

---

**Indian Investing Conclave**

**Presentation by**

**Samit Vartak, CFA**

***Founding Partner & CIO***

**SageOne Investment Advisors LLP**

**Quest for Outstanding Investments**

India dedicated long only equity manager with mission to preserve the purchasing power of capital whilst providing superior sustainable returns over long term

# What do we look for in an Investment?

---

- High quality business
  - How the business does in tough economic environment
  - How protected is the profitability (pricing power, margins stability, etc.) under unfavorable scenarios such as input costs shooting up
  - Threat from disruptive innovations
  - Management Quality
- Business offering > 20% annual earnings growth over 3 to 5 year period
  - Market size and positioning against the competitors
  - Does historical growth trend (relative and absolute) provide support
- Reasonable valuation
  - Is market assigning more than deserving risk to the business
  - What are absolute multiples this business deserves considering the ROCE/ROE, leverage, growth potential and riskiness of the business
  - How high is the probability of multiples derating?

# Edelweiss Financial Services

---

Industry: **Financial Services**

Current Mcap/Price (as of May 19, 2019) : **INR 143.4 bn/ INR 153.65 per share**

- Edelweiss has transformed itself from a pure play capital markets player into a diversified financial services conglomerate with presence across the whole spectrum of financial services
- Market leader in structured financing space
- Largest ARC with ~50% Asset share in ARC industry
- Leading player in capital markets, asset management, wealth advisory, credit and insurance
- It serves a 12 lac strong client base through over 10,000 employees based out of over 450 offices. Together with strong network of Sub-Brokers and Authorized Persons, Edelweiss group has presence across all major cities in India

# Customer Assets Over INR 2 Trillion

As on 31 <sup>st</sup> March'19 (rounded off to nearest 100)	INR Cr	YoY Growth
<b>Customer Assets</b>	<b>2,00,900</b>	<b>19%</b>
<i>Assets Under Advice (Wealth Management)</i>	<i>1,06,000</i>	<i>18%</i>
<i>Distressed Credit (ARC Assets)</i>	<i>39,200</i>	<i>4%</i>
<i>Funds under Management (Asset Management)</i>	<i>35,800</i>	<i>26%</i>
<i>Assets under Custody &amp; Clearing</i>	<i>19,900</i>	<i>56%</i>
<b>Balance Sheet Assets</b>	<b>53,900</b>	<b>(3%)</b>
<b>Total Assets</b>	<b>2,54,800</b>	<b>13%</b>

**Balance sheet assets require equity. The rest are capital light, fee generating businesses**

Source: Company management

# Business Segments

FY19 (INR Cr)	EOP Equity	Profit After Tax	RoA	RoE
<b>Total Pre Minority</b>	<b>8,715</b>	<b>1,044</b>		
Credit	4,870	752	2.0%	15.7%
Distressed Credit	1,869	417	6.2%	28.4%
Advisory	192	292		
Life & General Insurance	1,048	(330)		
BMU, Corp & Others	736	(87)		
<b>Minority Interest (MI)</b>	<b>1,038</b>	<b>49</b>		
<b>Total Consolidated Post MI</b>	<b>7,677</b>	<b>995</b>	<b>1.8%</b>	<b>13.4%</b>
<b>Total Ex-Insurance Post MI</b>	<b>7,084</b>	<b>1,193</b>	<b>2.4%</b>	<b>17.6%</b>

Source: Company management

# Business Segments (contd.)

Business Segments (INR Cr)	FY19 Pre MI PAT	% Contribution
Retail Mortgage	100	7%
SME, ESOP and Other Business Loans	120	9%
Structured Collateralised Credit	217	16%
Wholesale Mortgage	315	23%
Distressed Credit Business	417	30%
Wealth Management and Asset Management	225	16%
Capital Markets	67	5%
BMU, Corporate and Others	(87)	(6%)
<b>Total Ex- Insurance Pre MI PAT</b>	<b>1,374</b>	<b>100%</b>

