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Initiating Coverage

# Edelweiss Financial Services Ltd.

22-July-2021

RETAIL RESEARCH

# Edelweiss Financial Services Ltd.

| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|---|---|---|---|---|---|
| BFSI – NBFC | Rs 88.8 | Buy in Rs 88-90 band and add further in Rs 73-75 band | Rs 108 | Rs 117 | 2 quarters |

| | |
|---|---|
| HDFC Scrip Code | EDELWI |
| BSE Code | 532922 |
| NSE Code | EDELWEISS |
| Bloomberg | EDEL IN |
| CMP Jul 20, 2021 | 88.8 |
| Equity Capital (cr) | 93.7 |
| Face Value (Rs) | 1 |
| Eq- Share O/S(cr) | 93.7 |
| Market Cap (Rs cr) | 8305.2 |
| Book Value (Rs) | 73.8 |
| Avg.52 Wk Volume | 28,12,000 |
| 52 Week High | 100.9 |
| 52 Week Low | 50.0 |

| **Share holding Pattern % (Jun, 2021)** | |
|---|---|
| Promoters | 32.85 |
| Institutions | 34.38 |
| Non Institutions | 27.97 |
| Total | 100.0 |

**Fundamental Research Analyst**
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## Our Take:

Edelweiss Financial Services (EFS) has evolved from a capital market player to become a financial conglomerate with interests across lending, asset reconstruction, wealth management, asset management, and insurance. Over the last two years the company has pivoted from one company with multiple divisions to making all its businesses independent. In the lending business it is gradually moving from being a wholesale lender to building a more granular loan book as the credit crisis post the IL&FS fiasco hit the company hard. It is amongst the leader in the asset reconstruction and wealth management industries both of which are fast growing and have huge potential. Recent stake sale in the wealth management and insurance broking business would provide much needed capital for investment mainly in the insurance business which is scaling up well.

The company is consistently focusing on strengthening its balance sheet and liquidity position. Its D/E (excluding Treasury assets) has come down from 4.4x in FY19 to 2.5x as on FY21 while company's exposure to wholesale loan assets has been constantly reducing from ~Rs 17,700cr in FY19 to Rs ~11,400cr as on FY21. With the retail strategy in place, comfortable capital adequacy and liquidity across businesses, EFS is poised for strong growth in the coming years. It has made a lot of investments in technology to build an asset-light retail credit business which should drive down operating expenses. The management expects subdued profitability for FY22 due to likely impact from Covid second wave, impact of maintaining liquidity buffer, declining Wholesale Credit exposure and calibrated growth in ARC with focus on recoveries.

## Financial Summary

| Particulars (Rs cr) | Q4FY21 | Q4FY20 | YoY-% | Q3FY20 | QoQ-% | FY20 | FY21P | FY22E | FY23E |
|---|---|---|---|---|---|---|---|---|---|
| Net Operating Income | 3523 | 811 | 334.5 | 1266 | 178.2 | 4810 | 7015 | 5359 | 5397 |
| Operating Profit | 1820 | -270 | LP | 109 | 1574.5 | 1105 | 2220 | 912 | 864 |
| APAT | 629 | -2245 | LP | -70 | LP | -2045 | 265 | 164 | 371 |
| Diluted EPS (Rs) | 7.1 | -25.2 | LP | -0.7 | LP | -23.0 | 3.0 | 1.8 | 4.2 |
| P/E (x) | | | | | | -3.9 | 29.8 | 48.1 | 21.3 |
| P/BV (x) | | | | | | 1.3 | 1.2 | 1.2 | 1.1 |

(Source: Company, HDFC sec)

## Valuations & Recommendation:

Investors can buy the stock in the band of Rs 88-90 and add on dips to Rs 73-75 band for a base case fair value of Rs 108 and bull case fair value of Rs 117 in the next two quarters.

