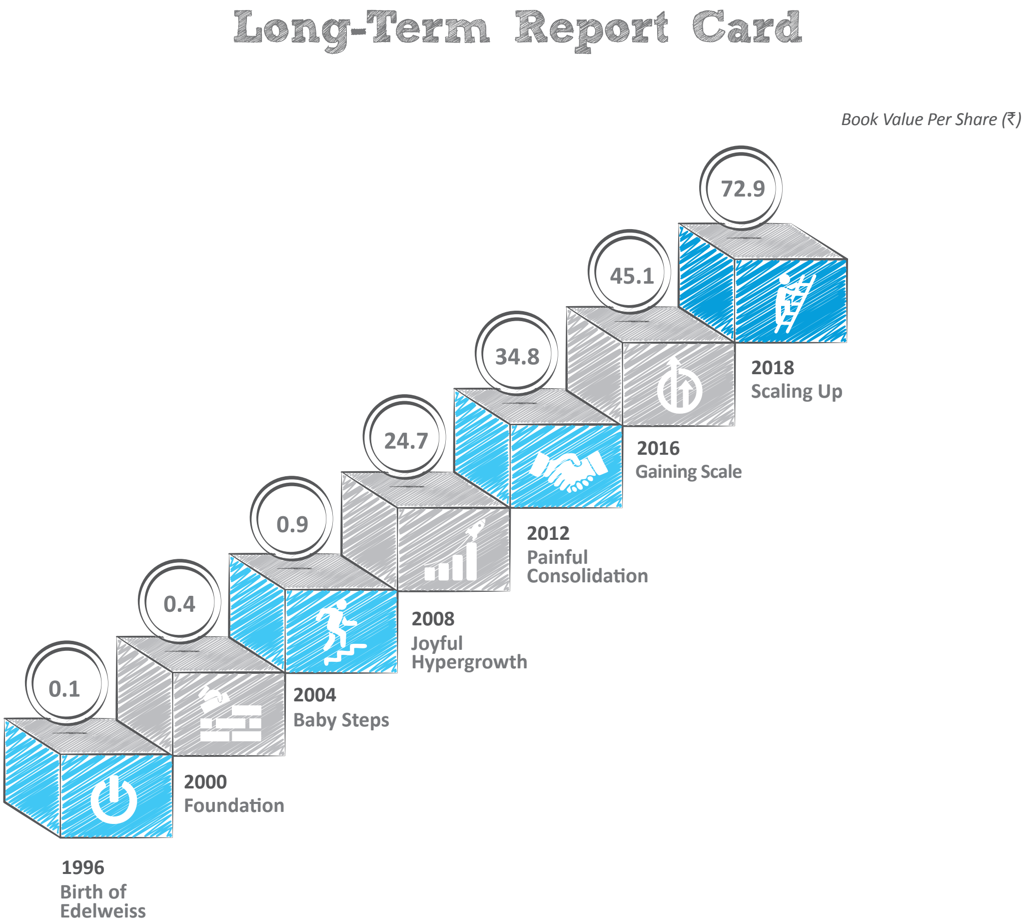
Edelweiss
Ideas create, values protect

# Chairman's Letter 2018

## Letter From The Chairman




We complete another year – our 23rd since inception, and look back at our journey! While the Edelweiss story is an amalgamation of the six phases mentioned above, what might not emerge is that it is also a story of two halves and a phase of re-birth in between. One was Edelweiss pre-2008, where we were primarily a Capital Markets led organisation. In the four years following 2008, we completely re-orchestrated our business model. This phase was essentially the seed for the Edelweiss of today – Diversified and Bank-like with a variety of businesses spanning almost the entire financial services domain. We completed most of this process by 2012 and our business model re-alignment has helped us to create an organisation with a strong and sustained track record, especially over the last six years.

| Year | Revenue (₹ million) | PAT (₹ million) | Net worth (₹ million) | BVPS (₹) | Diluted EPS (₹) |
|---|---|---|---|---|---|
| 2012 | 16,707 | 1,277 | 28,748 | 34.8 | 1.7 |
| 2013 | 21,840 | 1,785 | 26,909 | 32.1 | 2.3 |
| 2014 | 25,555 | 2,202 | 32,558 | 37.6 | 2.9 |
| 2015 | 39,119 | 3,287 | 35,314 | 39.9 | 3.9 |
| 2016 | 53,157 | 4,144 | 43,717 | 45.1 | 4.9 |
| 2017 | 66,336 | 6,093 | 52,879 | 52.0 | 6.9 |
| 2018 | 86,225 | 8,901 | 77,624 | 72.9 | 9.8 |

*Decline in book value from 2012 to 2013 is on account of exclusion of goodwill from Net worth on acquisition of Anagram Securities*

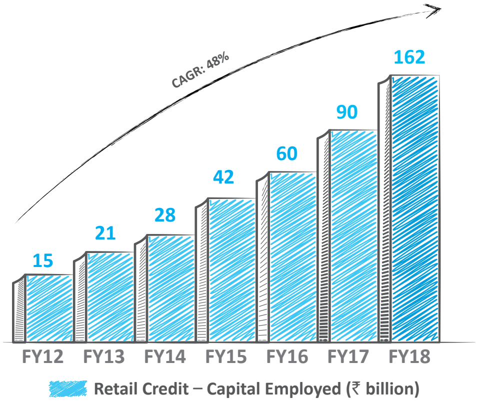
| Year | % change in EW Market Cap | % change in NSE FS index |
|---|---|---|
| 2013 | 12% | 14% |
| 2014 | -7% | 11% |
| 2015 | 123% | 43% |
| 2016 | -9% | -13% |
| 2017 | 180% | 33% |
| 2018 | 51% | 17% |

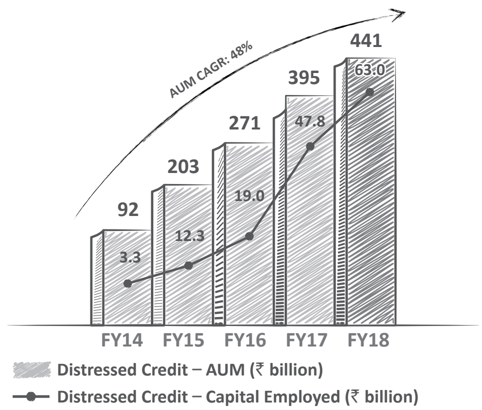
*Numbers are based on Management estimates*

