Equity Research

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Q4FY20 result review and reco change

Financials

Target price: Rs1,050

Shareholding pattern

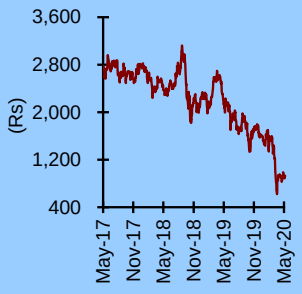
	Jun '19	Sep '19	Dec '19
Promoters	46.1	46.1	46.1
Institutional investors	37.6	38.6	39.3
MFs and others	0.5	0.4	0.4
FIs/Banks	0.0	0.0	0.3
Insurance	7.9	8.9	8.6
FIIs	29.2	29.3	30.0
Others	14.3	14.3	14.6

Source: CMIE

Target price revision

Rs1,050 from Rs2,025

Price chart



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INDIA

Piramal Enterprises

ADD

Downgrade from BUY

Covid-19 can accentuate stress in the book

Rs932

PEL has reported a healthy performance in its pharma segment with 13% YoY revenue growth in both verticals and ~26% margin in FY20 driven by its global pharma segment. We expect pharma segment to grow at a CAGR of 12.1% over FY20E-FY22E. The systemic credit cycle disruption has accentuated the perceived stress that could emanate in the financial services business of Piramal Enterprises (Piramal). This is especially pronounced in the context of an anticipated slowdown in the residential real estate sector with new sales coming down materially and consequently putting pressure on real estate prices in the top-tier cities where Piramal has exposure. Company made additional COVID provisioning of Rs19bn even as PCR on Stage 3 went up from 24% to 40% QoQ. High capital adequacy (~31%) and strong balance sheet (which became stronger after the capital raise) allows it to absorb any major stress that can potentially emanate from its wholesale exposures (real-estate/Corporate/Hospitality). Though it scores highly on the capital buffer and decently on liquidity, it would need to recalibrate its strategy given the stresses in real estate. Downgrade to ADD (from *Buy*) with an SoTP-based target price of Rs1,050.

- **Exposures are fully secured with high security cover, but incremental stress cannot be ruled out:** As highlighted in our initiation note (link), Piramal's conservative underwriting, asset monitoring capabilities and ability to find resolutions in stressed projects gives us confidence that it can navigate the turbulence likely in real estate sector post-lockdown. Even allowing for a one-time restructuring of loans, we feel there could still be newer stress in the book; we therefore estimate FY21E credit cost at 3%.
- **Borrowing costs will remain elevated even as incremental liquidity could become scarce:** Risk aversion to wholesale real estate financiers will likely remain high even after the lockdown is lifted and things return to a semblance of normalcy by Sep/Oct'20. While Piramal was able to tap debt markets last quarter, newer borrowings even if available will potentially come at a higher cost now.
- **Consumer lending, albeit delayed by Covid-19 dislocation, will likely be launched soon:** Consumer lending business, which the company is expected to soon venture into, will have a material gestation period since the incumbents have wide presence at the points of sale. However, Piramal's foray into consumer and SME finance using a digital analytics platform (in partnership with a leading telecom player) has the potential to be a real game changer in the post Covid-19 scenario. Economic dislocation can be a massive opportunity!
- **Resilient pharma performance:** PEL reported 10% YoY growth in the pharma segment in Q4FY20 driven by 11.4% growth in the global pharma segment. Some stockpiling of complex hospital generics due to COVID and initial batches from the two NCE product approvals (CDMO segment) have supported the growth. However, COVID severely affected the OTC segment that reported a decline of 8% in Q4FY20.

Market Cap	Rs210bn/US$8.8bn
Reuters/Bloomberg	PIRA.BO/PIEL IN
Shares Outstanding (mn)	225.5
52-week Range (Rs)	2233/623
Free Float (%)	53.9
FII (%)	30.0
Daily Volume (US$'000)	39,455
Absolute Return 3m (%)	(40.3)
Absolute Return 12m (%)	(56.0)
Sensex Return 3m (%)	(23.2)
Sensex Return 12m (%)	(14.7)

Year to Mar	FY19	FY20E	FY21E	FY22E
Revenues (Rs mn)	1,31,816	1,30,683	1,33,265	1,39,827
Net Income (Rs mn)	14,701	-5,530	14,424	19,632
EPS (Rs)	79.5	-24.5	64.0	77.4
% Chg YoY	-72.0	-130.9	-360.8	21.0
P/E (x)	11.6	-37.7	14.4	11.9
P/BV (x)	0.6	0.7	0.7	0.7
GNPA (%)	0.9	2.4	4	5
Dividend Yield (%)	3.0	1.5	1.5	2.3
RoA (%)	1.9	-0.7	1.9	2.6
RoE (%)	5.5	-1.9	4.6	6.1

- **Expect pharma resiliency to continue:** In FY20, global pharma grew 12.5% and reported its highest ever margin of 26-27% while the OTC segment grew 25.1% and reported single digit margins. Overall, we expect the pharma segment to continue its resilient performance in this pandemic and CAGR 12.1% over FY20E-FY22E with stable margins.
- **Valuations are factoring-in much lower value for the financial services business:** Given skepticism about the health of the real estate sector and the likely stress in Piramal's wholesale exposures, the stock is currently trading at 0.7x FY22E P/consolidated BV. We remain watchful of the potential stresses that could show up in the current fiscal and downgrade the stock to ADD (from Buy) with a revised SoTP-based (Table 1) target price of Rs1,050 (earlier: Rs2,025).

