

Edelweiss Financial Services Limited

March 25, 2020

Ratings

Instruments	Amount (Rs. crore)	Ratings ¹	Rating Action
Non-Convertible Debentures	284	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Reaffirmed
Commercial Paper	6,350	CARE A1+ (A One Plus)	Reaffirmed
Total Instruments	6,634 (Rupees Six Thousand Six Hundred and Thirty Four crore only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings on a consolidated basis of Edelweiss Financial Services Limited continue to factor in the diversified business profile of the Edelweiss group with experienced management team, adequate capitalization with continuous plans for equity infusion, moderate asset quality and moderate liquidity profile. The ratings are, however, constrained by dependence on revenue from the capital market related activities which has inherent volatility, client concentration and credit risk in its wholesale credit book, risk associated with relatively new businesses and substantial moderation in the profitability in 9MFY20.

The rating continues to factor in challenges in resource mobilisation for the NBFC sector in general and wholesale NBFCs in particular post confidence crisis in the NBFC sector post ILFS crisis, however, CARE takes note of approx. Rs.4,400 crore of resource mobilisation by Edelweiss Financial Services Limited (EFSL) and subsidiaries till H1FY20 at a relatively increased cost of borrowings due to increased risk perception of the lenders towards entities operating in NBFC/HFC segment. Further, ECL Finance Ltd, (NBFC in Edelweiss group) has successfully closed a public issue of NCDs of Rs.500 crore in December 2019 and Edelweiss Finance and Investment Limited, (another NBFC of Edelweiss Group) raised Rs.250 crore through public issue of NCDs in February 2020. While the company has been raising incremental funds from banks by way of bank lines and securitization and few retail NCDs, the yields in the secondary market continue to remain at high levels during 9MFY20.

Therefore, continuous mobilisation of resources for EFSL group and maintaining liquidity during this tough operating environment remains a key rating monitorable. The rating also continues to take into account the exposure of EFSL Group to real estate sector which is witnessing slowdown and experiencing heightened refinancing risk. During 9MFY20, EFSL has witnessed sell down in the wholesale book to Asset Reconstruction Companies as well as the towards real estate fund formed by Edelweiss Global Investment Advisors Business (EGIA) along with investment from Meritz Group, a South Korean financial conglomerate. The company expects further sell down in the wholesale book during Q4FY20 for reducing the total exposure towards real estate and structured credit. Apart from provisions, any losses arising out of sale of assets beyond the allocated provisions will also impact the profitability.

At present, the asset quality remains moderate with write offs and sell down in Q3FY20. Further, the collateral cover taken on the real estate exposures and control over project cash flows through escrow mechanism also provide comfort to an extent but continuation of slowdown in the real estate market may put some pressure on the liquidity with any increase in proportion of stressed assets in real estate portfolio and structured finance in the short to medium term. Further impact of COVID 19 on the asset quality will also remain key monitorable.

Rating Sensitivities

Negative Factor

- Increase in the gearing levels [Debt/Tangible net worth (including minority interest)] above 7x on a consolidated basis.
- Deterioration in asset quality with Gross Non-Performing assets (GNPA) increasing above 4% levels on consolidated basis.
- Lower than expected scale down of the wholesale loan portfolio

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

- Rise in the provisions above Rs. 850-900 crore as envisaged for FY20
- Widening gap of the asset inflows and outflows going forward

Positive Factors

- Improvement in the profitability parameters on a consolidated basis on a sustained basis
- Increase in the mobilization of resources on a steady basis at improved rates

Detailed description of the key rating drivers

Key rating strengths

Diversified business profile of the group

EFSL is a diversified financial services company with presence in various business segments related to credit in retail credit including mortgage finance (housing loans, loans against property) and SME credit, corporate credit and distressed assets credit including asset reconstruction. Its Advisory businesses include wealth management, asset management, and capital market businesses which include equity broking (both institutional and retail) and investment banking. Its insurance business includes both life and general insurance businesses. The share of the group's total interest income accounted for 60% of the total income in FY19 on consolidated basis. (FY18: 56.5%). The share of broking and fee based income has reduced to 22% of total income in FY19 from 27% of total income in FY18. This was mainly due to the slowdown in the advisory and broking business due to the volatility in the capital market in FY19 though the fees from distressed credit business were higher. The share of the insurance premium increased marginally.

