

Edelweiss Finance & Investments Ltd

Ratings

Facilities	Amount (Rs. crore)	Ratings ¹	Remarks
Principal Protected Market-linked Debenture	300	CARE PP-MLD- AA (PP-MLD Double A)	Assigned

CARE's rating of Market Linked Debentures is an assessment of the underlying credit risk of the instrument. The rating addresses only the credit risk associated with timely payment of obligations as per the terms of the issuance. The rating does not address the market risks associated with the instrument on account of linking of coupon payment to external variables such as reference equity index, equity shares, commodity process/index. This could result in variability or absence of coupon payments because of adverse movement in the value of external variables.

Edelweiss Financial Services Ltd (EFSL – Rated CARE AA), the parent company of the Edelweiss group, owns 100% in most of its subsidiaries and the management/line functions for these businesses is common with significant operational and financial integration among them. Accordingly, CARE has considered a consolidated view of EFSL for arriving at the rating.

Rating Rationale

The rating factors in the diversified business profile of EFSL (consolidated basis), strong loan portfolio growth with good asset quality, strong capitalisation and comfortable liquidity profile. The rating also takes into account the well-qualified and experienced management team, established institutional equity broking business and good retail distribution network. The rating is, however, constrained by the high dependency on the capital markets, which has an inherent volatility, risk associated with new businesses and competitive scenario in the capital markets. The ability of EFSL to further diversify its businesses, maintain competitive position in the capital market businesses, maintain asset quality and capital adequacy are the key rating sensitivities.

Background

Edelweiss Finance & Investments Ltd (EFIL) is a wholly-owned subsidiary of Edelweiss Financial Services Ltd (EFSL). EFIL (ND-SI-NBFC) was originally incorporated as a Private Limited company as "Crossborder Investments Private Limited" on October 27, 1994 in Maharashtra. The company became the subsidiary of Edelweiss Financial Services Limited (EFSL) in March 2000. The company's registered office was shifted to Hyderabad from Mumbai in 2007. The name was changed to "Edelweiss Finance & Investments Private Limited" in July 2009. In August 2009, EFIL became a public limited company and the name was changed to Edelweiss Finance & Investments Limited. EFIL is engaged in investment in shares, bonds, stocks, debentures and other securities primarily issued by the government of India and corporate lending.

About EFSL

Previously known as Edelweiss Capital Ltd, EFSL was incorporated in 1995 by Mr Rashesh Shah and Mr Venkat Ramaswamy. EFSL is registered as a Category I Merchant Banker with SEBI and is the parent company of the Edelweiss Group. The company on a stand-alone basis is primarily engaged in investment banking services and provides development, managerial and financial support to the businesses of the Edelweiss group entities. The Edelweiss Group offers a range of products and services, spanning varied asset classes and diversified consumer segments. The businesses of Edelweiss are organized around five broad lines – credit including housing finance, commodities, financial markets, asset management and life insurance. In addition, the Balance-sheet Management Unit (BMU) attends to the balance sheet and liquidity management. The Edelweiss group consists of 48 subsidiaries and seven associate companies and employs 4,001 professionals across 216 offices and branches spread across 118 major cities of India as on March 31, 2014.

Credit Risk Assessment

Diversified business profile

EFSL has emerged as a diversified financial services company, having a presence in various business segments related to lending to corporate, retail clients, capital market businesses including equity and commodities broking (both institutional and retail), investment banking etc. During the last few years, EFSL has also increased its presence in the non-capital market related businesses like mortgage finance (housing loans, loans against property and SME financing), life insurance, commodities, asset

¹Complete definitions of the ratings assigned are available at www.careratings.com and other CARE publications

management, etc, and these businesses now contribute a higher percentage of revenue compared with the capital market business. For FY14 (refers to the period April 01 to March 31), fund-based income accounted for almost 81% of the total income, 14% was fee-based income and the remaining was life insurance premium and other income.

EFSL has reduced the volatility in its performance due to lower dependence on capital market led businesses. EFSL's business plan indicates a higher growth going forward in the retail finance, commodities and life insurance businesses. With this, further diversification is expected in its business profile.

