

Initiating Coverage

16th June 2023

Sector	Ratings
NBFC	Buy
Current Price	Target
Rs.773	Rs.1,026
Potential upside	Holding
33%	12 months

Stock Information

Sensex/Nifty	62918/18,688
Bloomberg	PIEL:IN
Equity shares (Cr)	23.87
52-wk High/Low (Rs)	1202/630
Face value (Rs)	2
M-Cap (Rs Cr)	18,448
2-wk Avg Volume (Qty)	971,031

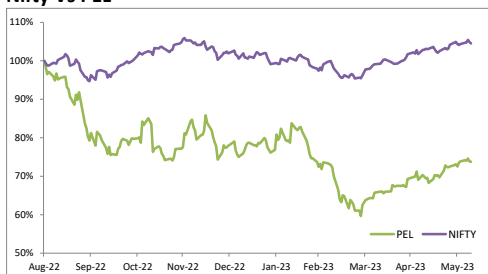
Financial Summary (Rs.cr.)

Year Ended	FY23	FY24E	FY25E
NII	4,893	5,076	5,718
NIM (%)	5.85	7.04	6.90
PPOP	2,830	2,962	3,482
PAT	1,514	1,529	1,686
BV (Rs.)	1,301	1,368	1,440
PBV	0.59	0.57	0.54
ROE	5.61	5.03	5.21
ROA	1.65	1.74	1.73

Shareholding Pattern (%)

	Mar-23	Dec-22	Sep-22
Promoter	43.48	43.48	43.48
Public	56.03	56.02	56.01
Others	0.49	0.49	0.50

Nifty Vs PEL



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Piramal Enterprises Ltd (PEL)

PEL, part of the Ajay Piramal Group, is a leading NBFC offering diverse products in retail and wholesale lending.

We highlight key strengths: a) Focus on multi-product retail franchise; b) De-risking wholesale lending business; c) Balanced exposure in high ROA unsecured lending; d) Expected resolution and recoveries in Wholesale 1.0 book; e) Strong balance sheet with Rs.31,000 cr. net worth and Rs.7,430 cr. cash & liquid investments; f) PEL is trading at a PBV ratio of 0.59x compared to its peers, indicating it is available at deep discount to its book value; g) Investments in Shriram Group provide huge optionality to shareholders. We recommend buying PEL with a target price of Rs.1,026, based on a P/BV of 0.75x its FY24 book value of Rs.1,368, as the company's strategic initiatives are expected to enhance its business and valuation.

Strategizing loan mix addresses cyclicity

PEL's strategic focus on loan mix aims to mitigate the impact of cyclicity, particularly in the wholesale business. Currently, the retail to wholesale mix is evenly distributed, but the management plans to shift it towards retail lending, which is projected to comprise 67% of the total AUM mix by FY26. This proactive approach towards enhancing the granularity of the loan book will help the company navigate market fluctuations more effectively.

De-risking the Wholesale book and making it more granular

PEL has de-risked its Wholesale book, enhancing granularity and provisioning 55% for Stage-3 assets. We anticipate positive developments in the Wholesale 1.0 book, with recoveries and resolutions expected from FY23-24 onwards, this instills confidence. Wholesale 2.0 books focuses on real estate and corporate mid-market loans with rigorous risk management, ensuring a resilient lending portfolio.

Improving asset quality and robust balance sheet

With a net worth of Rs.31,000cr and cash & liquid investments of Rs.7,430cr as of March 31st, 2023, PEL maintains a strong balance sheet. This solid foundation will support the company's retail expansion and lending activities. We anticipate a decline in GNPA from the current 3.8% to 2.8% by FY25E, indicating improving asset quality.

Unlocking investments in Shriram Finance

PEL currently holds a 8.34% stake in Shriram Finance Limited, current value of this holding is Rs.4,537cr. There is a high likelihood of PEL unlocking their stake in Shriram Finance during the next 12-18 months. Mark-to-Market (MTM) of this investment for the ongoing quarter stands at Rs.483 as on 15th June 2023. Investments in Shriram Finance and Shriram Life and General insurance provide huge optionality to shareholders over and above the current valuations of the company.

