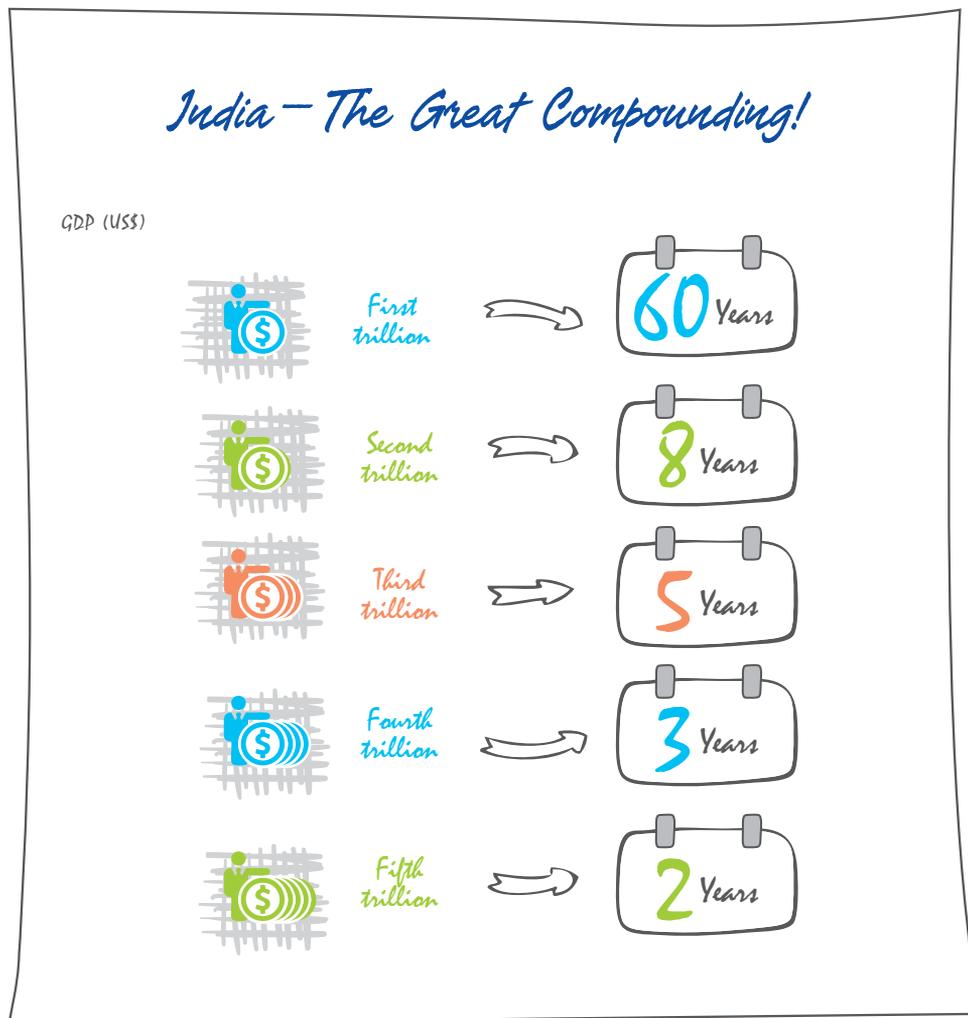


*Chairman's Letter 2019*

# Letter From The Chairman

## FY19 - An Overview

India is full of opportunities. A 7% GDP growth rate for the sixth biggest economy in the world is no small feat. We have all the key ingredients needed for sustained growth compounding – significant size, strong growth rate and importantly a prolonged period of time during which this growth will sustain, driven by our young demographics. These factors have been in action for some time now. As we map out our journey since Independence, our GDP touched its first trillion (in US dollar terms) only in 2007 – 60 years after independence. The next trillion took eight years and we achieved the landmark in 2015. We are now expected to touch US\$3 trillion by 2020 – in a matter of just five years! At this rate, we are well on our way to touching US\$5 trillion by 2025! The power of compounding is truly immense.



