Edelweiss Financial Services Limited

Q2 FY25 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day, and welcome to Second Quarter FY '25 Earnings Conference Call of Edelweiss Financial Services Limited.

As a reminder, all participant 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 the touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Priyadeep Chopra – President, Edelweiss Financial Services Limited. Thank you, and over to you, ma'am.

Priyadeep Chopra: Thank you, Rutuja, and good afternoon everyone. I wish you all a Very, Very Happy Dhanteras. A warm welcome to our Earnings Call for the quarter-ended September '24.

Today on the call, we have Mr. Mr. Rashesh Shah – Chairman, MD of Edelweiss, and Ms. Ananya Suneja –Chief Financial Officer of Edelweiss Financial Services.

We hope you all have had a chance to review the "Investor Presentation" as well as the "Strategic Overview Presentation" that we filed with the exchanges today.

During the discussion, we will be making references to it. Please do take a moment to review the Safe Harbor statements in our Presentation. We will be making some statements today that may be forward-looking in nature and, hence, may involve certain risks and uncertainties.

With that, welcoming you all, and I will hand over now to Rashesh to begin the proceedings of the call. Thank you, and over to you, Rashesh.

Rashesh Shah: Thank you, Priya, and a very good afternoon to all of you and a warm welcome for this Earnings Call. All of you, I am sure, have a fairly busy schedule, but the fact that you have taken the time, we are very grateful for that. As Priya said, wishing all of you a very Happy Dhanteras.

As with earlier calls, we just wanted to keep this call slightly briefer and keep more time for Q&A because I found that the questions and the interaction with all of you has been actually more enriching for all of us than just the commentary where we repeat what is in the investor presentation. So, I hope you have got a chance to see the investor presentation.

But broadly on the call, I think on the economic front, most of us are aware, Indian economy has had a little bit of slowdown in Q2, but overall, it is actually relatively doing pretty well as compared to the world. The interest rates are expected to come down. Everybody is waiting for that, but obviously, there is inflation pick up and some mutation in credit growth and deposit growth, but overall, the economy is in good health. The banking sector, the RBI finances, the government finances, everything is in a good place. The corporate balance sheets are very healthy.

At Edelweiss, we had a good quarter. Consolidated PAT has grown by 45% on a Y-o-Y basis to 110 crores, and what we monitor more is the ex-insurance PAT because we are still investing in the insurance businesses and hence there is a loss associated with the insurance businesses. So ex-insurance PAT came at 163 crores for the quarter.

Overall, our balance sheet continues to become more robust. We have very strong capitalization of all the businesses. As you know, in the last few years, there is a first thing we ensured that we had capital adequacy and solvency across all the businesses and our customer franchise continues to grow. We have now reached about 91 lakh more than 9 million customers and our total customer assets are at the 2.2 trillion mark, which has grown at about 12% Y-o-Y.

I just broadly want to just explain the four blocks of Edelweiss construct. As you know, we have seven businesses and we have the corporate balance sheet over and above that, but we also internally look at our businesses and blocks.

So, the first block is the asset management block, which has two businesses, Alternate Asset Management, which is EAAA, and mutual fund. And as we have spoken, EAAA has had a good quarter. There is a 20% growth in ARR, AUM and a 70% growth in PAT, CAGR over four years.

So, as we have been highlighting EAAA, the foundation has been laid. Now we are getting ready to significantly grow profit, and we think we should be able to maintain a 20-ish percent growth profit CAGR for this business over the next five years, and it can also bring a lot of free cash flow because now the funds are of a decent size, the profit has grown. So, EAAA is in a good place, good growth of strategies, which are yield and income oriented in private credit and real assets are doing well.

The other block of asset management is the mutual fund. So, mutual fund also, we are the third largest AMC. Our equity AUM has grown by 60% CAGR. As you know, we are focusing on not only overall AUM, but equity AUM. And the idea here is both these businesses, the first block of asset management, both EAAA and mutual fund have had good creation of what we call intrinsic value. And now ideas as they grow their profit and in this heuristic phase, we also unlock some of the value. We also, by setting some state monetizing it, try and also reduce the corporate debt in Edelweiss.

The second block we have is our insurance, the two insurance businesses. We have collectively invested almost 4,000 crores across these two businesses, almost 2,800-odd crores in the life insurance business, out of which about 1,200 is from Edelweiss and the balance 1,600 odd is from Tokio Marine. And in the general insurance business, we have invested close to 1,000 crores up till now.

So, a fair amount of very heavy investment has happened in this, 3,700 cumulative capital invested. Both these businesses and the losses have been reducing now and we are getting closer and closer to the breakeven. We remain confident to achieve breakeven by FY '27, and this is going to be an important step to get there. And after we get there, unlocking down the value will start after that. So, our current objective on insurance is to get to breakeven by '27.

