

CMP: 105.80 Weight:9%

Date: 14/09/2016



STOCK DATA

Market Cap(Rs. cr)	8707
Promoters Holding	37.3%
52 week high/low	44.4/119
Shares outstanding(cr)	82.3

KEY FINANCIALS

(Rs. in cr)

Ex Insurance	2014	2015	2016	Q1 2017
PAT	272	381	519	155
Credit Book	8953	15036	20014	21129
Net Rev/Avg Ass.	7.20%	8.5%	7.80%	8.60%
ROE	12.20%	15.60%	18.60%	19.40%
ROA	1.90%	1.90%	1.80%	2%
Cost to Income	59%	60%	60%	57%
Gross NPA	0.90%	1.30%	1.40%	1.40%
Net NPA	0.20%	0.40%	0.50%	0.50%

VALUATION: Edelweiss is trading at 14x FY 2017 PE. We believe there can be significant re-rating in the stock as there are many growth Triggers in the Company. Every Business edelweiss is in has massive opportunity size and can easily grow at more than 20% for next couple of Years.

Edelweiss Financial Services

Thesis – At Stallion Asset we have a consistent Strategy of only buying companies which fit our stringent Criteria of Growth at a Reasonable Price.

The Market started rewarding NBFC's way back from 2009 though the Horse has been different every 2 years. There has been massive value mitigation from banks to NBFC and we believe the next Horse is Broker Turned NBFC.

- 1) Wave 1 – Rural Finance
- 2) Wave 2 – Housing Finance
- 3) Wave 3 – Consumer Finance
- 4) Wave 4 – Micro-Finance
- 5) **Wave 5 – Broker Turned NBFC?**

We at Stallion Asset believe that there can be a massive credit upside in the Indian economy in every sector as the GDP increases from 2 Trillion to 5 Trillion in the next 10-15 years. I personally feel that in the next 3-5 years there may be a credit bubble.

There is a massive shift happening from Investing in Hard Asset's like Real Estate and Gold to Financial Asset is Mutual Funds and Direct Equity.

Financial Services is a Well Established Business Globally with Large Investment Banks like Goldman Sachs, JP Morgan creating Massive amounts of Wealth. Edelweiss, IIFL and Motilal Oswal are well placed and 1 of them will be India's Goldman Sachs.

Why Edelweiss

- 1) All Business' Expected to Fire Ahead
- 2) Superb Management Skills
- 3) Well Diversified Financial Services
- 4) Credit Bubble Thesis

Edelweiss has been there for last 20 Years and seen various cycles. It has a history of being extremely big during a bull market and consolidating during the Bear Market.

Period	Bull/Bear	In Crores		Growth(CAGR)
		Start Revenue	End Revenue	
1996-2000	Bull	0.02	8.5	373%
2000-2004	Bear	8.5	28.1	35%
2004-2008	Bull	28.1	1088.8	149%
2008-2012	Bear	1088.8	1670.7	11%
2012-2016	Consolidation	1670.7	5315.7	34%
2016-2020	Bull or Bear?	5315.7	?	?

Edelweiss is a well-Diversified Financial Services company; they are market leaders in many of their Business'.

Product Break up: (Please Note Edelweiss has a lot of Products and we have tried to explain all material products in the easiest possible manner. Feel Free to Ask on Query Desk if any Doubt)

Edelweiss Operates in 3 Parts –

Segments	Equity	PAT	ROE
Credit	2321	337	17%
Non-Credit	1112	182	22.30%
Total Ex Insurance	3433	519	18.60%
Life Insurance	939	-104	NA
Consolidated	4372	414	12.90%

