10 November 2022

2QFY23 Results Update | Sector: Financials

Piramal Enterprises

CMP: INR889 **TP: INR1,160 (+30%)** **Buy**

Bloomberg	PIEL IN
Equity Shares (m)	239
M.Cap.(INRb)/(USDb)	212.1 / 2.6
52-Week Range (INR)	1560 / 786
1, 6, 12 Rel. Per (%)	0/-29/-42
12M Avg Val (INR M)	1716

Financials & Valuations (INR b)

Y/E March	FY23E	FY24E	FY25E
PPOP	20.6	24.5	31.0
PAT	19.8	20.0	23.9
EPS	82.9	83.8	100.1
EPS Gr. (%)	19.1	1.0	19.5
BV/Sh. (INR)	1,295	1,360	1,441
RoA (%)	2.1	2.1	2.3
RoE (%)	5.8	6.3	7.2
Valuation			
P/E (x)	10.7	10.6	8.9
P/BV (x)	0.7	0.7	0.6
Dividend yield (%)	2.0	2.3	2.7

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	43.5	43.5	43.5
DII	7.9	8.1	8.4
FII	32.6	34.9	35.5
Others	16.1	13.5	12.6

FII Includes depository receipts

Stressed pool recognition in Wholesale led to elevated credit costs

- PIEL reported a consolidated loss of ~INR15.4b (PY: +INR4b) in 2QFY23. NII grew 36% YoY, but fell 15% QoQ, to INR8.4b. This included interest income reversals of ~INR2.3b due to the movement of Wholesale exposures to Stage 2 from Stage 1. PPOP declined by 16% YoY to ~INR4b.
- Total AUM declined by 5% YoY to ~INR638b, while Retail loans grew 12% to ~INR249b. The share of the Retail loan book rose to 43% (v/s 12% pre-merger). PIEL recently launched its Microfinance business under the BC model and has started offering Salaried Personal loans from its branches.
- It has raised ECL provisions to 8.6% (PQ: 6.2%), due to: a) the movement of ~INR59b of Wholesale assets to Stage 2 from Stage 1, and b) the increase in regular ECL provisioning in line with the growth in the Retail book.
- We estimate an AUM/PAT CAGR of ~13%/~9% over FY22-25, including consolidation in the Wholesale book over the next two years. We maintain our Buy rating with a revised FY24 SoTP-based TP of INR1,160.

Elevated credit costs due to stress recognition in the Wholesale segment

- GS3 was stable QoQ at 3.7% of AUM. NS3 improved to 1.3% (PQ: 1.8%). The company increased PCR on S3 loans to ~67% (PQ: 54%).
- Credit costs increased sharply to ~INR33b (PQ: INR902m). It included ~INR10b on account of loss on fair value changes and write-offs of ~INR3.6b. There were also a few investment instruments where PIEL took a haircut and closed its exposures as they are fully settled now.
- Exposures of ~INR59b, which moved to Stage 2 from Stage 1, were spread across 18 accounts and most of them were in the Real Estate sector. Within this, a Stage 2 exposure of ~INR1.5b got repaid in early Nov'22.
- PCR on Stage 2 and Stage 3 (30+ dpd) assets stood at 36% (PQ: 43%). While there can be some flows to Stage 3 from Stage 2 assets, the management said it will not be imminent, and exposures that eventually move to Stage 3 from Stage 2 will not require any significant provisioning.
- PIEL said the **asset recognition cycle was largely complete.** It expects the Wholesale book to moderate over the next two quarters, led by a higher focus on recoveries and monetization.

Improvement in the Retail product mix will aid expansion in the NIM

- Retail disbursements grew 62% QoQ to INR39.7b. Excluding embedded finance, disbursement yields improved to 12.3% in 2QFY23 (PY: 11.8%), led by a better product mix. Digital Embedded Finance disbursements of INR8.4b in 2QFY23 contributed 21% to overall Retail disbursements.
- PIEL launched Salaried Personal loans and disbursed INR310m in 2QFY23. ATS for the same stood at INR430k, with average yields of 19%.
- Average CoB fell by ~70bp YoY and was stable QoQ at 8.8% on account of its ability to borrow funds at a lower cost after the DHFL acquisition and the improved proportion of Retail in the loan mix.