## Great Movie, Bad Snapshot

The mistake we often make is to see India not only as large but also as a constant and linear opportunity. So while we see an ocean of possibilities, we often forget that this ocean will have its fair share of storms, typhoons and hurricanes. Often, these are very transitory, while sometimes they may last for a long time. However, eventually calm will prevail. The same holds true for India as well. In fact, our hypothesis with India has been that a dislocation that lasts about four to five quarters happens every four to five years. And we have seen that play out as well. An analysis of the last 90-odd quarters showed around 10-12 significant 'crises' in the market. Despite these dislocations, the long-term growth trajectory for India continues to hold steady. So while at any point of time, India might not be a good picture to watch, in the long-term, it is definitely a great movie to see!

The second half of FY19 and the ensuing market dislocation must be seen in a similar context. Eight months on, while borrowing costs continue to be higher than normal, the borrowing tap is coming back to normalcy. We do expect the marginal slowdown and elevated borrowing costs to continue for a quarter or two, consistent with our hypothesis of four to five quarters of slowdown. In such a backdrop, our focus in the second half of the year was on further strengthening the core of our organisation as we eschewed growth in favour of building strength and stability.

## FY19 performance

FY19 was a year of two halves. While the first half was business as usual, the market dislocation meant that the second half was moderate quantitatively. However, qualitatively, it was an important year as we used the disruption to further strengthen and stabilise the organisation, true to one of our internal mottos - 'Never waste a good crisis!'

For us, the important highlights of FY19 include -

- Equity Capital** – One of the defining characteristic of our journey over the years has been the prioritisation of equity over growth. Our mantra has been simple – *Equity precedes Growth!* At every point in our journey, we have closely tracked our Debt-to-Equity (DE) ratios, raising equity whenever we have neared even 5.5x. We raised US\$250 million of equity capital from Caisse de dépôt et placement du Québec (CDPQ) in ECL Finance in FY19, of which we have already received the first tranche of US\$150 million. Not only is this equity capital infusion a validation of the quality of our book, it also provides us with enough growth capital as we go ahead.

D/E Excluding Treasury Assets

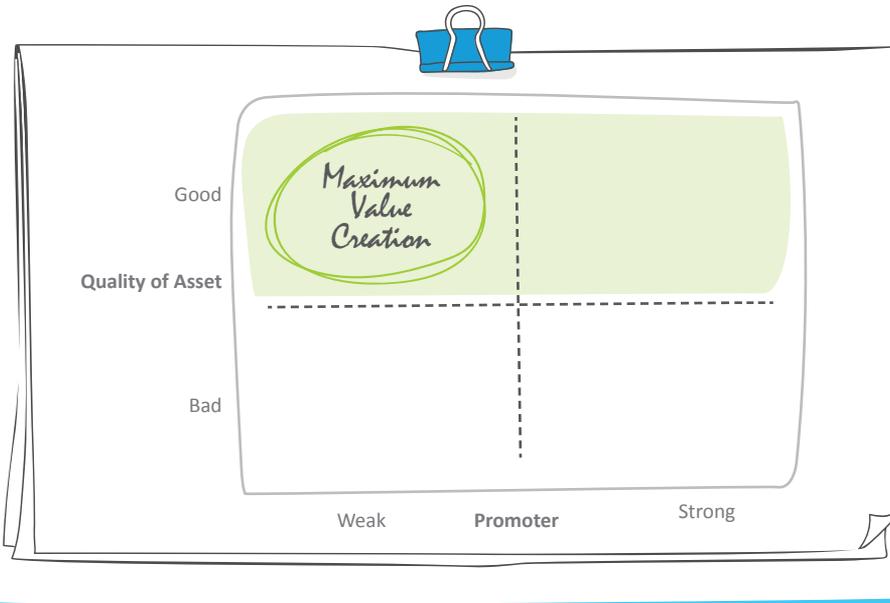


**2. Resolution & Recoveries** – Our Distressed Credit business had a good year with some big-ticket resolutions. Recoveries for the year were over ₹70 billion. Our journey in this business has been unique and highly fulfilling. Not only does it help us re-integrate temporarily non-productive assets back into the economy, it also helps us protect thousands of jobs across sectors. A sample size of nine portfolio companies that we analysed accounted for nearly 22,000 jobs protected! The total number of jobs we save and assets we revive over the years will be multi-fold.