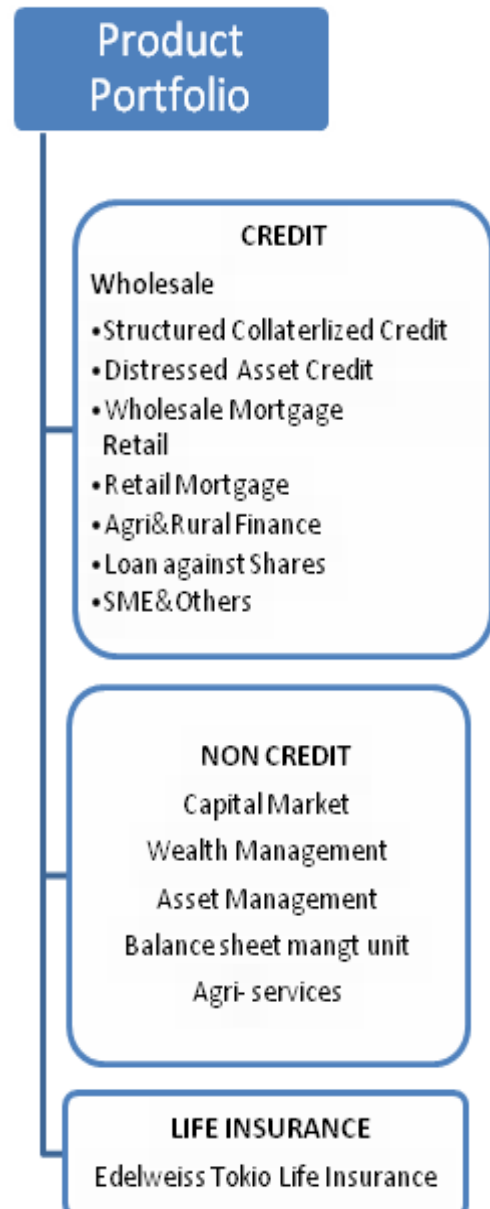
*FY 2016 Data

1) Credit Business-

Credit Business (20,000 Cr.) is Divided into 2 Parts

- 1) Wholesale Credit (14,000 Cr.)
- 2) Retail (6,000 Cr.)

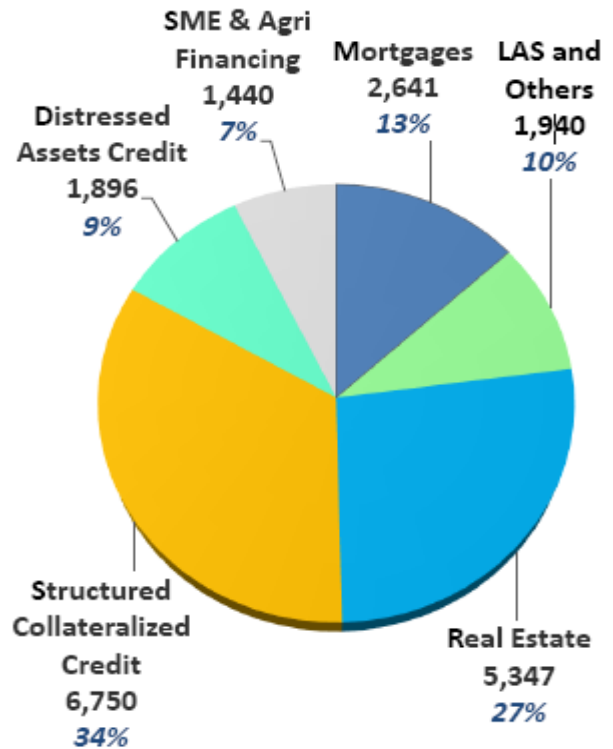
	2016	2015	2014	2013
Retail Book	6000	2900	2000	1627
% Growth	106%	45%	23%	110%
Whole Sale Book	14000	12100	6628	4945
% Growth	16%	83%	34%	23%
Total Credit Book	20000	15000	8628	6572
% Growth	33%	74%	31%	37%



The Image in the right shows that the management has a diversified lending base. The Growth in Retail base is expected to be higher in the coming years.

The Management has guided that they want to be present in 10 segments and each having book size of 5000-10000Cr so that they can move their funds out of sectors which are facing stress.

The Problem with having a non-diversified book is that even if the sector is slow you still have to lend to be in business. Example Mahindra finance still had to lent in 2013-2016 to rural market when clearly there was stress in that sector which resulted in Fall of ROE.