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Pockets of value will be accretive to profitability and Balance Sheet strength

- We expect PIEL to continue to exhibit recoveries from the POCI book. It has cumulatively recovered ~INR15.2b from the POCI book.
- The management plans to monetize its stake in SHTF after the Shriram group corporate merger is completed in 3QFY23.
- We strongly believe that the company will be able to utilize the DTL of ~INR33b in 2HFY23, which will accrue as an extra-ordinary (or exceptional) gain and will be accretive to profitability in FY23. We have modeled this in our FY23 PAT estimate of INR19.8b (after associate and exceptional).

Highlights from the management commentary

- The management will look to consolidate and reduce the size of its Wholesale book over the next two quarters. A part of this reduction will occur via resolutions or a run-down in Stage 2 and the remainder from Stage 1 assets.
- It wants to build a diversified Retail portfolio so that no economic or credit cycles in a single product will have a material effect on the Retail business.

Valuation and view

- Over the past two years, PIEL has: a) strengthened its Balance Sheet by running down its Wholesale loan book; b) improved the texture of its borrowings, c) targeted lower cost borrowings; and d) fortified itself against contingencies, with ECL provisions at 8.6% of AUM.
- Over the next three years, we expect PIEL to make meaningful inroads into Retail, led by Mortgages and complemented by shorter tenure loans originated through digital partnerships. Product diversification within Retail will help PIEL deliver strong growth and reduce concentration risks. We expect the business to deliver a consolidated RoA/RoE of ~2.3%/7-8% in the near term.
- We have cut our target multiple to 0.8x P/BV (earlier: 1x) for the Lending business. We arrive at our SoTP-based TP of **INR1,160** (FY24E based) and maintain our **Buy** rating.

Quarterly Performance (INR m)

Y/E March	FY22		FY23E		FY22
	1QFY22	2QFY22	1QFY23	2QFY23	
Interest Income	15,397	15,330	20,392	18,437	75,228
Interest Expenses	9,373	9,110	10,436	10,005	42,251
Net Interest Income	**6,024**	**6,220**	**9,955**	**8,432**	**32,977**
YoY Growth (%)			*65.3*	*35.6*	
Other operating income	548	407	585	500	2,027
Other Income	227	271	231	625	1,854
Total Income	**6,799**	**6,898**	**10,771**	**9,558**	**36,858**
YoY Growth (%)			*58.4*	*38.6*	
Operating Expenses	2,153	2,124	4,493	5,536	13,843
Operating Profit	**4,646**	**4,773**	**6,278**	**4,022**	**23,015**
YoY Growth (%)			*35.1*	*-15.7*	
Provisions & Loan Losses	-760	-683	902	32,567	6,740
Profit before Tax	**5,407**	**5,456**	**5,376**	**-28,545**	**16,275**
Tax Provisions	1,341	984	1,454	-6,938	4,062
PAT (before associate income)	**4,066**	**4,473**	**3,922**	**-21,608**	**12,213**
Associate Income	1,509	1,002	1,493	1,721	5,939
PAT (before exceptional)	**5,574**	**5,474**	**5,415**	**-19,887**	**18,152**
Exceptional items	0	-1,529	76,140	4,523	-1,529
PAT (after exceptional)	**5,574**	**3,945**	**81,555**	**-15,364**	**16,622**
YoY Growth (%)			1,363.0	-489.4	
Key Parameters (Calc., %)					
Yield on loans	13.4	13.6	11.7	10.9	14
Cost of funds	10.1	9.5	8.8	8.8	10
Spread	3.3	4.1	2.9	2.1	4.8
NIM	4.5	3.8	4.6	4.6	6.3
C/I ratio	32	31	42	58	38
Tax rate	25	18	27	24	25
Balance Sheet Parameters					
Retail Disbursements (INR m)	1,950	5,130	24,590	39,730	29,270
Loan book (INR b)	472	670	646	638	652
Growth (%)	-17	21	39	-3	34
Loan book mix (%)					
Wholesale	89	67	63	57	64
Retail	11	33	37	43	36
Asset Quality Parameters					
GS 3 (INR m)	20,280	19,500	23,620	22,100	22,270
GS 3 (%)	4.3	2.9	3.7	3.7	3.4
NS 3 (INR m)	9,900	9,490	10,800	7,350	9,980
NS 3 (%)	2.2	1.5	1.8	1.3	0.0
PCR (%)	51.2	51.3	54.3	66.7	55.2
Total ECL (%)	5.8	4.0	6.5	9.1	6.1

