PROFITMART advisory

15th Oct 2015

EDELWEISS FINANCIAL SERVICES LIMITED (EFSL)

BSE: 532922 | Sector: NBFC

Position: Close

CMP : Rs. 59

Target Price: Rs.96

BUSINESS BACKGROUND

EFSL was co-founded in 1995 by Mr Rashesh Shah and Mr Venkat Ramaswamy EFSL started out as an investment banking and advisory services firm. Over the past two decades, it has become a diversified financial services company. Its business straddles across lending, asset management, capital markets, commodities finance, and life insurance. However, the credit business now constitutes the core of its strategy. EFSL has further diversified within the credit business into niche segments such as ARC and agriculture commodity finance, which offer immense potential.

INVESTMENT HIGHLIGHTS

Strong Q1 FY16 Performance –

EFSL reported a strong set of numbers for 1QFY2016. Its Total income grew by 43% yoy to Rs 1154.15 crs from Rs 806.81 crs in Q1 last year. The EBITDA during the quarter came in at Rs 729.39 crs from Rs 499.18 crs in Q1 last year , an increase of 46% yoy with the PAT improving by 17% yoy to Rs 91.28 crs from Rs 78.25 crs in Q1 last year. .

For FY15 the company has recorded a Income of Rs 1922.77 crs, - a EBIDTA of Rs 642.50 crs while PAT is placed at Rs 325 crs. EFSL paid a dividend of 100% for FY15. .

EFS enjoys a diversified business model which is more balanced and less risky –

Unlike other NBFCs, which are largely focused on a single product, for example, mortgage, commercial vehicle, or micro finance, EDEL has much more diversified products. EDEL has adopted a strategy of building a bank-like diversified entity in a non-bank setup. Contribution of the agency business to the core revenue mix (NII + Commissions + Fees + Other Income) has fallen from 66% in FY11 to 45% in FY15, owing to an increase in the share of the credit business. Contrary to market perception, revenue from the broking business contributes only 6% of total revenue.

Credit business now makes up more than 60% of its PAT.EFSL's dependence on the volatile agency business has been reduced to 35% from 65% in FY11. The credit business registered 54% CAGR in the past four years; FY15 growth was even stronger at 68%. EFSL plans to focus on the business and has added new business verticals to achieve a scale on par with its ARC and commodity financing businesses

FACE VALUE Rs	1.00
DIVD YIELD %	1.70
52 WK HI/LOW	82/45
NSE CODE	EDELWEISS
BSE CODE	EDELWEISS
MARKET CAP	RS 4798 CRS

SHAREHOLDING PATTERN

PROMOTERS	- 38%
BANKS, MFs & DIIs	- 1%
FIIs	- 32%
PUBLIC	- 19%

KEY FUNDAMENTALS

Year Ending	FY16	FY17	FY18
Inc Gr%	21	16	15
PBT Gr%	25	17	17
PAT Gr%	23	22	20
EPS Gr%	23	22	20
Roe %	12.3	13.6	14.7
Roa %	1.2	1.2	1.2
BV (Rs)	42.56	47.10	52.66
P/BV(x)		1.4	1.2

Loan Book to grow at 25% pa over the next two years between FY16-18 –

EFSL offers customised products to its corporate clients and has diversified into mortgages, SME, agriculture, rural, and ARC financing in the last decade . EFSL's loan book is well diversified with mortgages at 40%, structural collateralised debt at 39%, distressed-asset loans at 8%, loan against shares at 7%, and SME & agriculture at 6%. EFSL's loan book grew by 54% CAGR over FY12-15 while loan growth in 1QFY16 was stronger at 72% YoY

We estimate loan book to grow at 25% pa over FY16-18, driven by mortgages, SME, and agriculture financing

Home Loans & LAP to drive the Mortgage Business for EFSL going ahead –

EFSL's mortgage portfolio comprises housing loans for individuals, loans to small traders/businessmen against property (LAP), and funding to developers of residential projects. Housing/LAP constitutes 46% of the mortgage book while development of residential properties account for the remaining share of the book. Given the low penetration in home loans, a rising middle-class population, and increasing urbanisation, growth in home loans would continue to be steady. EFSL has increased its geographical presence from 25 cities and 450 villages to 41 cities and 1,400 villages in the last two years. .

EFS's ARC is now India's largest player in this segment –

EFSL operates in the distressed loans business through its asset reconstruction company (EDEL ARC), in which it holds 47.7% stake. EFSL's support to ARC by way of debt amounted to Rs 12.6b (8% of loans). EDEL ARC's assets under management more than doubled in FY15 to Rs 203b from Rs 92 in FY14. It is now India's largest ARC in terms of AUM.

The ARC business is highly remunerative as it offers 1.5% pa management fees and a share of profit from the assets recovered or resolved.