**Capital light segments contribute more than half the PAT**

Source: Company management

---

# Credit Business

# Credit Business Capital Employed

As on 31 <sup>st</sup> March'19	Capital Employed (INR Cr)	%
<b>Retail Credit</b>	<b>18,075</b>	<b>42%</b>
Retail Mortgage	8,996	21%
SME & Business Loans	4,591	11%
ESOP and Margin Financing	4,089	9%
Agri and Rural Finance	399	1%
<b>Corporate Credit</b>	<b>18,055</b>	<b>41%</b>
Structured Collateralised Credit	6,456	15%
Wholesale Mortgage	11,599	26%
<b>Distressed Credit</b>	<b>7,380</b>	<b>17%</b>
<b>Total Credit Book</b>	<b>43,510</b>	<b>100%</b>

FY19 (INR Cr)	Total	Y-o-Y
<b>EOP Capital Employed</b>	<b>43,510</b>	<b>4%</b>
<b>EOP Equity</b>	<b>6,739</b>	<b>24%</b>
<b>Net Interest Income</b>	<b>3,576</b>	<b>38%</b>
<b>PAT</b>	<b>1,169</b>	<b>61%</b>
<b>Net Interest Margin</b>	<b>8.1%</b>	
<b>Cost to Income</b>	<b>37%</b>	
<b>RoA</b>	<b>2.6%</b>	
<b>RoE</b>	<b>18.7%</b>	

This has been the concern area for investors

Source: Company management

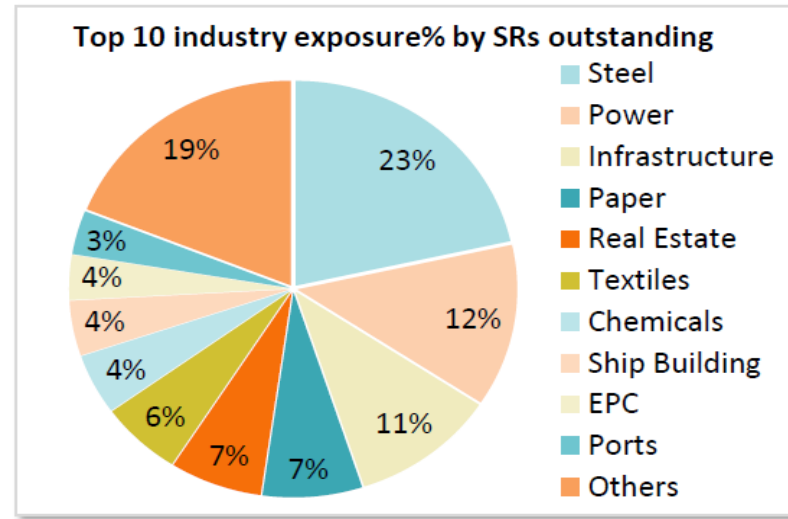
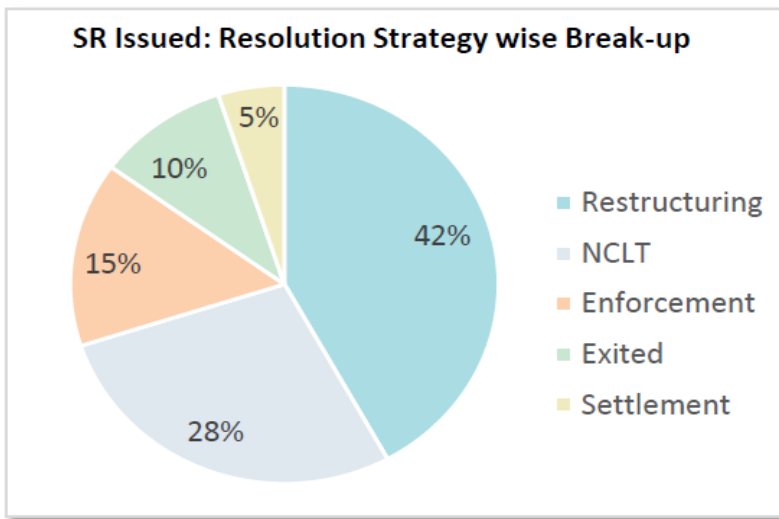
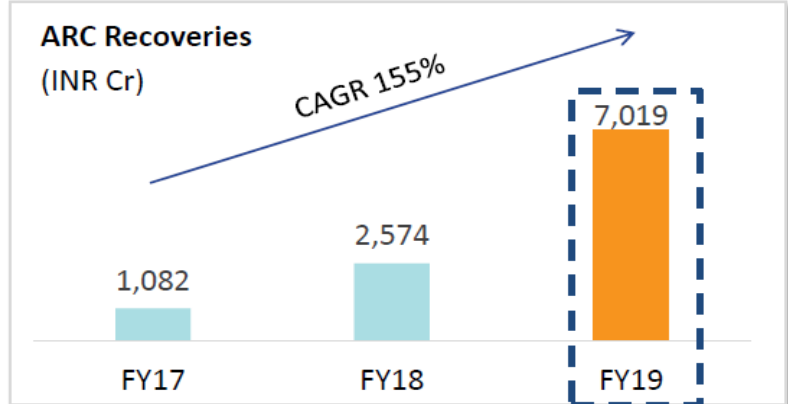
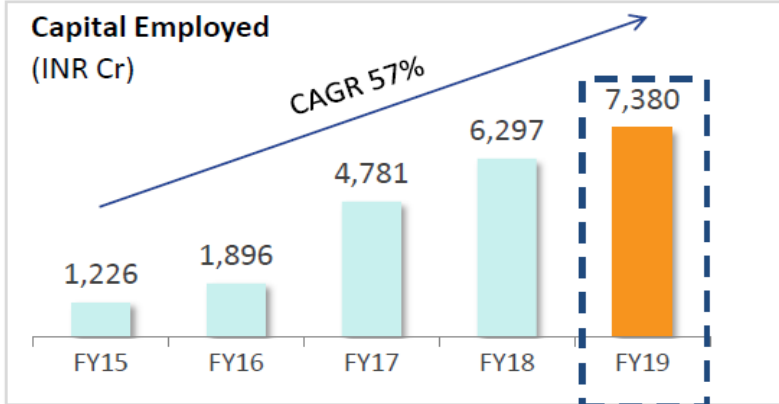