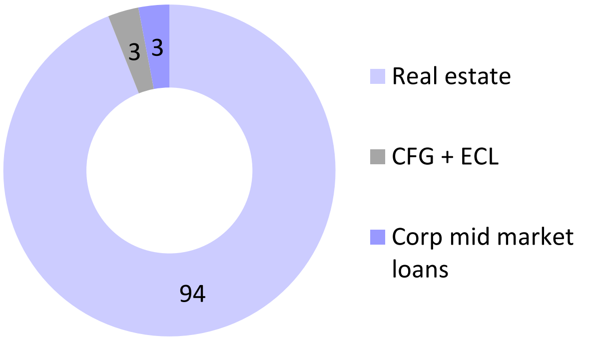
E: MOFSL estimates

Texture on Wholesale Book

The company has shared different cuts of its wholesale book to provide some texture and address some of the skepticism which has always surrounded PIEL's wholesale advances.

We hope and believe that the company will keep sharing more details and disclosures on its wholesale loan book which will help the analyst/investor community better appreciate the asset quality (or stress) in its wholesale book.

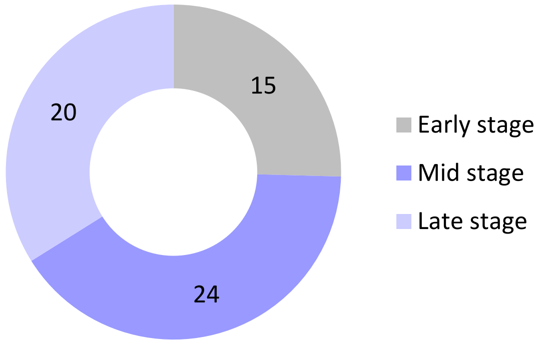
Exhibit 1: Real estate lending forms majority of wholesale book (%)



Source: MOFSL, Company

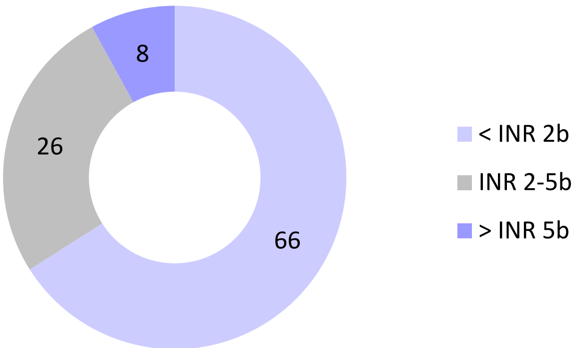
Note: Excludes DHFL's wholesale loans of ~INR 13.3b

Exhibit 2: Basis stage of construction (%)



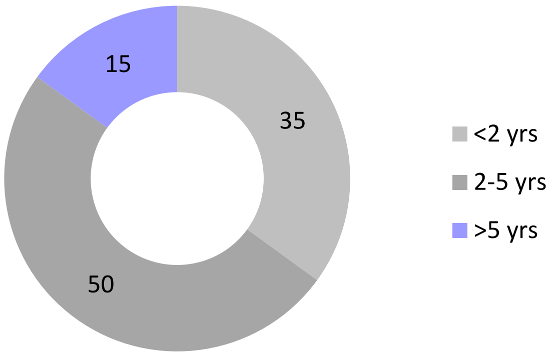
Source: MOFSL, Company;

Exhibit 3: 8% of loans have ticket size greater than INR5b (%)



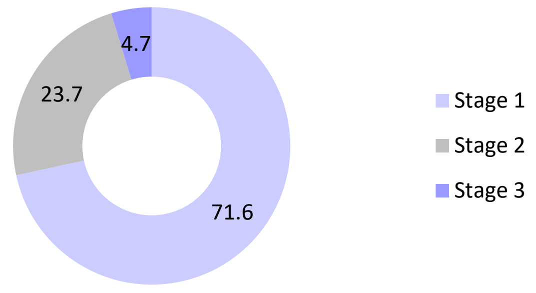
Source: MOFSL, Company;

Exhibit 4: Tenor wise loan mix (%)



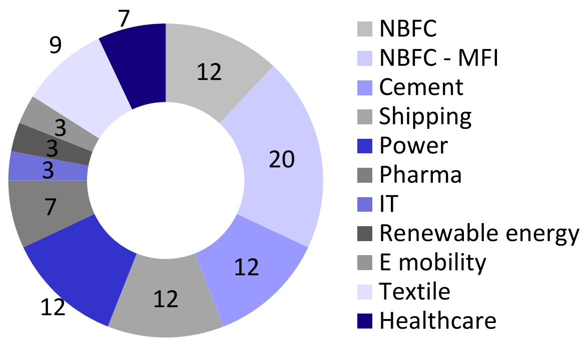
Source: MOFSL, Company;