	2016	2015	2014
Average Interest Yield	16.2%	15.8%	15.1%
Average Cost of Borrowing	10.7%	10.9%	10.3%
Interest Spread	5.5%	4.9%	4.7%
Net Interest Margin	6.8%	6.7%	6.7%

Wholesale Lending -

The company is the market leader in Structured Collateralised Credit which is 34% of the total Credit book size. They even provide mortgage loans to real estate. The company started with Wholesale credit in 2007 and now has Rs. 14900 cr.

Retail Segment

Retail segment is high growth segment with potential opportunity size. The company started its operations in this segment in 2011 and since then they have managed to grow their book size considerably to Rs. 6000 cr i.e. accounts for 30% of the total credit book. This includes Retail mortgage, Agri and rural finance and loan against shares and SME.

Company has shown robust growth in the credit business and the management has guided 20-25% growth every year. The credit business contributes more than 60% to the PAT of the company. It is fast growing business with NIMs of 6.9% and NPAs of 0.5%. The company has grown its total credit book at a CAGR 63% since FY09.

The management believes that there is potential growth on the NBFC side where the company can easily scale up their business. They already have presence in various credit products like SME, Housing finance, Retail Finance, Agri Finance, Real Estate Finance and the management aims to grow their AUM size in each segment to

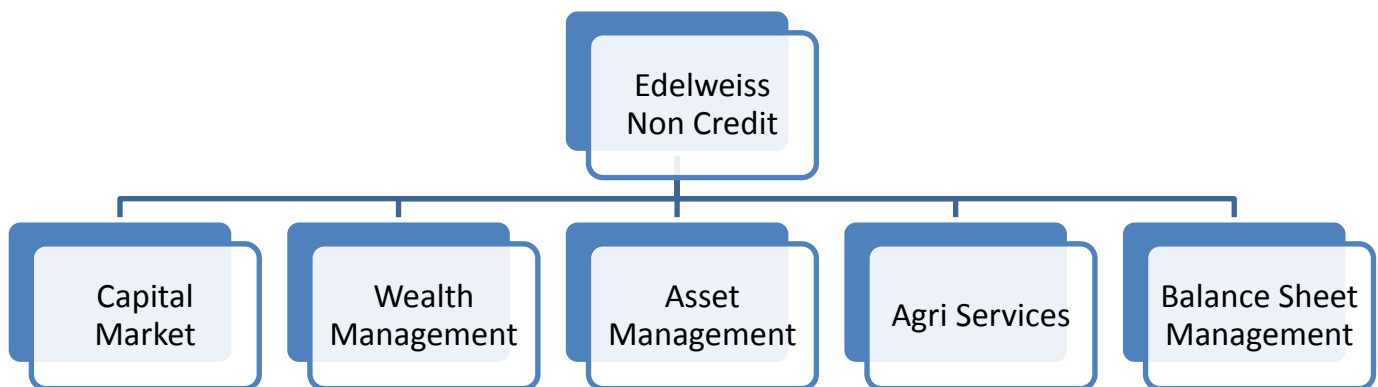
4000-5000 levels by leveraging the untapped opportunity. The management believes that they have an edge over their competitors as they are not as big as large bank like Kotak and HDFC nor are they very small. Their business in each segment is very much scalable with a healthy and consistent growth.

Edelweiss has not only made diversification their core strength but have also taking maximum advantage of their synergy of existing client base of 8 lakh+ customers.