Our third block is our credit businesses, which have three of them, ARC, NBFC and Nido Housing Finance. In this business, we are adequately capitalized, or I must say actually more than adequately capitalized. We have an equity of cumulative of 7,500 crores and we are currently achieving only about 5% collective ROE on that, a large part coming from the ARC business. But overall, we need to improve ROE, reallocate capital if required and make it the right size of that.

And the fourth block we have after the credit block is the corporate debt, where we had a peak consol debt of 40,000. Our current corporate debt is about 5,500 crores, which we want to bring down even further and in the next 18 months, we will get down to below 3,000 or 2,500 crores. And for that, as we said, the asset management business is both mutual fund and EAAA could be used to sell some stake and use that capital for the reduction of debt.

We also in this current quarterly presentation, investor presentation, have attached an addendum, which is a strategic overview on businesses, which highlights some of the things that I have said and that could also be very useful. That addendum is for giving a slightly broader strategic view on the businesses rather than the quarterly performance and the quarterly parameters.

So, a quick update on some of the other important items:

On EAAA value unlock, we are working on the 10% to 20% stake sale. We are evaluating an IPO process on that and very soon we will be able to come back to investors and give a timeline and a schedule for the EAAA stake sale and the value unlock.

On the RBI order, on ECL Finance and EARC, which came out in end of May, we are engaged with RBI. Both the boards are monitoring progress. Almost everything that RBI would have liked to do, we are implementing it and also giving that progress report to RBI, and we do hope that very soon all the requirements that RBI has in terms of process, overall and all, in both the businesses will get done, and we will hopefully convince RBI that whatever checks and balances were required have been put.

In the meantime, EARC, we are not acquiring fresh assets, but recover is continuous plan. And in the first half of this year, we have made 2,800 crores of recoveries in EARC. In ECLF, we continue to reduce the wholesale book in the normal course of business and the book is down by 34% or 3,700 crores now.

We also have update on each of the businesses in the investor deck. Again, it is the same thing. Both the asset management businesses continue to grow. ARC focuses on the recoveries. NBFC is working through the RBI order and reducing the wholesale book. Nido Housing Finance is still slowly and steadily scaling up. We remain very bullish on that. This business is very well capitalized, but co-lending is a key vector for growth and our partners, especially State Bank of India, are putting a lot of things in place which will allow the co-lending to grow. And both the insurance business has done well. Zuno in this quarter grew at about 27%. The industry grew at only 8% to 9%. So, we are still growing at 2 to 3x the industry in the Zuno insurance business.

In the life insurance, we had a 14% growth. APE has come in at 130 crores for the quarter. The AUM has become 8,700 crores for the business. And we focus on persistency, which is at 78% and claim settlement, which is at 98.8%.

So, broadly, just executing as per plan, there has been steady growth on all the key matrices across businesses. And our idea is to get the businesses to grow. All the businesses are at a different stage. They have different issues to grapple with. And at an Edelweiss level, focus on reduction of debt, make the balance sheet more robust, maintain more than adequate liquidity. And we think the next five years from now to 2030 is the horizon we want to take and focus on building the organization and making it ready for that.

So, along with that, once again, thank you to all of you for being on this call. Also wishing you all of you a very Happy Diwali. And we will open up for any questions that you may have. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Rahul from StockEdge. Please go ahead.

Rahul: I have two questions. First, in your AGM deck, you mentioned about some 6% stake sale in Nuvama for 1,500 crore in the last month. And we have another 1,800 crores stake over there. So, are we planning to utilize the entire proceeds towards repayment of debt? And we might see, can we see some decline in Q3?

Rashesh Shah: Yes, whether we do it in Q3 or Q4, but yes, the remaining stake sale is also earmarked for reduction of debt.

Rahul: And another question is, like you mentioned about stake sale in your mutual fund and insurance business. So, can you throw some light on that? And what are the expected timelines?

Rashesh Shah: So, our current plan is to do both of them in the next 18 months. Most likely though, we are still evaluating both a private stake sale option as well as an IPO for EAAA. And in the next three or four weeks, we should be able to finalize whether we want to do a stake sale or an IPO. Either way, I think the EAAA should be in the next two or three quarters. And the mutual fund should be another two, three quarters after that. So, in the next 18 months, we would like to do a stake sale in both the mutual fund and the EAAA.

Moderator: Thank you. We will move to the next question, which is from the line of Varun Kumar from Flowering Tree Investment Management. Please go ahead.

Varun Kumar: So, I had a question about the life insurance business. If you could elaborate on the timeline regarding the breakeven in that business and the path forward?