Leveraging phygital space to expand retail business

PEL is strategically expanding its unsecured lending business by partnering with leading Fintech and Consumer Tech companies. This move aims to tap into the highly profitable digital lending sector, offering an attractive yield of 18% on advances and a robust return on assets (ROA) of around 5%.

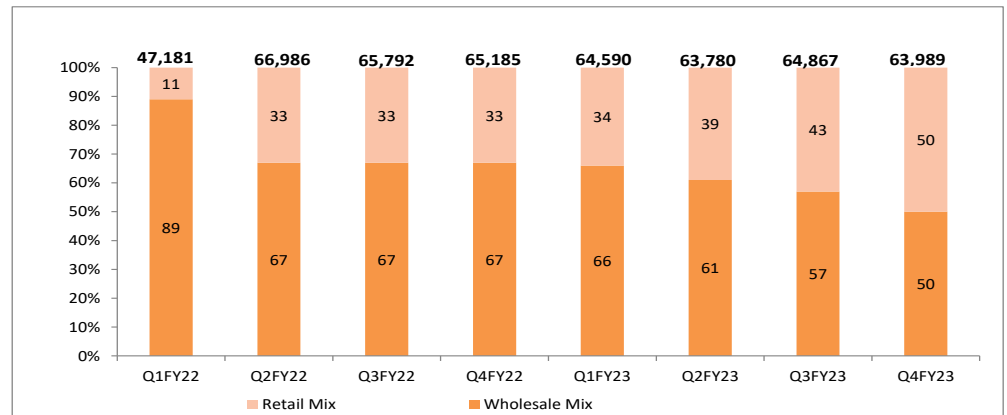
Key Risk: Risks include slower retail lending growth, delayed resolution in Wholesale 1.0 impacting recoveries, and unforeseen issues in Wholesale 2.0 despite risk management measures.

INVESTMENT RATIONALE

Strategizing loan composition - From wholesale-led to diversified portfolio

PEL is transitioning to a multi-product retail franchise, aiming to reduce cyclicality and achieve scalability. The company plans to increase its share of retail loans in the total assets under management (AUM) while gradually de-risking and moderating the Wholesale 1.0 book. They are building a granular Wholesale 2.0 book in a controlled manner. The retail loan book grew by 49% to Rs. 32,144 cr. as of March 31, 2023, compared to Rs. 21,552 cr. the previous year. Meanwhile, the Wholesale book decreased by 27% from Rs. 43,633 cr. to Rs. 31,845 cr. during the same period.

Exhibit 1: AUM (Rs.cr.) and AUM Mix (%)



Source: Investor Presentation, PCG Research

PEL is actively expanding its retail franchise by investing in manpower, branch infrastructure, technology, and analytics. The company has a well-defined multi-product strategy for its retail lending business, focusing primarily on housing loans, secured MSME Loan Against Property (LAP), and used vehicle loans. These secured retail loans constitute 80% of the total retail loan book. The remaining 20% share of the assets under management (AUM) consists of unsecured lending products such as Salaried Personal Loans, Microfinance Loans, Business Loans, and Digital Embedded Finance.

While serving a diverse customer base, PEL has managed to maintain a low credit risk in its retail portfolio. In this company's branches play a crucial role in underwriting these loans by evaluating informal sources of income. This approach helps PEL assess the creditworthiness of these individuals effectively.

