquidity available for these projects. The projects we have, the good news now is, after last year, there are not much unknown-unknown. You know almost everything that is good, bad, ugly in the project now. And in that project, if you say I can allocate so much liquidity or I can raise so much liquidity, your estimate on credit cost will be a lot more stronger and in fact, your ability to even control credit cost will go up if you have liquidity. And this is a new strange thing that has happened in the last 1 year.

So, I think the next 2 quarters unless credit flow starts smoothening out on almost all the wholesale businesses across the board, not just real estate; for banks, for NBFCs, a part of the credit cost will be liquidity led. For banks it's easier because they are in the NPA model that it becomes NPA, they know how much to provide. So, if they know something is going to be an NPA, while in ECL model even if something is not NPA, you provide. Even if it becomes NPA, you can provide 10%, you can provide 30%, and that is the loss given default estimate and all you have to estimate and that itself is also impacted by liquidity because if the project gets stretched for 3 years, your loss given default will go up. If you can complete it in 18 months, your loss given default will be reduced. That is my estimate. I think we would say another couple of quarters but the only good news about credit cost is like with everything, I think eventually credit cost goes away. So, we focus on PPOP. As long as the PPOP is stronger, I think credit cost is the pain you have to go through, and I think it's happening to all the wholesale books on the street in some form or the other. We do hope the credit flow improves and this kind of credit cost should not percolate down to other asset classes. Wherever loans are given to individuals and against the salary, we are seeing that credit costs are still under control and they have not gone up. Whether it is a home loan or a personal loan, all those are under control. Wherever the loans are to businesses, we are seeing cash flow is impacting estimated credit cost.

Your question #2 on group structure, you are absolutely right. We have raised equity from various partners. Our ambition is to run Edelweiss as 3 businesses – credit, EGIA, and insurance. Insurance, we only have a partner that is stand-alone. I think in EGIA, we have investors now. And Credit, we have investors. We would like to make these 3 as independent and reduce any other things underneath that. Now the ARC is the legacy issue because, as you remember, when we started the ARC, RBI rule said that you can only own 49% of that. That's a legacy element that is still there. But outside of that, our idea would be to streamline everything under EGIA and make EGIA as a well-capitalized, independently governed strong entity. And the same thing about credit and the same thing about insurance.

Avinash Singh: But in terms of listed entity in the near future that the holding company will be our only listed entity or do you have sort of a timeline in mind to separately list the three?

Rashesh Shah: We have not made a plan and a timeline. Of course, the investors who have come in, we have kept the option open. With all the investors who have come into the businesses, there is a liquidity plan for those entities. We also obviously can pay cash and buy them out or swap into Edelweiss shares, but the investors would expect us to go towards independent listing. But we have not yet structured and made up our mind. Our idea is to run this in a way that if you want to do that, that can easily be done. But our current short-term, next 3 to 6 months, the ambition is to make these 3 stand-alone entities. The EGIA is almost got done. We have investors out there. And by March, EGIA will be a stand-alone company by itself with all these advisory businesses underneath that. After that, if you want to add the list or demerge, then it's only a process. You don't have to go through any other structural changes as such.

Avinash Singh: But within EGIA, you have this CDPQ, that is again at a one company level. It's not at the EGIA level, right?

Rashesh Shah: Yes, and it has always been there, and that is not a problem. Because under EGIA, when the investors came in now, Kora and Sanaka, this was the structure that is there. So, even if you keep the same structure, there is no issue on that because as I said, ARC, you were not allowed to own 100%. You started off with owning only 49%. That's a legacy item. But other businesses of EGIA are all 100% held by us.

Moderator: The next question is from the line of Punit Mittal from Global Core Capital. Please go ahead.