| Company | Holding | Valuation Method | Add level (x) | Value (Rs) | Base case (x) | Value (Rs) | Bull case (x) | Value (Rs) |
|---|---|---|---|---|---|---|---|---|
| Credit | 100% | FY23E Networth | 0.3 | 17 | 0.6 | 34 | 0.7 | 40 |
| Life Insurance | 51% | FY21 EV | 1.5 | 10 | 2 | 14 | 2 | 14 |
| Wealth Management | 39% | FY23E PAT | 10 | 12 | 14 | 17 | 16 | 20 |
| Asset Reconstruction | 60% | FY23E PAT | 6 | 9 | 8 | 12 | 9 | 13 |
| Asset Management (excl. ARC) | 100% | FY23E AUM | 2% | 22 | 2.5% | 27 | 2.5% | 27 |
| Other Investments (FY20) | | Book Value | 0.6 | 11 | 0.6 | 11 | 0.6 | 11 |
| **TOTAL** | | | | **81** | | **115** | | **125** |
| Add: Cash per share | | | | 2 | | 2 | | 2 |
| Less: Debt per share | | | | 9 | | 9 | | 9 |
| **Value (Rs)** | | | | **74** | | **108** | | **117** |

## Recent Triggers

### Q4FY21 Financials

Net income increased by 335% to Rs 3523cr as the company realised gains on its stake sale in Wealth Management business to PAG Group. Excluding the gains of stake sale, net income increased 161% to Rs 2100cr. Interest income declined 32% to Rs 928cr as the company continued to reduce its wholesale book. Wholesale loan book was down 14.8% yoy to Rs 11,413cr. Overall AUM increased by 3.5% to Rs 19,783cr driven mainly by growth in retail loan book and modest growth in mortgage book. Retail credit collection efficiency improved to 94% in NBFC and 99% in HFC in March’21. Overall the company reported a consolidated PAT of Rs 629cr against a loss of Rs 2,245cr in Q4FY20 and Rs 70cr in Q3FY21.

Equity AUM almost doubled in FY21 as the asset management witnessed Rs 3,600cr of equity inflows against outflows of Rs 55,000cr for the industry. Overall AUM increased by 8.3% to ~Rs 55,000cr. Monthly SIP inflows doubled from Rs 60cr in Mar-2020 to Rs 125cr in Mar-

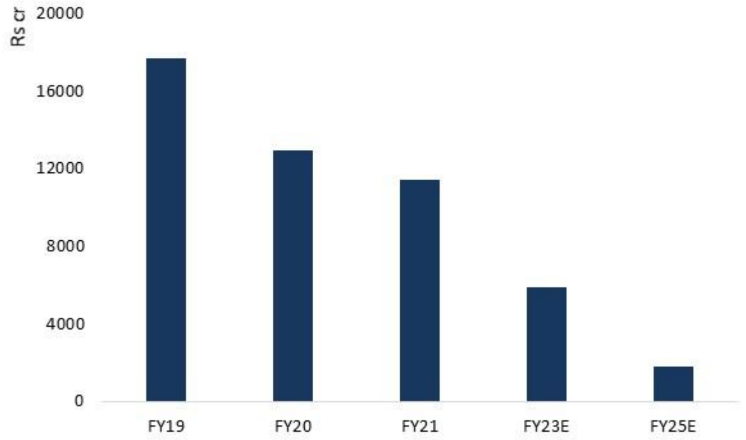
2021. In the asset reconstruction business the company made gross recoveries of Rs 1,800cr in Q4FY21 and Rs 5,400cr in FY21. It had an AUM of Rs 40,800cr. Net revenues declines by 21% yoy in in FY21 for the ARC business to Rs 433cr. Life Insurance APE grew by 25% to Rs 404cr while General insurance premium increased by 49% yoy in FY21. Wealth management assets under advisory grew by 36% yoy to Rs 1.55 lakh crore and client base expanded by 22%.

## Long term Triggers

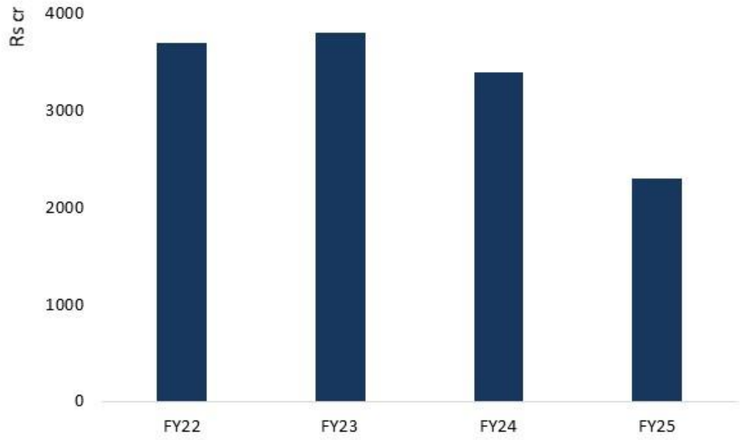
**Reduction in wholesale lending to strengthen balance sheet; retailisation to be the key thrust**