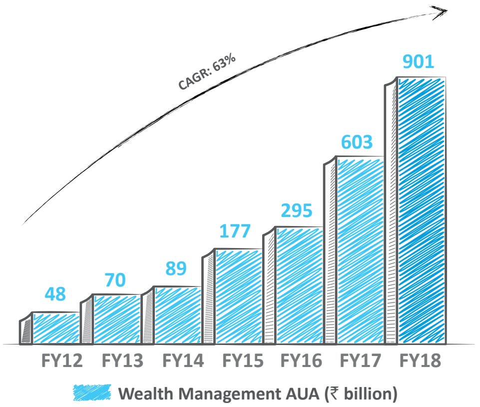
## Scaling Up

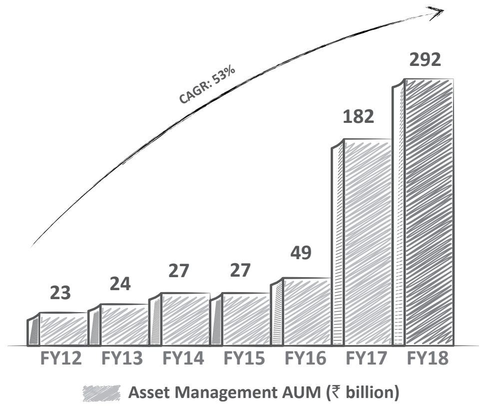
This phase of mature and balanced growth has helped us lay the foundation of our current phase – a phase of Gaining Scale. Over the last 20 years, we have scaled up our businesses substantially and we today occupy a sizable position in the Indian financial services market. However, for the new businesses that entered the Edelweiss fold from 2008-12, we are now at an inflection point. In most of these businesses, we have established a clear business model which works well for us and created the necessary enterprise backbone in the course of the last few years. With the India tailwinds at play, we are now primed to further scale up these businesses rapidly, something we have started doing in the last three years.

Strong and Consistent Growth since 2012



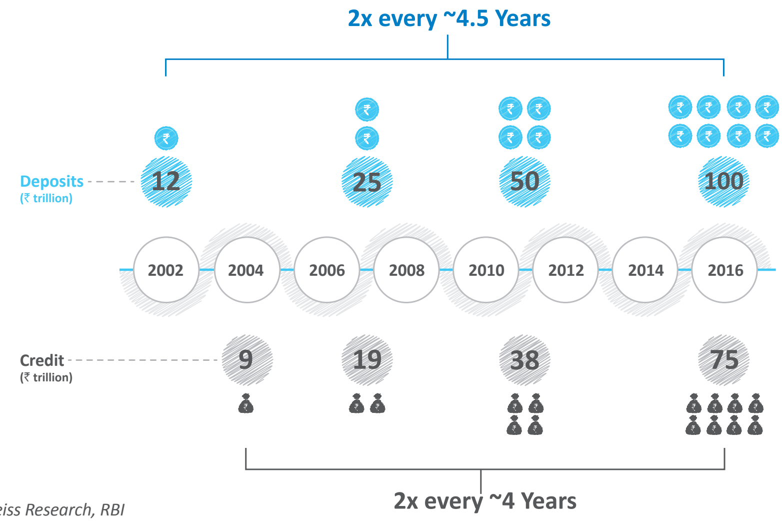




## Financial Services in India – Our World View

The financial services sector is the engine that drives the economy. By providing capital to be utilised across productive avenues, financial services drives a significant part of the growth in the country. The growth in financial services can roughly be translated as an outcome of a few key trends –

**1. Compounding Growth**

The story of the compounding in India's GDP which we see happening in the future is well-documented. What is not so commonly observed is how this compounding has already been a key vector in the growth of financial services



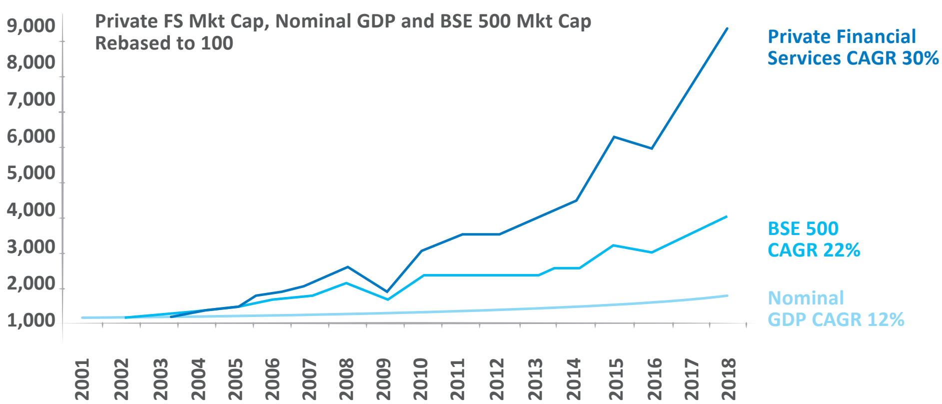

*Source: Edelweiss Research, RBI*

in India. A common trend we have observed is the doubling in most of the key financial metrics every 4-5 years. For example, in the last 15 years, outstanding bank deposits have doubled every 4.5 years while credit has doubled every 4 years.

Similar trends have been seen in Mutual Fund AUMs as well as the AUMs of Insurance companies. Interestingly, in the last few years, the growth in Mutual Fund, Insurance and Pension AUMs has been much faster than the growth in system credit. By size, they are now close to 50% of outstanding credit compared to around 25% less than two decades back. With the ascending wave of financialisation, we expect their share to continue moving up.

**2. Privatisation of Financial Services**

While the system has doubled every 4-5 years, implying a 16-18% growth, private financial services have grown even faster. This is something which we are increasingly seeing across industries, a trend we will discuss in detail going forward. An analysis of the market cap of private FS companies present over the last two decades gives very interesting results – In the last two decades, the market cap of Private Financial Services companies has grown much faster than the overall index, which in turn has grown faster than the growth in GDP. In fact, growth in Private FS market cap is nearly 2.5 times the growth in GDP. This is a trend which has sustained for the last two decades and one which we expect to continue for the next two decades as well!




*Source: Edelweiss Research, BSE, World Bank*

**10-20%**
**Pre-tax Profits**

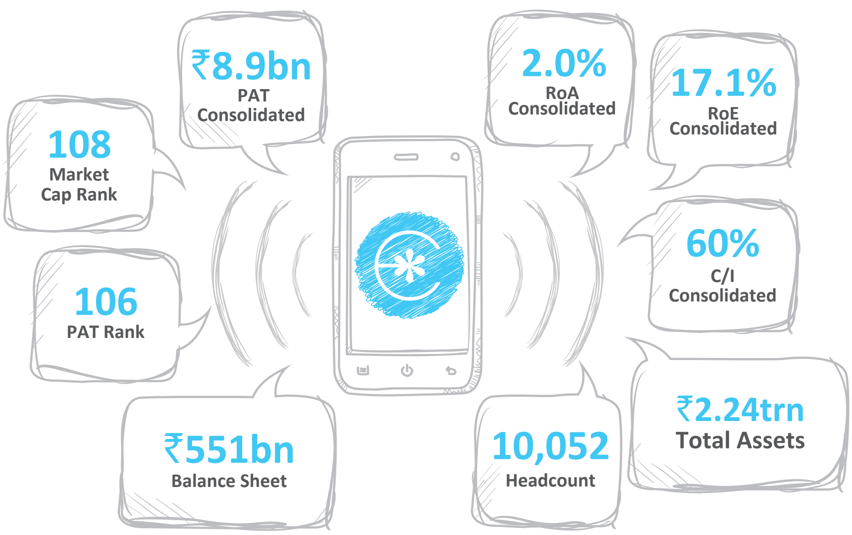
*Doing experiments is good but there is a small problem attached with it they cost money!*