## ARC Strategy

Typically, the assets that we encounter in this business are of two kinds – they can be either operationally strong, EBIDTA positive, good quality assets or they can be bad quality assets where the business model itself is broken. It is the first category of assets that we focus on. Even within this, it might be a case of having a strong promoter or a weak promoter. While we do consider both kind of assets, maximum value creation will usually happen in a good asset, weak promoter kind of scenario.

At the same time, we understand only too well the blood and sweat that goes into building an organisation from scratch. So, in cases where we encounter a good promoter whose company has fallen into distress primarily due to market environment and a stretched balance sheet, we endeavour to work together and create viable solutions which are long-term positive for the entrepreneur and the business, Edelweiss and society at large.



**3. Insuring India** - We completed our business roster with the launch of the General Insurance business in February 2018. Being the best avenue to translate long-term savings into long-term investible capital, the impact of insurance in nation building cannot be underscored enough.

The General Insurance business has had a strong start - in its first full year of operations, the business has already crossed ₹1 billion of premium! Even in life insurance, Edelweiss Tokio Life Insurance (ETLI) continues to be amongst fastest growing life insurance companies in the industry. More importantly, the quality of the business we are building in ETLI is what defines Edelweiss. Our Insurance business is reflective of the kind of franchise we are trying to build – long-term and steady. While the gestation period might be long, a well-run insurance business has the potential to provide stability of income in the long-term.

## *Customer Perspective – Core to strategy building*

The foray into insurance is also a reflection of our increasing retailisation. As we have become increasingly retail, be it in Credit, Wealth Management or in Insurance, we have ramped up our focus even more on putting the customer at the centre of our strategy. Across businesses, we have innovated and endeavoured to enhance customer experience. Be it our mobile trading application, loan approval system or portfolio management services, each product has been crafted after taking concerted feedback on the pain points and needs of the customer.

A key tenet to this is our consistent focus on putting ourselves in the customer's shoes and seeing things from his perspective. We strongly believe that this customer-centric approach is the only winning strategy in financial services of the future. This unique focus towards the customer has helped us fulfil the home dreams of more than 34,000 clients, insure more than 300,000 individuals, provide asset management services to more than 350,000 clients and help build more than 100,000 houses. Our client base today stands at around 1.2 million and as always, we will continue to work towards fulfilling their dreams and aspirations.

## **Never waste a good Crisis!**

We have always believed in using every crisis as a stepping stone. Like one of the characters in the popular TV series Game of Thrones says,

*"Chaos isn't a pit. Chaos is a ladder".*

— Petyr Baelish, Game of Thrones

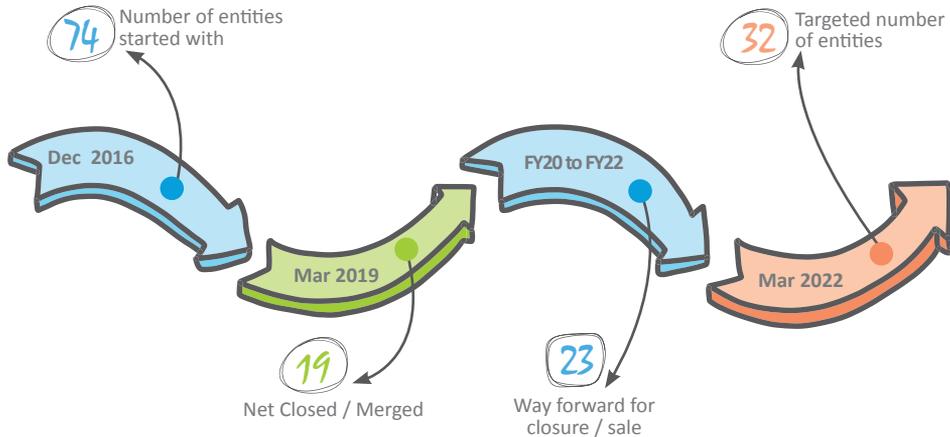
Similarly, every market disruption is an opportunity to strengthen from within. In this backdrop, we focused on enhancing capabilities which could create an even more solid foundation for future growth.