Rashesh Shah: So, as we have said, I think FY '27 by the third or fourth quarter of FY '27, we should get the accounting breakeven. As you know, we are already at embedded value breakeven. So, about a year ago, we hit embedded value breakeven. So now that goalpost is behind us. The accounting breakeven, we are expecting in the third or fourth quarter of '27, we are also hoping that IFRS is implemented for insurance companies. And if IFRS is implemented and we get there, then we think we can get to breakeven about two to three quarters earlier than that also. But current target is by end of FY '27, under the current accounting rules.

Varun Kumar: And on the EAAA, if I heard correctly, you said two to three quarters is when we would do a stake sale or some kind of capital raising in that business.

Rashesh Shah: Yes. I think we would look at some time around June of 2025, because anywhere whether you do stake sale or anything, it takes four to five months IPO, it takes four to five months for closure and everything, right?

Varun Kumar: Yes.

Moderator: Thank you. The next question is from the line of Praveen Agarwal, an individual investor. Please go ahead.

Praveen Agarwal: So, the first question that I have is regarding the alternative business. So, can you give us some insight on the players which are there in the industry in the alternative asset management space? Who are the typical peers that one can compare Edelweiss to? And also, a lot of fund houses are entering into this space, as you can see in market. So, going forward, do you think there will be a lot of competition? What is the view on this?

Rashesh Shah: So, I think it is a good question because alternatives is a new business and very few people have put their arms around and very few research reports are there. So, I would say, we are in alternatives, but in one category of alternatives called income and yield strategies. So, in alternatives, you also have private equity. So, we are not in private equity.

In private equity, there are a lot of Indian players and foreign players, including Blackstone, Kalaari, Innova, Pincus, Multiples, True North, ChrysCapital. So, they are all in private equity. We are not in private equity. We are in what we call income and yield solutions, which are mainly private credit and real asset funds.

Now in this, the Indian players, asset managers who are there, one is Kotak. Kotak is fairly big in this. There is IIFL Wealth, which is 360 ONE Wealth. They have a few AIFs also in this category, a private credit fund, absolute return funds and some real assets fund. Then we have Piramal has a couple of funds on that. So, HDFC has, HDFC has for real estate.

So, in the non-equity alternative, so one alternative is the private equity and the other is what is not private equity, which are usually income and yield solutions. In that, it's mainly Edelweiss, Kotak, HDFC, Piramal, 360 ONE in the Indian players.

Among the foreign players, there are people like Blackstone in real estate, like the REIT business and all. There is Brookfield. There is Actis, and there are people like Oaktree and Salarian and Cerberus. So, there are international players and there are Indian players. So, it's a fairly robust set of people.

There are a lot of people who are also raising funds, but amongst people who have larger size, people who are, let us say, more than a couple of billion dollars would be all of this. There is Oaktree, Cerberus, Brookfield, Blackstone on the international side and Kotak, Piramal, HDFC, 360 ONE on the Indian side.

In this business, I would look at one parameter is how many people have crossed $1 billion of AUM. So, a lot of competition is people who have 1,000 crores fund, 1,500 crores, 2000 crores fund, and a lot of them can also grow, but to break through to $1 billion AUM, especially fee-paying AUM, or what we call ARR AUM is the first threshold that people cross. So, if you look at, if you want to analyze competition for EAAA, I will look at people who are in the $1 billion plus category.

Praveen Agarwal: I have a follow up question on this. So, very recently, SEBI has also introduced this new asset class, which is basically an alternative product in the shape of smaller ticket investments. Any thoughts on this? Will Edelweiss be participating in launching any products under this category?

Rashesh Shah: That will be in the mutual fund, and we will definitely want to look at it. Our early-stage analysis for that category is that a lot of that is going to be basically proxy or eating into the PMS and equity AIF market. As you know, there are a lot of equity AIFs out there, and there is a PMS where there is a lot more flexibility out there. Obviously, very similar products on the mutual fund platform will have income tax advantages and all that as compared to AIF. At least on equity AIF, there is a lot of grey area in terms of the capital gains tax session and all that. And the same thing, PMS, where the individual client pays tax is there can be a pooled vehicle inside the mutual fund but offers the same thing as equity PMS and equity AIF structure could be more efficient and could appeal to a very new class of the investors and can expand the market. But we think this new asset class under mutual fund is going to be for equity oriented strategies.

Moderator: The next question is from the line of Siddhartha Shah, an individual investor. Please go ahead.

Siddhartha Shah: I think you mentioned just evaluating the stake sales maybe to a strategic versus an IPO. Can you help us understand what are the key criteria you are looking at to make that decision that would help unlock better value for the shareholders?

Rashesh Shah: So, on the strategic there have been two options. One is strategic who want to be in the alternative asset management business in India. And the other there are PE funds or stake, there are what are called GP stake funds who like to buy stakes in an alternative asset management asset manager. So that we have been evaluating. We have been in conversation with some people.

The key issues on that are the strategic value and the cost and benefit of that because a lot of strategic players also come with their own agenda, their own requirements, whether you can access their markets and not access their markets and all of that for investor money and all that. So, there are a lot of complications on that which you have to evaluate, and that's case to case.