## Experiment, Establish, Elevate!

This scale-up has come on the back of a strategy of experimentation via calculated risk-taking, something which we have also tried to inculcate across the Group. Our philosophy has always been to invest about 10-20% of our pre-tax profits in areas which we expect to be significant opportunities in the future. This number was around ₹3-3.5 billion for the year gone by. These "experiments" of past include highly profitable businesses of today including wealth management, asset management and ARC amongst others. While we've had several successes, we've had failures as well – initiatives like gold loans and Finpro are amongst our experiments which have failed, some due to our inability to establish a workable business model like in the case of gold loans and some due to lack of a viable market opportunity at that time like in the case of Finpro.

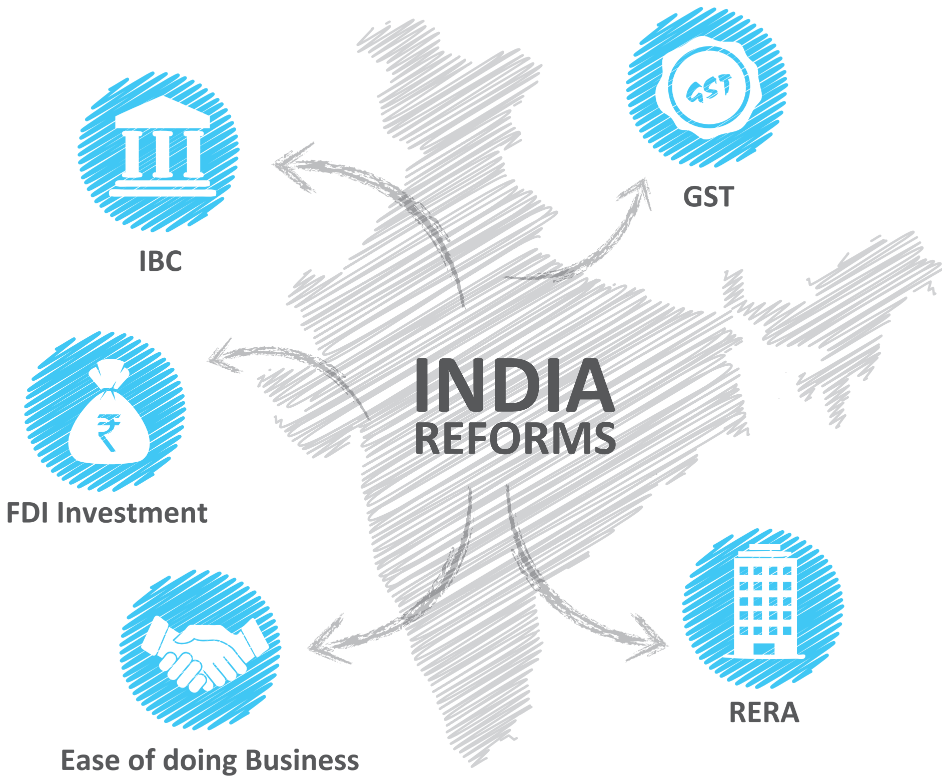
Usually, it is a three-step process of Experiment, Establish and Elevate, wherein we Experiment with various business models, Establish the one that works best for us and then Elevate the business rapidly to take advantage of this. Many of our businesses are in various stages in this journey – so while we are doing a variety of Experiments within our Mortgages Business, we have after some permutations established a profitable business model for the SME Lending business. In businesses like Wealth Management, we are now aggressively into the Elevate stage as our recent scale-up trajectory suggests. While we've had successes as well as failures with this approach, in the long-term, these experiments have given us asymmetric returns and we continue to do several experiments within Edelweiss across businesses.

## FY18 Report Card



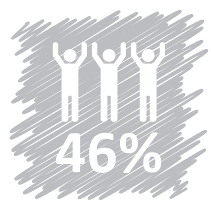

## FY18 Overview

It was another good year for Edelweiss as the scale up and maturity in our businesses, coupled with the India tailwinds drove strong growth across all areas. While there have been some concerns around the slowdown in GDP growth, people tend to forget that we are still amongst one of the fastest growing economies in the world! Quantitatively, it was a decent year for India but more importantly, qualitatively it was a great year for India with a slew of reforms paving the way for sustainable, long-term growth compounding.