Punit Mittal: Two questions. One is on the asset management, especially more specifically on the mutual fund business. Though we have seen increase this quarter, which is mainly related to the Bharat Bond ETF, the mutual fund business seems to be not growing along the line or better than the industry. And that has been for the last many quarters. Why is that and what's your plan for that business? Given that there will be, I think, the advisory business model has been changing with the regulatory changes by the SEBI and all. So, on the mutual fund side, what's your plan? And how do you plan to scale it up?

Rashesh Shah: Our idea is to grow mutual fund. What we have learned about the mutual fund business is, in a way, it's like the Insurance business. It has to age, and you have to just grow it every year on a year-on-year basis. If you see, we have added assets, of course, the Bharat Bond, but even outside of Bharat Bond, we have been growing at about 15% to 25% annualized rate every quarter. In this quarter, we have gone from the mutual fund assets of about 11,000 crores to 24,000 crores. Out of this increase of about 13,000 crores, about 12,000 odd was the Bharat Bond, but the others have also been growing.

We want to continue to invest in that. Currently, on the mutual fund business, we are close to about breakeven from a P&L point of view. If you want to grow faster, it's a function of allocating capital because asset gatherings will come with earnings impact. Our idea has been to build focus on innovative products, more on distribution, AIF, all of that, so that we are not just gathering AUM by spending a huge amount of money. So, I think this business will take another 3-4 years for us to grow and we are fairly happy with the progress. Our idea is to grow this steadily. The last couple of quarters, the environment was also slightly more muted, but we remain confident that our products and all are getting more and more accepted. A lot of our funds are now having 3-year track record and 4-year track record. All of that is also important before we start pushing on distribution.

Punit Mittal: The second question, I think, what you mentioned, just an extension of your previous comment on liquidity. Naturally, most participants did not anticipate this kind of liquidity stress in the market, which has happened in the last 2 years. Having said that, also probably most participants underestimated this liquidity risk in the market. From your comment, it seems that liquidity growth is still not coming in. And we are hoping that in the next 2 quarters, it will. Let's say, if the credit flow still doesn't happen to the corporate book, what kind of situation are we looking at given that the corporate book still is 15,000 crores? Can we see a spike on this book? Or whether sell down will become critical given the situation on the liquidity?

Rashesh Shah: As I said earlier, a lot of the credit cost is a function of liquidity, especially in the real estate book because in real estate, any housing project has got 2 kinds of risks; one is a sales risk and the other is the project completion risk. To give you an example, when the demonetization happened, sales came down, but because liquidity was good at that time, the projects did not get stalled. The projects were continuing at that time. But sales did come down if you look at the numbers. What has happened in last 18 months, the sales are okay – not great, but okay; they haven't fallen as sharply. In fact, they've been more or less flattish, but liquidity has impacted project completion, and that project completion status is impacting the viability of the project and hence the expected credit losses and all that.

So, our approach has been, as long as we can find partners and put this in a fund structure, because these projects require 2-3 things; they need long-term flexible patient capital and they also need liquidity for completion because once the project keeps on moving, then it is like a virtuous cycle where inflows start happening, customer sales happen, installments come in, and then the project will move along. And it takes usually 30-40 crores, 100 crores to keep a project going, and that has fully dried up. And as you correctly said, this has been unprecedented. We haven't seen this and a lot of people who have been around for a long time have not seen this in many many years that complete drying up of any liquidity. Otherwise, earlier, some high-net-worth investors, some NBFC will step in, provide the last mile funding, do some bulk buying, and get 20-30 crores to keep the project going.

So, that is the larger problem if environment remains the same, but as long as we are able to sell down and generate some liquidity, a part of that can be allocated to just complete the project, and that's what we want to do. When we did the Meritz fund, out of the fund itself, we kept some part aside for completion of those projects. And that is what we want to do. Not only release some liquidity and reduce our wholesale book but ensure that those projects also have clearly earmarked funding available to complete the project. And that, in our estimate, will impact all credit cost even if the environment remains like this because we don't see sales changing much. Even if they remain flat, your ability to complete the project and the ability to complete the project now is 80% of that is liquidity related. If you have the liquidity, project will get completed. And that we are seeing time and time again. Even if you go back and see the normal NPAs, a lot of NPAs were a function of whether you can give the working capital to a company because a lot of good quality companies were stuck for working capital and the drying of a working capital resulted in the companies going down. This is a very similar situation we are seeing and this drying up of liquidity is unprecedented.