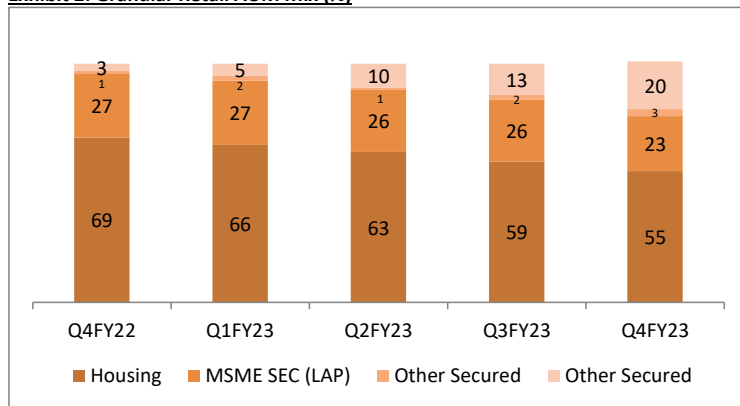
Overall, PEL's retail lending business demonstrates a focused approach, emphasizing secured loans while also offering unsecured lending products to a varied customer base. The company's emphasis on risk management has resulted in a favorable credit risk profile for its retail portfolio.

Building Granularity in the retail book –

- PEL offers a total of 13 retail products, out of which 9 are sold directly by the company, while the remaining 6 are distributed through Fintech and Consumer tech firms and while 2 products are distributed both by PEL and the Fintech partner.
- The geographic diversification of Retail AUM is as follows: West India accounts for 43%, North and East India accounts for 29%, and South India contributes 28%.

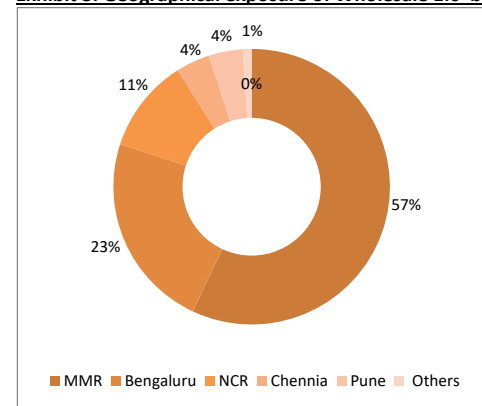
- The lending for housing loans in Tier 2 and 3 cities constitutes 67% of the portfolio, with an average ticket size of Rs. 18 lakhs. The average loan-to-value ratio (LTV) and average CIBIL score stand at 61% and 748, respectively.
- The AUM for housing loans is divided between customer types, with 40% allocated to salaried individuals and 60% to self-employed individuals.
- In Tier 2 and 3 cities, secured MSME (LAP) loans constitute 67% of the lending portfolio, with an average ticket size of Rs. 21 lakhs. The average loan-to-value (LTV) ratio and CIBIL score stand at 46% and 745, respectively.
- In Tier 2 and 3 cities, used-car loans account for 51% of the lending portfolio, with an average ticket size of Rs. 6 lakhs. The average loan-to-value (LTV) ratio and CIBIL score stand at 77% and 737, respectively.
- Among digital loans, 63% have duration of greater than 1 year, while the remaining 37% have duration of less than 1 year.
- The customer franchise comprises a total of 3 million customers, with 1 million active customers, including a mix of fintech and other customers.

Exhibit 2: Granular Retail AUM Mix (%)



Source: Investor Presentation, PCG Research

Exhibit 3: Geographical exposure of Wholesale 1.0 book



Source: Investor Presentation, PCG Research

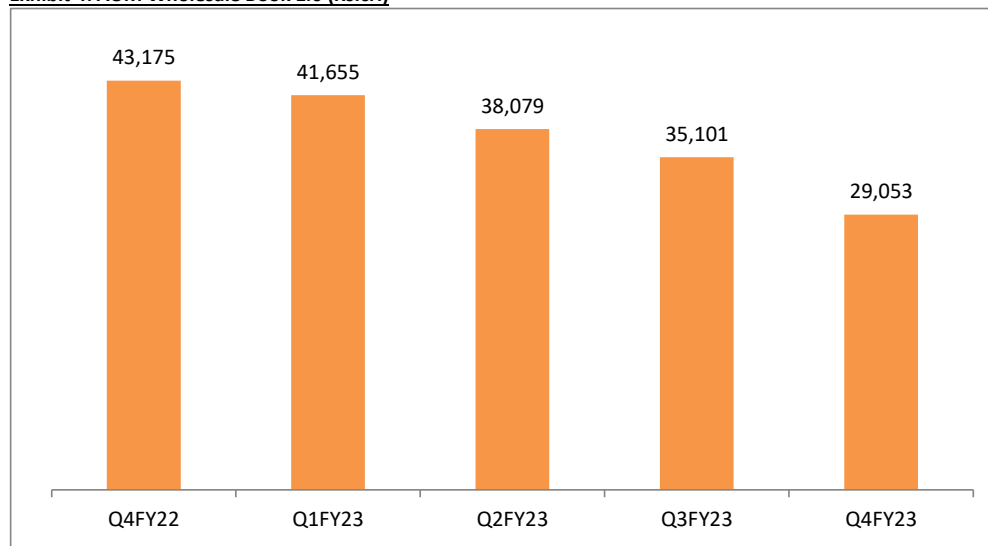
Harnessing the Power of Phygital Space to Drive Retail Business Expansion

