31 August 2018

Update | Sector: Financials

Piramal Enterprises

BSE SENSEX	S&P CNX
38,645	11,681

CMP: INR3,202 **TP: INR3,685 (+15%)** **Buy**

Builds up a head of steam in Financial Services

Focus more on profitability than growth; looks to be among top 10 HFCs

- **Piramal Enterprises (PIEL) hosted an analyst meet to discuss its Financial Services business in detail. Management believes that opportunities in corporate lending are aplenty, given that most public sector banks and some private sector banks are not so active in this space. Hence, while bulk of its loan book (~75%) is wholesale real estate lending, management expects the share of non-real estate corporate lending to expand meaningfully over the next three years.**
- **Before investing/lending in any segment, the company does a deep study of the sector, which usually takes around six months. To the company's advantage, several executives in the corporate lending team have good working experience in the respective industries. In addition, what differentiates PIEL from its peers is that its legal team is hands-on – it is involved in a transaction right from the start (structuring, etc.) and is not merely involved in documentation and other administrative tasks.**
- **Management has a clear intention to generate at least 20% RoE across businesses over the long term. PIEL does not have any 'growth' targets for its executives – the only targets are on RoE/profitability and asset quality.**
- **With a favorable operating environment (waning competition from PSU banks, better transparency due to RERA, etc.), strong management at helm of affairs and adequate capital, we believe PIEL is well poised to capture the growth opportunities that exist in the wholesale lending space. The company has demonstrated its track record of delivering value to shareholders across businesses. With a confluence of factors working to PIEL's advantage, we upgrade our FY19/20 EPS estimates by up to 4% (to factor in better growth) and roll over our SOTP to Sept'20. With better growth, we have also increased the multiple for the Financial Services business to 3.2x from 3x earlier. Our revised SOTP-based TP is INR3,685. Buy.**

Product diversification driving growth and mitigating risks

Over the past three years, **the share of mezzanine lending in overall loan book has declined from 65% to 19% and that of construction finance has increased from 20% to 46%.** While this has impacted yields (-300bp to 14%), management is comfortable, as this has moderated the risk profile and deepened the relationship with developers. **Corporate finance – a business started two years back – has already grown to a loan book size of INR100b+ (22% of loans) and is expected to further gain share.** In this segment, while the company first started off with infrastructure deals, it now does deals in renewables, logistics and other sectors too. Also, about a year back, PIEL received a housing finance license from the NHB and started retail home loans. Thus, PIEL has demonstrated its ability to successfully continue diversifying its loan book mix and maintain growth.

Stock Info

Bloomberg	PIEL IN
Equity Shares (m)	173
M.Cap.(INRb)/(USDb)	584 / 8.2
52-Week Range (INR)	3149 / 2279
1, 6, 12 Rel. Per (%)	17/12/-3
12M Avg Val (INR M)	642
Free float (%)	49.2

Financials Snapshot (INR b)

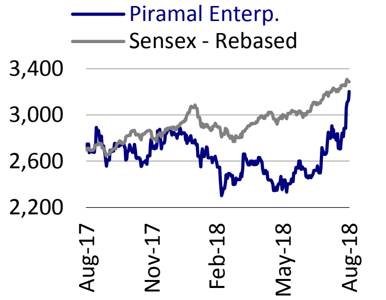
Y/E March	2018	2019E	2020E
Revenues	106.4	134.4	171.1
EBITDA	29.6	37.0	46.5
PAT	12.7	12.7	23.8
EPS (INR)	77.8	78.9	137.6
EPS Gr. (%)	7.2	1.4	74.5
BV/Sh. (INR)	1,326	1,378	1,468
Payout (%)	32.1	28.3	29.2
Valuations			
P/E (x)	41.1	40.6	23.3
P/BV (x)	2.4	2.3	2.2
Div. Yield (%)	0.8	0.7	1.3

Shareholding pattern (%)

As On	Jun-18	Mar-18	Jun-17
Promoter	50.8	51.4	51.4
DII	4.4	3.8	3.6
FII	27.5	28.0	28.7
Others	17.3	16.8	16.3

FII Includes depository receipts

Stock Performance (1-year)



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Upbeat on retail home loan prospects

Management appeared confident of being able to scale up the retail home loan book. **While PIEL already has six branches, it looks to add one branch per month over the next 18 months – this should be a key growth driver. With a loan book of INR16b already, management is quite confident of being among the top 10 HFCs by loan book size over the next 12 months.** In this business, relationship with the builder and innovative products would be the key moats of the company.