The wholesale credit book has faced many headwinds over the last 2-3 years on account of liquidity crunch. EFS has reduced its wholesale book from ~Rs 17,700cr in FY19 to Rs ~11,400cr in FY21 and targets to cut it further by half to ~Rs 5,900cr by FY23E and further reduce to ~Rs 1,800cr by FY25. EFS expects inflows/recoveries of Rs 3,700cr in FY22 and Rs 3,800cr in FY23. A substantial portion of the wholesale book consists of exposure to real estate projects, which has seen an improvement in demand over the last 6-12 months. Strong recoveries in the wholesale business will help profitability from FY23 onwards, further strengthening the capital adequacy.

*Sharp reduction in wholesale credit book*



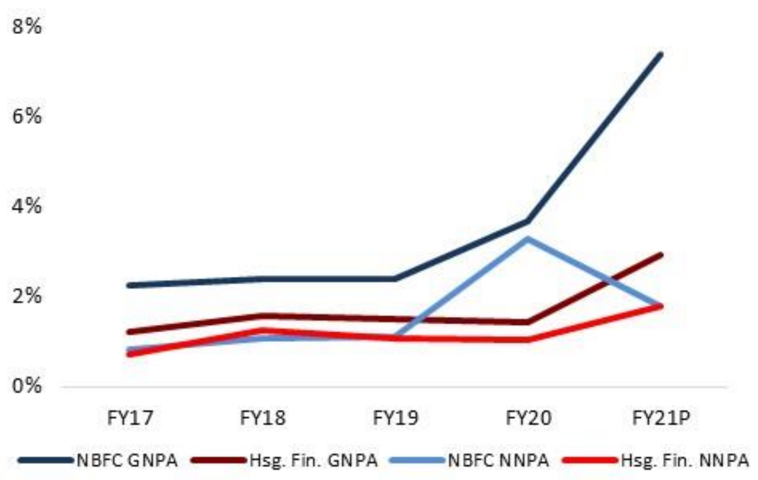

*Expected inflow/recoveries*



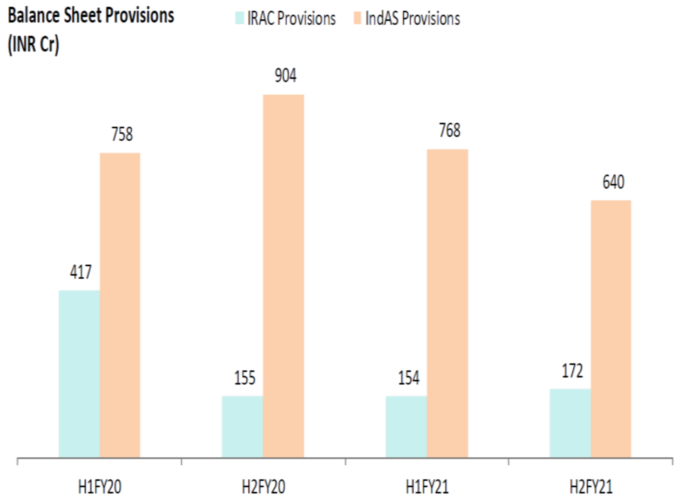

*(Source: Company, HDFC sec)*

The wholesale portfolio comprises of ~Rs 8,500cr advances given to ~145 projects, 90% of which are residential projects. 30% of the projects are either in the last stages or OC complete inventory, 40% are likely to get completed in the next 24 months, and the remaining 30% is likely to complete after two years. The balance Rs 2,900cr is security receipts held by EFS.

*Asset quality trend of NBFC and Housing Finance book*




*Provision carried in Balance Sheet*




*(Source: Company, HDFC sec)*

In Mar ’19, CDPQ Private Equity had entered into an agreement to invest Rs. 1,800cr in Edelweiss’ NBFC arm ECL Finance. CDPQ is a partner in Edelweiss NBFC business and in the long-term strategy it aims to build a strong credit portfolio, with an increasing focus on the retail segment.

From FY23 to FY26, a lot of liquidity and capital from the wholesale book could come back. EFS had lot of economically viable projects which were stuck because of last mile funding. As liquidity as well as real-estate environment has improved, EFS is seeing new developers coming in, new agreements being signed with clear cash flow plan. Strong recoveries in wholesale book will help profitability from FY23 onwards further strengthening the capital adequacy.