We would ideally like an investor who buys the stake but does not put any business restrictions on us on terms of product introduction or market access or even our ability to do an IPO in the future. There were some strategic players who would like not to IPO at all and give them an option to buy. So, we are looking at all those considerations on that.

On the other side, as you know, Indian IPO market is very robust, and the business has also grown in the last two, three quarters as we have been in conversation with some investors. So, the other alternative ways which we are evaluating is to do an IPO in India, which still allows us to do a stake sell, also allows us to maybe sell 8%, 10% to a strategic partner if we so want, who can be a partner in that business and 10% we can create win-win opportunities with them. But at the same time, our primary route is IPO.

IPO has its own pros and cons. But a year ago, we thought the business was too small and early for IPO. But in the last two quarters, and three quarters, the business has grown a lot. And if you look at an IPO in the next three quarters, we expect the business will grow also along with that. So, as you know, this business now is at a profit run rate of about 250 crores of PAT a year and can grow at about 20%-25% a year. So, at that trajectory, now it is very IPO able.

So, we are just evaluating the pros and cons of IPO on one side and what I call a private market stake sale on the other side.

Siddhartha Shah: And if I understood correctly, even if we choose an IPO with filings and everything, this will still happen by June 2025 or so.

Rashesh Shah: Yes, I think three quarters either will take. Whether it's a stake selling the private market or IPO, I would expect three quarters from now is what it would take.

Siddhartha Shah: And maybe just one last small question. You know, I think earlier you used to report FP AUM and you have changed that to ARR AUM now. Is there any difference between the two?

Rashesh Shah: Yes. So, what happens is the ARR AUM is the AUM on which we are earning fee, or we will in the near future earn fees. While the FP AUM was only the ones where we are currently earning fees. And so earlier we had AUM, which was a more just a historic number. There was some AUM in that where we were not going to earn any fees in the future because those funds had completed the investment phase. So, the AUM did not give a clear picture on what is the fee-earning and the fee earning potential of the AUM.

So, ARR AUM is where we earn fees or will earn fees. And on that basis, we just calculate the ratio on that, which is because the investors wanted to know what are our yield ratios, how much is our fee upon AUM. So, either look at AUM or overstating the AUM, a fee paying AUM, understating the AUM. So, ARR AUM gives the right picture of what is the fee we are earning and can earn, and what is that AUM in that sense.

Moderator: The next question is from the line of Niranjan Kumar from Equirus. Please go ahead.

Niranjan Kumar: First of all, congrats for a good set of numbers. Sir, can you please give a brief update on the RBI order in the ARB business? Like what's the status and when do we foresee that the regulator to lift their restrictions?

Rashesh Shah: So, as you know, in ARB business, RBI has said we can't acquire new assets. We can still continue recoveries, and I have said recoveries are doing very well. We have recovered almost 2,800 crores in the first half. Anyway, asset acquisition was going anyway on a slow burn because as you know, there are not too many NPAs in the market in any case. So, RBI wanted us to strengthen some processes, some Board level processes, some framework, some valuation certificate, all of that as part of the deal. Even some of the structuring when we structure a deal for acquisition, how it is done and all that.

So, there were a lot of things they have asked us to do. We have completed a lot of that along with their RBI just completed their annual inspection also. So, we were also waiting for them to complete their annual inspection. So, even the inspection report, they will give us a task report very soon. So, we are, I think, pretty ready to, we have already submitted to RBA that we meet all the things that they have asked. So, if they come back and ask us to do a few more things, we will have to add that.

But it's been about five months, and so there is no timeline to that. We think we should hopefully get this. Again, it is very hard to say what exact date, but we are very actively engaged with RBI, and we have started with a point that whatever RBI wants us to do, we will complete that as fast as possible. So, given that approach, I do think that we should be able to hopefully get the order lifted from RBI. But we just have to wait and complete all the things that RBI wants.

Moderator: Thank you. The next question is from the line of Aman from Dolat Capital. Please go ahead.

Aman: Currently around 50% of alternatives AUM is contributed by offshore clients. Can you give some update on which geographies we are currently operating? Any plans to enter new regions? And on a steady state basis, what will be the ideal offshore to onshore mix? And is there any difference in pricing for offshore and domestic clients?

Rashesh Shah: So, on the first one, a lot of our current clients are from North America and the European continent. I think almost all our offshore clients are from North America and European continent. We are just getting some early investors from Far East now. But we have been doing a lot of coverage in Australia, Far East and the Middle East also. We do hope that we will get some new clients from this area.

But in international markets with institutional clients, the coverage period is about four to five years. So, we started our coverage for the European market, Scandinavia and the European market in 2011-12. And by '16-'17, we had about five or six large insurance clients out there. Same thing in America, we started in about '12-'13, and by '17-'18, we have some clients in America, North America, Canada, all of that.