Strong loan portfolio growth with good asset quality

EFSL, on a group basis focuses on the credit business across wholesale and retail products. The wholesale loan portfolio accounted for around 67% of the loan portfolio as on March 31, 2014. Its loan portfolio (including credit substitutes in the form of NCD included under investments) has increased by 31% Y-o-Y to Rs.8,628 crore as on March 31, 2014, compared with Rs.6,572 crore as on March 31, 2013 (66% Y-o-Y growth over FY12). Mortgage loans (housing loans, LAP and SME finance) accounted for 24.2% of the total loan portfolio. Its loan portfolio continued to perform well despite the stressed macro-economic operating conditions. Its asset quality has been comfortable with GNPA and NNPA ratios at 0.95%, and 0.25%, respectively, as on March 31, 2014, compared with 0.43%, and 0.11%, respectively, as on March 31, 2013. Further GNPA and NNPA ratios stood at 1.12%, and 0.32%, respectively, as on March 31, 2014.

Asset quality of EFIL has deteriorated during FY14 with Gross NPA % rising to 3.33% (FY13: GNPA – 1.52%). However, the company has done 100% provision for the same. On account of 100% provision made during FY14, EFIL wrote off the same NPA by reversing the entry.

Strong capitalisation

EFSL is the parent company for the Edelweiss Group and its strong capitalisation is reflected in its consolidated tangible net-worth of Rs.2,644 crore (excluding minority interest) with gearing level of 4.92 times as on March 31, 2014. EFSL has two major subsidiaries in the lending business, viz., ECL Finance Ltd (NBFC - 92.2% shareholding) and Edelweiss Housing Finance Ltd (HFC – 100% shareholding). ECL Finance Ltd reported CAR of 16.06% (Tier-I – 15.56%) and Edelweiss Housing Finance Ltd reported CAR of 23.50% (Tier-I – 22.83%) as on March 31, 2014. As on Mar 31, 2014, EFIL reported CAR of 64.46% with Tier-I CAR at 57.21%. Furthermore, the company reported CAR of 60.64% with Tier-I CAR at 53.58% as on June 30, 2014.

Comfortable liquidity profile

EFSL had a comfortable liquidity profile with 18.6% of the total assets in BMU related assets which includes Government securities, FDs and bonds as on March 31, 2014. It also ensures a matched ALM profile and an overnight liquidity cushion. In the past, its borrowings were mainly from mutual funds. However, with the shift to longer tenor portfolio like mortgages, EFSL has diversified its resource profile with longer term borrowings by way of NCDs, subordinated debt, retail bonds and term loan facilities from banks. As on March 31, 2011, 63% of its total borrowings were short-term borrowings (CP and CBLO) which have gone down to 44% by March 31, 2014. At the same time, as on March 31, 2011, 34% of EFSL's total borrowings were from the banks and in the form of NCD, which has gone up to 55% by March 31, 2014.

ALM profile as on March 31, 2014 is comfortable with positive cumulative mismatches across all time buckets.

Experienced management team

EFSL has a strong management team with a rich experience in the financial sector. Mr Rashesh Shah, founder of EFSL, has more than 20 years of experience after graduating from IIM – Ahmadabad. Mr Venkat Ramaswamy, co-founder of EFSL, heads the Alternative Asset Management businesses and has an MBA degree from the University of Pittsburgh, USA. They are also supported by a strong second line of management, who has rich experience in their respective fields. The senior management team of Edelweiss has been quite stable over the last few years and most of the senior management has been with Edelweiss for a long period.

Established institutional equity broking business and good retail distribution network

EFSL on group basis has 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 had a market share of 4-4.5% in the overall equity broking segment in FY14 by revenue and is one of the largest domestic institutional broking houses in India with over 400 foreign and domestic institutional investors. The institutional equity business is supported by a strong equity sales team and relevant and timely research. Currently, its research team covers 190 stocks across 20 sectors. The offline broking model is also well-supplemented by its organically built online broking model through the portal www.edelweiss.in. EFSL now caters to the total retail client base of 403,900 from 216 offices in 118 cities with a strong network of over 5,700 authorised persons and sub-brokers as on March 31, 2014.

High dependency on capital markets which has inherent volatility

A significant proportion of ESFL's revenue is related to the capital markets led activities, which include broking, investment banking, capital market related loan portfolio, asset management and some treasury operations. In recent times, the capital markets have witnessed volatility, subdued volumes and lower margins owing to heightened competition. However, following the strategy of diversification of businesses, the group has already reduced its dependence on the capital markets related income. With the planned scale up of mortgage finance business, commodities business and life insurance, the dependence on capital markets is expected to reduce further. However, with an improvement in the overall capital market related activities, share of capital market related income to total income is expected to be volatile.