# Wholesale Mortgage Concerns

---

- Total exposure of 11,599 crs across ~ 160 projects
- Average funding ~ 72 crs/project
- Collateral cover ~ 2x
- Around 10-15% of the projects under watch i.e. 1000-1500 crs
- Stage 3 accounts: 3 amounting to 208 crs
- Provisions on book: 164 crs
- Foreclosure losses to date: **zero**

# Distressed Credit Business



**Total ARC Exposure = 39,200 crs. Revenue recognition back ended.**

Source: Company management

# ARC Business

---

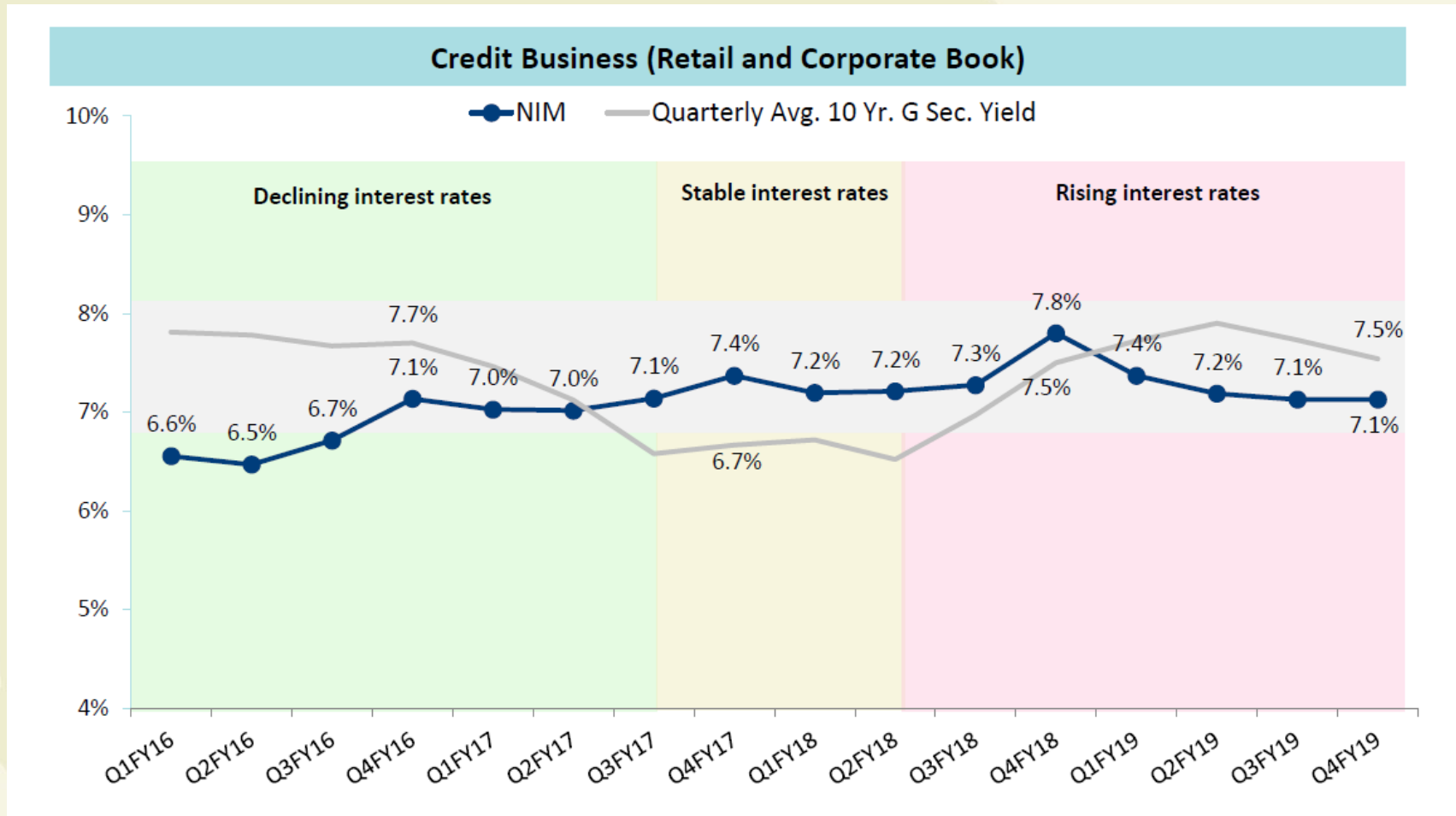
- 60% is owned by Edelweiss. 20% CDPQ and 20% Others
- Total exposure is 39,200 crs
- 7,380 crs capital employed by the ARC
- 15 : 85 ratio of ARC : Banks. This was 5 : 95 earlier
- Management fees of ~ 1.5-2 % p.a. Not recognized until the exit and debt recovered by the bank
- Revenue (management fees + profit sharing) is back ended
- Management fees on the entire exposure

# Asset Quality & Provisioning

As on 31 <sup>st</sup> March'19 (INR Cr)	Q3FY19	Q4FY19
Credit Book (Ex - Distressed Credit)	35,554	36,130
<i>Of which Stage 3</i>	654	677
ECL Provision	805	815
<i>Of which Stage 3</i>	378	377
Specific Provision Cover	58%	56%
Total Provision Cover	123%	120%
Average Collateral cover on Corporate Book	1.9x	1.8x
Average Loan-To-Value on Retail book	~45%	~45%
Gross NPA	1.84%	1.87%
Net NPA	0.78%	0.83%
Provisions & Write Offs for the quarter	107	106