So, we currently are very strong in these two geographies. But last three years, we have been investing a lot in Australia, Far East and the Middle East. So, we hope that in the next couple of years, we should also get that.

The nuance of international market versus Indian market is that the international market is largely you have to do your own coverage. You build relationship with institutional investors. Most of the investors are institutions, and it's a more B2B coverage kind of a thing. In India, most investors are high net worth investors and family offices, and usually you go through a wealth manager. The pricing is more or less the same.

The distribution cost in the first one is in-house, while in India, it is outsourced. But if you look at the cost, the India cost is slightly higher distribution cost than the international one. But India has some other advantage in terms of tax and all. Your hurdle rate and all that are more pre-tax and all of that because internationality, it is after tax and all that. So, it just makes up for that. The broad profitability of both these client-based, onshore and offshore is more or less the same.

I must also add that internationally, it's been institutional clients, but now we are starting to see individual and family offices internationally also looking at India alternatives. And in India, it's been mainly HNI and family offices, but first time we are starting to see institutional clients in India, mainly insurance companies and pension funds also now looking at investing in AIFs and all.

So, it's going to be an interesting journey for the next four, five years. And as I said, both in-house and third-party versus onshore and offshore, it's a matrix, but we have actually shown that we have covered all of that, our in-house coverage for international clients, our third-party partners and distributors for Indian clients. So, we know how to manage it. There are a lot of bells and whistles in managing it and all that. And we have currently at least experience on both of them, in-house and outsourced third-party distributor partners.

Aman: What will be the ideal offshore to onshore mix then?

Rashesh Shah: I think it will change from year to year, but we think the steady state will be about 55 to 60 offshore and 40 to 45 onshore.

Moderator: Thank you. The next question is from the line of Ritika Dua from Bandhan. Please go ahead.

Ritika Dua: Some more basics I wanted to check on the AIF piece. So, firstly, when we actually look at the profitability and just trying to maybe look it at on a PAT to AUM basis, I know it's a scaling business, but how should we look at like a scaled-up profitability for this entity?

Secondly, even in terms of growth opportunities, as you have been alluding, like, you look to maybe diversify on the distribution. On the product side also, what products can get added here to understand that how the AUM in this piece can continue to grow? So, two questions around this.

And secondly, on the mutual fund business, obviously we have grown very healthily. Just some numbers around how do you look maybe the profitability also may be catching up on this piece? So, that's the second on mutual fund.

And lastly, on the ARC, I missed your comments, I think somebody did ask, but some views around you have written in the presentation that this will also be, this will incrementally be an asset light model. I think, another large peer of yours who is also into ARC is getting into asset light. So, where is this industry really getting into from here? And how should we see Edelweiss ARC also maybe growing? So, three questions, and I will come back.

Rashesh Shah: Again, I have to write down all three ones. So, the first one was on the profitability of EAAA. I forgot the second one. The third one I have on ARC.

Ritika Dua: Yes, the first was the profitability and growth prospects of EAAA. Second is that how should mutual fund, now that is a considerable size, how should profitability move there? And the third was ARC getting into asset light and even another peer is getting asset light. So, where is the industry heading ? So, these are the three.

Rashesh Shah: So, on the first one, see, I think alternatives have two levers of profitability, one is the fee and one is what is called the variable fee, or the carry part of it. On average, an alternative funds on your ARR AUM, you make about 1.5% as your gross yield, as an yield and you have a cost-income ratio of about 50%, very broadly.

So, if you make about between 60 to 70, and if you study the results of 360 ONE or even Motilal has a fairly, also an alternative business. All of them, I think the average profit is between 0.5%

to 0.8% of the AUM, PAT level, PAT, if you calculate, sorry, PBT level. So, I think PBT is about between 0.5% to 0.8% of the AUM in an alternative business.

If you look at it in the mutual fund, it is usually about 15 to 20 basis point. In alternatives, it should be 50 to 80 basis point. We are currently averaging about 70, 75 basis points as profitability. And we think that that is maintainable. Maybe quarterly ups and downs will be there, but overall, on an annual basis, this is the profitability, basically, PBT upon AUM is what you should get.

In terms of growth, since we have a lot of strategies and we are across private credit and DL assets, we currently have about 11 or 12 strategies and we are always raising new funds all the time. So, it's not like a private equity where you raise one fund and for four years don't raise any other fund. This is because it's a multi-strategy approach. We have quite a few strategies which are on the road raising money.

If you look at the last two, three years, we have raised about 14,000, 15,000 crores every year. We have deployed about 8,000, 9,000 every year, and we have excited about 5,000, 6,000 every year, just on an average, if we look at the last. So, these are three important parameters to look at from a growth point of view. And when you do all of this in this way, getting a 20% PAT growth is what we think this business is capable of going forward.