Exhibit 5: Stage wise loan mix (%)



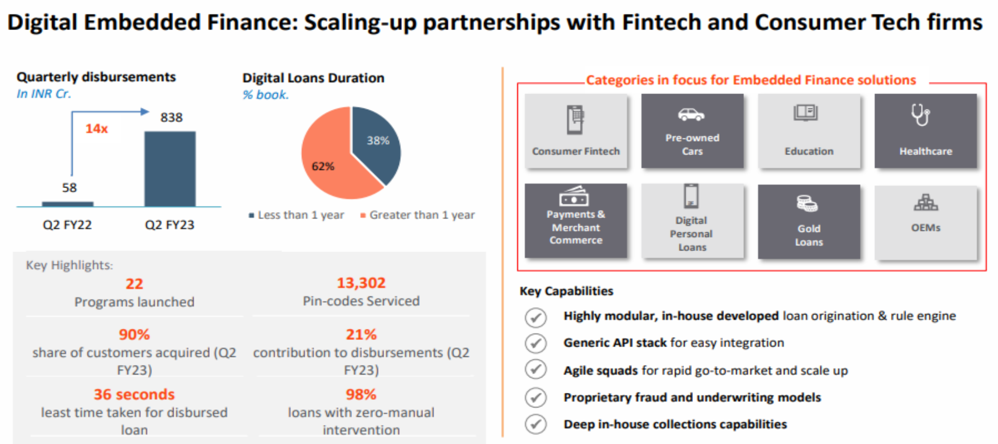
Source: MOFSL, Company

Exhibit 6: Industry wise loan mix



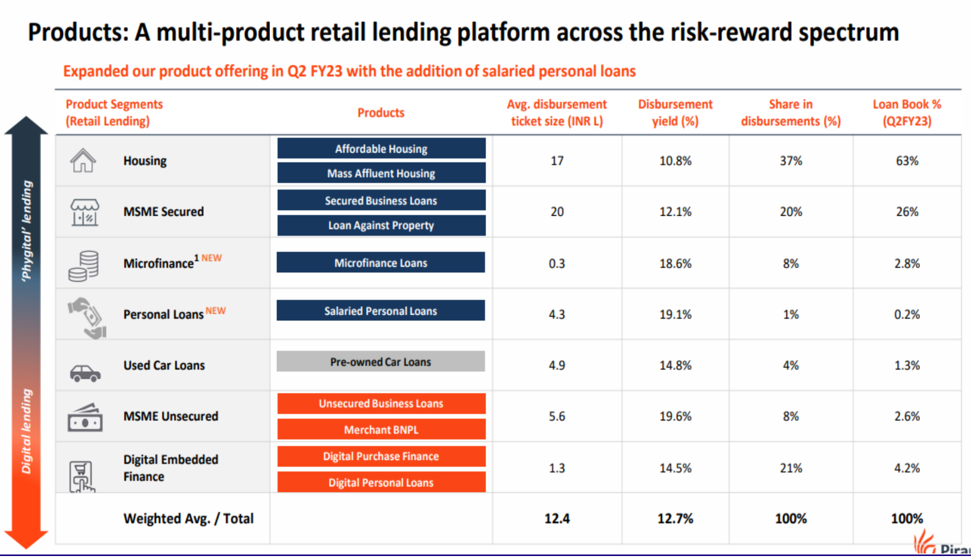
Source: MOFSL, Company

Exhibit 7: Scaling up partnerships with Fintech and Consumer Tech companies



Source: Company, MOFSL

Exhibit 8: Key products with average ticket size and the disbursement yields



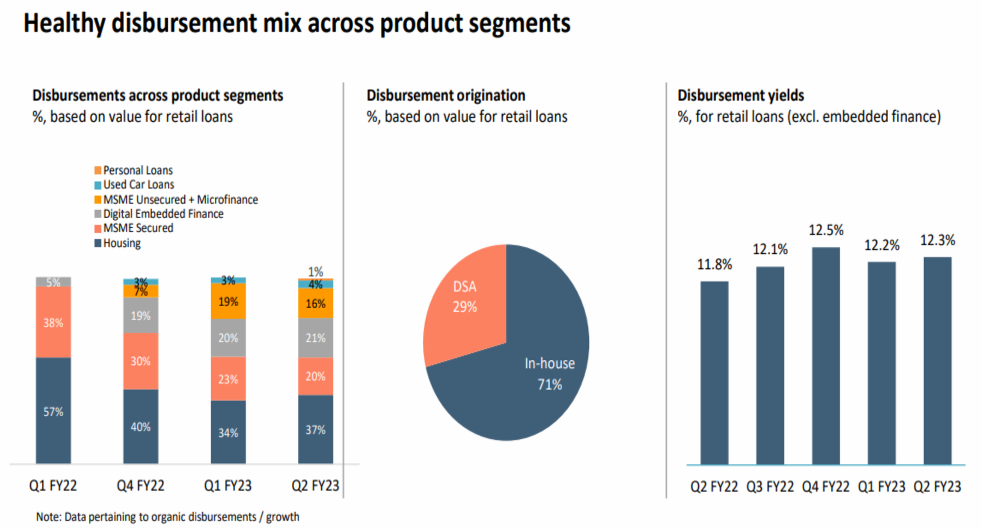
Products: A multi-product retail lending platform across the risk-reward spectrum

Expanded our product offering in Q2 FY23 with the addition of salaried personal loans

Product Segments (Retail Lending)	Products	Avg. disbursement ticket size (INR L)	Disbursement yield (%)	Share in disbursements (%)	Loan Book % (Q2FY23)
Housing	Affordable Housing Mass Affluent Housing	17	10.8%	37%	63%
MSME Secured	Secured Business Loans Loan Against Property	20	12.1%	20%	26%
Microfinance[1] NEW	Microfinance Loans	0.3	18.6%	8%	2.8%
Personal Loans NEW	Salaried Personal Loans	4.3	19.1%	1%	0.2%
Used Car Loans	Pre-owned Car Loans	4.9	14.8%	4%	1.3%
MSME Unsecured	Unsecured Business Loans Merchant BNPL	5.6	19.6%	8%	2.6%
Digital Embedded Finance	Digital Purchase Finance Digital Personal Loans	1.3	14.5%	21%	4.2%
Weighted Avg. / Total		12.4	12.7%	100%	100%

Source: Company, MOFSL

Exhibit 9: 71% of disbursements were originated in-house; disbursement yields improving with a change in the mix



Source: Company, MOFSL

Highlights from management commentary

Wholesale Business

- Stage 3 loans (as % of wholesale AUM) have remained stable; INR58.9b moved from Stage 1 to Stage 2 largely completing the asset recognition cycle
- Exposure to Top-10 accounts reduced by 33% since Mar'19
- Stage 1 Loan book (with 130 loan exposures) is much more granular with ATS of INR1.89b. Stage 1 loans consists of asset backed SPV, OpCo loans in real-estate