Punit Mittal: Can you tell me, just an extension of that, where will…. The NBFCs basically stepped in to provide this kind of funding historically to the developers, and now, naturally, all the NBFCs are saying that they would structure into a fund structure or they will move away from wholesale. The banks are still not. So, where is this money going to…. The government's initiative of last mile funding is not big enough to really move the needle so much. So, where will that fund come from? Where will the credit start flowing? Any color on that would be very helpful.

Rashesh Shah: Exactly. The total requirement today of all the current projects – I'm not talking about the new projects. I think going forward, NBFCs will find it hard to do wholesale financing, not because of the economics of that business, but because of the ALM and the liquidity management of that business, which is what we have seen has got challenged in the last 18 months. The economics of the business will adjust and I think, there is still a lot of profitability that is where we are able to raise private credit funds. So, I think AIFs and funds will be one way of getting this capital for these projects. The other would be, maybe, the bond market or the high-yield bond market, if it gets developed, then people will be estimate. Third will be, I think people will recycle a lot, and that is what we have seen. A lot of the real estate developers have been selling their commercial assets being LRD on that and using that money for the housing project completion financing for that.

So, I think it will be a combination of all of that. You borrow against your assets which are earning and then use that to complete because a housing project financing is still a viable business, but it can't in an NBFC or a bank structure. The ALM and the NPA issues are too overwhelming to make it very profitable and scalable. In an AIF, you don't have an NPA issue, you don't have an ALM issue, and hence, you have, what I call, patient flexible capital, which can be appropriate for this kind of need.

Moderator: The next question is from the line of Aditya Jain from Citigroup. Please go ahead.

Aditya Jain: On the stress recognition and provisioning, how do you see this quarter? Would you call it a conservative level of stress recognition and provisioning done? Or are we still expecting a few more quarters of elevated trade costs?

Rashesh Shah: We have always guided. I think on a BAU basis, if the environment and liquidity situation remains like this, then I would expect at least another couple of quarters. Because, as I said, liquidity is still or I should not say liquidity, I should say credit flow is still fairly tight and that is why we are doing this whole exercise to try and overcome that availability of liquidity for last mile funding issue because that will give you an answer to how to manage it. Otherwise, I think for all wholesale books, at least another couple of quarters should be the expectation.

Aditya Jain: On the loss given default, the Stage 3 coverage is around 29%. I understand you will be doing the ECL exercise, but as of now, what is the view on the 29% coverage? Is it enough or do you think there is a need to raise the coverage?

Rashesh Shah: It is adequate. Our historic experience has been, when we did the batch testing on not just our portfolio, but real estate and others, we have seen that on collateralized and secured portfolio, 20% LGD is a good estimate. Because historically, loss given default has been 18% to 19% for collateralized wholesale portfolios. So, we think this should be enough. And we also looked at other banks and others on this kind of real estate portfolios.

Aditya Jain: The portfolio sales that have happened so far – you mentioned 7 projects in this quarter – have these happened at par or at a discount or premium to book value?

Rashesh Shah: This happened at par. And since we want to do a lot more of this, some will be good portfolios, some we can sell NPAs and others also or what we call accounts under watch, and hence, we want to do this ECL so that we can do this in a transparent manner. We'll do 2 to 3 deals, we won't do only 1 deal. There are many investors we are talking to because our idea is to be able to then have enough liquidity even within those funds so that you can complete the projects. The last one was at par.