To answer your second question, from the mutual fund, you are right. We have been investing a lot in scaling up the mutual fund, especially the equities business. If you see the equity AUM in our mutual fund has grown pretty well on a Y-o-Y basis. Currently, we are making about 4 basis points of AUM as our PAT. Our target is to get to between 10 to 15 in the next three to four years.

Our current cost-income ratio holds at about 85%, 86% because we are still investing and the scale-up is happening now, but on a long-term steady state, we would like the cost-income ratio to be around between 55% to 58% in that business which is the industry average. So, if you can scale up the AUM, bring down the cost-income ratio, we think the profitability of a mutual fund between 10 to 15 basis points is achievable. It will take us about 2, 3 years.

We are also adding more offices. We opened 8 more branches in this first half. So, we are also opening We are now currently present in about 40 odd branches we have. We want to go to about 100 branches. So, there is going to be a fair amount of investment we will continue to make, which will keep maybe profitability slightly lower, but it's a good investment to make in that sense. So, that's our plan on the mutual fund side.

And on ARC we also want to be asset-light, but the current problem with ARC is on two fronts. One is there are not a lot of good quality assets available that you can buy. And the other is, even if you buy them, your capital is mainly coming from equity, because there is not a lot of borrowing that you can do.

So, if you think of ARC as also another form of NBFC, it is not able to gear itself. If you look at our ARC also, at the peak was geared 3 is to 1. Now it is currently geared at 0.2 is to 1. So, what has happened? ARC, even if you become asset-light, you can make about 5%-6% ROA, about 6%-7% ROA, but even if you make a 7% ROA and if you can be geared 1 is to 1, you can get to 14% ROA. But if you can make only, if you can gear only 0.2 or 0.3 or 0.4x, then getting to more than 8%, 9%, 10% ROA is going to be harder.

So, the problem here is going to be, on one side, there is not a lot of assets available for growth, and the other side is your balance sheet structure, because of the lack of borrowing availability, your ROEs will be subdued, though your ROAs can be very healthy. So, that's the current challenge, all of us have to grapple with it. Maybe if you become asset-light, you can increase your ROAs a little bit more, but eventually getting to more than 10%, 12% ROE is going to be a challenge in this business. And that is currently what the industry is experiencing.

Ritika Dua: If I can maybe ask two more questions. Sir, coming to the, just like maybe on the ARC front, any expectations on any past assets that we had bought and maybe any write-downs may be expected of them still, and so what is the, maybe from a write-down perspective, any further expected here on the ARC front? And also, on similar question on the wholesale book also, it has run down materially, but of this number, if I am not wrong, some 3,700 odd crore wholesale NBFC, what are the further hits that you expect?

Rashesh Shah: So, on ARC, we are fairly okay in the sense because we, by the time you acquire an ARC asset is acquired, it's already an NPA. So, usually you can price it pretty well because now there are no more unknown unknowns in that sense, because when an asset is standard goes to NPA, the real markdowns and all that happen. Once it is an NPA, then you keep on calibrating the value of the SRs on a quarterly basis with the cash flow. So, the book on the whole in ARC is fairly well marked. And usually, it's fairly has been consistent in that sense.

Again, I think ARC partly gets the money out of the assets it owns, and partly gets out of the fee and the incentive and the carry that it gets. So, as I said, on that basis, our ARC is making about close to 100 crore PBT a quarter. And if you go back and see the last five, six quarters, it has consistently been in that range, and we expect to stay there. So, ARC will be able to make about around 100 crores PBT every quarter. There won't be a lot of growth in that business, as I said, because no new assets are getting acquired, but there won't be any significant markdown because that is not the big thing in ARC. The assets are usually fairly well marked and at a portfolio level, we have not seen any markdown in the last three or four years. So, that's on the ARC.

On the NBFC, we have the wholesale business is now the non-continuing business. So, it is now going straight to the balance sheet. We have 3,700 crores of the wholesale book remaining, but against that, we have 3,500 crores of equity also in the NBFC business that we have. So, we think a large part of the wholesale book is equity funded and we do a quarterly mark-to-market on that. So, we keep on looking at the cash flow. We keep on marking it conservatively. So, as and when we feel that the marks have changed because the cash flows have either got delayed or the quantum is changing at a portfolio level, we keep on calibrating it every quarter. As of now we don't see any big structural things on the wholesale side, but as I said, it is a non-continuing business. So, everything is now at the balance sheet level in the wholesale business.

Moderator: The next question is from the line of Kshitij Saraf from Tusk investments. Please go ahead.

Kshitij Saraf: I am a little bit new to the company. So, pardon me if this is a very basic question, but just wanted to understand the net gain on fair value changes to the tune of 1,300 odd crores. Just thought there is a mark-to-market on MTM and at the same time in insurance services, we see another component which is registered at June. But just to understand what would be the breakdown and how this is reported?