The total number of customers in Edelweiss group in 2018 was about 5 lakh, which has risen to 25 lakh customers. This has happened across Life Insurance, General Insurance, Mutual Fund, Retail Credit etc. The truly retailisation of its strategy is also underway. Even in its ARC business, it has been buying more retail loans (home loans and SME loans) from Banks and NBFCs.

Going forward growth in the Credit book will be in MSME book (disbursed Rs 350cr in FY21), partly in partnerships with Banks. EFS aims to become digitally enabled and data led organisation and will maintain conservative stance on disbursements.

Its gross stage 3 loans in ECL and ERFL are Rs 780cr as on March 2021 against which 76% provision has been made. In housing finance similar numbers are Rs 128cr and 39%.

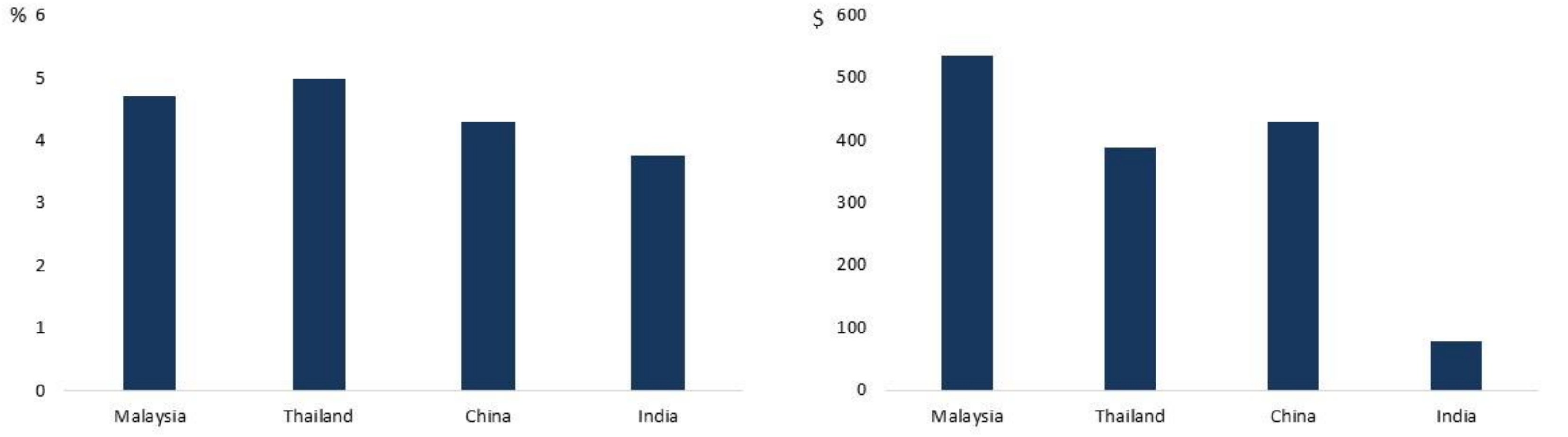
**Robust growth in insurance business**

EFS provides Life insurance services in JV with Tokio Marine Holdings, one of the largest Japanese insurance companies. EFS holds 51% stake in the company. EFS also offers General insurance, which is fully owned by the company. The Life Insurance business is almost eight years old, and the General Insurance business is in its fourth year of operations. Both the life and general insurance businesses have seen strong growth in FY21. The annual premium equivalent (APE) grew by 25% in life insurance business as compared to 3% industry growth and 3% de-growth among the peer companies. It launched 2 products in FY21 and its 13$^{th}$ month persistency stood at 76%. Embedded value at the end of the year was Rs 1,256cr.

In the general insurance business, premium grew by 49% yoy in FY21 as compared to 5% industry growth. Within the general insurance the company is focusing on motor and health insurance which witnessed a growth of 46% and 184% respectively in FY21. Solvency ratio stood at 209%. The company has developed external distribution partnerships with newage internet players which should aid in higher growth in the coming years.

Insurance industry in India is highly underpenetrated. India’s insurance penetration, which was at 2.71% in 2001, has steadily increased to 3.76% in 2019 (with life insurance penetration at 2.82% and non-life insurance penetration at 0.94%), but stayed much below the global average of 7.23% (3.35% for the life segment and 3.88% for the non-life segment). In comparison, insurance penetration in some Asian countries such as Malaysia, Thailand and China was at 4.72%, 4.99% and 4.30%, respectively, in 2019. The insurance density in India (ratio of insurance premium to population), which was $11.5 in 2001 reached to around $78 in 2019. In comparison, figures for Malaysia, Thailand and China in 2019 were much higher at $536, $389 and $430, respectively. Thus, the Indian insurance industry has significant growth potential.