- Within Corporate Mid-Market Lending (CMML), it has already built a book of ~INR8b with average ticket size of ~INR500m
- This was the first quarter as a FS company and it has completed the recognition of pockets of stress.
- Write-offs of INR3.6b were on accounts where it has made 100% provisions and from the perspective of managing the Stage 3 book, the company has prudentially written off those accounts. PCR on wholesale Stage 3 is 67%
- Movement from Stage 1 to Stage 2 is driven purely by the desire of the company to exhibit conservatism and recognize pockets of stress. When they are moved to Stage 2, they are done because it allows the company to make provisions on those accounts and start engaging with potential buyers. Some sub-set of these accounts was nearing resolutions/closures and which required a certain level of provisions.
- ~INR59b of loan exposures (which moved from Stage 1 to 2) were categorized into the following buckets
  - Bucket 1: Issues which were there in the parent entity and there was stress at the parent level. This includes some developers where the promoters have been put behind bars.
  - Bucket 2: Assets which can be resolved with a certain haircut
  - Bucket 3: Cash flows seemed weak.
- There were some changes in the group's ECL provisioning model and certain assumptions with respect to wholesale lending business have undergone a change which resulted in significant increase in ECL provisions.

- Intent is to consolidate and reduce the size of the wholesale book over the next two quarters. Some part of this reduction will come from Stage 2 and the remainder from Stage 1.
- Close to ~40% PCR on Stage 2 and Stage 3 which gives it a lot of room to pursue resolutions even if it requires certain haircuts. In Stage 2, there was one account of ~INR1.5b which got repaid in early November.