Brief update on the Financial Services business in Q4FY20

- **Loan-book declined by 10% YoY in FY20.** Focus of the management in most part of FY20 was on balance sheet protection and in running down the large single-borrower exposures in the wholesale real estate and corporate loan book through refinancing or sell-downs. Given the anticipated systemic stress in the system, we foresee that the management will have to continue with same strategy in FY21 as well. Balance sheet protection will take precedence over growth.
- **Pressure on NIM evident:** Financial Services lending business witnessed severe NIM compression. NIM in FY20 stood at 5.2% down, down 120bps YoY. While this was partly a function of the higher cost of borrowings, the NIMs were also compressed because of the higher liquidity buffer that the company carried during the year.
- **Company made additional provisioning of Rs19bn even as PCR on Stage 3 went up from 24% to 40% QoQ:** Two exposures slipped into Stage 3. In Marvel Realtors where Piramal has an exposure of Rs2080mn, there was a one-time settlement by taking a loss of Rs310mn. Piramal was the sole lender in Marvel and Marvel brought in another investor. Also, while in Stage 2, Piramal has entered into negotiations for selling off the assets of Mytrah Group. In Mytrah group it has an exposure of Rs12.7bn including accrued interest and the company has taken a specific provision of Rs3.4bn. GNPA was up 60bps QoQ and stood at 2.4%. With the additional provisioning of Rs19bn, total provisions as a % of the loans stood at 5.8% (up from 1.8% in Dec'19),
- **Allocation of Rs20bn in equity to the Financial Services business:** From the stake-sale in Shriram Transport, additional equity of Rs17bn was allocated to Financial services (FS) in Q2FY20. Again in Q4FY20, additional equity of Rs20bn was allocated to Financial Services. This was against the equity capital raise and sale of the DRG business. Company also repaid some of the high-cost borrowing in FS and with it the gross-debt to equity in the lending business came down from 3.9x to 2.6x YoY.
- **Retail housing finance book still continues to run down:** Retail book stood at Rs55.3bn and was down 10% QoQ. Given the higher cost of borrowings of the company, it has been trying to convince some of its customers to take balance-transfers to other lenders. From the run down, looks like that the company has

been fairly successful in bring down its low (or no) profitability loan book. Going forward, the company will be looking to cater to the higher-yielding self-employed in Tier 3, Tier 4 cities who are not eligible for home loans from PSU banks.

- **Liquidity position:** Piramal had Rs15bn-Rs20bn of bank term loan interest/principal repayments during the moratorium period. It has availed moratorium where it was available as per Board-approved policies of banks. It has also repaid ~50% of the amount under moratorium in cases where moratorium was not available. Piramal has ~Rs100bn in repayments due over H1FY21. It had Rs40bn in cash and cash equivalents as on Mar'20. Piramal got sanctions of Rs40bn from SBI and PNB in April. Also, it has Rs10bn sanctioned under LTRO 1.0 but could not avail anything in LTRO 2.0 because HFCs were not eligible for it. **However, almost the entire wholesale book and about ~25% of the retail housing finance book is under moratorium.**

Table 1: SOTP valuation

SOTP	Value (Rs bn)	Value (USD bn)	Price (Rs/share)	% of total	Rationale
Financial Services (ex Shriram)	50	0.7	221	21	We value this business at 0.3x Mar'22 P/BV; Loanbook CAGR of ~2% over FY20E-FY22E; RoA of 1.4%-2.1% over FY21-FY22. RoE while subdued will improve with leverage.
Shriram Investments	28	0.4	122	12	~10% stake in Shriram City and ~20% stake in Shriram Capital.
Pharma	160	2.2	707	67	We value the Global Pharma business at 12x Mar'22 EV/EBITDA and the India consumer products business at 3x Mar'22 EV/Sales
Target value	**237**	**3.2**	**1,050**		

Source: Company data, I-Sec research

Piramal Enterprises: Q4FY20 – earnings call takeaways

Earnings and outlook

- Net profit impacted by: 1) ***prudent provisioning of RS19bn due to macro crisis*** emanating from COVID-19; 2) ***DTA of Rs35bn*** – new corporate tax regime of 25% led to one-time non-cash impact Rs17.6bn; 3) DRG was sold for USD950mn – gain of USD100mn was reversed to determine normalized profit.
- Revenues were down sequentially due to reversal of interest income, fair valuation losses and excess liquidity.
- Treading with utmost caution - not growing and preserving liquidity. ***Last 18 months have been challenging due to tight liquidity and further worsened by COVID-19***.
- Will lead to consolidation in NBFC sector – well capital, well governed, well managed will gain dominance.