*Insurance penetration and density compared to Asian peers*




*(Source: Economic Survey, HDFC sec)*

**Stake sale to free up capital**

EFS recently entered into an agreement to sell its balance 70% stake in the insurance broking business to Arthur J Gallagher & Co for a consideration of Rs 307.6cr. Gallagher, who previously held 30% in the business, will now be acquiring all the remaining shares, taking its stake to 100%. In addition to the sale consideration, EFS will also be entitled to receive a deferred contingent consideration based on the future revenue of Edelweiss Gallagher Insurance Broker, in the manner set out in the agreement. The sale will free up capital to reallocate and invest in the fast-growing life and non-life insurance businesses.

Earlier EFS had sold 51% stake in Edelweiss Wealth Management (EWM) to PAG Group for a consideration of ~Rs 2,366cr valuing the firm at ~Rs 4,400cr. Currently it holds 38.5% stake in EWM with an option to increase it to ~44%. As per the management, ESL will unlock the value of the de-merged entity by listing which is expected by Sep-Dec ’22.EWM has ~700,000 affluent clients with an AUA of ~Rs 160k cr as on FY21, up 5.3x over FY16.The proceeds from the partnership will go to the group holding company EFS, which will deploy the funds into its various verticals.. The Rs 300-lakh crore domestic wealth management industry has been expanding rapidly, with a five-year CAGR of 11.3%. It is expected to reach Rs 540 lakh crore over the next five years, growing at 12.5% per annum.

EFS’ idea is to go through the demerger process, so it is filing for NCLT demerger. The Wealth Management business will be demerged from Edelweiss and subsequently get listed (over 12-15 months). Edelweiss shareholders will still have more than 40% holding in this company. When the demerger happens all of EFS shareholders will be individual shareholders of that business.

**Market leader in ARC**

Edelweiss Asset Reconstruction Co. (EARC) is the largest player in the asset reconstruction business with a market share of over 40% and AUM of Rs 40,800cr as of FY21. The asset reconstruction business is strategically important to the group, as seen by the increase in the group’s stake in EARC to 60% as on March 31, 2021 from 47.41% as of March 31, 2016. Edelweiss has CDPQ as a strategic partner in the ARC business who hold 20% stake acquired in Oct ’16 for $750Mn. The high stress in the banking sector has resulted in strong growth for asset reconstruction companies in the last few years. Recent initiative like IBC and regulatory changes by RBI and Government of India have made ARCs more effective and efficient in their business of reviving such assets and re-orient themselves as turnaround specialists. ARC is a high RoA business with a strong pipeline of growth. EARC had a PAT of Rs 186cr in FY21.

In ARC, the book growth and earnings have come down in the last two years, as the company has not acquired as many new assets. Nevertheless, the ARC business has Rs 2,200cr of equitywith a lot of potential and the company wants to exploit that going forward.

**Established institutional equity broking business and good retail distribution network**

EFS has a strong and established institutional equity business comprising institutional equity sales and research. It provides services to a large and diversified base of Foreign Institutional Investors (FIIs) and domestic institutional investors. Its clients include large pension funds, long only funds, Exchange Traded Funds (ETFs) and hedge funds. It is one of the largest domestic institutional broking houses in India with around 700 foreign and domestic institutional investors. The institutional equity business is supported by a strong equity sales team and relevant and timely research.

# Edelweiss Financial Services Ltd.

**Asset Management (including Alternatives) on a growth path**

Its Mutual Fund business AUM grew by more than 80%, Alternative Asset Management AUM grew by 38% YoY in FY21. EFS is now the largest alternative asset manager in India. It has more than $4 billion of alternative assets under management. FY21 was the largest fund raise year for Alternatives with total raise of Rs 8,000+ crore. In credit funds, unlike private equity funds, you earn fees only on deployment. So, out of the Rs 30,000cr of AUM, about Rs 13,000cr, almost 40% odd of its AUM is not yet deployed. So, as it deploys that, the profitability will go up. And there is a lot of carry that you get on the funds when you exit. A lot of its AUM has been built from 2017-2018 onwards. The carry on this will start coming out after 2024 onwards.