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 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. EFSL manages an AUM of Rs. 2,00,900 crore of customer assets which comprises of Assets under advice (Wealth Management), Distressed Credit (ARC Assets)(excluding Edelweiss contribution), Funds under Management (Asset Management) (excluding Edelweiss contribution) and Assets under custody and clearing.

Experienced management team

EFSL has a strong management team with a rich experience in the financial sector. The senior management team of Edelweiss has been quite stable over the last few years and most of the senior management have been with Edelweiss for a long period.

Adequate capitalization levels with fresh capital infusion plans

On a consolidated basis, the tangible net worth (excluding minority interest) stood at Rs. 6919 crore as on March 31, 2019 compared to Rs. 6027 crore as on March 31, 2018. In March 2019, the company has signed an agreement with CDPQ (Canadian Pension Fund) for investment in the NBFC arm ECL Finance Limited of ~Rs. 1800 crore in a span of 2 years. Out of the said investment, Rs. 1040 crore was received in May 2019 in the form of compulsorily convertible debenture. The group maintained the Capital Adequacy levels (as per company) at 18.01% as on March 31, 2019. (17.4% as on March 31, 2018). During FY20, the company announced capital infusion plans in the advisory arm of the group i.e. EGIA to the tune of Rs. 883 crore from two foreign investor viz. Kora Management Limited and Sanaka Capital. Out of the said investment, Rs. 177 crore was received in November 2019 from KORA Management in the form of compulsorily convertible preference shares and the company received Rs. 117 crore from Sanaka Capital during Q3FY20.

The groups' debt levels have decreased from Rs.48031 crore as on March 31, 2018 to Rs.45217 crore as on March 31, 2019. Subsequently, gearing levels (excluding minority interest) decreased from 7.97 times as on March 31, 2018 to 6.53 times as on March 31, 2019. The gearing (excluding MI) post the capital infusion in May 2019 stood at 5.60 times (based on March 2019 debt figures). The group's gearing excluding the liquid treasury assets maintained for liquidity management as on March 31, 2019 as per the management is 4.4 times based on reported net worth.

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The Group has demonstrated a track record of raising funds at regular intervals to take care of the leverage at the group level. Further, the Group has a strong track record of raising and deploying managed funds, which supports its overall business capabilities.

Moderation in asset quality

EFSL has been able to maintain comfortable asset quality on the book including the wholesale book over the years. As on March 31, 2019, Gross NPA ratio was 1.87% (1.75% as on March 31, 2018). Net NPA ratio was 0.83% (0.70% as on March 31, 2018) while Net NPA to Net-worth ratio was 4.32% (3.43% as on March 31, 2018). Including the written off amounts, Adjusted GNPA ratios stood at 2.5% as on March 31, 2019 as compared to 2.91% as on March 31, 2018.

Edelweiss group has outstanding exposure to real estate with financing to developers accounting for 26% of the total credit book as on December 31, 2019. The current environment prevailing in the real estate sector with funding constraints on account of crisis in the NBFC sector coupled with higher inventory is expected to put pressure on the asset quality of the NBFCs including Edelweiss which has relatively higher exposure to real estate developers in the NBFC segment. As on December 31, 2019, the group on a consolidated basis witnessed deterioration in the asset quality metrics. Gross NPA ratio was 2.76% as on December 31, 2019 as compared to 1.87% as on March 31, 2019. The Net NPA ratio was 1.97% as on December 31, 2019 as compared to 0.83% as on March 31, 2019. During 9MFY20, the company has witnessed sell down in the wholesale book to ARC's and Completion financing fund managed by EGIA with Meritz Group. The company has plans for further sell down of the wholesale book during Q4FY20.

