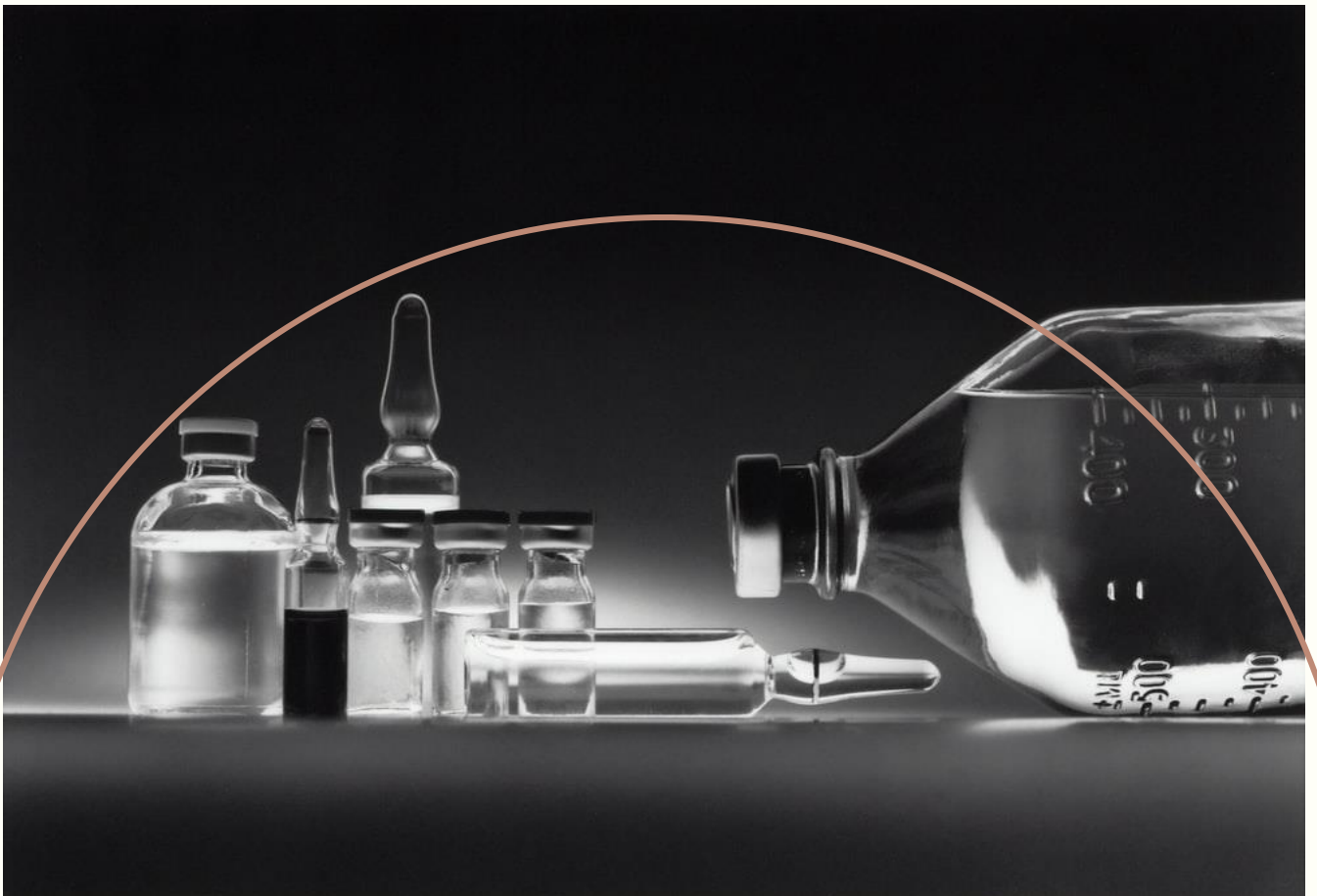


CASE STUDY DOCUMENT

First & Second Generation of an Unlisted Pharma Company





The Situation

This case pertains to an unlisted company in the pharmaceutical space. The company was started by a first-generation entrepreneur in the late 1980s. The second generation has recently entered the business. The family has come into substantial liquidity due to the sale of their stake in a foreign company. The shareholders of the company are now looking to allocate / transfer the funds lying in this company to three separate legal entities, which would involve a demerger process. The main shareholders of the company that received the proceeds of the stake sale are the founder, his son and a private trust. Since this process could take 6-9 months, Waterfield had to be mindful of an investment strategy that was defined in two stages, one which was for a maximum period of 9 months and the other as a long-term investment strategy, once the funds had been allocated to the distinct entities. During the initial phase, Waterfield worked with the firm's management consultants who were advising them on the restructuring to ensure there were no gaps in the understanding of the final objectives that the family was looking to achieve.