### **1. Liquidity Management**

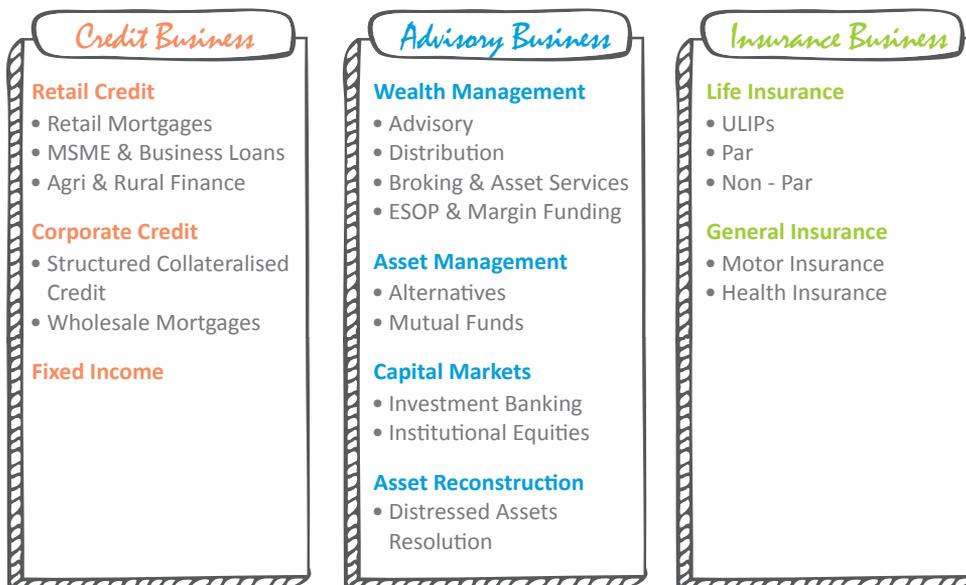
In addition to equity capital, over the last few years, we have been on a journey towards strengthening our liabilities side of the balance sheet as well. Long-term liabilities now stand at 61% of our total borrowings, up from 34% in FY15. Reliance on Commercial Papers (CPs) is now a meagre 2% of our borrowings. In the long-term, we do not expect CPs to constitute more than 10% of our total borrowings at any point of time. Even more importantly, 93% of our borrowings today constitute bank loans and Non Convertible Debentures (NCDs). One more vector we have focused on is enhancing the share of retail borrowings which now stands at 23%. In fact, in FY19, we raised more than ₹66 billion of retail borrowings. It is truly a reflection of the faith and trust that the public has reposed in us that despite the challenging times, we have been able to raise such a significant sum from retail investors.

## 2. Simplification for Scale

Over the last couple of years, we have been on a path to simplicity. We have closed and/or merged several entities - this journey will continue till FY22 when we expect to be at around 32 entities, down from 74 a couple of years ago.



At the same time, we have simplified our business structures and re-aligned businesses into three distinct Business Groups (BGs) viz. Credit, Advisory and Insurance. Each of these BGs will be self-sufficient and independent business units. This means that they will each have their own strategic investors to provide growth capital for the next 3-4 years. Additionally, each of the BGs will have an Independent Board with compositions similar to the Edelweiss Financial Services Limited Board, where we have a majority of Independent Directors.