The current global outbreak of COVID-19 would further put pressure on the overall economy going forward. Thus, the ability of the group in maintaining the asset quality across the business cycles is a key rating sensitivity.

Moderate liquidity profile and diversified resource profile

EFSL on a consolidated basis maintained a cumulative positive asset-liability mismatch across the time buckets as on December 31, 2019. At the group level, the company maintained liquidity to the tune of Rs.5450 crore as on December 31, 2019 which comprised of Rs. 3250 crore of cash/bank balance & fixed deposit, Rs.900 crore of investment in government securities and bonds, Rs 1300 crore of investment in mutual funds and bonds.

As on December 31, 2019, resource profile (excluding CBLO) is well diversified with NCDs / Sub debt / MLD - 58% (FY19: 53%), Bank borrowings- 41% (FY19: 34%), Commercial Paper- 1% (FY19: 2%) of total borrowings respectively. EFSL has reduced its dependence on the commercial paper in FY19 and continues to maintain the CP borrowings as negligible in FY20 as well.

Key rating weaknesses

Substantial proportion of revenue from the capital markets related activities

A significant proportion of ESFL's 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 and distressed assets business, dependency on capital markets has been declining over past few years.

Client concentration and credit risk in its wholesale credit book

As on March 31, 2019, the total loan portfolio comprised of retail book of 42% (March 2018: 41%), wholesale book of 41% (March 2018: 45%) and distressed asset book of 17% (March 2018:14%). Wholesale credit book of EFSL comprises of the real estate financing and the structured collateralised credit book. The real estate financing accounted for 27% of the total credit book as on March 31, 2019 as compared to 24% of the total credit book as on March 31, 2018. Even though the company has demonstrated a reduction on the concentration in the wholesale book as compared to the last year, the real estate segment continues to dominate the credit book. As on December 31, 2019, top 50 exposures (of which 41 accounts were from real estate segment) shared by the company accounted for 1.04 times of Tangible Net-worth. The top 10 accounts accounted for 41% of the tangible net-worth. (March 2019: 45% of tangible net worth). As on December 31, 2019, the retail and wholesale proportion of the total loan portfolio (including distress asset) stood at 51:49. There has been a considerable decline in the wholesale book (excluding distress assets) from Rs. 18055 crore as on March 31, 2019 to Rs. 13927 crore as on December 31, 2019 as the company has witnessed considerable sell down in the wholesale book.

As on March 31, 2019, the real estate book which has high ticket concentration and higher proportion of the book (based on analysis of information provided for 32 top exposures in RE book) under principal moratorium is expected to impact the liquidity in the short to medium term given the prolonged slowdown in the real estate sector. However, the company tries to mitigate the risk associated with the real estate exposures by the adequate collateral cover of 2-3x maintained on each exposure and control over the cash flows of the projects through Escrow mechanism. The company undertakes regular monitoring of each projects by an in-house team of 70+ employees which is engaged in fortnightly physical verification of the projects, marketing and controlling the construction if required.

Risk associated with distressed assets and new businesses

The Edelweiss group has recently forayed into new businesses, including expanding insurance (both life and general), and distressed assets. The insurance business is characterized by high competition and the group's ability to successfully establish a position in these segments is yet to be seen. Furthermore, the group has acquired a large portfolio of distressed assets in the past few years and the resolution in such cases needs to be seen.

As on March 31, 2019, the distressed assets (DA) accounted for 17% of credit book stood as on March 31, 2019 compared to 15% as on March 31, 2018. Till date the ARC has redeemed Rs.7553 crore of security receipts which account of approximately 13.99% of the issued security receipts. The ARC has made recoveries of Rs. 7019 crore during FY19. (FY18: Rs.2574 crore) and recoveries of Rs. Edelweiss ARC reported a Profit after tax (PAT) of Rs.435.02 crore in FY19 (Rs.180.02 crore in FY18).