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

Renish Bhuva: Sir, two questions. One is on our structure. Going forward, as you know, you have been highlighting that we will have a separate subsidiary or a holding company, which will cover the advisory and ARC business. But again, there will be multiple partners having invested in those entities. So, on a going-forward basis, if you can just highlight the broad structure of Edelweiss holding, which company, which business will fall under which subsidiary and how much Edelweiss as a group will hold in those subsidiaries would be of great help, sir.

Rashesh Shah: You had any other question also?

Renish Bhuva: Yes, sir. This is slightly on a longer-term basis. I can understand the current environment is leading to all this deterioration in earnings, but let us say after a year or so, what sort of sustainable business model you would like to have it on the balance sheet side? Maybe a credit business would be how much? Advisory and ARC would be how much? Insurance, what is your plan, etc.?

Rashesh Shah: On the first point, you're right. Our current idea is that Edelweiss becomes 3 companies, which is credit, advisory, and insurance. Currently, in credit business, we have CDPQ as an investor and we expect that they will own about 18% to 20% of that business. Assuming that on the credit business, 80% is Edelweiss and 20% will be CDPQ.

On the EGIA business, the 2 investors we have will own about 10% to 12%. All these are convertible structures. So, there is a range on what they will own, but they will own approximately 10% of that, and the other 90% is with Edelweiss as of now. So, when I say the EGIA business made a PAT of 151 crores, if you were to take that, you should assume that when they convert after they become equity owners, they will be 10%, we'll be 90%, approximately. These are very broad ranges out there.

And then we have insurance ETLI, Edelweiss Tokio Life, which we own 51% and they own 49%.

Our idea is that these are the platforms we have built, and we want to do the best-in-class partnerships. Along with this, we also do partnerships at a product level. So, we've got somebody like Meritz from Korea, who is a partner in the real estate platform. Then we have other partners in our other businesses. So what we have done is, at a product level, we'll keep on doing partnerships. And at an equity level, these are the 3 platforms at which if we need to raise equity, we will raise, and that has been our plan that we want to raise equity in these 3 platforms – insurance, advisory, and credit. And we own, I think, reasonably good chunk. We own 80% of credit, 90% of advisory. So, we have scope to raise more capital at that level.

The idea of that is that these businesses that have their independent boards, independent investors, independent capital structure, and independent governance because what happened until last year, the advisory business for whatever capital need they had, either working capital or margin funding or whatever else, they were completely dependent on the NBFC because they had no capital base of their own. We had not raised equity for them. So, the idea is that from now onwards, they become independently capitalized and they have their own balance sheet. They also run their own organizations underneath that. And that will be good from a focus, governance, and growth point of view.

Renish Bhuva: Sir, just a follow-up on that. Advisory business will also include ARC or ARC is a completely separate vertical?

Rashesh Shah: Currently, ARC is under advisory because the long-term nature of ARC is still the fee income. If you look at ARC even today, there is a fee income and there is an interest you get on basis of capital that you deploy. For example, you asked me about the long-term sustainable, we think, given the liquidity conditions and all of that, any good capital-oriented business should make about 14% to 15% ROE whether it's NBFC, credit, or whatever else, and a good advisory business should make about 25% to 30% ROE because advisory businesses may also require some capital from a working capital point of view and all that. So, when you add up the two, you can actually end up making a good decent 18% to 20% ROE, but you need a good combination of advisory and capital-based businesses.

If you look at ARC, whatever returns we are currently making, there is a fee part of it and there is a capital deployed part of it. And our idea is that ARC also increasingly will get more and more part of the earnings coming from the fee and the skill part of it rather than the capital part of it.

Renish Bhuva: Sir, when you say this 10% all put together will be held by investors, CDPQ is also part of that 10%?

Rashesh Shah: No, CDPQ is not in the EGIA level. They are in ARC because as I told you earlier, ARC when we started the business, we were allowed to own only 49%.

Renish Bhuva: If we include CDPQ in this new structure, what will be the Edel's share post CDPQ conversion to advisory level?