Agriculture Commodity Financing is the next big growth driver for EFSL –

Agricuture financing offers an Rs 4000 bn opportunity, of which only 15-20% is through formal channels.
The bulk of the funding needs of farmers, traders, and intermediaries are carried out through moneylenders and other unorganised players. Banks have not been able to expand their presence in this space, owing to challenges pertaining to warehouse management, availability of storage, judging quality of produce, pricing of produce, and transit of materials.

EFSL started its agriculture commodities business in 2010. It aims to cater to the entire value chain of agriculture financing. The value chain includes sourcing of commodities through farmers and intermediaries, facility for storage in warehouses, finance against warehouse stock, transition of produce, efficient distribution, and sale of produce.
EFSL manages 160 warehouses in 100 locations. It plans to increase this to 300 by Mar'16, after which it plans to add 200 new warehouses each year. It plans to increase the current warehouse storage capacity from 600,000 tonnes to 3m tonnes in the next three to five years. We forecast loans to grow at 50% CAGR over FY16-18 on a low base.

Asset quality stable with strong focus on RM –

Strong risk management practices have resulted in stable asset quality for EFSL The gross NPLs have remained stable at 1.3% and net NPLs were at 0.4% in 1QFY16

Broking & Investment Banking Business to also grow steadily –

EFSL's capital markets businesses include investment banking, advisory, institutional broking, retail broking, wealth management and asset management businesses. It has a strong presence in IB, and institutional broking. EFSL's market share in institutional broking has remained consistent at 4-5% and that in IB is at 3-4%. Traditionally, EFSL has been strong in the capital markets business and going ahead over the next 12-18 months we expect a steady flow of IB deals and Broking income to increase on the back of good capital markets ahead,

Edelweiss Tokio Life: Long-term value creation –

Edelweiss Tokio Life Insurance (ETLI) started in 2011 as a JV between EDEL and Tokio Marine of Japan. Tokio Marine holds 26% in ETLI. It has secured regulatory approval to increase the stake to 49% from the FIPB. With improving profitability and an increase in the allowable ownership limit for foreign partners to 49% in JV's, insurance players have seen a significant jump in valuation. ETLI is still at a nascent stage of growth. ETLI strengthened its network of insurance advisors from 7,700 to 11,000 in Jun'15. The gross premium income registered growth of 75% in FY15 to INR1.9b off a low base. Given the long gestation period of the insurance business, ETIL reported a small loss in FY15

Business Outlook & Stock Valuation

On a rough cut basis, in FY16, operating Income will see a steady rise wherein Income is expected to touch Rs 2320 crs in FY16E.

On the bottomline level we expect the company to record a PAT of Rs 401 crs in FY16E. Thus on a conservative basis, EFSL should record a EPS of Rs 5.06 for FY16E. For FY17E our expectation is that earnings traction for EFSL would continue to be robust wherein we expect a EPS of Rs 6.19 which would further improve to Rs 7.45 in FY18. .

On a relative basis the EFSL stock trades at a P/Bv of 1.38x and 1.25x based on FY16 and FY17E. This looks cheap when one looks at other players like Motilal Oswal, IIFL Holdings and Capital First which trade at much higher valuations both on PE as well as P/BV parameters.

Hence looking at the strong growth prospects and strong balance sheet, a well experienced management team the EFSL stock could get re rated to levels to little over 2x FY17 BV which gives us a TP of Rs 96.

On the institutional funds side, currently around 219% of EFSL's equity is being held by large domestic funds and FIIs like Carlyle, BIH SA, Fidelity, SAIF Advisors and Amansa Investments indicating that the stock is in strong hands now.

Hence we believe that the EFSL stock should be purchased at the current price for a price target of around Rs 96 keeping a two year time frame.

FINANCIALS

For the Year Ended March RsCrs	FY15A	FY16E	FY17E	FY18E
Operating Income	1922.77	2320.4	2680.1	3090.6
EBIDTA	642.5	780.9	915.1	1080.1
EBIDTA %	33.42	33.65	34.14	34.95
Pre Tax Profit	525	656	770	901
Prov for Tax	200	255	280	310
Profit After Tax	325	401	490	591
Diluted EPS (Rs)	4.10	5.06	6.19	7.46
Equity Capital	79.18	79.18	79.18	79.18
Reserves	3077.1	3370.1	3730.1	4170.2
Networth	3156.28	3449.28	3809.28	4249.38
Loan & Advances	15036	18740	23430	29400
Book Value Per Share	38.86	42.56	47.10	52.66

KEY CONCERNS

Interest rate risks

EFSL's borrowing profile is wholesale in nature. In a scenario of tight liquidity, its ability to borrow may be impacted. Also, volatility in interest rates may impact the profitability of the business.