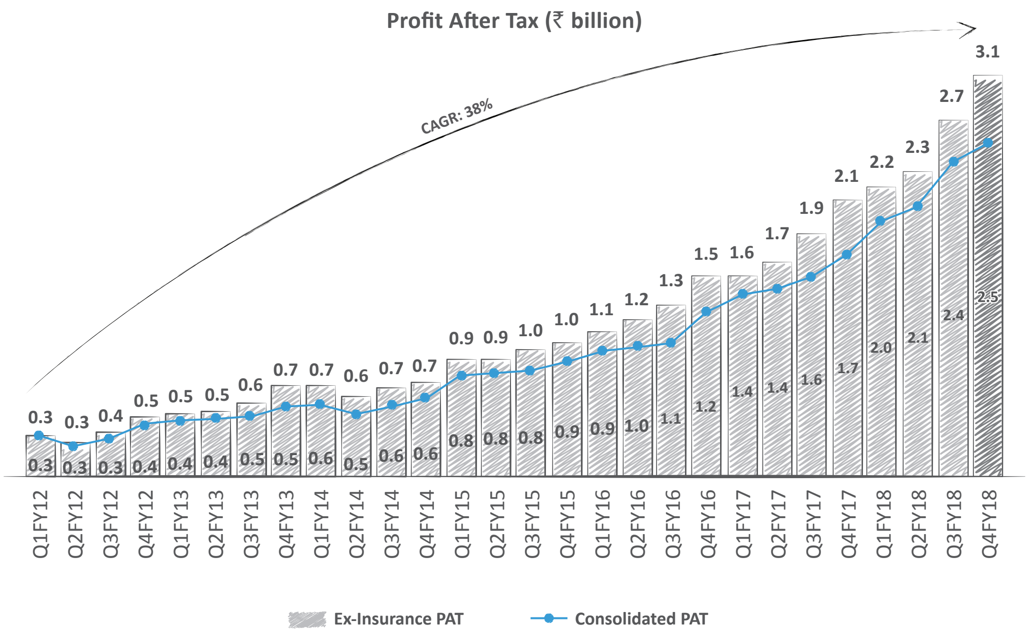

## Highlights

- Our Profit After Tax (PAT) was up 46% YoY to ₹8.9 billion while our Ex-Insurance PAT was ₹10.4 billion, a growth of 44% over the previous year. This is the first time that our Ex-Insurance PAT for the full year has crossed ₹10 billion
- Profitability has also improved with Ex-Insurance RoE now standing at 22.1% and Ex-Insurance RoA at 2.6%
- FY18 has been a continuation of our long-term growth trajectory which has seen our Quarterly PAT grow with a CAGR of 38% in the last 28 quarters
- In this time period our profits have grown more than 7x from ₹1.3 billion in FY12 to ₹8.9 billion in FY18 while our balance sheet has also multiplied 4 times – another journey of Scaling Up that we have successful executed
- We raised equity capital in the holding company, EFSL, in November 2017. This was the first capital raise since EFSL's listing more than 10 years ago. We see this as a key next step in our journey to Scaling Up
- There were two other milestones in the year which are really close to us
  - o The Edelweiss family is now more than 10,000 strong. Our journey in the last 22 years is primarily a function of our human capital and this achievement is another reinforcement of the same
  - o We signed a long-term agreement with the Indian Olympic Association (IOA) to sponsor the Indian contingent for the recently concluded Commonwealth Games 2018 and upcoming Asian Games 2019 and Olympics 2020, in addition to the National Games. This is in line with our continued focus on promoting sports in India



Profit After Tax

Growth in 7 years




## Our Businesses

**10,000+**

**Employees**

FY18 witnessed further diversification of our earnings as the Franchise & Advisory businesses continued to grow faster, driven by strong growth in the Indian capital markets and backed by our investments in these businesses over the last few years. No business in Edelweiss now contributes more than 20% to the overall profit, a testament to our strategy of diversification. This has helped us not only diversify our earnings base to be able to withstand any shocks in the market, it has also helped us establish sizable market share in several emerging opportunities. With our current size, there is ample headway for growth in each of these businesses as the India growth story pans out.

**Edelweiss Profit – Well Diversified**

| Business Segments | FY18 Pre MI PAT (₹ million) | % Contribution |
|---|---|---|
| **Credit Business** | | |
| Retail Mortgage | 657 | 6% |
| LAS, SME, Agri and others | 1,340 | 12% |
| Structured Collateralised Credit | 1,584 | 14% |
| Wholesale Mortgage | 1,804 | 16% |
| Distressed Credit | 1,927 | 17% |
| **Franchise & Advisory Business** | | |
| Wealth Management & Asset Management | 1,621 | 15% |
| Capital Markets | 1.464 | 13% |
| **BMU, Corp and Others** | 826 | 7% |
| **Total Ex-Insurance** | **11,222** | **100%** |

Mature Businesses    Growth & Focus Areas

## Credit Business

Credit continues to be the backbone of our business model and the largest contributor to our profits. Our credit book now stands at ₹420 billion, a YoY growth of 52% with robust growth in Corporate and Distressed Credit and exponential growth in Retail Credit.

We continue to see healthy traction in the credit book, like many of our peers. Overall credit growth in the economy might be subdued but in addition to the incremental opportunity, there continues to be a shift in market share from public players to private players, a trend we will discuss in detail.

**1. Retail Credit**

a. Outstanding book of ₹162 billion

b. PAT of ₹2.0 billion in FY18, YoY growth of 64%

c. RoE of 15.8% and RoA of 1.6%

As we saw earlier, the retail credit book has scaled up substantially after the first few years of the bedding-in phase and now makes up 39% of our total credit book. This growth has been majorly on the SME Lending and Loan Against Property side. We are now focusing on scaling up our Housing book as well. Accessibility is one of the key aspects to growing a retail business. We are doing this through a multitude of avenues. We have significantly expanded our presence across the country in the last year. We now have 132 branches in 118 locations across the country.

However, our end goal is to meet the customer wherever he/she is present. This will need distribution excellence and innovation in customer outreach. We are undertaking a variety of experiments in terms of our distribution channels, some common and some 'not so common'. These include enhancing both the fulfilment channels as well as the lead generation channels through enhanced geographical footprint, DSAs, a direct sales team and tie-ups with brokers and other intermediaries. We strongly believe that there is a massive opportunity on the housing side in the Indian credit market and with the increasing urbanisation and rising incomes, the demand for housing will pick up substantially going forward. Our investments are in anticipation of this opportunity that we see panning out over the next 8-10 years.

**2. Corporate Credit**

a. Outstanding book of ₹195 billion

b. PAT of ₹3.4 billion in FY18, YoY growth of 18%

c. RoE of 18.8% and RoA of 2.2%

Our Corporate Credit book saw steady growth as we continued to see offtake on the corporate side. This has come on the back of two main reasons –

- Several PSU banks have come under RBI's PCA framework, hence lending has become more difficult for them. Many of their good quality clients are now shifting towards NBFCs and other private players, a trend which we expect to continue over the next 12-18 months. This is a part of a general trend of privatisation across industries which we will discuss in detail further ahead
- The Asset Quality issue in the system has limited the amount of equity capital available for lending. Most banks with high NPAs, even if they do not fall under PCA, are utilising the excess capital available to clean up their books. This has limited their ability to provide growth capital which has been captured by Financial Service providers with better asset quality and free growth capital

We continue to see a strong pipeline in Corporate Lending which will be fulfilled partly through our own book, partly through sell-downs and the remaining via our private debt funds.

**3. Distressed Credit**

a. Capital deployed of ₹63 billion with AUM of ₹441 billion

b. PAT of ₹1.9 billion in FY18, YoY growth of 98%

c. RoE of 20.0% and RoA of 3.6%

We continue to be India's leading player in distressed credit with a strong track record of acquisitions as well as recoveries. Our focus continues to be on acquiring EBITDA-generation operating assets which could be financially broken. By providing our financial expertise as also the ability to do priority funding, we aim to maximise the value of the asset.

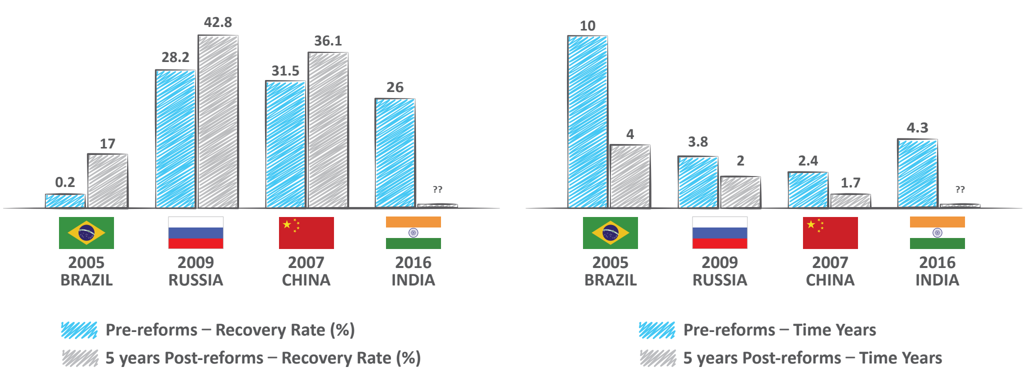
The introduction of IBC and the ongoing process in NCLT is a potential game changer in addressing the stressed assets problem in the country.