Rashesh Shah: It's there in the presentation. We own currently 60% of the ARC. EGIA will own about 60% of ARC and that's the only minority they will have for historic reasons.

Renish Bhuva: Sir, just 1 question on the press release. In note #8, we have said something that CDPQ has actually exercised the put option under ARC. What is that sir?

Rashesh Shah: They had an option to sell 10% to us in ARC. We've been keen to buy it. So, we've also been encouraging them to do that because, as you also correctly said, ideally we would like to own as much of ARC as possible so there is a complete unity and clarity of structure. So, we will basically figure it out on how to slowly and steadily increase our holding in ARC.

Renish Bhuva: Of course, it is subject RBI approval, but let's say if RBI agreed to this, then Edel will hold a 70% in ARC, right?

Rashesh Shah: Yes, EGIA will own 70% of ARC.

Renish Bhuva: Sir, just a last question, again, on the press release. There is a line item called change in valuation of credit loans which is basically a revaluation of the ARC assets, which actually have gone up from 87 crores to almost 215 crores in this quarter. Which assets or which sector is actually leading to this sudden spike in the valuation or a drop in valuation?

Rashesh Shah: I don't have the details here, but if you contact our IR team, Ramya, she'll be able to give you the details on that.

Renish Bhuva: Okay, sir. I will take it offline.

Moderator: The next question is from the line of Avinash Singh from SBICAP Securities. Please go ahead.

Avinash Singh: A follow-up on the advisory business on this wealth management and asset management. About a year back or so, you had sort of guided basically that broadly, with the scale achieving, your PAT yields on these 2 businesses will reach more in the band of 20 basis points or over the AUA or AUM. In this quarter, again, that has become much weaker, and also in the asset management piece, particularly with the ETF, of course, the composition had changed. So, what kind of or sort of PAT yield going forward you see on a stable basis in the wealth management and assets management businesses?

Rashesh Shah: I think you are talking about slide #22, right? I think on a long-term basis, if there is a lot of ETF, then obviously asset management yields will come down. The other thing in asset management, you should remember, we have a lot of alternatives out there. And in the alternative asset management, there are 2 things that happen. One is, you get paid in credit funds only on deployed capital. We have almost about 10,000 crores of undeployed capital in that. As we deploy that, our costs will not go up, but the fee income will go up. So, that will improve the yields as we go forward. And the second is, whatever has been deployed, when you exit, you start getting a carry on that. So, maybe this is a good time to just spend half a minute, when you do like this wholesale credit kind of a business, when you do it in an NBFC, there is usually instant gratification because from the point you book the loan, you start earning money. You get your processing fee and you start earning money. In fact, on wholesale businesses as we have seen, usually you get the profit upfront and if there is a deterioration in environment, you get the credit cost afterwards.

In the same wholesale in an asset management format, when you raise the fund, you don't earn anything. When you deploy the money, you start earning the management fee where your profitability is lower because all your expenses come out of that. And when you exit is where you get the carry. Usually, half your fees is management fee and half your fees is the carry in a credit AIF. As a result of that, a lot of your profit is back ended. So, I think asset management, given the alternatives mix we have and all that, we still think about 15 to 18 basis points of PAT yield should be possible on a steady-state basis when you have got your deployment cycle and exit cycle stabilized. We have been accumulating a lot of assets in the last 3-4 years. A lot of these assets are not yet deployed, and obviously, a lot of these assets are not yet exited also, but because these are credit assets, you can estimate the yield on them unlike equity assets where it can vary a lot.

So, I would say, on the whole, for asset management, I think 15 to 18 is what we would aim for, and for the wealth management, I would say about 14 to 15 should become steady state. We are currently at 11, but I think we should aim for about 14 to 15 on that.

Moderator: The next question is from the line of Amitabh Sonthalia from SKS Capital. Please go ahead.

Amitabh Sonthalia: I just had a quick question on your bond deals having your debt papers that have been issued by Edelweiss. There has been some spike in that in the secondary traded securities. I was wondering if you have any comments on that and is that having an effect on your incremental borrowing costs?