The Digital Embedded Finance business provides personalized financing solutions to retail customers through strategic partnerships with leading Fintech and Consumer Tech firms, leveraging digital and tech platforms. The retail unsecured lending business has the potential for exponential growth through phygital collaborations. To address asset quality concerns associated with lending through fintech platforms, PEL has implemented two distinct strategies. Firstly, digital lending is limited to pin-codes where PEL has collection branches. Secondly, PEL has established its own screening mechanism in addition to the screening criteria of fintech partners, resulting in a rejection rate of approximately 30% for such leads. Digital lending proves to be highly lucrative, with an impressive yield on advances of around 18% and a remarkable ROA (Return on Assets) of approximately 5%.

Mitigating Stress through Wholesale 1.0 Book Resolution

The stress experienced in the Wholesale lending business during FY23 was unprecedented, largely attributed to the change in management and their assessment of the asset quality. However, PEL managed to utilize a one-time gain of Rs. 3,000 crore to provision for these loans. We are optimistic that the worst is now behind for the Wholesale 1.0 book, and do not anticipate any further negative surprises affecting the company's profitability. PEL has already made provisions for 55% of its stage-3 assets in the wholesale segment, instilling confidence that there will be no unexpected setbacks. PEL's current focus is on resolving and settling stressed assets within this portfolio. Looking ahead to FY23-24, we anticipate recoveries and resolutions in the Wholesale 1.0 book, which will strengthen PEL's balance sheet.

Exhibit 4: AUM Wholesale Book 1.0 (Rs.cr.)



Source: Investor Presentation, PCG Research

Diversified and Granular Wholesale 2.0 – Post its experience in Wholesale 1.0 book, PEL is now cautiously building Wholesale 2.0 book in a much-calibrated manner with ultimate focus on risk management. This management intends to achieve through bringing granularity in terms of exposure to a particular sector, company, group, and average ticket size. The Wholesale 2.0 book has been built across Real estate and Corporate Mid-Market loans keeping all the risk parameters checked. As on 31st March 2023, Wholesale 2.0 AUM was worth Rs. 2,792 cr, with an average ticket size of Rs.200 cr. for Real Estate and Rs.55 cr in Corporate Mid-Market Loan.

Unlocking Investments in Shriram Group.

PEL currently holds a substantial stake in Shriram Finance Limited, accounting for 8.34% of the total shares of the company. Additionally, PEL also holds stakes in Shriram General Insurance and Shriram Life Insurance, with ownership percentages of 13.33% and 14.91% respectively. Collectively, the value of these holdings amounts to Rs. 6,586 crore. (source ICRA 8th April 2023).

It is worth noting that there is a high likelihood of PEL unlocking their stake in Shriram Finance during the next 12-18 months. However, what requires close monitoring is the exact magnitude and timing of this unlocking. According to the management's statements, the proceeds from this transaction will be utilized either for funding potential inorganic opportunities or for providing benefits to the shareholders.