## Insolvency and Bankruptcy Code – Will it Work?

In the one year since IBC has been in existence, while we may not have seen too many big ticket resolutions, the year has definitely brought in significantly more clarity than when we started out. As is said, Laws are made in the Parliament but truly tested in Courts. It was always expected that the IBC will face a variety of questions as we introduce what is a seminal bankruptcy reform in India's history. However, IBC has ably stood through all these challenges and we definitely expect the coming year to witness some big-ticket resolutions, thus truly reflecting the value that the process will bring in. Equally importantly, we expect the insolvency process to generate valuations around 10-20% higher than what would be normally expected. It will, however, take some time to create an effective price discovery mechanism and an efficient market. The recommendations of the Insolvency Committee in terms of enhancing the bidder pool, especially, will play a major role in this aspect. Once that is established, we could see valuations improve even more. As long as the asset is in good, operating condition, we can expect IBC to extract good value from insolvency cases.

Globally, bankruptcy reforms have led to a significant impact on the recovery rates. A simple

**Impact of Introducing Bankruptcy Reforms**

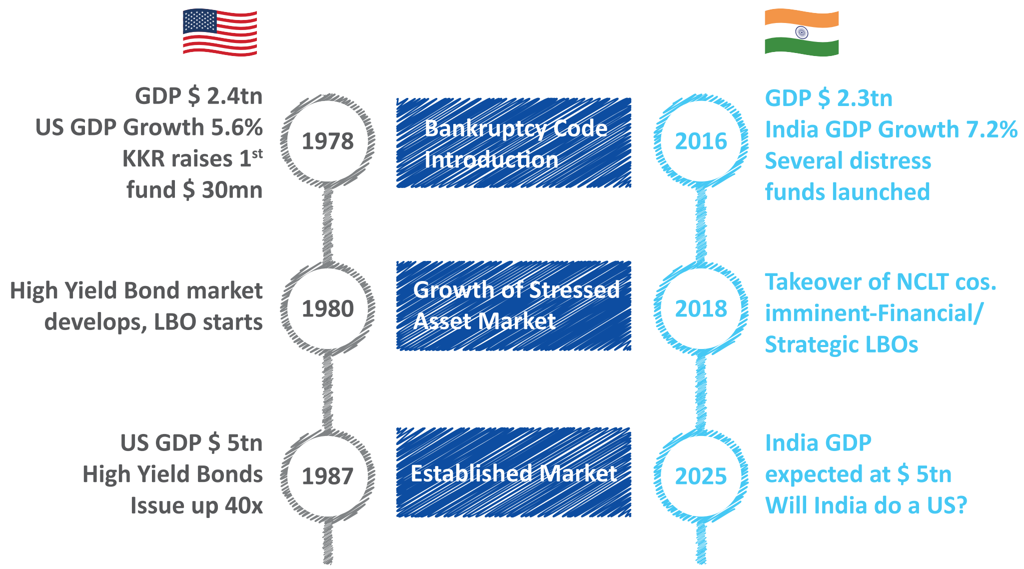



*Source: CRISIL*

comparison amongst our BRIC peers will make this clear.

As is evident, the reform in each of these countries has been a game changer. In this context, it would also be interesting to see how the distressed assets industry has panned out. In USA, the law was introduced in 1978, probably the first across the world. A comparison of the evolution of the industry should give us an idea of how the Indian distressed assets market could potentially pan out, especially since India today is roughly the size of the US economy in 1978.

Clearly, the potential for the industry growth in the next 8-10 years is massive! With these factors in mind, we continue to be strongly bullish about our distressed assets business going forward.




*Source: Edelweiss Research*

## Franchise and Advisory Business

Franchise and Advisory consists of our wealth management, asset management and capital markets businesses. This has been another fabulous year for these business as the confluence of rapid scale-up and a supportive market environment helped us sustain and even enhance the growth momentum. As we saw earlier, these businesses now form around 34% of our Consolidated Profits in FY18 and more than 40% in Q4-2018. Our focus on these businesses is driven by their ability to generate significant returns without consuming too much capital. These businesses will continue to generate a significant RoE kicker for us going forward.

**1. Wealth Management**

a. PAT of ₹1.3 billion in FY18, YoY growth of 83%

b. Cost to Income has declined from 76% in FY17 to 67% in FY18

c. Assets Under Advice now stand in excess of ₹900 billion, with 50% growth over FY17

The wealth management business saw good growth, both on the Mass Affluent side as well as the UHNI side. The growth on the UHNI side, especially, has come on the back of the creation of a robust pipeline of new Relationship Managers who have helped us scale up our business not just within our existing locations but also at newer locations across the country. We added 63 RMs in FY18, bringing the total RM count to 172. These are in addition to the RMs we have in our Mass Affluent Business. With this fresh hiring, we are now geared for continued strong traction in this business.

**2. Asset Management**

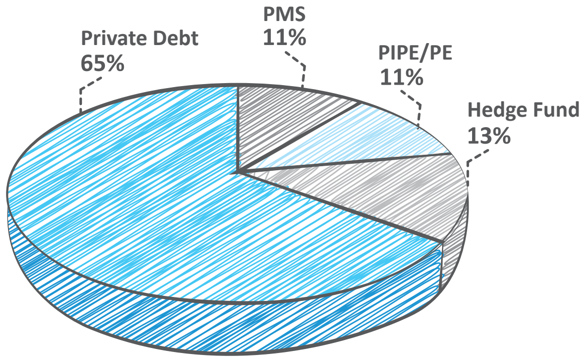
a. PAT of ₹0.3 billion in FY18, up from ₹0.07 billion in FY17

b. Cost to Income Ratio has improved from 80% to 63%

c. Assets Under Management of ₹292 billion, up 60% YoY

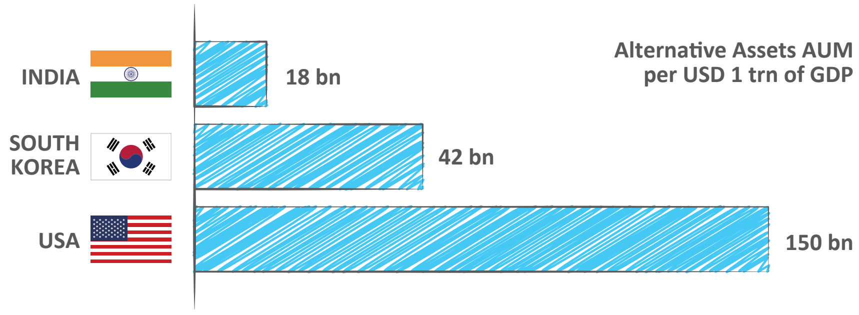
Our asset management business is a mix of our Mutual Fund business and the Alternatives Asset Management. Both these businesses have done fairly well in the last year. The mutual fund business crossed an AUM of ₹100 billion. While still a small number considering the existing market size, we are fairly confident of scaling this up rapidly going forward. While the opportunity has been there for some time, we felt that we were lacking the right model to really be able to afford scaling up this business. However, this has been overcome in the last twelve months and we would expect to see a fair amount of traction on this business going forward. We are especially excited about our alternatives business, in terms of potential opportunity, our ability to tap this opportunity and the consequent returns we will generate.