Rashesh Shah: As you know, I think in the last 1 year, the bond markets have been highly dislocated. And unfortunately, dislocated bond market with a kind of the volume and the liquidity and depth that is there, I personally think the bond markets will stay dislocated for at least another 3-4 quarters because I think the mutual funds, and all are still grappling with their bond portfolios and their bond strategy and credit analysis and all that. We are able to raise bonds from other investors – retail, HNI, and all – and you would have seen we continue to raise.

Our current yields are about between 10 to 10.5 or around that depending on tenure. Usually, we think that should be the yield. Ideally, the yields should have come down because the current yields we are paying on fresh borrowing of bonds is about 80 to 100 basis points higher than what we were paying 18 months ago. And in these 18 months, yields have come down by another 80 to 100 basis points. So, ideally, there should have been a 200 basis points difference. That is the higher yield that is there, part of it we have been able to pass on to our customers. But we also don't want to excessively pass on and then have some future credit quality issues.

The other thing is, on the bond yields in the market, it's like stock price. I think on any given day, there is somebody wanting to sell at any price because they need to exit, or they need the liquidity. We look at steady state and we look at the fresh borrowing that we are able to do. We currently don't need a lot of liquidity because we are also not disbursing in a very aggressive way. We are still continuing to disburse on the retail books. But given the environment, we don't want to be very aggressive because we don't know whether these liquidity conditions or these credit flow conditions can have an impact on retail and SME books also in the future.

So, the idea is, until things stabilize, to be conservative. I think the liquidity environment has stabilized. The credit flow environment will take another couple of quarters to stabilize. The bond market will take maybe another couple of quarters after that to stabilize. That would be our outlook.

Amitabh Sonthalia: As a follow up on that, the fact that you have some listed bonds trading at 17% to 18% type of yields, it has a negative signaling effect for the group. I'm just wondering if there's anything you can do in terms of buying back some of those bonds you're providing. I understand that those bonds which are traded may be very liquid and therefore not a very firm reliable indicator....

Rashesh Shah: It's also a function of duration. We are very clear. Our board has said, use your liquidity first for meeting contractual obligations and we remain extremely focused on that. The second is, use your liquidity for customer needs because customers come first. If some mutual fund wants to sell a 25-crore bond and wants to sell it at a high yield, we should just accept it because trying to stand there and trying to defend it is not a good use of your liquidity nor a good approach on this because if there is a 2025 Edelweiss bond which is trading because our ALM is based on that. When we issued the bond which is maturing in 2025, we have disbursed money according to that. Now suddenly going out of turn and starting to buy that, how will you ever manage your ALM? And your creditors are more also focused on saying, can you meet your contractual obligations and all your liquidity should go towards that. So, if you look at our ALM slide, we have focused a lot more on that. I think for either ego reasons or whatever else because honestly, I can tell you, as long as the bond market is dislocated, raising money in bond market will not be easy even if you go and buy your own bonds at 18%. I don't think it's going to make a huge difference to you. But you don't want to use the liquidity. We are clear. First call on liquidity is the contractual obligation. Second call is your customer needs. And after that, if you have, then you look at other things like growth or stabilizing market and others.

And by the way, the ones you're talking about are here and there on and off because a lot of bonds are trading at 10% to 11% also on a steady-state basis. We do monitor that, we are not obsessively focused on that.

Moderator: Ladies and gentlemen, that was the last question for today. I now hand the conference over to Mrs. Ramya Rajagopalan for closing comments. Thank you, and over to you.

Ramya Rajagopalan: Thank you everyone for your time today for our Q3 analyst call. We come to the end of the call for today. But if you have any further questions or require information, as always, please do not hesitate to contact us. You have our number, 61879505, or you can write in to us at ir@edelweissfin.com. Thanks again for your time, and good afternoon.

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