### 3. Transformation through Technology

The sheer pace at which technology is changing the world is astounding. At Edelweiss, we have always believed in the power of technology and have moulded ourselves into a tech-enabled company. We believe that the time has come to embark on a new journey – from a tech-enabled organisation to a tech-led one. Increasingly, technology will occupy a similar presence on the table as business strategy does and we are starting to get ready for this long-term disruption. This elevation in technology will help us create a compelling offering for our clients – be it in terms of variety of service, cost efficiencies, safety and security, turnaround time, customisation and specialisation, among others. With this in mind, the technology function is now reporting directly to me. I am very excited by this new digital journey we are undertaking and feel confident that this new direction will open up several new vectors for Edelweiss, going forward.

## Learnings from FICCI

*“Yet, I am learning”*

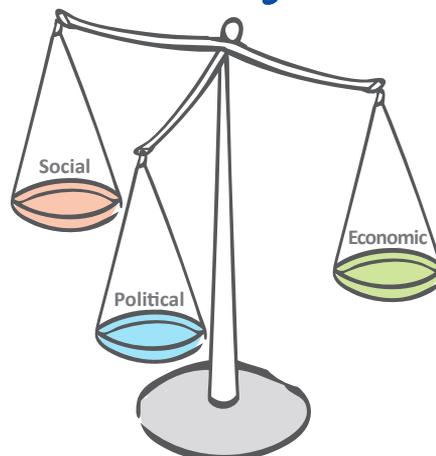
— Michelangelo at the age of 87

The beauty of life is that it never stops teaching us lessons. What we absorb and take in is our prerogative. Personally, for me, last year was especially rich in this regard, since the dual role at Edelweiss and FICCI (as President from Dec 2017 to Dec 2018) accorded me an opportunity to look at things in an entirely new light. Some of these learnings were a reinforcement of things I have seen in action over the years, while some of them provided me with a completely fresh perspective.

### The Indian Decision Making Conundrum

The FICCI tenure was an eye-opener for me, in more than one way. The nuances involved in nation building, particularly the need to balance all sides of an issue is a difficult skill to master. It was the first time I was able to experience in close quarters how the Government thinks and how policymaking works. For us in Mumbai, what might seem a no-brainer because of the economic value attached could have severe social and political repercussions attached, something we are not attuned to thinking about. A bank re-capitalisation of ₹300-400 billion might seem like an obvious choice but the trade-offs one makes, say for instance, in under-allocating to another sector like education must be taken into cognizance.

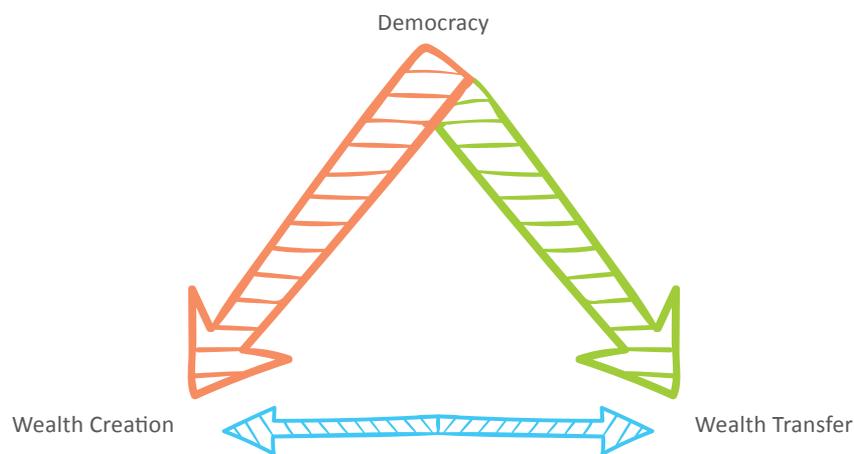
*The Balancing Act*



Earlier, the default thinking whenever we heard of some decision being stuck or some action not happening was to blame it on the ineffectuality of the Government. Today, the thinking is much more nuanced and it is much easier to understand that there would be multiple objectives that would have been under consideration on any given decision. It is a tough balancing act and one which I have learnt to understand and respect over the last year.