**Edelweiss Alternative AUM split (Alternative AUM ₹152 billion)**




## Alternatives are going Mainstream!

The alternatives market in India has almost doubled in the last five years to around USD 50 billion with significant scope for expansion. Even today, we don't compare too well globally in terms of penetration of alternatives.




*Source: Prequin Insights, Edelweiss estimates*

However, there is significant cause for optimism with the growth seen in the last few years. There are three main reasons why the alternatives market has been seeing strong traction in recent times –

a. Demand for yield, particularly amongst foreign investors

b. Growing affluence of domestic investors

c. Development of AIF platforms in India

The ability of alternatives to offer superior risk-adjusted returns with the added benefit of diversification compared to mutual funds provides an attractive investment option. Investors have now started recognising that, leading to the rise in AUM of alternatives. At the same time, alternatives are also more profitable for asset management companies as the profitability is nearly 3-4 times that of mutual funds. Edelweiss is well-positioned to tap this rising opportunity as we are one of the few asset managers in India with leadership position across the full bouquet of product offerings.

**3. Capital Markets**

a. PAT of ₹1.5 billion in FY18, YoY growth of 28%

b. Cost to Income has improved from 69% in FY17 to 64% in FY18

c. Assets Under Custody have crossed ₹120 billion, a YoY growth of 171%

Capital Markets is a legacy business for Edelweiss – our founding core, so to say. Over the years, we have added newer businesses to this core, not just across Edelweiss but within the Capital Markets group as well.

Today, we are amongst the leaders in the market on both Equity Capital Markets (ECM) and Debt Capital Markets side. Besides these, we have also steadily built other niche businesses within the Capital Markets business. This includes Financial Product Distribution which acts as a distributor for various kinds of financial products like mutual funds, IPOs and fixed income securities, etc., amongst the retail masses. We are also building a Custody and Clearing business which we think can be a strong growth vector in the near future. Already, our Assets Under Custody have crossed ₹120 billion and we expect to see continued traction on this business.

## Insurance

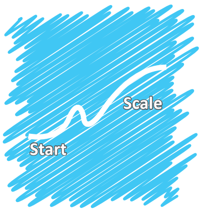
Our insurance offering has now doubled with the launch of our general insurance business through Edelweiss General Insurance Company Limited in February 2018. With our business span, we are now one of the most diversified financial services company in India, a model, as we mentioned earlier, we have consciously attempted to build.

Our Life Insurance business continued its strong growth in FY18. This was further accelerated by the capital infusion of ₹6.7 billion by Edelweiss and our JV partner Tokio Marine. While there was no immediate need of capital in the business, we have pro-actively ensured that not only are we well-capitalised, we are also not lacking in growth capital. The key to a life insurance business is not only to provide quality to its clients but also to be able to consistently scale up the reach and the overall business. Sustainability comes from creating a quality business with scale. While we think we have managed to achieve the former, we are still some way away from the scale we would want to see. As always, our long-term plan is to break-even in Life Insurance by FY22.

# Beyond Business–Some Thoughts

The last one year has been a seminal one for the Indian economy. While the short-term impact might have been restrictive, the long-term benefit that will accrue from the structural reforms more than compensates for any short-term pain. It is refreshing to see the focus on the long-term, something we have always tried to inculcate in the Edelweiss way of thinking. However, we have often seen companies, especially the young start-ups, failing to grasp the power of the balance between the short-term and the long-term. This is one of the biggest reasons why there are so many companies in India that start off very well but do not manage to eventually scale up.

## Startup to Scaleup




India's young demographic has made us one of the world's leading startup hubs. This has been a journey that has been in the making for more than a decade now. However, in this decade, many startups have done really well in the beginning, only to lose that momentum as they try and scale up. While some like Flipkart, Naukri and PayTM have changed the industry, many others have not been able to make the transition. It is a question we have encountered many times, not just through others but also in our reflection of the Edelweiss journey. What does it take for a startup to scaleup?

Often, entrepreneurs are very good at starting new and innovative things. However, the same capabilities which give a startup its core competency can sometimes end up being bugbears to scaling up the organisation. Building an organisation requires a certain amount of institutionalisation, an anathema at startups which proud themselves on their agility. However, as the organisation starts becoming larger, one needs to create a healthy balance between the two, sacrificing one partly for the sake of the other.

Even when Edelweiss had started growing bigger, we would frequently get complaints on how the organisation was losing its closeness as we expanded on multiple sides. In our minds, all this was a cost we had to pay for creating a truly scalable organisation. Balancing the short-term and long-term is this the most delicate balancing act that an entrepreneur needs to play. And the only way to really scale up is to follow the 3 Ds – Delegate, Decentralise, Decontrol!

## Delegate, Decentralise, Decontrol

As organisations scale, it becomes increasingly clear that a central control mechanism adds lesser and lesser operational value and more and more strategic value. In such a scenario, keeping everything centralised could not only be less beneficial, it could actually be detrimental to the growth of the organisation. A business is like a child, whom you nurture, feed and take care of until it grows up. At some point of time, the child becomes an adult and will be better off with some guidance and support rather than continuous oversight. It is important that business leaders are able to identify that moment and act on it through the 3 Ds.

Within Edelweiss, we have been gradually undergoing this journey over the years. While this has been happening in small phases until now, we have undertaken a concerted decentralisation of central functions and controls in the last 18 months. This has culminated in a structure where we have distinct Business Groups, which we hope will be as independent as possible, akin to mini-Edelweiss in themselves. This structure is still being implemented and is yet to attain its final shape. However, it does include all the above steps we have espoused.