Active legal team and post-disbursal asset monitoring a key differentiator

What differentiates PIEL from its peers is the hands-on approach of its legal team, which is involved in a transaction right from the start (structuring, etc.) and is not merely involved in documentation and other administrative tasks. The team reports directly to the Chairman and Board. Also, PIEL set up an asset monitoring team four years back. This team is involved not only in real estate projects but also other corporate lending projects. **Site visits are done on a monthly basis and a scorecard comprising detailed information on the number of workers on site, the numbers of floors built, reason for stalling of project, etc. is presented to management.** Any issues/early warning signals are relayed back to the team and appropriate measures are taken.

Profitability and asset quality, not growth, the key objective; expects 30-35% dividend payout ratio over the medium-to-long term

Overall, management's intention is to generate at least 20% RoE in all its businesses over the long term. **PIEL does not have any 'growth' targets for its executives – the only targets are on profitability and asset quality.** As a result, management would allocate more capital to new businesses initially and then allocate it more evenly later on. Currently, ~INR200b is invested in the Financial Services business (including investment in the Shriram Group). As the businesses grow, management expects a dividend payout ratio of 30-35%.

Reiterate Buy; strong foundation for robust growth

PIEL has the distinction of being one of the few companies in India to generate 25%+ book value CAGR over past 25+ years. We believe the company has the DNA to incubate and grow businesses in niche segments. With a large product suite, huge growth opportunity and a focused team, the overall Financial Services business will continue growing at a robust pace and generate 20%+ RoE, in our view. We increase our FY19/20 EPS estimates by up to 4% and use SOTP to arrive at a target price of INR3,685 (Sep'20E based). Maintain **Buy**.

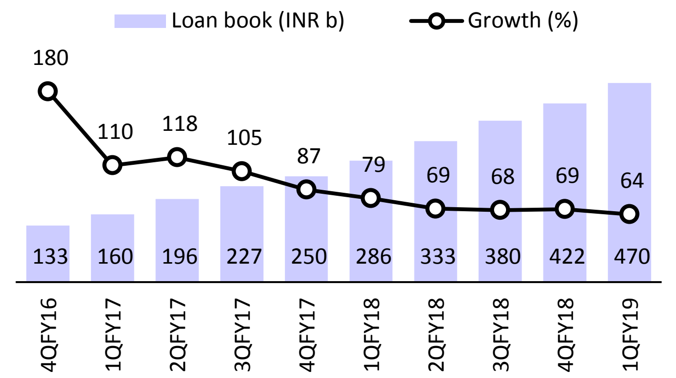
Exhibit 1: PIEL: SOTP - Sep 2019 (without factoring in the proposed capital raise of up to ~INR50b)

	Value (INR B)	Value (USD B)	INR per share	% To Total	Rationale
Lending Business	494	7.6	2,476	67	3.2x PBV; ROA/ROE of ~3%/20%+ - Loan CAGR of 35% FY18-20
Shriram Investments	108	1.7	540	15	Based on our Target Multiple; Implied 2.2x of invested capital
Pharma, IT and Others	133	2.1	669	18	Pharma EV/EBITDA 14x; IT EV/Sales of 4x
Target Value	**735**	**11.3**	**3,685**	**100**	**Implied 2.4x Consolidated BV**
Current market cap.	638	9.8	3,201		
Upside (%)	**15.1**	**15.1**	**15.1**		