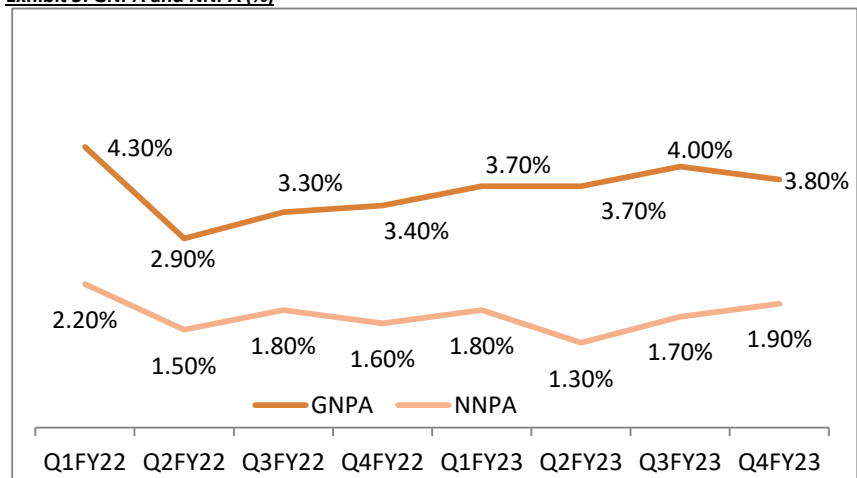
During the fourth quarter of FY23, Shriram Finance Limited reported a Mark-to-Market (MTM) loss of Rs. 375 crore. However, it is worth noting that since 1st April 2023, the share price of Shriram Finance has witnessed a significant increase of 15%. Based on this, a potential MTM profit of Rs. 483 crore (as on 15th June 2023) can be anticipated for Q1FY24, assuming the share prices remains at their current levels until the end of June 2023.

Additionally, it is important to consider the embedded value of PEL holding in Shriram's insurance business, which is estimated to be approximately Rs. 2,200 crore. This signifies the potential value that PEL holds within the insurance segment. The whole investments in the Shriram group provide huge optionality to shareholders over and above the current valuations of PEL.

To summarize, upon liquidating these investments, PEL is projected to receive an inflow of approximately Rs. 6,200-6,700cr. Coupled with the existing cash in hand of Rs.7,430cr, the company's total cash and liquid investments would reach an impressive sum of Rs.13,630-14,130cr. This significant cash reserve represents 72%-74% of the company's current market capitalization of Rs.18,448cr. Such robust financial positioning provides shareholders with compelling prospects for value creation.

Asset quality – The total AUM in stage 1 currently amount to Rs. 25,471 crore, and these assets are not stressed, experiencing no slippages or reductions. Stressed assets worth Rs. 6,374 crore are concentrated in the stage 2 and stage 3 categories. The company successfully reduced stage 2 and 3 assets by Rs. 3,995 crore, representing a 39% quarter-on-quarter decrease, primarily driven by the resolution of stressed assets in the Wholesale 1.0 book. In Q4FY23, the company concluded four monetization transactions for stressed assets. These included the exit of a holdco loan worth Rs. 1,908 crore, the sale of certain stressed assets through two separate Asset Reconstruction Company (ARC) transactions structured as 15:85, and the sale of one NPA portfolio for cash.

Exhibit 5: GNPA and NNPA (%)



Source: Investor Presentation, PCG Research

KEY RISK

- Slower-than-expected growth in the retail lending book.
- Delays in resolving the Wholesale 1.0 book would negatively impact recoveries.
- Possibility of negative surprises in Wholesale 2.0, despite implementing necessary risk management measures during lending.
- The weak economic environment and policy decisions by the central bank are expected to have an adverse impact on the company's profitability.

RECOMMENDATION

PEL, a part of the Piramal Group, is a leading NBFC company offering a wide range of products in retail and wholesale lending. We appreciate the following aspects of the company:

- a) Focus on establishing a multi-product retail franchise.
- b) Efforts to de-risk the wholesale lending business.
- c) Strategic exposure in unsecured, high-return-on-assets lending.
- d) Anticipated resolution and recoveries in the Wholesale 1.0 book.
- e) Strong balance sheet with a net worth of Rs. 31,000 crore and cash & liquid investments of Rs. 7,430 crore.
- f) PEL's strategic investments in Shriram Finance, Shriram Life Insurance, and Shriram General Insurance present substantial opportunities for shareholders, surpassing the current valuations of the company. Upon liquidating these investments, PEL is projected to receive an estimated inflow of approximately Rs. 6,200-6,700cr. Coupled with the existing cash in hand of Rs.7,430cr., the company's total cash and liquid investments would reach an impressive sum of Rs.13,630-14,130cr. This significant cash reserve represents 72%-74% of the PEL's current market capitalization of Rs.18,448cr. Such robust financial positioning provides shareholders with compelling prospects for value creation.
- g) PEL is trading at a PBV ratio of 0.59x compared to its peers, indicating it is available at deep discount to its book value.

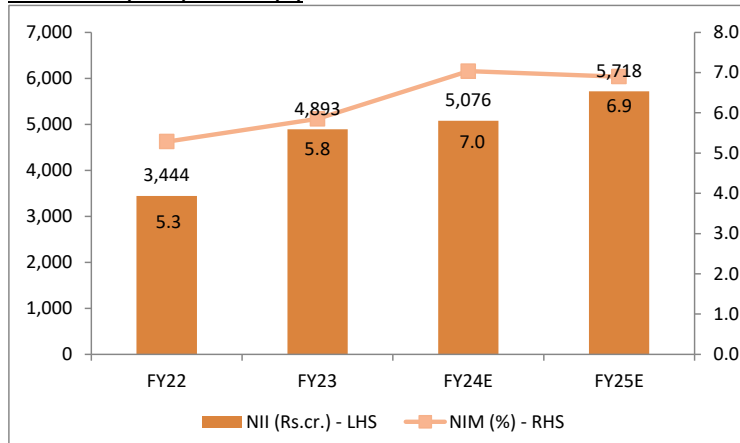
We initiate coverage on PEL with a buy rating and a price target of Rs. 1,026. Currently, the stock is trading at 0.59x its FY23 book value. We expect the company to trade at a P/BV of 0.75x based on its FY24 book value of Rs. 1,368. This assumption is based on our belief that the management's initiatives to strengthen and diversify the business will lead to a re-rating of the company's valuation.

FINANCIAL ANALYSIS

Advances to grow by 15% while NII to grow by 8% during FY23-25E

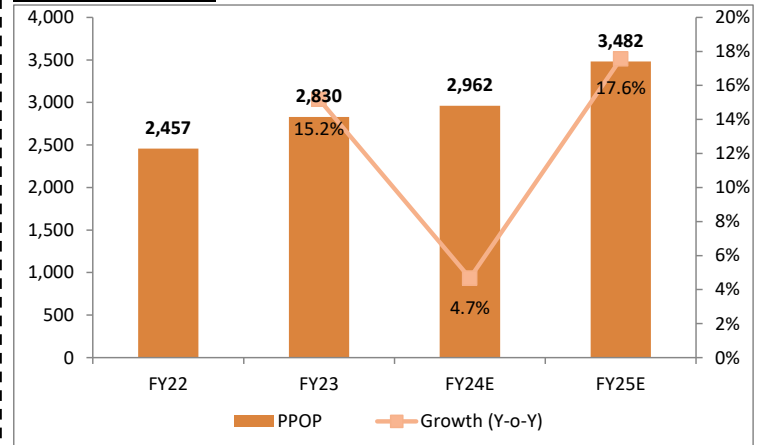
The company is expected to witness a 15% growth in advances during FY23-25E, driven by its expansion in a product category with limited competition from banks. This growth will contribute to an 8% increase in Net Interest Income (NII) over the same period. The relatively lower growth in NII compared to advances is attributed to the narrowing spread between the yield on advances and the cost of funds. Furthermore, the Net Interest Margin (NIM) is projected to rise to 7% in FY24E and 6.9% in FY25E, compared to the current level of 5.8%.

Exhibit 6: NII (Rs.cr.) and NIM (%)



Source: Investor Presentation, PCG Research

Exhibit 7: PPOP (Rs.cr.)