Retail Lending

- Building a diversified and granular retail portfolio with a large part of the book comprising of secured lending products
- Disbursement growth has been impressive. Disbursements grew to 8x YoY and 62% QoQ. As the disbursements are now higher than the run-off in the retail book, the retail AUM has started to grow
- Activation of branches to sell multiple products and growth in the customer base through digital lending platform.
- Company is now present pan-India in 27 states and 293 cities with 343 branches. Plans to grow to 500-600 branches over the next 5 years
- Company started branch-led personal loans to salaried individuals in Tier2/3 towns. 82% of the branches are now selling multiple products. Disbursements under the non-mortgage product category have been seeing good traction.
- As of 30th Sep, Company has 20 Live partnerships with Fintechs, OEMs and aggregators under its Digital Embedded Finance
- Cross-sell disbursements of INR9.45b over the last year.
- Continues to make recoveries from the POCI book. Cumulative recoveries of ~INR15.2b from the POCI book.
- Serving the budget customer of Bharat. Company does not want to be product-specific but instead segment-specific.
- Company wants to build a retail portfolio which would be diversified enough and no economic/credit cycles in a single product will have a material effect on the retail business.

- **Guidance**
- Doubling the AUM from FY22 levels. Net debt to equity of 3.5x to 4.0x.
- Credit costs of 1.5%-2.0% in steady state

Inorganic Acquisition

- Shriram City Union is MtM but Shriram Capital is not MtM. Once the merger in the Shriram group is complete it will have liquid shares of Shriram finance which the company will monetize.
- There is excess equity and monetizable investments in the near-future. Company will evaluate some inorganic acquisitions.

Others

- Pockets of value: Remain fairly confident and the confidence has gone up; Retail POCI book from where it continues to get recoveries; Investments in the Shriram Group and the monetization after the corporate merger; DTL/DTA which was created at the time of the DHFL integration
- PTCs stood at INR2.55b as on Sep'22
- Raised ~INR10b at 8.55% in 2QFY23
- Interest reversals of ~INR2.3b in 2QFY23

- Company is consciously bringing down the wholesale book which will be a combination of the natural attrition and the conscious actions taken by the company.
- With regards the land parcel which was acquired from the Omkar group, the company is actively looking to engage with various developers.

Valuation and view

- Over the past two years, PIEL has: a) strengthened its Balance Sheet by running down its Wholesale loan book; b) improved texture of its borrowings, driving lower cost of borrowings; and d) fortified itself against contingencies, with ECL provisions at 8.6% of AUM.
- Over the next three years, we expect the company to make meaningful inroads into Retail, led by mortgages and complemented by shorter tenure loans originated through digital partnerships. Product diversification within Retail will help PIEL deliver strong growth and reduce concentration risks. We expect the business to deliver ~2.3% consol. RoA and ~7-8% consol. RoE in the near term.
- We have cut our target multiple to 0.8x P/BV (earlier: 1.0x) for the lending business. We arrive at our SoTP-based TP of **INR1,160** (FY24E based) and maintain our **BUY** rating.

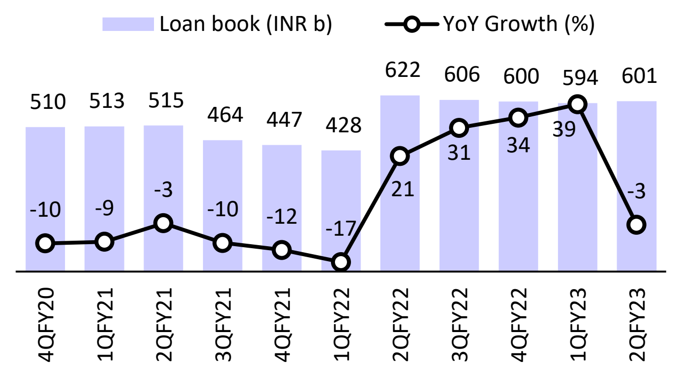
Exhibit 10: SOTP valuation (FY24E-based)

	Value (INR B)	Value (USD B)	INR per share	% To Total	Rationale
Lending Business	201	2.7	845	73	0.8x FY24E PBV
Shriram Group	63	0.8	266	23	Based on our TP for SHTF and SCUF
Life Insurance	5	0.1	20	2	0.5x FY22 EV
Alternatives	7	0.1	29	2	0.5x FY22 Equity
Target Value	**276**	**3.7**	**1,160**	**100**	