The minimum valuation for edelweiss Credit Business is 2x Trailing 2016 P/B i.e. 56.4 Per share

2) Non-Credit Business

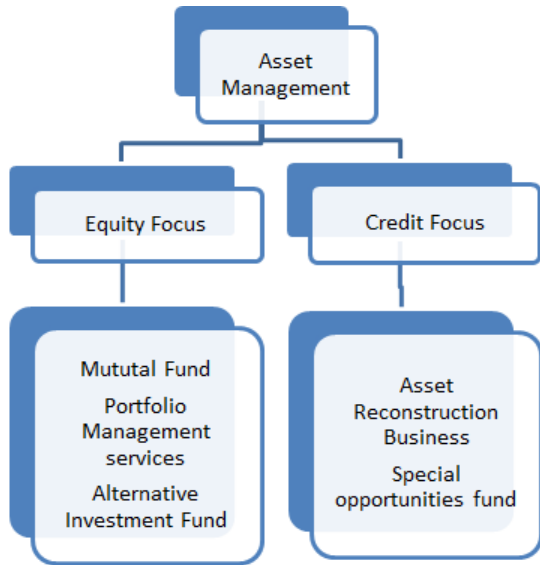
Year	2014	2015	2016
PAT (cr.)	101	152	182



Capital Market - Edelweiss is Leader in the Capital Market Space being the biggest player in Public Bond Market, Institutional Brokerage.

Wealth Management includes advisory and investment services with Assets under Advice worth Rs. 31100 cr. They have grown their assets under advice at 82% CAGR in last three years.

Agri services business provides end to end services in the entire Agri-value chain from warehousing facility to procuring, grading and distribution of various cash and non-cash crops in India and outside India. It has 315 warehouses under management with a capacity of over 12.3 Lacs MT.



Asset Management

The company has 5700 cr funds under management as on Q1FY17. The company has lately acquired JP Morgan's onshore fund schemes. The AUM of JP Morgan stood at 7081 cr thus strengthen Mutual Fund assets under management. One of the important part of this segment is Asset Reconstruction business. Edelweiss is India's largest ARC with Distressed assets worth 29300 cr as on Q1FY17.

Asset Reconstruction Company (ARC) – “Every Crisis is an Opportunity in Disguise”. The Latest Problem of bank NPA's Report is a Massive opportunity for ARC Companies like Edelweiss. **Edelweiss is the largest company in the country in the ARC having market share of 40-50%.**

An asset reconstruction company's primary goal is to manage and to make profitable those assets which are underperforming or are classified as NPA's belonging to companies who have been unable to generate sufficient timely revenue to service their outstanding obligations.

Asset Reconstruction Company is regulated under SARFESI Act and has the responsibility to function as intermediaries between promoters and trust (banks).

Following the clean-up order, the banks, led by state-run ones, have reported close to 14 per cent or over Rs 8 trillion (Rs 8 lakh crore) of their assets as stressed as of March 2016, while NPAs alone crossed 7.6 per cent.

This has favoured the asset reconstruction companies. It is important to know that these bad loans have not come overnight, but they have been piling up since a long time. ARCs cannot come into the picture unless the banks starts showing up their bad loans. This has started already last year in true sense and we believe that it is not going to stop.

Currently there are 16 ARCS registered with RBI. ARC has already acquired 1.2 lakh crore worth of Bad Loans from the bank, which is only 1/10th of the stressed assets. The Opportunity Size of ARC is equal to Atleast 50% of the NPA's reported by the bank.

Edelweiss has about 30,000 Crores of Asset under management in the ARC business. Out to these 15% is paid upfront by Edelweiss under RBI's 85/15 rule.

The Management has guided a Return on Asset of about 3.5-4% in long run and ROE Between 14-18% for this Business. Lately there has been speculation that the Company is selling 30% to a Canadian pension fund for a valuation of 4500-6800 Cr. [Click here for complete news](#)

The minimum valuation for Non Credit Business is 15x 2016 Earning which is 33 per Share