Source: Investor Presentation, PCG Research

Pre-Provision Operating Profit (PPOP) to increase by 11%

We estimate that the PPOP of the company will grow by 11% during the FY23-25E period, increasing from Rs. 2,830 crore in FY23 to Rs. 3,482 crore in FY25E. Meanwhile, operating expenses are expected to grow by only 5% during the same period. This is attributed to the management's strategic focus on closing down non-productive branches and opening branches in new, highly productive catchment areas located in tier-2/3 cities.

Improving asset quality

The anticipated resolutions and recoveries in the Wholesale 1.0 book, along with efforts to enhance granularity in the Wholesale 2.0 book and shift the AUM mix towards retail, are expected to bring significant improvements to the company's asset quality and overall business stability. We estimate that the GNPA ratio will decrease from the current 3.8% to 2.8% by FY25E.

Furthermore, our projection indicates that the AUM mix will be 67% retail and 33% wholesale, shifting from the current ratio of 50:50. This shift reflects the company's strategy to place a greater emphasis on retail lending, which is generally considered to have lower credit risk compared to wholesale lending.

COMPANY BACKGROUND

Piramal Enterprises Limited (PEL) is a prominent entity within the Ajay Piramal Group. PEL has established itself as a leading non-banking financial company (NBFC) with a widespread presence, operating through over 400 branches across 26 states in India. The company offers a comprehensive range of financial products and solutions, catering to both Retail and Wholesale lending segments.

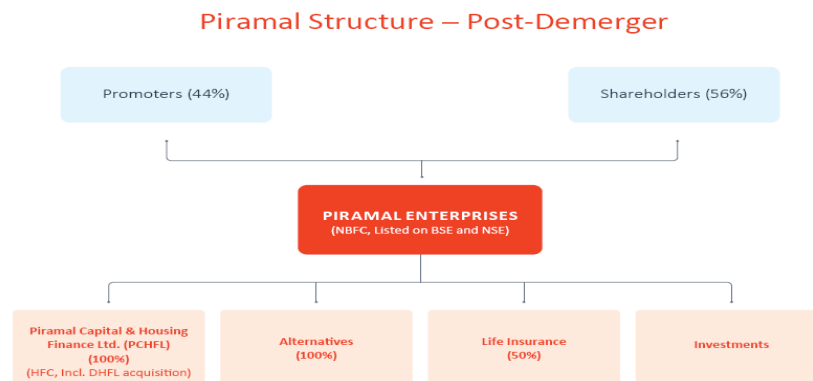
In the Retail lending business, PEL provides a diverse portfolio of secured and unsecured lending products. This enables the company to cater to a wide range of customer needs. On the other hand, the Wholesale lending business focuses on extending financing to real estate developers and mid-market corporate players. PEL has emerged as a market leader in the real estate financing domain, demonstrating its strong position in the industry.

Furthermore, PEL has successfully completed the integration of Dewan Housing Finance Ltd. (DHFL), a significant accomplishment that has positioned the company as one of the largest housing finance companies in India. As of March 31, 2023, PEL boasts an impressive AUM of Rs. 63,989 crores, highlighting its substantial presence and financial stature in the market.

Exhibit 8: Corporate Structure

CORPORATE STRUCTURE

The Company now houses the Financial Services and allied businesses



Source: Investor Presentation, PCG Research

Piramal Alternatives, the fund management arm of PEL, received around USD 1 billion commitment from CDPQ and Bain Capital. It offers customized financing solutions through its flagship products 'Piramal Credit Fund' and 'IndiaRF'.

PEL owns a 50% stake in Pramerica Life Insurance, a joint venture with Prudential International Insurance Holdings. Pramerica Life Insurance excels in the defense segment with over 3.4 million customers and an embedded value of Rs. 1,931 crore as of March 31, 2023.

Following the restructuring of Shriram Group, PEL obtained shares in multiple Shriram group companies. PEL now holds an 8.34% stake in Shriram Finance Limited, along with 20% stakes in Shriram GI Holdings, Shriram LI Holdings, and Shriram Investment Holdings. Consequently, PEL effectively owns 13.33% in Shriram General Insurance Company and 14.91% in Shriram Life Insurance Company. As of March 31, 2023, these investments are valued at Rs. 6,211 crore.