Source: MOFSL, Company

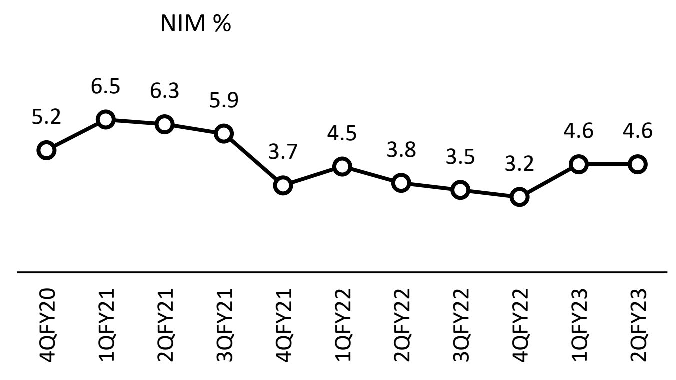
Key exhibits

Exhibit 11: Loan book growth was muted (%)



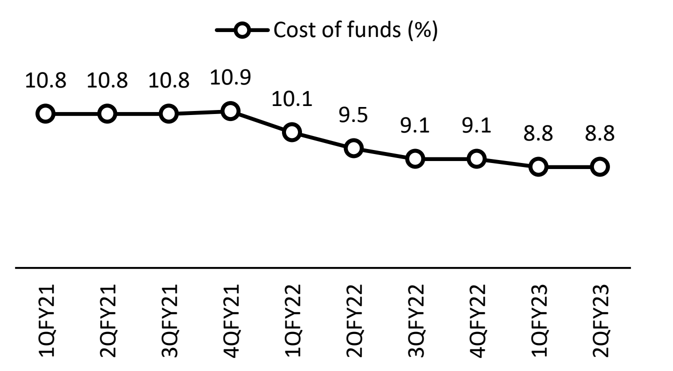
Source: MOFSL, Company

Exhibit 12: NIMs stable sequentially at 4.6% (%)



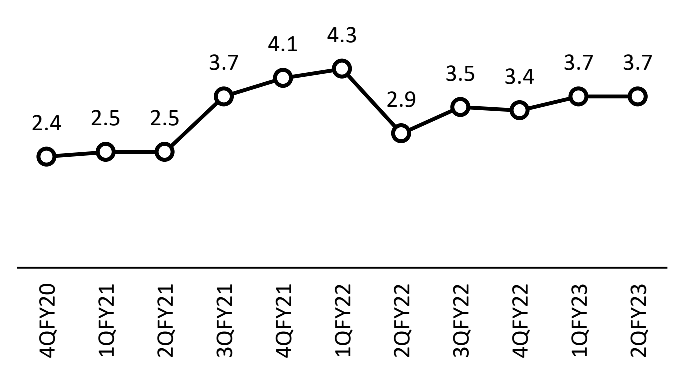
Source: MOFSL, Company

Exhibit 13: CoF flat QoQ (%)



Source: MOSL, Company

Exhibit 14: GNPA ratio was stable QoQ (%)



Source: MOSL, Company

Financials and valuations

Consolidated Income statement INR m

Y/E March	FY22	FY23E	FY24E	FY25E
Interest Income	75,228	82,686	91,768	1,09,844
Interest Expended	42,251	45,948	50,288	60,098
Net Interest Income	**32,977**	**36,738**	**41,479**	**49,747**
Change (%)	19.1	11.4	12.9	19.9
Other Income	3,881	4,533	4,759	4,671
Net Income	**36,858**	**41,271**	**46,238**	**54,418**
Change (%)	27.8	12.0	12.0	17.7
Operating Expenses	12,284	20,636	21,732	23,400
PPoP	**24,574**	**20,636**	**24,506**	**31,018**
Change (%)	9.4	-16.0	18.8	26.6
Provisions/write offs	8,299	36,358	7,781	9,869
PBT	**16,275**	**-15,722**	**16,725**	**21,149**
Tax	4,062	-3,962	4,215	5,330
Tax Rate (%)	25.0	25.2	25.2	25.2
PAT (before associate income)	**12,213**	**-11,760**	**12,510**	**15,819**
Associate Income	5,939	6,800	7,480	8,078
PAT (before exceptional)	**18,152**	**-4,960**	**19,990**	**23,898**
Exceptional items	-1,529	24,750	0	0
PAT (after exceptional)	**16,622**	**19,790**	**19,990**	**23,898**