## The Difficult Trinity

Economists often allude to the problem of the impossible trinity – a fixed foreign exchange rate, free capital movement and an independent monetary policy. However, there is another important trinity which is difficult to balance but necessary for long-term growth and stability – an insight again gleaned from the FICCI tenure.



World over, countries have unsuccessfully tried to achieve an optimum level for each of the above, all at the same time. However, only a few have attained some degree of success. So while USA is a functioning democracy and the biggest economic superpower in the world, the stark economic inequalities (reflected in its high Gini coefficient of 41.5) is a reminder of the major income re-distribution it still needs to undertake. In comparison, countries like Germany and France have done better. While not as economically big as the USA, they have a lower Gini co-efficient, indicating a better handling of economic inequality.

As the biggest democracy in the world, India's political process, despite whatever flaws it might have, is a benchmark in itself. We are now starting to realise our economic potential as well. Wealth creation is happening at a rapid pace and the power of compounding is expected to further push the growth agenda. However, the growing wealth has also brought in growing inequalities.

Segment of Population by Wealth Share	2000	2016
Top 1%	37%	58%
Bottom 10%	0.1%	-0.7%

Source: Credit Suisse

A -0.7% share suggests that this segment of the society, has lower assets than liabilities and is increasingly sinking into more and more debt. The next two deciles held just 0.2% and 0.5% of the total wealth. Taken together, this effectively means that the bottom 30% of the Indian population owns next to nothing!

This wealth inequality can be a strong deterrent to holistic economic development of the nation and must be urgently addressed. Inability to provide a large part of the population the benefits of a rapidly growing economy can further deepen inequalities, creating social unrest and a deep sense of mistrust in the powers that be. Only when India can optimally balance the three sides of the triangle can it hope to become a global economic superpower.

## Outlook

### Near-Term Outlook

The global economy today is going through volatile times. Even the domestic market seems to be facing its own troubles. It might seem like a doom and gloom scenario. However, we actually think that this could be the onset of a strong growth phase for the economy. There are a few key reasons behind this thinking –

#### 1. Disruption-Adjustment Phase is over

The last two years were more of a disruption and subsequent adjustment phase for the economy. A variety of economic reforms were introduced at regular intervals. While each of them has a clearly defined long-term structural benefit, it was expected that there would be teething troubles as well. Most of these reforms are now well-entrenched and we are even starting to see the benefits coming in, which will only accelerate going forward.

#### 2. NPA Endgame

Gross NPA for banks has now peaked and started showing a downward trend as per the latest Financial Stability Report. While the absolute amount is still significant, the effectiveness and efficacy of the IBC is now firmly established. Not only are stressed assets getting resolved faster than earlier, the value realisation has also jumped substantially. As it is, the system has already provided for nearly ₹5.5 trillion of the total system NPAs of ₹13 trillion. Total loss on this portfolio would be around ₹6 trillion – so effectively, we have only about ₹1.5 trillion of provisioning left to achieve. Even on a normal provisioning run-rate, this should be achievable in the next three years without any of the excessive pain that we have seen over the last two-three years. So the NPA endgame is truly approaching its logical conclusion.

### 3. Credit growth coming back

Credit growth has started picking up, especially on the corporate side. This has been due to a multitude of factors – bank re-capitalisation has lifted some banks out of Prompt Corrective Action (PCA), resolution of stressed assets has freed up capital and Government investments on infrastructure continue, more so with the renewed majority of the Government. However, discretionary consumption has taken a hit due to the recent liquidity squeeze on NBFCs and must be monitored closely. A quick resolution will help take consumption trends back to normal levels but a prolonged slowdown could drastically impact the economic growth.