Source: Company management

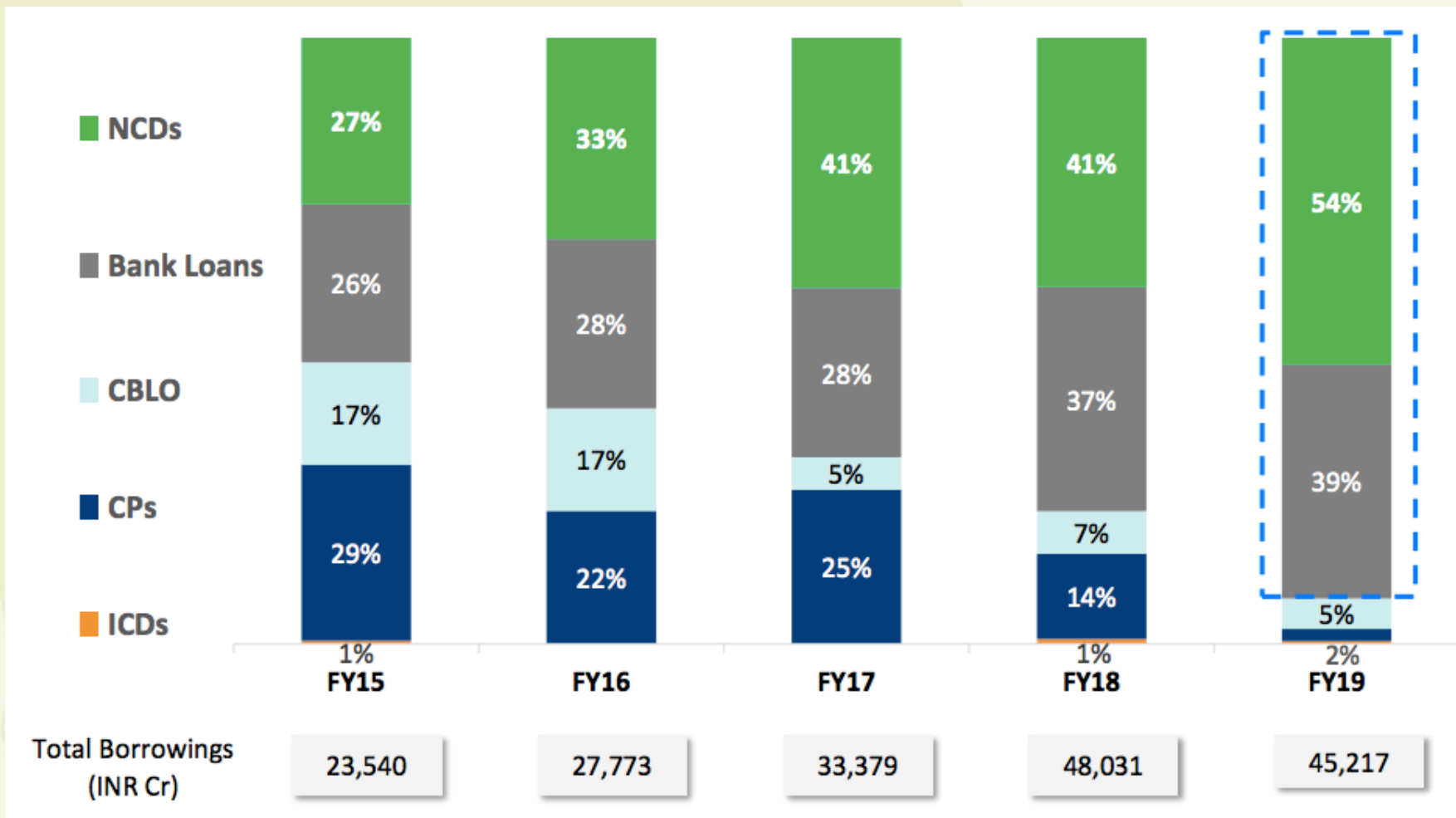
# Credit Business NIMs



**Have maintained NIMs in the current toughest environment the company has ever faced**

Source: Company management

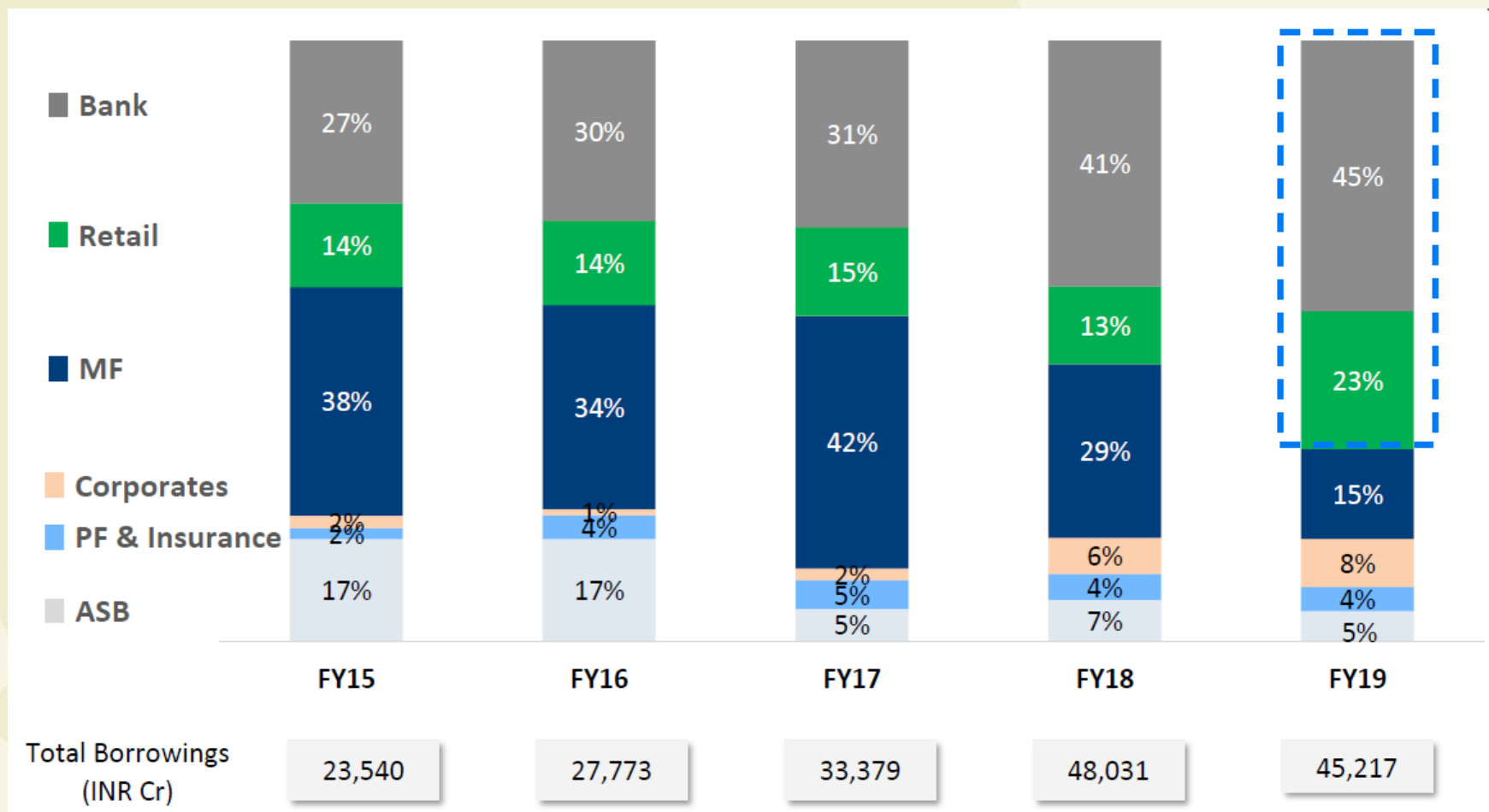
# Debt by Instruments



Source:  
Company

Source: Company management

# Debt by Source



Source: Company management

---

# Advisory Business



# Advisory Business Overview

FY19 (INR Cr)	Total	Y-o-Y	Wealth Mgmt	Y-o-Y	Asset Mgmt	Y-o-Y	Capital Mkts	Y-o-Y
Net Revenue	1,310	-	725	30%	243	88%	342	(45%)
PAT	292	(3%)	162	49%	63	52%	67	(55%)
Cost to Income	66%		67%		58%		69%	
PAT Yield			17 bps		19 bps		-	
Customer Assets			Assets under Advice		Assets under Management		Assets under Custody and Clearing	
			1,06,000	18%	37,000	27%	19,900	56%

- Asset management business PAT yield should significantly improve as carry income is generated
- AIF structure is the future direction, wherein many offshore institutions invest. This reduces the risk to Edelweiss.