Its Mutual Fund assets are now Rs 55,000cr. It is already profitable, but because it is investing a lot of money in building products and platforms. Mutual Fund should start being significantly profitable post FY24-FY25, once it crosses Rs 80,000- 100,000cr of AUM.

Mutual Fund

| INR Cr | Q4FY21 | FY21 |
|---|---|---|
| AUM | 55,000 | 55,000 |
| Equity | 161 | 161 |
| Net Revenues | 39 | 120 |
| Operating costs | 38 | 115 |
| Profit before tax | 1 | 5 |
| Profit after tax | 1 | 5 |

Alternatives

| INR Cr | Q4FY21 | FY21 |
|---|---|---|
| AUM | 30,000 | 30,000 |
| Equity | 152 | 152 |
| Net Revenues | 44 | 164 |
| Operating costs | 43 | 150 |
| Profit before tax | 1 | 14 |
| Profit after tax | 1 | 14 |

*(Source: Company, HDFC sec)*

**Diversified business profile**

Over the years EFS has transformed from a pure play capital market players to a financial conglomerate with interests into lending, asset reconstruction, wealth management including capital market activities like broking and investment banking and insurance. Although credit growth had initially come from wholesale lending, it is now focusing on building a granular loan book comprising mainly of retail mortgage and SME loans. It is among the largest players in ARC (AUM of Rs 40,500cr) and Wealth management business (assets under advisory of 1.6 lakh crore). The credit business provides stability and offset the cyclicality of wealth management business. The insurance business is scaling up well and holds immense potential for the future.

**Value unlocking possibilities in future**

Asset Management businesses, alternatives as well as Mutual Funds, are 100% owned by Edelweiss. Its General Insurance business is also 100% owned by Edelweiss. These businesses are adequately capitalised for the time being. In future, EFS can invite strategic partners in these businesses and unlock value depending on the need.

## What could go wrong

**Substantial proportion of revenue from the capital markets related activities**

A significant proportion of EFS' revenue is related to the capital markets led activities, which include equity broking, investment banking, capital market related loan portfolio, asset management. However, with increase in size of the credit business, dependency on capital markets has been declining over past few years.

**NARCL could reduce ARC business**

In the Budget FY21-22, the government proposed to set up a National Asset Reconstruction Company (NARCL) which would take over the stressed assets of lenders. The aggregate amount of bad loans likely to be transferred in tranches would be ~Rs 2 lakh crore. The proposed bad bank will have a public sector character and majority ownership is likely to rest with state-owned banks. This could impact the available pool of stressed assets for Edelweiss ARC.

**Asset quality could worsen especially in wholesale book**

The asset quality in the credit business has deteriorated in the last 18 months. While the asset quality in the retail loan book remained comfortable, it deteriorated significantly in the wholesale book. GNPA in the wholesale portfolio stood at ~7.4% as of FY21.

**Competition from peers**

Most of the peer companies are moving towards building their retail book, thereby increasing competition for the company. Also, many new fintech companies are coming offering their services at lower costs which could impact growth of EFS.

**Covid impact on insurance business**

The Covid pandemic could result in higher claims in the life and general insurance business leading to increased losses.

**Capital requirement by subsidiaries**

Insurance business are loss making and could require further capital infusion.

**Delays in scaling up mortgage business**

EFS is still a small player in the mortgage finance industry and has yet to achieve significant scale. Delays in scaling up the business segments could hamper its profitability.

In the ARC company, EFS owns 60%, CDPQ owns 20%, another 5% is with Swedish pension fund and the remaining 15% is with two or three individual shareholders, out of which one shareholder has made allegations of minority grievances. Although EFS is confident of its stand, one does not know as to which turn this will take and how long will the dispute carry on.