Risk associated with the new business segments

The Edelweiss group has recently forayed into new businesses, including expanding retail broking, life insurance and mortgage finance (housing loans and loans against property). The retail mortgage finance business has started from Q3FY11 and life insurance from Q2FY12. As on March 31, 2013, it had mortgage finance portfolio of a Rs.1,439 crore, which grew to Rs.1,686 crore as on March 31, 2014. Life insurance business is also growing and yet to break-even. These businesses have high competition and the group's ability to successfully establish a position in these segments is yet to be seen.

Profitability

During FY14 total income registered growth of 17% in line with growth in total interest income, which accounted for 70% of the total income. Within total interest, interest income from loans increased by 39% to Rs.979 crore. Interest expenses grew by 8.8%, which resulted in 33.6% Y-o-Y growth in Net Interest Income (NII). Hence, PAT increased by 23.6% in FY14 to Rs.220 crore. Total life insurance premium earned more than doubled to Rs.106 crore in FY14. Improved profitability has resulted in the strengthening of other profitability parameters. Return on total assets (ROTA) improved by 15 bps to 1.27% in FY14.

Prospects

EFSL has a presence in various business segments. It has continued to scale up its new businesses and established businesses of credit, commodities and wholesale financial markets. Its retail financial markets and retail finance businesses have achieved a break-even in FY13. Going forward with the expanding new businesses, EFSL is expected to witness more diversification in its income profile, characterized by higher stability. Thus, going forward, the ability to improve the diversification in businesses, maintaining competitive position in the capital market businesses, maintaining asset quality and capital adequacy are the key rating sensitivities for EFSL.

Financial Performance EFIL (Standalone)

				(Rs. Cr)
For the period ended / as at March 31,	2012 A	2013 A	2014 A	
P&L A/C				
Total Income	148	224	290	
Operating expenses	21	15	20	
Depreciation & amortization	2	2	2	
Interest Expense & Financial Charges	115	180	202	
Provisions / Write-offs	0	3	5	
PBT	11	25	61	
Tax	6	7	19	
PAT	6	18	42	

Balance Sheet			
Net Worth	325	290	324
Total Borrowings	1,789	2,173	1,974
Investments	186	192	171
Stock-in-trade	1,622	1,966	1,869
Cash & Bank Balance	9	9	10
Loans & Advances	179	217	131
Total Assets	2,168	2,491	2,334
CAR (%)	41.73	46.46	64.46
Tier-I CAR (%)	41.64	46.35	57.21
Overall Gearing (times)	5.5	7.5	6.09
Interest coverage (times)	1.1	1.14	1.30
Operating Expenses/Average Total Assets (%)	1.39	0.63	0.84
ROTA (%)	0.37	0.77	1.74
RONW (%)	1.54	5.8	13.70
Gross NPA (%)	1.68	1.52	3.33
Net NPA (%)	1.51	-	-
Net NPA to Net-worth (%)	1.02	-	-

Financial Performance (Consolidated)

(Rs. Cr)

For the period ended / as at March 31,	2012 A	2013 A	2014 A
P&L A/C			
Total Income	1,671	2,184	2,556
Employee Cost	271	364	458
Operating and Other Expenditure	329	396	483
PBIDTA	1,071	1,424	1,615
Depreciation	42	51	52
Interest Expenditure	830	1,113	1,211
PBT	199	259	351
Tax	68	88	135
PAT	131	171	217
Minority Interest	3	-7	-3
PAT After Minority Interest	128	178	220
Balance Sheet			
Tangible Net-worth	2,456	2,406	2,644
Total Borrowings	10,487	11,659	13,017
Fixed Assets	507	483	501
Investments	1,401	1,211	2,126
Loan Portfolio (Credit)	3,956	5,793	7,017
Stock in Trade	3,383	3,152	3,791
Cash and Bank Balance	3,410	4,008	2,282
Total Current Assets	12,456	14,484	15,317
Current Liabilities	1,183	1,879	1,918
Total Assets	14,365	16,178	17,945

Overall Gearing (times)	4.27	4.85	4.92
Interest Coverage (times)	1.24	1.23	1.29
Total Income / Average Total Assets (%)	11.41	14.3	14.98
Operating Expenses/Average Total Assets (%)	2.25	2.59	2.83
ROTA (%)	0.89	1.12	1.27
ROE (%)	5.56	7.04	8.59
Gross NPA Ratio (%)	0.47	0.43	0.95
Net NPA Ratio (%)	0.14	0.11	0.25
Provision Coverage (%)	69.85	73.82	73.85
Net NPA to Net worth (%)	0.28	0.31	0.81

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(This follows our brief rational for entity published on 16 October 2014)

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