Rashesh Shah: So, I don't have the details of the exact breakdown, and if you want offline, our CFO Ananya can be happy to take you or anybody through that on what is the exact on the components of the breakdown. In this quarter, obviously, there was a mark-to-market gain on the Nuvama stake that we are owning because as you would have seen, the stock has gone up in this quarter. So, it was part of that, and the mark-to-market in the Nuvama stake, we sold part of that also. So, part of that is a fair value gain. We also have all the SRs and all we have which also get marked. As I said, every quarter they get marked accordingly. So, the exact break up on that maybe Ananya can give you offline if you contact her.

Kshitij Saraf: That's fine. And on the insurance business, there is an investment income and other income in both Zuno and life insurance. So, what sort of investments are sitting here because in life insurance the investment and other income is almost 340 crores in this quarter?

Rashesh Shah: I wouldn't know that. Ananya, are you on the call? Can you explain that? The insurance investment income?

Ananya Suneja: So, the insurance businesses obviously have, once you have collected the premium, you invest a set of assets against the long-term liabilities you have. These investments are held at value and are mark-to-market. So, what you are seeing on that line is the mark-to-market on the investments that the insurance business holds.

Kshitij Saraf: And primarily treasury sort of asset or are these like fixed income generating assets?

Ananya Suneja: No, so it is on investment assets. So, everything according to Ind AS, which is fair value and mark-to-market every quarter is what you see on that line. That is also true for your other question across all our businesses. So, I am happy to walk you through a business wise break up of that line at a later point, but the idea is to for mark-to-market.

Moderator: Thank you. The next question is from the line of Deepak Agrawal from Param Capital. Please go ahead.

Deepak Agrawal: So, sir, my first question was on the Nuvama lines of business. So, obviously, we will be selling our entire stake in whatever a quarter or two. So, some of those fee income line items like broking and wealth, so any thoughts there, is there any non-compete clause, anything you can share there, sir?

Rashesh Shah: So, currently we don't have any. The Nuvama income doesn't come because a year ago when we demerged the business, it was already deconsolidated from Edelweiss. So, right now in the Edelweiss consolidated, there are no line items of Nuvama. The Nuvama shares we own is just an investment, liquid investment category for us, and it's mark-to-market like any other investment instrument. We don't consolidate the Nuvama results with us since the demerger that happened almost 18 months ago. So, that's on the Nuvama.

The Nuvama non-compete we had was up to March 24. So, we did the deal in March 2021, and we had a three year non-compete, though we are not in the wealth management business at all, so we don't have any line items of the wealth management business in our category. We are in this, the seven businesses we have, NBFC, Housing Finance, ARC, LI, GI and EAAA and mutual fund. Those are 7 businesses we have. We are not in the wealth management business at all, but we have the stake in Nuvama, but there is no fee income or investment banking income in our balance sheet as of now for operating activities.

Deepak Agrawal: So, what I was referring to is in terms of restarting some of these businesses, which earlier, maybe till, as you said, March '24, you are not allowed to do as a part of non-compete.

Rashesh Shah: Yes. See, we have so much on our hands because this current seven businesses are also scaling up well. As we have highlighted, there is quite a bit of work to do. We have, as I said, excess capital in the credit businesses, which is not earning good ROE. So, we have to get that capital efficiency in the credit businesses. We have to bring the insurance businesses to break even, and we have to scale up both the asset management business and do a stake sale and hopefully list them in the near future. So, since we have our hands pretty full, and we also want to reduce the overall corporate debt that is there.

So, we have our agenda pretty focused, and all businesses take about 5, 10 years to build. So, it's not that you can start a business tomorrow without having a 5, 10-year investment horizon. I personally think to start a wealth management business is a 500 to 600 crore investment with at least a minimum five to six years kind of horizon you have to take to build the business to get to a certain scale. So, any such business just because the non-compete is over should not be started. You should start it when amongst all the opportunities you have, the capital you have, the bandwidth you have, you want to get into that. We are currently pretty happy with the range of businesses we have, and we want to scale this up and focus on the priorities that we have highlighted.

Deepak Agrawal: So, my second question was for the alternate business. So, if we list it separately instead of, so if we do a demerger like what we did for Nuvama, so that holding company discount which

Edelweiss will start attracting, right, once it gets listed separately, so any thought there if we directly list it and then let the markets do the correct valuation of the company?

Rashesh Shah: See, I think listing of the EAAA is separate from maybe demerging it or unlocking the value because there are a lot of optionality on that which is what we did with Nuvama. So, currently, the idea is to sell the stake, get that capital to reduce our debt and all, and then decide on how to unlock the value where also there are many options are there, and slowly and steadily we are seeing that market will get some hold co discount, but the market will also understand the value of the hold co. So, it is our job if the hold co discount is very high, then you can unlock that value in actually quite a few ways, like we have done with Nuvama, or if it is you can also sell a stake and do a stock buyback also. So, there are ways of addressing the hold co discount.