**SOTP Valuation**

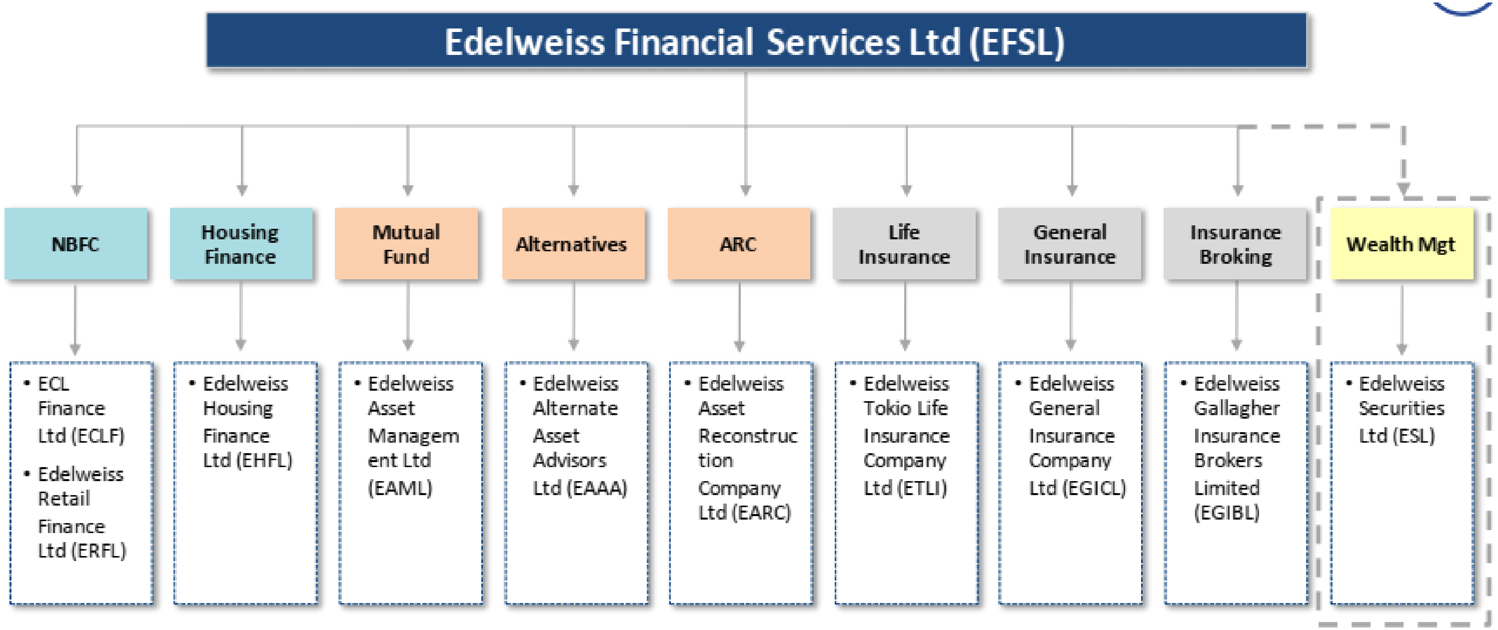
| Company | Holding | Valuation | Add level | Value | Base case | Value | Bull case | Value |
|---|---|---|---|---|---|---|---|---|
| Credit | 100% | FY23E Networth | 0.3 | 17 | 0.6 | 34 | 0.7 | 40 |
| Life Insurance | 51% | FY21 EV | 1.5 | 10 | 2 | 14 | 2 | 14 |
| Wealth Management | 39% | FY23E PAT | 10 | 12 | 14 | 17 | 16 | 20 |
| Asset Reconstruction | 60% | FY23E PAT | 6 | 9 | 8 | 12 | 9 | 13 |
| Asset Management (excl. ARC) | 100% | FY23E AUM | 2% | 22 | 2.5% | 27 | 2.5% | 27 |
| Other Investments (FY20) | | Book Value | 0.6 | 11 | 0.6 | 11 | 0.6 | 11 |
| **TOTAL** | | | | **81** | | **115** | | **125** |
| Add: Cash per share | | | | 2 | | 2 | | 2 |
| Less: Debt per share | | | | 9 | | 9 | | 9 |
| **Value (Rs)** | | | | **74** | | **108** | | **117** |

# Edelweiss Financial Services Ltd.

**About the company**

EFSL is the holding company of the Edelweiss Group and one of India's leading diversified financial services conglomerate. Incorporated in 1995 by Mr. Rashesh Shah and Mr. Venkat Ramaswamy, it has grown to provide a broad range of financial products and services such as retail lending, wholesale lending, asset reconstruction, wealth management including broking and capital markets, asset management, life insurance and general insurance., catering to a substantial and differentiated client base, including corporations, institutions and individuals. The promoter group holds a 32.9% stake, and the management and employees hold 10.9% stake in EFSL as of FY21. The group had 47 subsidiaries as on 31 December 2020.