Source: Company, MOSL

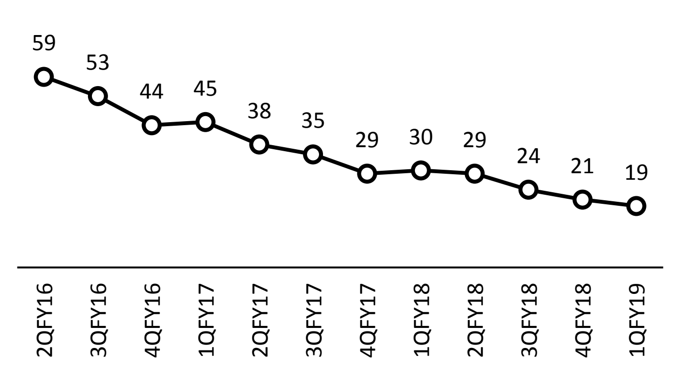
Story in charts

Exhibit 2: Overall AUM growth remains robust (%)



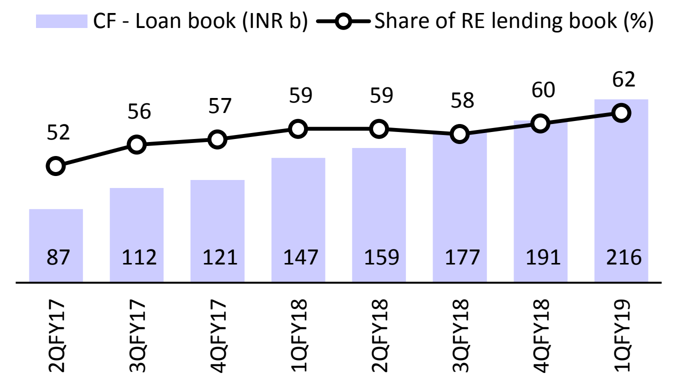
Source: MOSL, Company

Exhibit 3: Share of mezzanine lending on the decline (%)



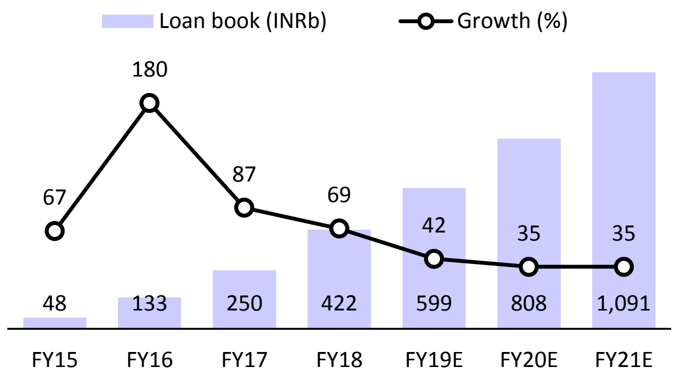
Source: MOSL, Company

Exhibit 4: Construction finance mix inching up (%)