Waterfield worked as an advisor to the family, alongside existing wealth distributors to enable execution of mutual fund investments. Waterfield also evaluated and advised on the product recommendations made by the distributors and directly sourced products exclusively for the family.

The deployment of the funds received happened over two Phases:

Phase 1: During the Demerger process, the liquidity received on sale of stake was invested into Ultra-Short-term mutual funds for a period of 6-9 months.

Phase 2: Detailed Migration plan was constructed out for three entities, basis the risk profile and investment horizon of the beneficiaries.



Waterfield's Strategy

Waterfield's strategy, in the first phase of the investments, was to ensure liquidity and tax-efficiency. When we reviewed the portfolio, it came to light that all the sale proceeds had been invested in Bank Fixed Deposits. While the family was looking at the safety of the investments, they were losing 90-100 bps (post-tax) on the returns by not investing the sale proceeds into debt mutual funds.

The family's main concern was that the company should not be viewed as an NBFC, as per RBI guidelines, as for a temporary period of time, the firm would have more than 50% of its income coming from Investments and that the financial assets of the company would constitute more than 50% of the total assets. Waterfield worked with the firm's consultants to seek a formal clarification from the RBI that the company would not be classified as an NBFC and thereafter implemented the first phase of the investment strategy.

In Phase I of the investments, the family specifically sought liquidity in 48 hours (if required) and indicated that the maximum investment horizon was 9 months.

Accordingly, Waterfield suggested that all the investments should be made only into Ultra-Short-Term mutual funds, as these funds were yielding, on a Net YTM basis, approx. 7.5%-8%, with no exit loads and liquidity on a T+1 basis. We used Waterfield's whitelisting mutual fund process, which is refreshed every quarter, to identify the most consistent fund manager performance in a specific category to identify the specific funds for allocation. No fund would have an allocation > 4% of their corpus.

The investments were made in the Dividend Reinvestment options, to lower the tax impact and all the investments were put through the "Direct" option, to ensure optimal expense ratios. Specifically, from a taxation point of view, the tax being paid by the company was 34.61% on their fixed deposits, while through the Dividend Reinvestment options, the family was paying only 28.33% through Dividend Distribution Tax and nominal capital gains. In the Ultra-Short Term category, Waterfield further identified funds with "high credit" quality and "moderate credit" quality (where the exposure to A rated paper was >10%) and ensured a judicious mix of the same to ensure optimised returns, while ensuring a comprehensive understanding of risk.

Once the demerger process was complete, Waterfield initiated Phase II of the investments, which was a long - term investment strategy. The funds were divided amongst three portfolios / entities:

1. **Aggressive Portfolio:** Earmarked for the Promoter's son, with a mandate of generating returns of >12 % (pre-tax) over a 10-year period.
2. **Moderately Aggressive Portfolio:** Earmarked for the Promoter's daughter's kids, with a mandate of generating returns of >11% (pre-tax) over a 10-year period.
3. **Conservative Portfolio:** Earmarked for the Promoter of the family with a mandate of wealth preservation, looking to generate returns of >9% (pre-tax) over a 5-10-year period. All the entities wanted to generate a certain amount every year that could be distributed to the family and its members.



For the **first portfolio**, which was expected to generate a pre-tax return >12%, following is the proposed allocation:

| Asset Categories | Liquidity Factor | Investment Horizon | Indicative Pre-tax Returns (%) | Indicative Post-tax Returns (%) | Proposed Allocation (INR Crores) | Proposed Allocation (%) | Sub-Allocation (%) | Returns Allocation - PreTax (%) | Returns Allocation - PostTax (%) |
|--|------------------|--------------------|--------------------------------|---------------------------------|----------------------------------|-------------------------|--------------------|---------------------------------|----------------------------------|
| Fixed Income | | | | | 250 | 50% | | | |
| Mutual Funds | | | | | 160 | | 64% | | |
| Ultra Short Term Funds | Liquid | 1-3years | 7.40% | 6.90% | 40 | | 16% | 0.60% | 0.60% |
| Arbitrage Funds | Liquid | 1-3years | 6.00% | 6.00% | 20 | | 8% | 0.20% | 0.20% |
| High-Yield Funds | Liquid | 1-3years | 7.80% | 7.30% | 75 | | 30% | 1.20% | 1.10% |
| Fixed Maturity Plans(AA) | Illiquid | 3 years | 8.00% | 7.40% | 25 | | 10% | 0.40% | 0.40% |
| Bonds/ CPs | | | | | 25 | | 10% | | |
| Tax Free Bonds | Illiquid | 10-15 years | 9.50% | 6.20% | 15 | | 6% | 0.30% | 0.20% |
| Commercial Paper (High Yield) | Illiquid | 1year | 10.00% | 6.50% | 10 | | 4% | 0.20% | 0.10% |
| Preference Shares | | | | | 15 | | 6% | | |
| High Yield Debt AIFs | Illiquid | 5- 6 years | 14.10% | 9.30% | 50 | | 20% | 1.40% | 0.90% |
| Equity | | | | | 200 | 40% | | | |
| Mutual Funds | | | | | 110 | | 55% | | |
| Large Cap Funds | Liquid | 3-5 years | 13.00% | 13.00% | 45 | | 23% | 1.20% | 1.20% |
| Large & Midcap Funds | Liquid | 3-5 years | 13.50% | 13.50% | 30 | | 15% | 0.80% | 0.80% |
| Flexicap Funds | Liquid | 3-5 years | 14.00% | 14.00% | 25 | | 13% | 0.70% | 0.70% |
| Small & Mid Cap Funds | Liquid | 3-5 years | 15.00% | 15.00% | 10 | | 5% | 0.30% | 0.30% |
| PMS | Liquid | 3-5 years | 15.00% | 15.00% | 50 | | 25% | 1.50% | 1.50% |
| Direct Equity Portfolio | Liquid | 3-5 years | 15.00% | 15.00% | 25 | | 13% | 0.80% | 0.80% |
| Alternate Equity Funds Alternates | Illiquid | 3-5 years | 15.00% | 12.80% | 15 | | 8% | 0.50% | 0.40% |
| Alternates | | | | | 50 | 10% | | | |
| Venture capital /Private Equity Funds/ Unlisted/ Imact Investments | Illiquid | 10 years+ | 18.00% | 11.80% | 50 | | | 1.80% | 1.20% |
| Overall Portfolio | | | | | 500 | | | 12.10% | |

For the **second portfolio**, which is a moderately aggressive portfolio, expected to generate a pre-tax return >11%, following is the proposed allocation:

| Asset Categories | Liquidity Factor | Investment Horizon | Indicative Pre-tax Returns (%) | Indicative Post-tax Returns (%) | Proposed Allocation (INR Crores) | Proposed Allocation (%) | Sub-Allocation (%) of total | Returns Allocation - PreTax (%) | Returns Allocation - Post Tax (%) |
|--|------------------|--------------------|--------------------------------|---------------------------------|----------------------------------|-------------------------|-----------------------------|---------------------------------|-----------------------------------|
| Fixed Income | | | | | 280 | 70% | | | |
| Mutual Funds | | | | | 210 | | 53% | | |
| Ultra Short Term Funds | Liquid | 1 - 3 years | 7.10% | 6.70% | 40 | | 10% | 0.70% | 0.70% |
| Arbitrage Funds | Liquid | 1 - 3 years | 6.00% | 6.00% | 20 | | 5% | 0.30% | 0.30% |
| Fixed Maturity Plans (AAA) | Illiquid | 3 years | 7.00% | 6.60% | 10 | | 3% | 0.20% | 0.20% |
| Fixed Maturity Plans (AA) | Illiquid | 3 years | 7.40% | 6.90% | 20 | | 5% | 0.40% | 0.30% |
| Short Term Funds | Liquid | 1 - 3 years | 7.10% | 6.70% | 40 | | 10% | 0.70% | 0.70% |
| High - Yield Funds | Liquid | 1 - 3 years | 7.70% | 7.10% | 80 | | 20% | 1.50% | 1.40% |
| Bonds | | | | | 10 | | 3% | | |
| High Yield Debt AIFs | Illiquid | 10 - 15 years | 9.00% | 5.90% | 10 | | 3% | 0.20% | 0.10% |
| High Yield Debt AIFs | Illiquid | 5 years | 13.90% | 9.10% | 50 | | 13% | 1.70% | 1.10% |
| Preference Shares | Illiquid | 3 years | 10.70% | 7.00% | 10 | | 3% | 0.30% | 0.20% |
| Equity | | | | | 120 | 30% | | | |
| Mutual Funds | | | | | 60 | | 15% | | |
| Large Cap Funds | Liquid | 3 - 5 years | 13.00% | 13.00% | 20 | | 5% | 0.70% | 0.70% |
| Large & Midcap Funds | Liquid | 3 - 5 years | 13.50% | 13.50% | 20 | | 5% | 0.70% | 0.70% |
| Flexicap Funds | Liquid | T + 3 | 14.00% | 14.00% | 20 | | 5% | 0.70% | 0.70% |
| PMS | Liquid | T + 7 | 15.00% | 15.00% | 30 | | 8% | 1.10% | 1.10% |
| Direct Equity Portfolio | Liquid | T + 3 | 15.00% | 15.00% | 20 | | 5% | 0.80% | 0.80% |
| Alternate Equity Funds | Illiquid | 3 - 5 years | 15.00% | 11.30% | 10 | | 3% | 0.40% | 0.30% |
| Total | | | | | 400 | | 100% | 10.30% | 9.20% |
| Alternates | | | | | 75 | | | | |
| Venture Capital / Private Equity Funds / Unlisted / Impact Investments | | | 18.00% | 11.80% | 75 | | | | |
| Total (including Alternates) | | | | | 475 | | | 11.50% | 9.60% |
| Tactical Opportunities | | | | | 25 | | | | |
| Tactical Opportunities | | | | | 25 | | | | |
| Overall Portfolio | | | | | 500 | | | | |



For the **third portfolio**, which is a conservative portfolio, expected to generate a pre-tax return >9%, Waterfield suggested the following allocation:

| Asset Categories | Liquidity Factor | Investment Horizon | Indicative Pre-tax Returns (%) | Indicative Post-tax Returns (%) | Proposed Allocation (INR Crores) | Proposed Allocation (%) | Sub - Allocation (% of total) | Returns Allocation - PreTax (%) | Returns Allocation - Post Tax (%) |
|---|------------------|--------------------|--------------------------------|---------------------------------|----------------------------------|-------------------------|-------------------------------|---------------------------------|-----------------------------------|
| Fixed Income | | | | | 415 | 83% | | | |
| Mutual Funds | | | | | 345 | | 69% | | |
| Ultra Short Term Funds | Liquid | 1 - 3 years | 7.40% | 6.90% | 100 | | 20% | 1.50% | 1.40% |
| Arbitrage Funds | Liquid | 1 - 3 years | 6.00% | 6.00% | 55 | | 11% | 0.70% | 0.70% |
| Fixed Maturity Plans (AAA) | Illiquid | 3 years | 7.30% | 6.80% | 30 | | 6% | 0.40% | 0.40% |
| Fixed Maturity Plans (AA) | Illiquid | 3 years | 8.00% | 7.40% | 30 | | 6% | 0.50% | 0.40% |
| Short Term Funds | Liquid | 1 - 3 years | 7.30% | 6.80% | 50 | | 10% | 0.70% | 0.70% |
| High - Yield Funds | Liquid | 1 - 3 years | 7.80% | 7.30% | 80 | | 16% | 1.20% | 1.20% |
| High Yield Debt AIFs | Illiquid | 5 years | 14.20% | 9.30% | 25 | | 5% | 0.70% | 0.50% |
| Tax Free Bonds | Illiquid | 10 - 15 years | 9.50% | 6.20% | 15 | | 3% | 0.30% | 0.20% |
| Preference Shares | Illiquid | 3 years | 11.10% | 7.30% | 30 | | 6% | 0.70% | 0.40% |
| Equity | | | | | 75 | 15% | | | |
| Mutual Funds | | | | | 65 | | 13% | | |
| Large Cap Funds | Liquid | 3 - 5 years | 13.00% | 13.00% | 35 | | 7% | 0.90% | 0.90% |
| Large & Midcap Funds | Liquid | 3 - 5 years | 13.50% | 13.50% | 30 | | 6% | 0.80% | 0.80% |
| Alternate Equity Funds | Illiquid | 3 - 5 years | 15.00% | 12.80% | 10 | | 2% | 0.30% | 0.30% |
| Alternates | | | | | 10 | 2% | | | |
| Venture Capital / Private Equity Funds / Unlisted / Impact Investments | Illiquid | 10 years + | 18.00% | 11.80% | 10 | | 2% | 0.40% | 0.20% |
| Overall Portfolio | | | | | 500 | | 100% | 9.10% | 8.00% |