3) Life Insurance Business

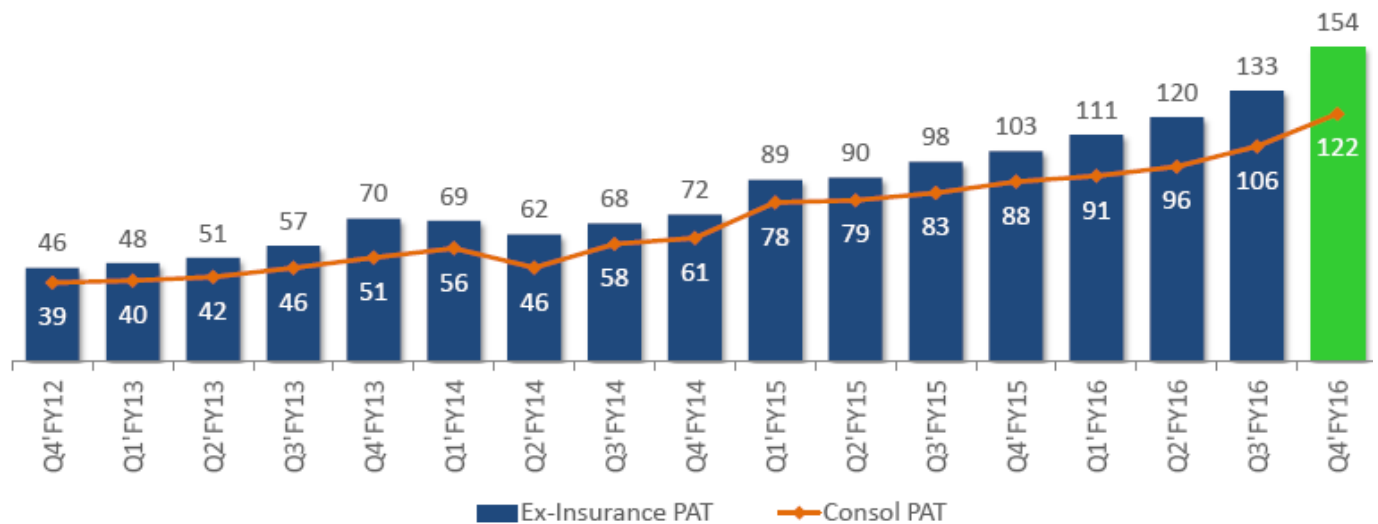
Life Insurance sector in India is less penetrated at 3.3% of the GDP and per capita density of Rs 3498 as compared to 6.2% and Rs 42100. Edelweiss Tokio Life Insurance is one of the fastest growing company with a gross premium of Rs. 310 cr for FY16. The company, which started operations in 2011, is a joint venture between Edelweiss Financial Services (51%) and Japan's Tokio Marine Holdings Inc. It now has 59 branches across 49 cities in India.

Life Insurance has still not turned profitable for the company since insurance business typically have a longer gestation period. The insurance business has grown at CAGR 42% since FY13. The Company has invested Rs. 350 cr in the Insurance business and will infuse 150 cr more in next 5 years.

Edelweiss lately Sold 23% stake to its Partner Tokio in its insurance business at 527 crores valuing the firm at 2292 crores. Currently Edelweiss holds 51% stake in the insurance arm and its 51% stake is valued at 1168 crores. In last 5 Years edelweiss has smartly created value by investing 350 cr. and created a Valuation of 1168 crores for itself.