Even though the ARC business has demonstrated growth in the past year with steady recoveries and growth in profitability, the inherent high riskiness of business leads to uncertainty and credit risk. At the same time, the implementation of IBC has improved the pace of resolution. The company's ability to demonstrate adequate and timely resolution performance is a key rating sensitivity.

Moderation in profitability growth

Moderation in the growth in profitability is on account of moderate growth in the advisory income due to capital market volatility in FY19 and increase in the loss in the life insurance business coupled with the rise in the cost of borrowings of the group post H2FY19 on account of liquidity crunch in the market and also the lower dependence on the commercial paper borrowings. The operating expense as a % of average assets increased from 5.73% in FY18 to 6.24% in FY19 on account of creation of capacity to build the retail book. Credit cost has declined from 1.17% in FY18 to 0.77% in FY19 on account of reduction in the provisions in FY19. As a result of the above, the Return on total assets continued to be maintained at 1.66% in FY19.

During 9MFY20, the group reported a decline in the profitability (Profit after tax) by 74% on a Y-o-Y basis. The major reasons for the decline in the profitability are decline in the interest income due to de-growth in the loan portfolio, and rise in the provisions. The company witnessed decline in the total loan portfolio (including distress assets) by 15% from Rs. 43510 crore as on March 31, 2019 to Rs. 36783 crore as on December 31, 2019. The company has envisaged a decline in the profitability for FY20 as the company aims at strengthening the balance sheet.

Liquidity Profile

EFSL on a consolidated basis maintained a cumulative positive asset-liability mismatch across the time buckets as on December 31, 2019. EFSL has contractual inflows of advances of Rs. 8816 crore upto one year against which EFSL has contractual outflow of debt obligations of Rs. 14067 crore (excluding CBLO) due to continuous sell down of assets. For the said mismatch, at the group level, the company maintained liquidity (unencumbered) to the tune of Rs.5250 crore as on December 31, 2019 which comprised of Rs. 3250 crore of cash/bank balance & fixed deposit, Rs 1300 crore of investment in mutual funds and bonds and Rs. 700 crore of undrawn bank lines. The above liquidity is exactly adequate to take care of the said mismatch. Going forward, any stress witnessed in the credit book of EFSL with wholesale book would lead to further stretch in the liquidity maintained by EFSL. Thus, any further widening of the asset-liability mismatch leading to stretch in the liquidity maintained by EFSL which would be a key rating monitorable.

Analytical approach: Edelweiss Financial Services Ltd (EFSL – rated 'CARE AA-'; Stable), the flagship 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. The list of the subsidiaries considered for consolidation are as per Annexure 3.

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Applicable Criteria

[CARE's Criteria on assigning Outlook and Credit Watch to Credit Ratings](#)

[Policy of Default Recognition](#)

[Financial ratios – Financial Sector](#)

[Criteria for Short term instruments](#)

[Consolidation and Factor Linkages in Ratings](#)

About EFSL

Previously known as Edelweiss Capital Limited, Edelweiss Financial Services Limited (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 standalone 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 three broad lines – credit including housing finance, SME loans, Loans against Property, Loans against Securities, Rural finance, Agri credit, Structured collateralised credit to corporates and real estate developer finance, Franchise & advisory businesses including wealth management, asset management and capital markets and insurance including life and general insurance. In addition, the Balance-sheet Management Unit (BMU) attends to the balance sheet and liquidity management. The group conducts its business from 476 offices (including 8 international offices in 6 locations) in around 200 cities as on March 31, 2019. EFSL now caters to the total client base of 12 Lakh served by 11,410 employees pan India.