Source: Company management

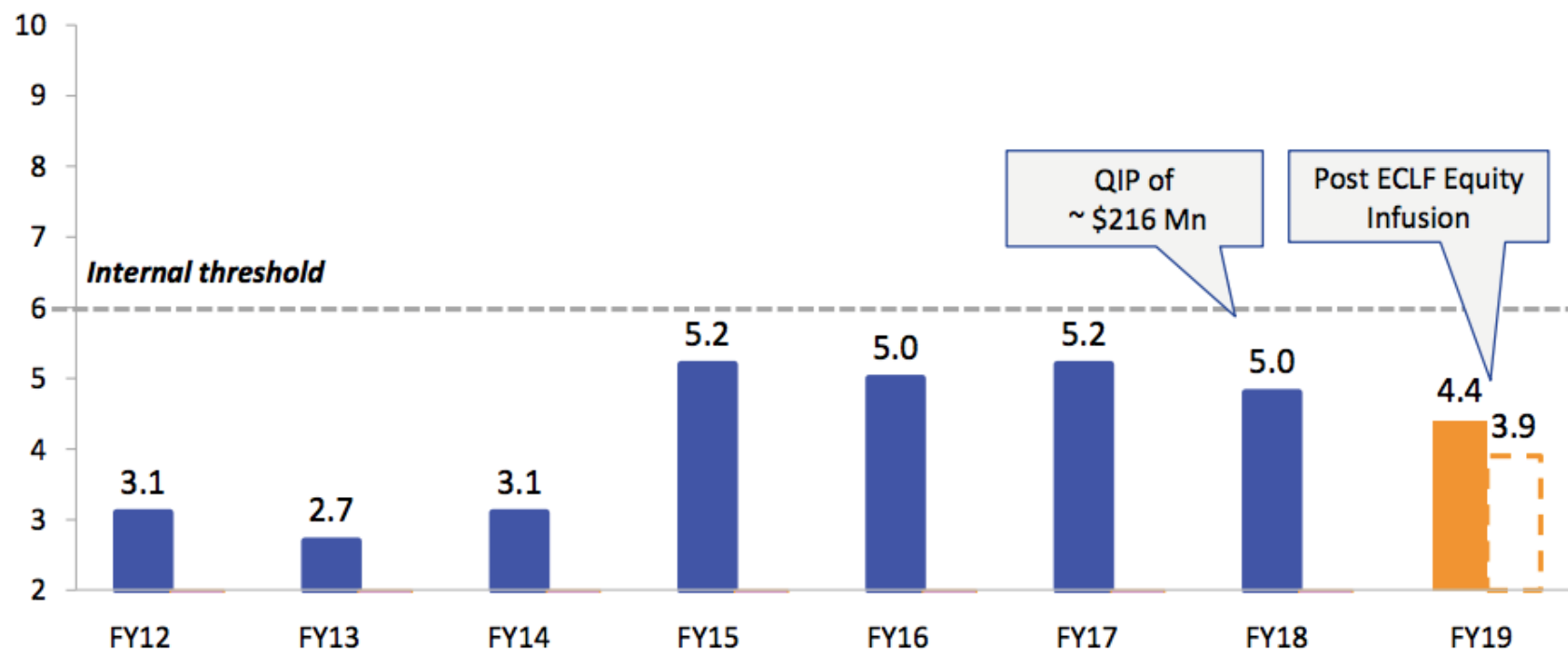
# Structured Funds (AIF) Business

---

- Edelweiss contributes 5%+ of the fund. Remaining comes from global investors
- Management fees: 1.5-2% p.a.
- Carry: 15-20% of the profits with hurdle rate of 8% (\$) or 12%(INR) **with Catch up**
- At 15% gross returns, the fund doubles in 5 years. Carry could be 15-20% or 3-4% p.a. in addition to the 1.5-2% p.a. of management fees
- Investors seem to underestimate the back ended potential of the carry revenue