Profit after Tax

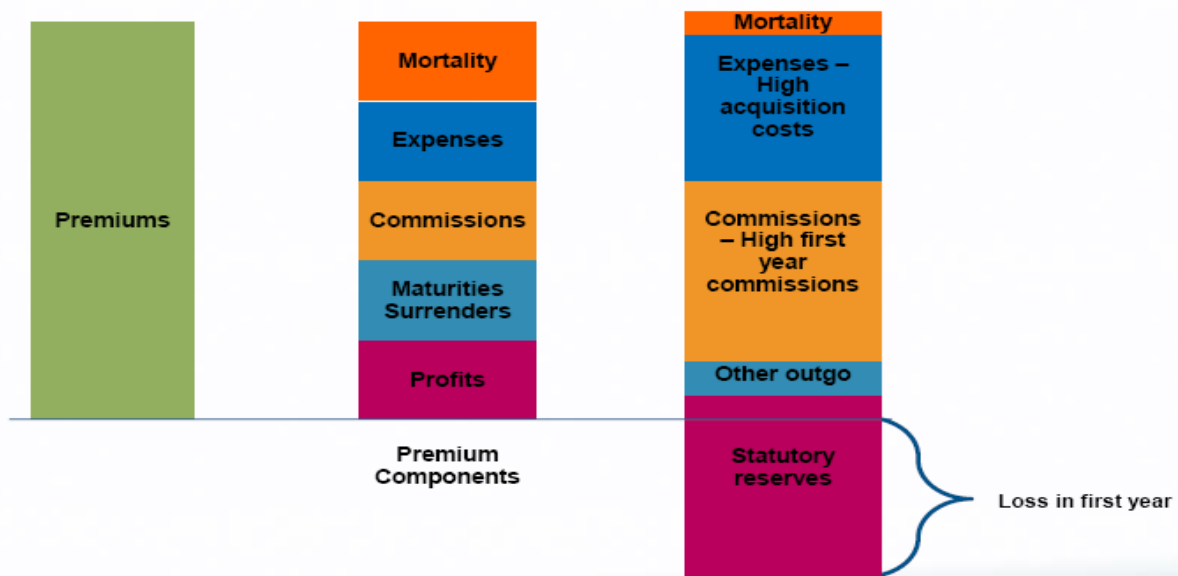
INR Cr



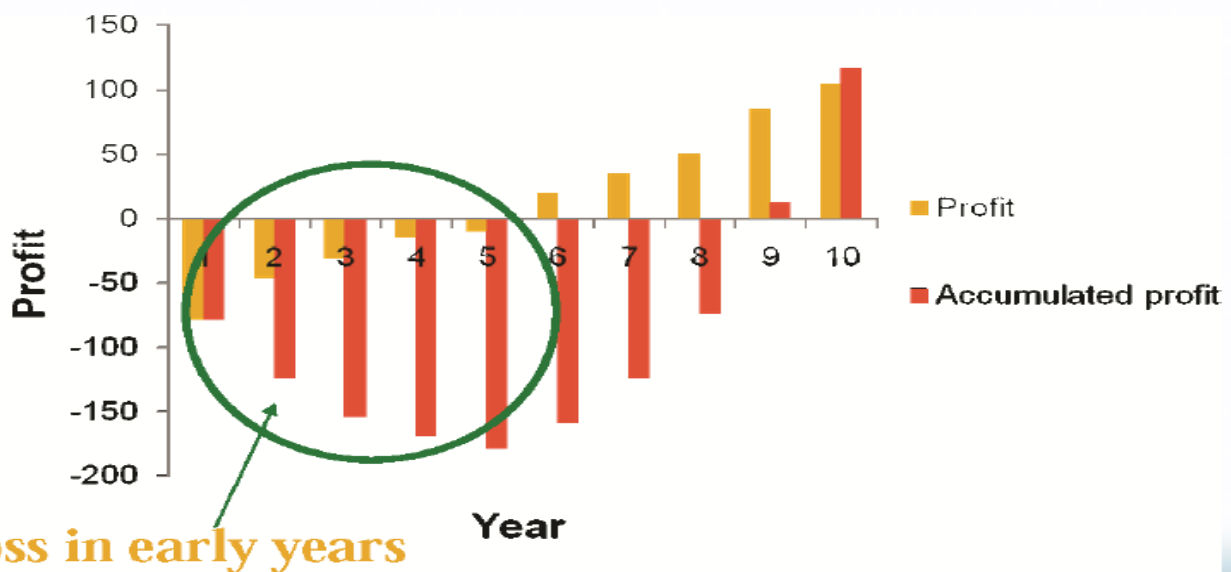
	2016	2015	2014	2013
Gross Premium	310	193	111	55
% growth	60.62%	73.87%	101%	400%
Loss	-155	-71	-69	-65

Edelweiss has been losing money every Quarter due to its insurance business by large amount of this loss is only accounting loss/actuarial loss.

How is life insurance priced?



*Source -Milliman



*Source -Milliman

In the above two charts we have shown how the gestation period in Insurance business is high, but once they touch the inflection point, large sustainable profits start flowing in for decades.