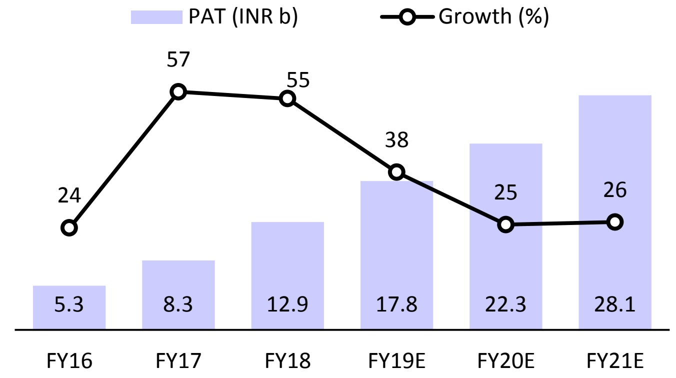
Source: MOSL, Company

Exhibit 5: 35%+ loan growth going forward



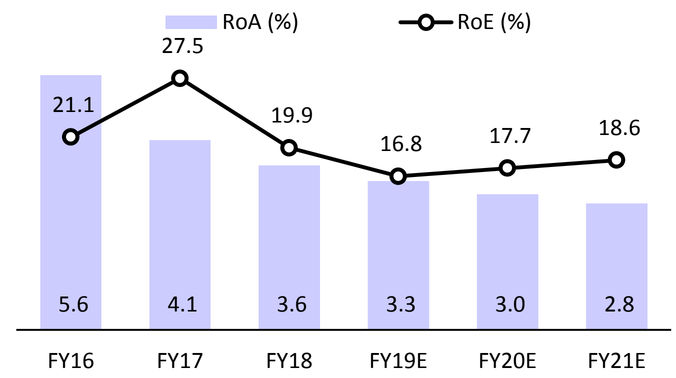
Source: MOSL, Company

Exhibit 6: Trend in PAT (FS business, MOSL estimate)



Source: MOSL, Company

Exhibit 7: RoA/RoE healthy (FS business, MOSL estimate)



Source: MOSL, Company

Financials and Valuations - Consolidated

INCOME STATEMENT									(INR M)
	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Revenues	**35,440**	**45,030**	**51,230**	**63,815**	**85,468**	**106,393**	**134,437**	**171,078**	**214,645**
Change (%)	50.7	27.1	13.8	24.6	33.9	24.5	26.4	27.3	25.5
HealthCare	24,410	28,200	31,210	34,670	38,927	43,220	47,542	53,390	59,959
Financial Services	3,930	7,260	9,371	17,397	33,515	49,817	71,959	100,988	136,013
Info Mgmt	6,510	8,900	10,196	11,559	12,224	12,092	13,543	15,168	16,988
Others	590	670	453	188	802	1,264	1,392	1,531	1,685
EBITDA*	**4,523**	**4,300**	**8,698**	**13,726**	**20,908**	**29,611**	**36,995**	**46,519**	**56,997**
Change (%)	33.8	-4.9	102.3	57.8	52.3	41.6	24.9	25.7	22.5
HealthCare	100	933	299	3,266	5,928	8,001	7,873	10,051	11,394
Financial Services #	2,796	2,110	6,575	8,185	12,837	19,933	27,429	34,345	43,225
Info Mgmt	1,628	1,257	1,824	2,276	2,143	1,677	1,693	2,124	2,378
EBIT*	**2,427**	**1,831**	**5,799**	**11,172**	**17,190**	**24,838**	**31,697**	**40,921**	**51,099**
Change (%)	16.2	-24.6	216.7	92.6	53.9	44.5	27.6	29.1	24.9
HealthCare	-1,358	-626	-1,628	1,151	3,124	4,191	3,564	5,492	6,585
Financial Services #	2,790	2,096	6,557	8,159	12,813	19,908	27,429	34,345	43,225
Info Mgmt	995	361	870	1,862	1,254	738	704	1,085	1,289
Unallocated Inc/(Exp)	**-4,001**	**-6,192**	**-2,407**	**-4,028**	**-3,988**	**-5,200**	**-5,775**	**-5,991**	**-5,991**
Core PBT	**-1,574**	**-4,361**	**3,392**	**7,144**	**13,202**	**19,638**	**25,922**	**34,929**	**45,107**
Change (%)	-224.3	177.2	-177.8	110.6	84.8	48.7	32.0	34.7	29.1
Exceptional Items	-191	14	26,962	457	-100	0	-4,500	0	0
Reported PBT	**-1,765**	**-4,348**	**30,354**	**7,600**	**13,103**	**19,638**	**21,422**	**34,929**	**45,107**
Taxes	**248**	**628**	**3,450**	**495**	**2,281**	**6,928**	**8,676**	**11,177**	**14,434**
Tax Rate (%)	-14.0	-14.4	11.4	6.5	17.4	35.3	40.5	32.0	32.0
PAT	**-2,013**	**-4,975**	**26,904**	**7,105**	**10,821**	**12,710**	**12,746**	**23,752**	**30,673**
Change (%)	-274.6	147.2	-640.8	-73.6	52.3	17.5	0.3	86.3	29.1
Minority Interest	56	8	-3	0	-3	0	0	0	0
Share from Asso. Co	-42	-31	1,593	1,942	1,699	2,801	2,980	3,684	4,595
PAT Post MI	**-2,111**	**-5,014**	**28,500**	**9,047**	**12,523**	**15,511**	**15,726**	**27,436**	**35,268**
Change (%)	-289.3	137.6	-668.4	-68.3	38.4	23.9	1.4	74.5	28.5
Dividend (Including Tax)	**3,533**	**10,599**	**4,154**	**3,635**	**4,348**	**5,415**	**5,347**	**9,603**	**12,344**