In case of the conservative portfolio, the family decided to take credit risk by giving allocation to High Yield Debt, primarily due to low yields in the interest rate markets and when the Credit market view was positive.

Within equities, a staggered approach was adopted for all three portfolios in order to take advantage of market dips, event triggered corrections, etc.

Simultaneously, Waterfield worked with the family to set up a formal Family Board and Investment Committee, which would ensure a risk and governance framework for all investments. The Committee's role along with Waterfield was to ensure the strategic risk and asset allocation, adoption of an Investment Policy Document, monthly and quarterly reviews of the investment portfolio, fund manager selection and product due diligence in the listed and unlisted space. The family wanted to set up a simple, lean, and effective organization where currently only the first two generations (male members) of the family are involved in all decision making, with a view to extending this to the respective spouses over the next 12 months.

The patriarch of the family is looking to support philanthropic activities through allocating funds through a trust structure for building a Charitable Hospital in their city. Waterfield is presently in discussions with the family to set up a family foundation.



The Results



Waterfield has been able to generate several positive outcomes for the family through our engagement. Specifically, we were able to improve the short-term post-tax returns by approx. 115 bps for the family by shifting the investments initially from fixed deposits to mutual funds; and ensuring that all the investments were done under the “Direct” option.















At the time of allocation of assets as Phase II of the investments, Waterfield was able to negotiate with each of the product providers to lower the costs of investment thereby ensuring substantial savings for the family.

The family now has a formal Investment process in place to monitor investment performance and ensure all the members of the family are involved. The family has a benchmark portfolio returns of CPI + 5% clearly established in its investment guidelines. Overall, we have helped the family in improving their financial literacy on Investments.

The family as the next step, wants to engage Waterfield for the following

1. Trust & Estate Planning
2. Offshore Investments
3. Philanthropic activities through the returns generated by the Promoter on the core investment portfolio every year. Waterfield is in discussions with the family to set up a family foundation.



| | | | |
|--|--|--|---|
| Mumbai  142,14th Floor Maker Chambers VI 220, Nariman Point Mumbai – 400021  +91 22 6621 0700 | Noida  18A108 & 14A110, 18th Floor, Berger Delhi One Sector 16B, Noida-201301  +91 8860 824008 | Chennai  No.10, Workafella Uthamar Gandhi Salai Nungambakkam High Road Chennai – 600034  +91 44 6638 5532 | Bangalore  Level 5, No. 501, Prestige Garnet, 36, Ulsoor Road, Bengaluru – 560042  +91 80674 33089 |
| Pune  Raheja Woods 01-112, Kalyani Nagar, 8, Central Avenue, Pune - 411006  +91 77580 42089 | Kolkata  916, PS Arcadia, Level 9, 4A, Camac Street, Kolkata - 700016  +91 98305 86561 | Goa  Unit No. 701, A Wing, 7th floor, Sunteck Kanaka Corporate Park, Patto Panjim, Goa - 403001  +91 99231 91607 | |

Regulatory Information

Non-Individual Investment Advisor
Principal Officer: Ms. Soumya Rajan
Email: principal.officer@waterfieldadvisors.com

CIN: U74900MH2012PTC234921
SEBI Reg. No. INA000001811
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Alternative Investment Fund Reg. No.
FOF I IN/AIF2/21-22/0876
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Contact Us

Website: www.waterfieldadvisors.com
Refer to our website for the SEBI Office Address

Compliance & Grievance Officer: Mr. Kartik Kini
Email ID: kartik.kini@waterfieldadvisors.com
Investor Grievance:
investor.grievance@waterfieldadvisors.com

Email:
info@waterfieldadvisors.com

Contact:
+91-22-66210700



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