We are confident that edelweiss will be able to pull off the insurance business. We Value the 51% stake in the Insurance Business as per latest Transaction at 1168 cr. or 14.2 Rupees a Share.

The minimum valuation for 51% stake in edelweiss Insurance Business is 15 per Share.

Risks:

- 1) Large Exposure to real estate finance: Company has sizable exposure to whole sale credit one of them being real estate finance. Keeping in mind that real estate industry has being sluggish from a while now and they haven't shown any signs of revival yet. Their books size for real estate stood at 5300 crores as on 31st March 2016.
- 2) Risk of Capital Market Underperformance: Every bull market is followed by a bear market. During the time when markets crash their business from the wealth management, asset management and capital market (.i.e. high ROE business gets disrupted due to uncertainties).
- 3) Cost of borrow still high at 10.7% whereas competitors have lower cost of borrowing. This can be seen as an opportunity as well.
- 4) Credit Risk: If NPA's goes above 2% the business will start showing signs of stress. That's our big red flag for this business. The company has managed this well, all average collateral cover is 2x.

Valuation - We have done a SOTP Valuation for edelweiss. We have divided business in 3 parts; the valuation is pretty Straight Forward.

- 1) **Insurance Business** – Looking at Acquisition of 23% stake we value it at Rs 15-20 a share
- 2) **Credit Business**- A 20-25% Growing NBFC generating an ROE OF 18% is Valued at 2-3 Times Book. We will take a valuation of 2x book i.e. 4642 Cr or Rs 56.4 a Share
- 3) **Non Credit Business** – It's not easy valuing the Non Credit business as the company doesn't disclose the individual Business' Revenue; All We know is the profit amount.

Let's break it up - Brokerage Business – The Company has an institutional market share of 4-5% and 2-3% in Retail business. We believe the brokerage business will be a cash cow for the company. Emkay has a 0.25% market share but has a valuation of 160 crores.

Asset under Advisory - The Company has 32,000Cr. Asset under Advisory which basically means it has sold mutual funds worth 30,000 Cr. and get 0.5-1% trail revenue from the Mutual Fund Company.

Asset Reconstruction Business – The company has an ARC book of About 29,300 Cr. and as per economic times they are selling 30% Stake for about 1600 Cr valuing the company at 5,333. So if the deal goes through the value of the 70% edelweiss stake would be Rs 45 per value or 3733 Cr.

Other Business' – The Company has other business like its own mutual fund, Owns 315 warehouses where it services the agri value chain. We believe these business' are very scalable especially the AgriValue Chain Business.

Business	ROE	PAT	Equity	Bear Case Value (Per share)	Bull Case Value (Per share)	Median(Per share)
Credit Business	17%	337	2,321	2x P/B =56.4	3x P/B=84.6	70.5
Insurance	NA	-155	939	15	25	20
Non Credit	22%	182	1,112	15PE =33.17	25PE= 55	45
				105	165	136

We have not taken ARC stake sale valuations in our valuation template to be conservative; we will update you when the stake sale happens.

Conclusion –In every Bull market the management has seized on to the opportunity and scaled up the business. I am expecting a massive credit uptick for the next 5 years. Today from small electronic appliances to large real estate projects there is a need of Financing, the consumer has accepted that debt. NBFC is the sector in play, with a very large opportunity size ahead. The Expected growth of Credit business of Edelweiss is 20-25% for the next couple of years. I am a bull on the capital market business as well and believe that ROE's there can improve to 25-30% atleast. Edelweiss is the largest Asset reconstruction company in the country and has a 40-50% market share. If they can get a billion dollar valuation for the Asset reconstruction business, that could be a bonus for us. On the Insurance business Side, even though in accounting term's edelweiss is losing money but it has created value for its shareholders by selling 23% stake for 527 crores. I personally believe that Edelweiss' return's will be 2-3x higher than market returns as it has higher growth than market, better ROE, Market leader in many products, excellent management and seizes every possible opportunity.



Disclosure: Amit Jeswani & Family have no positions

Analyst Disclosures: No positions

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