* Ex Exceptional, # Post interest expenses; FY16-18 nos based on IND AS; FY18 Excluding one off DTA of INR35.6b

Financials and Valuations - Consolidated

BALANCE SHEET									(INR Mn)
Y/E MARCH	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Equity Share Capital	345	345	345	345	345	399	399	399	399
Reserves and Surplus	106,891	92,866	133,910	129,138	148,481	264,055	274,434	292,268	315,192
Networth	**107,236**	**93,211**	**134,255**	**129,484**	**148,826**	**264,454**	**274,833**	**292,667**	**315,591**
Borrowings	**76,881**	**95,519**	**71,863**	**162,788**	**304,510**	**441,608**	**612,531**	**814,081**	**1,096,202**
Change (%)	275.6	24.2	-24.8	126.5	87.1	45.0	38.7	32.9	34.7
Other liabilities	**18,404**	**26,316**	**13,908**	**17,526**	**29,058**	**20,772**	**26,385**	**34,827**	**46,225**
Change (%)	26.0	43.0	-47.2	26.0	65.8	-28.5	27.0	32.0	32.7
Total Liabilities	**202,521**	**215,045**	**220,026**	**309,798**	**482,394**	**726,834**	**913,749**	**1,141,575**	**1,458,018**
Loans + Investments	**114,613**	**111,406**	**125,696**	**198,500**	**325,163**	**513,814**	**690,920**	**900,495**	**1,183,421**
Change (%)	-2.6	-2.8	12.8	57.9	63.8	58.0	34.5	30.3	31.4
Goodwill	40,045	44,236	49,437	54,854	54,272	56,326	56,326	56,326	56,326
Fixed Assets	20,768	22,585	18,298	23,949	54,251	57,402	63,142	69,456	76,402
Other assets	**27,094**	**36,818**	**26,595**	**32,495**	**48,707**	**99,293**	**103,362**	**115,299**	**141,870**
Change (%)	204.4	35.9	-27.8	22.2	49.9	103.9	4.1	11.5	23.0
Total Assets	**202,521**	**215,045**	**220,026**	**309,798**	**482,394**	**726,834**	**913,749**	**1,141,575**	**1,458,018**

Profitability Ratios (%)	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
EBITDA Margin - IT	25.0	14.1	17.9	19.7	17.5	13.9	12.5	14.0	14.0
EBITDA Margin - Pharma	0.4	3.3	1.0	9.4	15.5	18.5	7.1	18.8	19.0
Core ROE	-1.6	-5.0	2.6	5.1	9.0	7.5	5.8	9.7	11.6
ROE	-1.9	-5.0	25.1	6.9	9.0	7.5	5.8	9.7	11.6

Valuations									
Book Value (INR)	621	540	778	750	863	1,326	1,378	1,468	1,583
BV Growth (%)	-4.6	-13.1	44.0	-3.6	14.9	53.8	3.9	6.5	7.8
Price-BV (x)						2.4	2.3	2.2	2.0
EPS (INR)	-12.2	-29.1	165.2	52.4	72.6	77.8	78.9	137.6	176.9
EPS Growth (%)	-289	138	-668	-68	38	7	1	74	29
Price-Earnings (x)						41.1	40.6	23.3	18.1
DPS (INR)	17	51	20	18	21	25	22	40	62
Dividend Yield (%)						0.8	0.7	1.3	1.9