### 4. Strong FII inflows

FII inflows have seen strong traction after the deluge of outflows last year. Typically, this has been the observed trend over the last two decades. Market returns are typically fantastic in the year following one with increased outflows as foreign investors come back in even larger numbers, which is what we expect in the current year as well.

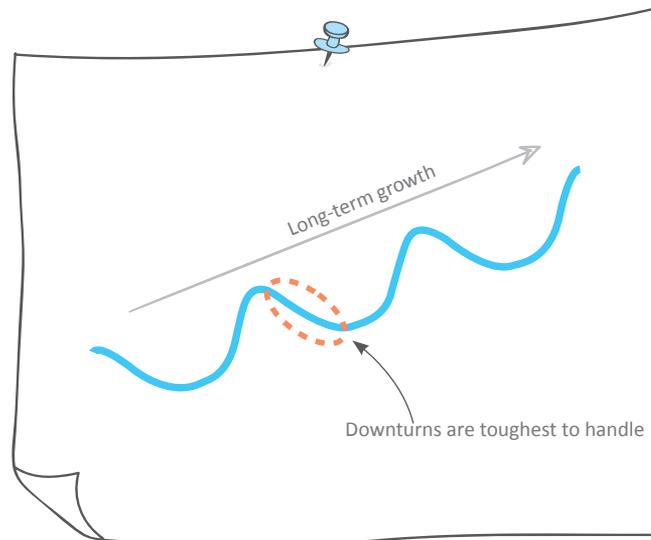
### 5. Dual expansionary environment

At any given point of time, it is rare to see an expansionary mandate for both monetary and fiscal policy in India. However, with inflation easing out, the RBI has been earnestly cutting interest rates in order to arrest the growth tempering. At the same time, the overall push by the Government has been towards investment, particularly in infrastructure and the rural economy. As a result, we are in a unique economic environment where we are seeing loosening on both fiscal and the monetary side. This bodes well for the growth prospects of the economy.

However, there are some areas which can impact the economy and need to be closely monitored. The slowdown in global trade could have an effect on the oil economy, which continues to have a significant say in the larger macro-economics of the country. Domestic consumption also needs to pick up for the growth momentum to accelerate. For this, the liquidity situation needs to start easing out. With elections out of the way and a stable and strong Government in the saddle, we do not see the squeeze lasting for too long now.

## Long-Term Outlook

The current slowdown is nowhere a reflection of India's long-term potential, which continues to be very optimistic. The greatest challenge during such a slow phase is not just figuring out ways to ease the pain of the slowdown but also having the faith and gumption to trust in the long-term.



In our journey as a country, we are in the one of the highlighted troughs. It seems that things seem to be going downhill and there is no end to the pain. However, we must remember -

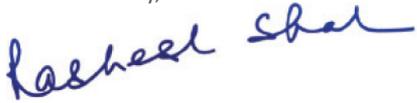
*"It is the darkest hour before the dawn"*

— Thomas Fuller

There will be many troughs like the one we are seeing now but the good thing about India is that there will be more crests than troughs and typically these crests will last much longer than the troughs. India is a self-correcting country. As and when a disruption happens, the normal is impacted but sooner rather than later, we successfully evolve and adjust to this new normal.

In the long-term, we continue to be highly optimistic of the path and the direction that the Indian economy is taking. The renewed majority of the reforms-oriented Government is a highly positive development. We now eagerly await the second wave of reforms. While global headwinds may continue, the domestic tailwinds are powerful enough to ensure that we make strong progress over the next few years. Like I relentlessly say, India is full of opportunity. The progressive Government and regulatory policies in recent years have only added to this opportunity size. It is a new India that is now rising – an India which can hold its own in the global arena.

Yours Sincerely,



Rashesh Shah  
Chairman & CEO







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