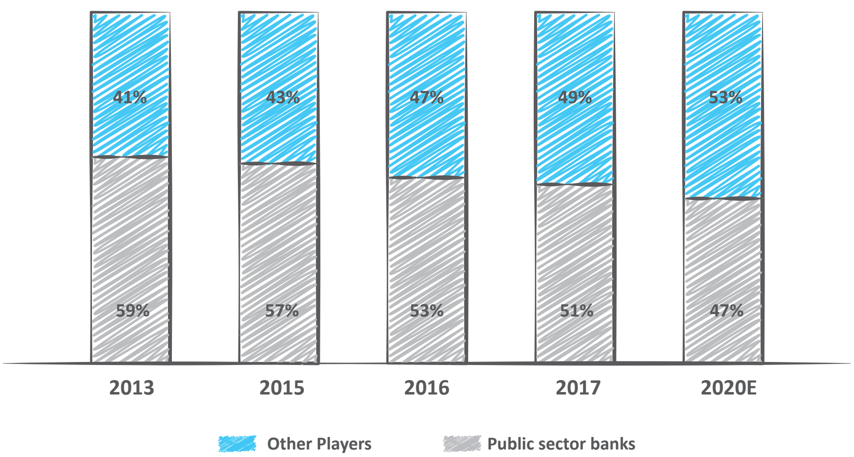
Delegation of responsibility has always been a hallmark of how we function at Edelweiss. We have always aspired to make our leaders as entrepreneurial as possible since we feel that they are the best judges of what works best for the business. We have also decentralised most of the enterprise functions now to reside in each of the businesses. While this might lead to a minor increase in cost, we feel that not only are we doing well enough to absorb any incremental cost, this enterprise decentralisation will help us create self-sufficient Business Groups which are agile enough, yet have in-built institutionalisation. We are also now passing on the control to the Business Group heads. All business heads now report to their BG heads who in turn report to the Corporate Centre. The central control is now being incrementally exercised at the BG level as the BG heads take independent control of all the businesses under their fold. While this is still an ongoing process which will take time to culminate, we expect this structural change to be key to the Edelweiss growth story going forward.

## Privatisation of the Economy – India Style!

In the last two or three decades, the face of the economy has changed completely. Liberalisation, Privatisation and Globalisation in the post-1991 era set the base for a new India which would retain its core, yet be markedly different from the India of old. There were several changes that came about in the economy, the most important being the enhanced participation from private players. Some sectors saw an instant impact while others took some time getting into the act. In fact, Edelweiss was also, in a way, an outcome of these winds of change.

These new private players established over the last 25 years are now challenging and in some instances, overtaking the erstwhile PSU market leaders. Most importantly, this movement towards privatisation is not happening through any kind of asset sales but through a shift in market share as the private players are capturing the existing market as well as growing faster in the incremental market. In some industries, this shift happened quite some time back – telecom, television and aviation are the examples that come to mind where the leaders, namely MTNL, Doordarshan and Air India have been left far behind by newer private players. In some industries like financial services, the trend is now increasingly becoming substantially clear. From a trickle about a decade back, we have now seen turning into a tsunami where almost 60% incremental lending is now being done through private players. We expect the trend to continue going forward and PSU banks will need to undertake substantive changes to be competitive in the new market environment.

**Share of total credit in India**

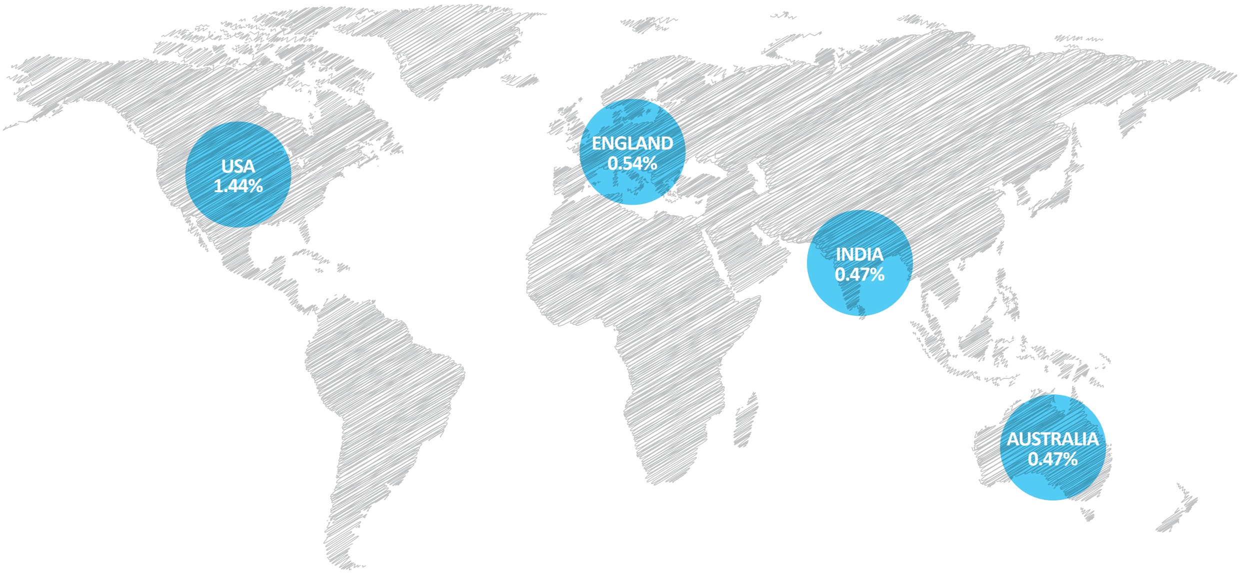



*Source: CRISIL, Edelweiss Research*

## Philanthropy aka Investing Back!

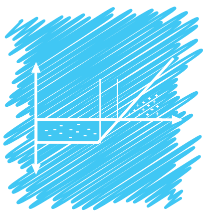
Traditionally, India has been amongst the laggards in the world order in terms of philanthropy. However, we have done well in the last few years though there is still a significant gap to be bridged.

**Philanthropy – GDP Ratio**




*Source: Dalbert Study of Diaspora Giving to India*

However, we do feel that there is an inherent flaw in how philanthropy is perceived globally. Across the world, philanthropy is equated with 'Giving Back'. That would essentially mean that one is trying to give back something which has been taken earlier, which is not necessarily correct. This brings in an element of laxity to measuring the impact of your 'giving'. In our view, the right way to look at philanthropy is as an investment in society. And like any other investment it is important that one targets asymmetric returns here as well, the only consideration being the returns here will accrue to society.



Asymmetric payoff

**Asymmetric payoff** – The primary goal of any investment portfolio is to accrue returns. Even more specifically, asymmetric returns are what an investor is looking for – investment strategies that maximise upside potential while capping downside risks. So is the case with philanthropy.

Ideally, the philanthropic investment should have zero downside risk. The reality is sometimes different because of external factors spanning across political, social, religious and cultural norms. Therefore, it is not only important to pick the right avenues for societal investment, it is also important to diversify these avenues. And most importantly, once the process is complete, patience is the key. Like no investment gives instant returns, so is the case with philanthropy. Social change is a long, slow process and the social investor needs tremendous patience. It is of course important to continuously track and monitor how the investment is doing but it is also important to let the process take effect.

We follow a similar model in our philanthropic arm, EdelGive Foundation, where the focus is on generating 10x returns for the society. This is done by providing 360 degree support to our partner NGOs – a mix of direct funding capacity building and linkage to other sources of funding. We help NGOs to leverage this bouquet of services to achieve 10x impact by scaling up in terms of reach and impact.