Brief Financials (Rs. crore) (IND AS)	FY18 (A)	FY19 (A)
Total income	8,920	10,886
PAT(after share of profit and minority interest)	863	995
Overall Gearing (excluding minority interest) (times)	7.97	6.53
Total Assets	62,554	63,630
Gross NPA (%)	1.75	1.87
ROTA (%)	1.57	1.65

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure I- Instrument Details

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures	-	-	-	284.00	CARE AA-; Stable
Commercial Paper	-	-	7 days-1 year	6350.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (12-Sep-17)	1)CARE AA; Stable (10-Mar-17) 2)CARE AA

								(21-Oct-16)
2.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1) Withdrawn (12-Sep-17)	1)CARE AA; Stable (10-Mar-17) 2)CARE AA (21-Oct-16)
3.	Debentures-Non Convertible Debentures	LT	284.00	CARE AA-; Stable	1)CARE AA-; Stable (05-Jul-19)	1)CARE AA; Positive (06-Jul-18)	1) CARE AA; Stable (12-Sep-17)	1)CARE AA; Stable (10-Mar-17) 2)CARE AA (21-Oct-16)
4.	Commercial Paper	ST	6350.00	CARE A1+	1)CARE A1+ (05-Jul-19)	1)CARE A1+; (06-Jul-18)	1)CARE A1+ (12-Sep-17)	1)CARE A1+ (10-Mar-17) 2)CARE A1+ (21-Oct-16)

Annexure-3: List of subsidiaries taken for consolidation

	Subsidiaries of Edelweiss Financial Services Limited	Shareholding by EFSL (directly/indirectly)
1	Edelweiss Securities Limited (ESL)	100%
2	Edelweiss Comtrade Ltd.	100%
3	Edelweiss Securities (Hong Kong) Private Limited	100%
4	Edelweiss Financial Services Inc.	100%
5	Edelweiss Custodial Services Limited	100%
6	Edelweiss Asset Reconstruction Company Limited	74.8%
7	Edelweiss Financial Services (UK) Limited	100%
8	Edelweiss Finance & Investments Limited	100%
9	EC Global Limited, Mauritius	100%
10	Edelweiss Rural & Corporate Services Limited (ERCSL) (Formerly Edelweiss Commodities Services Ltd. (ECSL))	100%
11	Edelweiss Housing Finance Limited (EHFL)	100%
12	Edelweiss Broking Limited (EBL)	100%
13	Edel Finance Company Ltd.	100%
14	Edelweiss Capital (Singapore) Pte. Limited (ECSPL)	100%
15	Edelweiss Alternative Asset Advisors Pte. Limited	100%
16	Edelweiss International (Singapore) Pte. Limited	100%
17	Edelweiss Investment Advisors Private Limited, Singapore	100%
18	EC International Limited, Mauritius (ECIL)	100%
19	Aster Commodities DMCC, Dubai	100%
20	EAAA LLC, Mauritius	100%
21	EFSL International Limited	100%
22	EW Special Opportunities Advisors LLC, Mauritius	67%
23	EW India Special Assets Advisors LLC, Mauritius	100%
24	ECap Equities Limited	100%
25	Edelcap Securities Limited	100%
26	Edelweiss Finvest Private Limited (formerly Arum Investments Private Limited)	100%
27	Edelweiss Retail Finance Limited	100%
28	ECL Finance Limited	100%
29	Edelweiss Alternative Asset Advisors Limited	95%
30	Edelweiss Global Wealth Management Limited	100%
31	Edelweiss Insurance Brokers Limited	100%
32	EC Commodity Limited	100%
33	Edelweiss Investment Adviser Limited	100%
34	Edelweiss Tokio Life Insurance Company Limited	51%
35	Edelweiss Trustee Services Limited	100%
36	Edel Investments Limited	100%

37	Edel Land Limited	100%
38	Edelweiss Trusteeship Company Limited	100%
39	Edelgive Foundation	100%
40	Edelweiss Asset Management Limited	100%
41	Edelweiss Holdings Limited	100%
42	Edelweiss General Insurance Company Limited	100%
43	Edelweiss Securities (IFSC) Limited	100%
44	Alternative Investment Market Advisors Private Limited	100%
45	Allium Finance Private Limited	55.48%
46	Lichen Metals Private Limited	50.32%

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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About CARE Ratings:

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Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

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