# Debt to Equity

## D/E Excluding Treasury Assets



Source: Company management

---

# Insurance Business

# Insurance Business

(INR Cr)	FY18	FY19	Y-o-Y Growth
Net Premium Income	601	855	42%
Investment Income & Other Income	148	202	36%
<b>Total Business</b>	<b>749</b>	<b>1,057</b>	<b>41%</b>
Profit After Tax	(236)	(270)	-
Minority	(115)	(133)	-
Edelweiss' Share in PAT	(120)	(138)	-
<b>Net Worth</b>	<b>1,160</b>	<b>929</b>	

**Embedded Value: 1,570 crs**

Source: Company management

---

# Growth Potential

# Historical Growth

---

	10 year CAGR	5 year CAGR
Net Sales	27.26%	22.67%
EBIT	27.67%	22.52%
Net Profit	16.35%	25.91%

---

# Valuation



# Financial Highlights

---

Year Ending	Mar 2019	Year Ending	Mar 2019
Market Price (May 19, 2019)	153.65	Net Profits (post MI)	995 Cr
Market Cap	14,340 Cr	P/E	14.4
Equity	7,677 Cr	P/B	1.87
		D/E	3.9

# SOTP Valuation

(Rs mn)	Parameter	Mar-21 value	Multiple	Valuation	EDEL's Stake	Value
Credit Business	Book value	82,708	1.9	1,54,582	85%	1,13,711
Franchise Business	Net Profit	3,937	20.0	78,745	100%	78,745
BMJ& Corporate	Net Profit	87	10.0	872	100%	872
Life Insurance	EV	18,770	1.0	18,770	51%	9,573
<b>Total</b>						<b>2,02,900</b>
Share count (mn)						908
<b>Fair Value per share</b>						<b>224</b>

Source: SBI Securities Research Report May 16, 2019

- **Credit business was valued at around 10,000 crs based on the CDPQ equity infusion of 1,800 crs for 13-18% stake (formula based)**
- **I believe the Advisory Business (or Franchise Business) normalized profits if accounted for carry profits is higher**
- **2% on a 10,000 crs AUM is 200 crs incremental revenue without much increase in cost. This is just as an example for the carry potential.**

# Risks

---

- Company not able to monetize the real estate investments
- Liquidity crisis blows up and credit market freezes
- Exposure to the Real Estate Industry
- Regulations against the NBFC sector

# Investment Rationale Summary

---

- **Synergies of having the ecosystem and various fund structures is underappreciated**
- **Market underappreciates the profit and ROE boost from the carried interest in the asset reconstruction business as debt recoveries accelerate in the next 3 years**
- **Asset and wealth management businesses are under-earning and will multiply profits as incremental assets cost less to raise and manage**
- **Monetizing wholesale credit opportunities through asset-light fund structure improves RoE and releases equity for retail lending**
- **Increasing contribution of retail will give a tailwind to valuations**
- **Management has a history of scaling back in face of undue risk**

# Disclosure

---

**Disclosure:** Some or all of SageOne's clients and partners are invested in this stock

- This is not a recommendation to buy but a presentation to showcase our analysis of this business
- In preparing this document, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources or which was otherwise reviewed by us. While the information provided herein is believed to be reliable, neither the presenter nor SageOne makes any representation or warranty whether express or implied, and accept no responsibility for its completeness or accuracy or reliability
- Please seek advice of your personal advisor and take your own independent decision before acting on the idea presented
- This presentation is being provided to you solely for your convenience. However, it is not intended to be, nor shall it be construed as, an offer, or a solicitation of an offer, to buy or sell an interest in the Funds
- Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including but not limited to loss of capital, revenue or profits that may arise from or in connection with the use of the information.
- SageOne is an Investment Advisor and a PMS provider registered with SEBI

# Learn More

---

## Contact Details

Website: [www.sageoneinvestments.com](http://www.sageoneinvestments.com)

Email: [ir@sageoneinvestments.com](mailto:ir@sageoneinvestments.com)