FINANCIAL STATEMENT

Consolidated Income Statement (Rs.cr.)	FY22	FY23	FY24E	FY25E
Interest Income	7,523	7,799	9,383	10,708
Other Operating Income	203	1,136	425	492
Operating Income	7,726	8,934	9,808	11,200
Less: Interest Expense	4,282	4,041	4,732	5,482
Net Interest Income	3,444	4,893	5,076	5,718
Other Income	185	152	178	194
Total Income, Net of Interest Expenses	3,629	5,045	5,254	5,912
Less: Operating Expenses	1,172	2,215	2,292	2,430
Pre-Provision Operating Profit (PPOP)	2,457	2,830	2,962	3,482
Less: Loan Loss Provisions & FV Loss / (Gain)	830	5,294	1,002	1,321
Profit Before Tax	1,628	-2,464	1,960	2,162
Less: Current & Deferred Tax	406	-3,978	431	476
Profit After Tax (PAT)	1,222	1,514	1,529	1,686
Associate Income	594	389	73	58
PAT Before Exceptional Gain	1,816	1,902	1,602	1,745
Exceptional (Expense) / Gain	-153	8,066	0	0
PAT After Exceptional Gain	1,663	9,969	1,602	1,745

Consolidated Balance Sheet (Rs.cr.)	FY22	FY23	FY24E	FY25E
Total Non-financial Assets	15,573	9,316	8,497	8,562
Investments	24,857	22,332	24,894	26,895
Loans & Advances	49,318	46,395	53,450	61,409
Cash and cash equivalents	7,187	4,649	3,797	4,057
Other assets	2,939	1,061	1,336	1,532
Total Assets	99,873	83,752	91,974	102,454

Equity Capital	48	48	48	48
Reserves & Surplus	35,441	31,011	32,588	34,322
Networth	35,489	31,059	32,636	34,370
Borrowings	58,569	51,667	58,181	66,755
Other liabilities	5,814	1,026	1,157	1,329
Total Liabilities	99,873	83,752	91,974	102,454

Basic Ratios (Rs.)	FY22	FY23	FY24E	FY25E
EPS	51.20	63.44	64.07	70.65
Growth (%)		23.9	1.0	10.3
Book Value	1,487	1,301	1,368	1,440
Growth (%)		-12.5	5.1	5.3

Valuation Ratios	FY22	FY23	FY24E	FY25E
P/E	15.10	12.18	12.06	10.94
P/BV	0.52	0.59	0.57	0.54
ROE (%)	4.9	5.6	5.0	5.2
ROA (%)	1.2	1.7	1.7	1.7
D/E (x)	1.65	1.66	1.78	1.94

Spreads (%)	FY22	FY23	FY24E	FY25E
Yield on Loans	14.3	13.0	13.8	13.8
Cost of Funds	9.6	8.6	8.6	8.8
Spread	4.7	4.3	5.2	5.0
NIM	5.3	5.8	7.0	6.9

Asset Quality (%)	FY22	FY23	FY24E	FY25E
Gross NPA	3.4	3.8	2.9	2.8
Net NPA	1.6	1.9	1.9	1.8
AUM (Rs.cr.)	65,185	63,989	72,151	82,894
Growth (%)		-1.83	12.76	14.89

Growth Ratio (%)	FY22	FY23	FY24E	FY25E
Int. Income		3.67	20.31	14.12
Int. Expenses		-5.63	17.11	15.84
NII		42.07	3.74	12.65
PPOP		15.18	4.67	17.55
PBT		-251.35	-179.56	10.26
PAT		23.90	1.00	10.26

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Disclosure of Interest Statement	Update
Analyst holding in the stock (%)	None
Served as an officer, director or employee	No

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EXPLANATION TO RATINGS: BUY: TP>15%; ACCUMULATE: 5%<TP<15%; HOLD: -5%<TP<5%; REDUCE: -15%<TP<-5%; SELL: TP<-15%

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