E: MOSL Estimates

Financials and Valuations - NBFC

INCOME STATEMENT							(INR Million)
Y/E MARCH	2015	2016	2017	2018	2019E	2020E	2021E
Interest Income	7,505	14,879	30,073	44,803	64,800	91,465	123,477
Interest Expense	505	5,857	15,945	24,062	35,247	52,912	73,942
Net interest income	**7,000**	**9,022**	**14,128**	**20,741**	**29,553**	**38,552**	**49,535**
Change (%)		28.9	56.6	46.8	42.5	30.5	28.5
AMC Fees	1,201	1,287	1,191	1,155	1,416	1,730	2,107
Fee income	381	905	1,916	3,357	5,102	7,036	9,498
Other income	284	326	336	502	641	757	931
Net Income	**8,866**	**11,540**	**17,570**	**25,755**	**36,712**	**48,076**	**62,071**
Change (%)		30.2	52.3	46.6	42.5	31.0	29.1
Operating Expenses	**1,836**	**1,849**	**2,872**	**2,490**	**3,671**	**5,288**	**7,449**
Change (%)		0.7	55.3	-13.3	47.5	44.0	40.8
Operating Profits	**7,030**	**9,691**	**14,698**	**23,265**	**33,041**	**42,788**	**54,622**
Change (%)		37.8	51.7	58.3	42.0	29.5	27.7
Total Provisions	**473**	**1,532**	**1,886**	**3,357**	**5,613**	**8,443**	**11,398**
% to operating income	6.7	15.8	12.8	14.4	17.0	19.7	20.9
PBT	**6,557**	**8,159**	**12,813**	**19,908**	**27,429**	**34,345**	**43,225**
Change (%)		24.4	57.0	55.4	37.8	25.2	25.9
Tax	2,295	2,856	4,485	6,968	9,600	12,021	15,129
Tax Rate (%)	35.0	35.0	35.0	35.0	35.0	35.0	35.0
PAT	**4,262**	**5,303**	**8,328**	**12,940**	**17,829**	**22,324**	**28,096**
Change (%)		24.4	57.0	55.4	37.8	25.2	25.9

BALANCE SHEET							
Y/E MARCH	2015	2016	2017	2018	2019E	2020E	2021E
Networth	**22,507**	**27,811**	**32,784**	**97,250**	**115,079**	**137,403**	**165,499**
Borrowings	**31,078**	**109,052**	**231,789**	**357,233**	**523,937**	**721,058**	**998,527**
Change (%)		250.9	112.5	54.1	46.7	37.6	38.5
Other liabilities	**0**	**0**	**0**	**0**	**1,685**	**6,486**	**3,651**
Total Liabilities	**53,585**	**136,862**	**264,574**	**454,483**	**640,701**	**864,946**	**1,167,677**
Customer assets	**47,660**	**133,380**	**249,750**	**421,680**	**598,786**	**808,361**	**1,091,287**
Change (%)		179.9	87.2	68.8	42.0	35.0	35.0
Other assets	**5,925**	**3,482**	**14,824**	**30,639**	**41,915**	**56,585**	**76,390**
Change (%)		-41.2	325.7	106.7	36.8	35.0	35.0
Total Assets	**53,585**	**136,862**	**264,574**	**452,319**	**640,701**	**864,946**	**1,167,677**

RATIOS							
Y/E MARCH	2015	2016	2017	2018	2019E	2020E	2021E
Spreads Analysis (%)							
Avg. Yield on loans			15.7	13.3	12.7	13.0	13.0
Avg. Cost of funds			9.4	8.2	8.0	8.5	8.6
Interest Spreads			6.3	5.2	4.7	4.5	4.4
Net Interest Margins			7.4	6.2	5.8	5.5	5.2
Profitability Ratios (%)							
RoE			27.5	19.9	16.8	17.7	18.6
RoA			4.1	3.6	3.3	3.0	2.8

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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