Consolidated Balance sheet INR m

Y/E March	FY22	FY23E	FY24E	FY25E
Capital	477	477	477	477
Reserves & Surplus	3,67,892	3,08,502	3,24,197	3,43,318
Net Worth	**3,68,369**	**3,08,979**	**3,24,675**	**3,43,795**
Borrowings	5,54,510	5,34,277	6,21,776	7,44,076
Change (%)	48	-4	16	20
Other liabilities	75,850	37,925	41,718	45,055
Total Liabilities	**9,98,729**	**8,81,181**	**9,88,169**	**11,32,926**
Net Loans + investments	**7,41,745**	**8,36,044**	**9,49,128**	**10,96,477**
Change (%)	61	13	14	16
Net Fixed Assets	4,440	4,884	5,128	5,385
Cash and Cash equivalents	71,872	40,000	35,000	35,000
Other assets	1,80,672	253	-1,088	-3,936
Total Assets	**9,98,729**	**8,81,181**	**9,88,169**	**11,32,926**

E: MOFSL Estimates

Financials and valuations

Ratios				INR m
Y/E March	**FY22**	**FY23E**	**FY24E**	**FY25E**
Spreads Analysis (%)				
Yield on loans	14.4	13.0	13.3	13.4
Cost of funds	9.5	8.6	8.7	8.8
Spread	4.8	4.4	4.6	4.6
Net Interest Margin	6.3	5.8	6.0	6.0
Profitability Ratios (%)				
RoE	6.1	5.8	6.3	7.2
RoA	2.1	2.1	2.1	2.3
C/I ratio	33.3	50.0	47.0	43.0
Asset Quality (%)				
Gross NPA	22,270	27,402	27,794	29,967
Gross NPA (% of AUM)	3.6	4.0	3.5	3.2
Net NPA	9,980	8,769	9,450	8,990
Net NPA (% of AUM)	1.7	1.4	1.3	1.0
PCR (%)	55.2	68.0	66.0	70.0
AUM (INR m)	651,850	685,044	794,128	936,477
AUM Mix (%)				
Retail	66.9	53.8	45.5	39.7
Wholesale	33.1	46.2	54.5	60.3
Total	**100.0**	**100.0**	**100.0**	**100.0**
Wholesale Loans (INR m)	384,620	319,235	316,042	331,844
YoY growth (%)	-2.3	-17.0	-1.0	5.0
Retail Loans (INR m)	215,520	316,809	433,086	564,633
YoY growth (%)	306.4	47.0	36.7	30.4
Total Loan Book	**600,140**	**636,044**	**749,128**	**896,477**
YoY growth (%)	34.4	6.0	17.8	19.7
VALUATION				
Book Value (INR)	1,544	1,295	1,360	1,441
Price-BV (x)	**0.6**	**0.7**	**0.7**	**0.6**
EPS (INR)	69.7	82.9	83.8	100.1
EPS Growth YoY	-6	19	1	20
Price-Earnings (x)	**12.8**	**10.7**	**10.6**	**8.9**
Dividend per share (INR)		18.0	20.0	24.0
Dividend yield (%)		**2.0**	**2.3**	**2.7**

Du-pont	**FY22**	**FY23E**	**FY24E**	**FY25E**
Interest income	9.6	8.8	9.8	10.4
Interest expense	5.4	4.9	5.4	5.7
NII	**4.2**	**3.9**	**4.4**	**4.7**
Fee and other income	0.5	0.5	0.5	0.4
Total income	**4.7**	**4.4**	**4.9**	**5.1**
Operating expense	1.6	2.2	2.3	2.2
PPOP	**3.2**	**2.2**	**2.6**	**2.9**
Provisions (annualized)	1.1	**3.9**	**0.8**	**0.9**
Provisions during the period	1.6	4.2	1.2	1.1
Recoveries from POCI book	-0.4	-0.4	-0.4	-0.2
PBT	**2.1**	**-1.7**	**1.8**	**2.0**
ROA (before associate and exceptional)	**1.6**	**-1.3**	**1.3**	**1.5**
Consol RoA (including associate and exceptional)		**2.1**	**2.1**	**2.3**
Assets-to-equity	2.8	2.8	3.0	3.2
Consol ROE (PAT)	**6.1**	**5.8**	**6.3**	**7.2**

E: MOFSL Estimates

NOTES

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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

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