Our current priority is not usually focused on how to reduce the hold co discount. It is how to make the asset management businesses scale up, institutionalize, unlock some value out of that, how to get the insurance business to break even, how to get the credit businesses to generate a decent ROE, and how to reduce corporate debt.

These are the four things we are focused on. Once we get some progress on that in the next three, four quarters, then we can change our priorities and then look at how to reduce the hold co discount and other things. And there are various instruments available for that, options available for that.

Deepak Agrawal: And my last question was on the NBFC, scaling up of NBFC. So, obviously, we have had challenges, and seems like liabilities, we are constrained on liabilities on that, right, in terms of…

Rashesh Shah: Actually, more than that, we have believed last three, four years and it is proving to be true that NBFC is either you are part of a corporate house where you can take some ALM risk and make some extra return because you can be more aggressive in making your ALM assumptions or you are part of a PE fund or whatever where you have a lot of backstop capital available to you.

Otherwise, NBFC is a much harder business to make it work, and given what is happening in the banking space, and I think availability of bank lines and all that, the cost of that because bank deposits are also not growing, so bank credit to NBFC is also coming down. So, I think the large corporate houses as well as maybe the PE-funded players have an inherent advantage. People like us don't have an advantage. Even if we get the credit lines and all, we will end up holding a lot of capital for ALM, which is also eating to the return.

So, today, a pure play NBFC, if you don't scale it up much, can you make 10%-12% ROE, yes, but can you make 15%-18% ROE? We think it's harder and harder unless you have a corporate house umbrella or a fee umbrella with you. So, our idea is maybe convert this into more a co-lending partnership model.

And by the way, that is coming out true. You look at what the Q2 results have been because if you want to make returns, then you go up the risk curve, or you take ALM risk, and both of them like what is happening with MFI and unsecured and all is starting to show that stress. So, we too believe that NBFC businesses have some inherent challenges, which have come to fore in the last 4-5 years post ILFS.

There are clear advantages that large corporate house NBFCs and PE-funded NBFCs have which people like us don't have, but we can try and do a co-lending partnership and instead of competing with banks, we can partner with banks and still actually aim for a 14%-15% return but not with an asset heavy strategy but with asset light, more a combination of partly servicing, originate and partner with banks to co-lending bank and get the service income. All of that will allow you to get to a 14%, 15% ROE.

And that would be our ambition in our credit business is, can we get to 14%-15% ROE without ballooning the balance sheet a lot, without borrowing a lot. Because after seeing what has happened last four, five years, even if you borrow, we hold a lot of liquidity. Last five years, we have held a lot of excess liquidity at a group level and collectively it has cost us about couple of hundred crores a year in terms of foregone profit of just the holding cost of that liquidity. So, in a way, the liquidity management, ALM management is a bigger challenge in an NBFC business than just credit cost any longer.

Deepak Agrawal: So, that was the whole reason why I was asking you.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, that we will take the last question, which is from the line of Naman, an individual investor. Please go ahead.

Naman: So, I have one question regarding EAAA, I think, which was answered. The question was basically, when can we as shareholders expect to get the shares distributed? And second question is, any book you would like to recommend? Any favorite book for this year?

Rashesh Shah: I think as I said, our current priorities, this is the four priorities I have highlighted for the next three quarters. We have a broader value unlock strategy that we are working on. We are looking at all the rules and regulations and doing it in a way that becomes win-win and hopefully in the next three, four months, four, five months, we will be able to come up with what is our broad value unlock plan for the shareholders.

As you have seen with Nuvama also, our current, our overarching objective is how do we align the shareholders being able to enjoy the value that we are creating, and we are all actually thinking like shareholders because I myself am also a shareholder of the company. So, we will come up with that. On the books, there are a lot of books. The one I like a lot that I read again and again every year is The Outsiders, which is about capital allocation and business structure and empowerment and all that. So, it's a book called The Outsiders, which I have always enjoyed reading, but happy to also get the recommendations from others on and off. You can send me a mail with your book recommendation.

Naman: Poor Charlie's Almanack.

Rashesh Shah: Yes, that is also a great book. That is also an amazing book.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference back to Ms. Priyadeep Chopra for closing comments.

Priyadeep Chopra: Thank you all for your time today. It was lovely to listen into the questions, and thank you, Rashesh, for patiently answering all of them. Please do write in to us at Edelweiss Investor Relations for any other questions or additional information that you may need. Once again, wish you all and your family members a very Happy Diwali and a great festive season ahead. Bye bye. Thank you for your time.

Rashesh Shah: Thank you, and Happy Diwali to everybody. Bye bye.

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