Not only does EdelGive fund charitable organisations, we also provide an avenue for other philanthropic trusts to find the best avenue for their investments through co-funding cohorts. This is enabled by direct involvement in capacity building for these charitable organisations where EdelGive shares support which is monetary, physical as well as intellectual. We actively encourage employees to be a part of these initiatives through volunteering exercises. All these factors come together to create a model which generates asymmetric or 10x returns.

## India Growth Story – Not just a myth!

India is one of the fastest growing economies in the world. This has happened despite the short-term impact of the reforms like GST. The growth is expected to accelerate further with FY19 GDP growth being pegged between 7.2% and 7.5%. Amidst all this, we still encounter sections who are sceptical of our ability to continue growing strongly, especially for an extended period of time. While the government policies and global factors will have an impact, there is a simple way to show that it is highly unlikely that our GDP growth will fall below 5%.

With India's macro, it is more difficult to attain a GDP growth of less than 5% than to attain a GDP growth of more than 10%!

Capital output ratio is a frequently used tool to explain the relationship between the quantum of investment made in the economy and the consequent GDP growth. In simple terms, capital output ratio is the amount of capital needed to produce one unit of output. More specifically, we look at a metric called the Incremental Capital Output Ratio (ICOR). GDP growth rate can be calculated as a relation between ICOR and the quantum of investment.

$$\text{GDP growth rate} = \frac{\text{Annual Investment}}{\text{ICOR}}$$

A look at these metrics over the last few years gives interesting insights

| Year | Investment rate (%) | Real GDP growth rate (%, YoY) | ICOR |
|---|---|---|---|
| FY13 | 34.2 | 5.5 | 6.3 |
| FY14 | 32.6 | 6.4 | 5.1 |
| FY15 | 31.1 | 7.4 | 4.2 |
| FY16 | 30.3 | 8.2 | 3.7 |
| FY17 | 31.1 | 7.1 | 4.4 |
| FY18 | 31.4 | 6.6 | 4.7 |

*Source: Edelweiss Research*

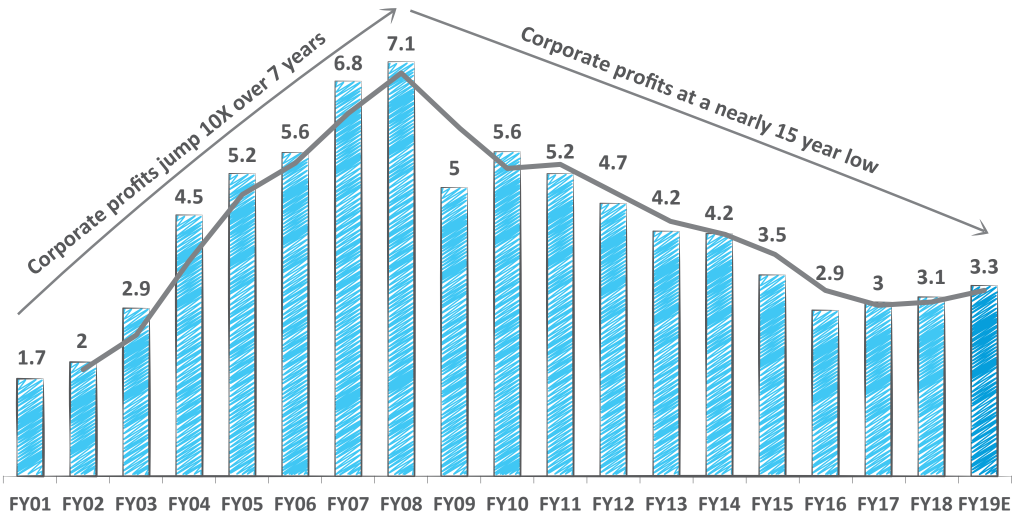
With an investment rate exceeding 30% (primarily from our savings) and the accelerating wave of financialisation of savings that we are seeing we expect the investment quantum to jump up in the coming years and reach closer to our peak of 38% last seen in FY08. At that time, it would need an ICOR of well in excess of 7 for our GDP growth to fall below 5%. In the last 20 years, this has happened only twice. Additionally, the spate of structural reforms as well as digitisation of the economy should actually help improve capital efficiency and lead to a lower ICOR value. It therefore seems a really challenging task to achieve a real GDP growth below 5% in India! In fact, with the right reformist agenda and a healthy confluence of global and domestic macro environment could actually push us beyond the magical 10% number.

## What does FY19 hold?

The government's fiscal push towards agriculture and infrastructure should help drive growth in the medium term while the structural reforms will help re-shape the Indian economy in the long-term. The impact of these is already visible and should enhance as they stabilise and entrench. However, it is important that this reforms-oriented agenda continues in the same vein. For long-term compounding to take effect, it is essential that not only do we continue with relentless execution on the current reforms but also continue working on fresh ones, particularly in critical areas like direct taxation and labour laws.

Corporate Earnings are also showing a very interesting trend. After a downward trend spanning almost a decade with Corporate Earnings as a percentage of the GDP at their lowest in almost 15 years, we are now starting to see an uptick. More importantly, the pick-up in earnings is much more broad-based and spread across sectors. We expect this uptick to continue in the coming financial year and it is important that we create an even more enabling mechanism for these to scale up.

**Corporate Profit as a % of GDP**




*Source: Edelweiss Research, CMIE*

Structurally, FY19 is a key year for India. By all indications, the asset quality issue is approaching its endgame and it is important that this happens in parallel to the earnings recovery. While recovery in earnings will spur a demand for fresh credit, the lending machinery must be ready to fulfil that demand. Despite the incremental demand being fulfilled by private players, even today there is unmet credit demand in the market. With earnings recovering, this will only increase. Therefore, it is essential that the NPA clean-up continues in the same intensity as it has in FY18.

As is often the case with financial markets, however, we do expect a reversion to mean in FY19. FY18 was a great year for the market, so FY19 should be slightly more volatile in nature. At Edelweiss, however, we have always excelled in difficult circumstances since they give the best opportunity for us to outperform! Our strong performance in FY18 has set the base for what should be a strong FY19 and a similar FY20. We have already achieved 4 of the 7 performance targets we had set for ourselves for FY20 (details available in our investor presentation on www.edelweissfin.com). Internally, we feel confident that not only can we achieve them, we can possibly achieve them well within our timeline.

In Edelweiss, we have created a clear 2020 path for ourselves. As we approach the same, we have started to think long-term once again. It is now time to re-align the objectives even loftier as we approach the next stage in our journey – FY25. In this new phase, we will also focus on two new capabilities – technology and customer orientation. Both of these are well-entrenched within Edelweiss. However, we feel the time is right to take them both to the next level – in tech terms, it would mean creating a cutting edge tech-enabled organisation while in customer orientation, it would mean creating a culture of customer obsession. We have already taken the first step towards these objectives. We do believe that the India opportunity provides enough "quantity" for us to grow. It is the "quality" that we will continue to strive for – quality that has defined our journey in the last 22 years and one we hope will continue to be our hallmark for years to come.

Yours Sincerely,

Rashesh Shah
Chairman & CEO