*Diversified company across ten key entities*




*(Source: Company, HDFC sec)*

# Edelweiss Financial Services Ltd.

## Financials (Consolidated)

### Income Statement

| (Rs cr) | FY19 | FY20 | FY21P | FY22E | FY23E |
|---|---|---|---|---|---|
| Interest Income | 6838 | 5902 | 4034 | 3696 | 3424 |
| Interest Expenses | 4783 | 4793 | 3834 | 3025 | 2392 |
| **Net Interest Income** | **2055** | **1109** | **200** | **672** | **1032** |
| Income from Insurance business | 884 | 1057 | 1325 | 1457 | 1603 |
| Other Income | 3439 | 2644 | 5490 | 3230 | 2763 |
| **Operating Income** | **6378** | **4810** | **7015** | **5359** | **5397** |
| Operating Expenses | 3935 | 3705 | 4795 | 4447 | 4533 |
| **PPoP** | **2443** | **1105** | **2220** | **912** | **864** |
| Prov & Cont | 704 | 3562 | 2074 | 709 | 390 |
| Profit Before Tax | 1740 | -2457 | 146 | 202 | 474 |
| Tax | 699 | -413 | -108 | 51 | 119 |
| **PAT** | **1040** | **-2044** | **255** | **152** | **356** |
| Minority Interest | -49 | -1 | 11 | 13 | 15 |
| Profit/Loss of Associates | 4 | 0 | -1 | 0 | 0 |
| **Adj. PAT** | **995** | **-2045** | **265** | **164** | **371** |

### Balance Sheet

| (Rs cr) | FY19 | FY20 | FY21P | FY22E | FY23E |
|---|---|---|---|---|---|
| Share Capital* | 89 | 89 | 89 | 89 | 89 |
| Reserves & Surplus | 7588 | 6040 | 6488 | 6640 | 6996 |
| **Shareholder funds** | **7676** | **6129** | **6577** | **6729** | **7085** |
| Minority Interest | 1038 | 1078 | 1100 | 1112 | 1127 |
| Borrowings | 46148 | 36657 | 28426 | 23280 | 18326 |
| Other Liab & Prov. | 9291 | 10416 | 9872 | 11427 | 11772 |
| **SOURCES OF FUNDS** | **64154** | **54280** | **45975** | **42548** | **38310** |
| Fixed Assets | 820 | 1770 | 1388 | 1319 | 1253 |
| Goodwill on Consolidation | 174 | 172 | 66 | 66 | 66 |
| Investment | 13027 | 10458 | 13390 | 14527 | 15577 |
| Cash & Bank Balance | 6455 | 8610 | 4760 | 4097 | 2902 |
| Advances | 38408 | 28361 | 21911 | 18624 | 15272 |
| Other Assets | 5269 | 4909 | 4459 | 3915 | 3241 |
| **TOTAL ASSETS** | **64154** | **54280** | **45975** | **42548** | **38310** |

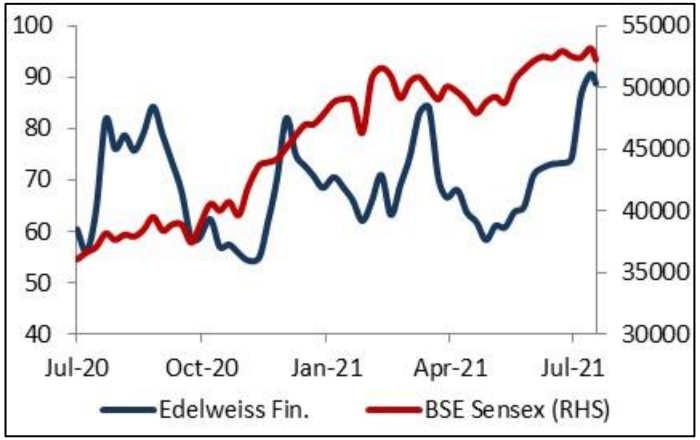
* excluding treasury shares

### Ratio Analysis

| | FY19 | FY20 | FY21P | FY22E | FY23E |
|---|---|---|---|---|---|
| EPS (Rs) | 11.2 | -23.0 | 3.0 | 1.8 | 4.2 |
| P/E (x) | 7.9 | -3.9 | 29.8 | 48.1 | 21.3 |
| BV (Rs) | 86.5 | 68.9 | 73.8 | 75.5 | 79.5 |
| P/B (x) | 1.0 | 1.3 | 1.2 | 1.2 | 1.1 |
| RoNW | 13.0 | -33.4 | 4.0 | 2.4 | 5.2 |

# Edelweiss Financial Services Ltd.

Price chart



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