Asset quality

- ***GNPLs rose by 60bps to 2.4% due to slippage of 2 accounts: 1) Marvel Realtors – an account of Rs2.08bn had one-time settlement with loss of Rs310mn***
- ***Mytrah group – exposure of Rs12bn of which provisioning is Rs3.4bn – of which Rs500mn provided in Q4***
- Commercial portfolio is 20-25% of wholesale book of Rs350bn – lot of projects are at a mid-stage. To hospitality sector has exposure of Rs20bn – Marriott, Taj, Hyatt. All operational projects and LTVs are low.
- ***LRD of Rs9.4bn to marquee assets in BKC of Wadhwa group – clients have not asked for deferment/moratorium.***
- ***Single borrower exposure declined by 12% and top 10 exposures went down by Rs42bn.***
- **Lod*ha exposure –*** *Company was on verge of* concluding deal but deal delayed & by September end will see reduction in Lodha. Has Rs30bn of loans and Rs60bn of security – *out of Rs60bn, ~30bn are in ready projects.*
- Corporate loan book is Rs70bn – Rs47bn is in infrastructure (renewables) – major portfolio (50% of the outstanding book) will run-down this year as its fully constructed running assets.

Scenario analysis, if COVID-19 is prolonged

- Adopting conservative and prudent approach of making a provision of Rs19bn – provision coverage increased from 1.8% to 5.8% of the loanbook in FY20.
- **Assumptions:** Outbreak peaks in June 2020, GDP slows and leads to job losses, liquidity is expected to remain tight. Stress is far more severe and assumed zero sales, zero collections for next 3 quarters.

- **Give money and provide liquidity to developer –** will fund developers to complete construction. Based on cash and collateral cover have estimated what would happen to cover – for its developers it would not fall below 1x. Developers will give discount to existing customers, slash prices for new projects or sell FSA rather than constructing it.
- ***In retail financing, sees no major challenges. 24% of housing finance clients have opted for moratorium.***
- In wholesale financing – closely monitoring and taking necessary action. Have initiated mitigation action. In corporate lending, it is in active discussion to part-sell the portfolio. ***Has offered moratorium to all the borrowers and most of the customers have asked for the moratorium.***

Liquidity and capital adequacy

- Raised Rs135bn of long term debt.
- ***Cash reserves of Rs89bn – Rs40bn (from SBI & PNB) has been drawn down in April since the outbreak of COVID; Rs10bn sanctions under LTRO and another Rs40bn to flow from banks in the near term.***
- ***Rs100bn of repayments due till September. As far as borrowings is concerned, some banks have agreed and it has availed moratorium for Rs7.5bn – 50% of repayment due is already paid.***
- ***CAR is 32%. Capital allocation across businesses: Networth of Rs305bn – Financial services Rs156bn for book of Rs510bn (additional allocation of Rs20bn in Q4); Pharma business Rs45bn and unallocated networth of Rs105bn.***
- ***Incremental borrowing cost of 9.5-10.0%.***

Consumer lending:

- Fully tech enabled multi product lending platform – digital at the core. Started with housing finance.
- Competitive intensity is expected to reduce.
- Will discuss strategy at a later stage

Pharma business:

- Process is on track to raise funds by sales of minority stake (~20%) to potential investors.
- ***Pharma business will be restructured into a subsidiary of PEL first and then investor will come at subsidiary level. Part of money will flow to Piramal Enterprise.***
- CDMO segment has witnessed consistent demand in the quarter as it received queries from more than 30 new clients post COVID. Some clients preferred PEL due to its ability to manufacture products locally.
    - Two client NCE molecules received approval in Q4FY20 and its benefit would be reflected in FY21.

- Company might incur marginal capital investment to cater to the increasing demand and new requirements.

- Apart from the initial stockpiling, company is witnessing a strong demand in the anesthetic and pain management drugs in the complex hospital generics segment especially (*Isoflurane*, *Sevoflurane*, etc.).
  - Company has launched 11 products in FY20 and three in Q4FY20.
- ***Debt level is Rs45bn – part of this debt will reduce to Rs30bn post the transaction.***
- Goodwill to pharma business will Rs10bn – accumulated through various transactions in last 10-12 years. No impairment likely as its valued regularly.
- DRG transaction worth USD950mn was completed by the end of Feb'2020

Financial summary

Table 2: Profit and loss statement (Consolidated)

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Revenues	**1,05,128**	**1,31,816**	**1,30,683**	**1,33,265**	**1,39,827**
-Financial Services	49,816	70,634	76,494	72,440	71,659
-Pharma	43,220	47,860	54,189	60,825	68,168
-DRG	12,092	13,322	0	0	0
-Others	1,266	337	0	0	0
EBITDA (Pre-exceptional)	**29,611**	**36,582**	**17,889**	**24,312**	**31,073**
-Financial Services	19,933	24,507	3,553	10,081	14,882
-Pharma	8,001	9,809	14,336	14,231	16,191
-DRG	1,677	2,266	0	0	0
Depreciation	**4,773**	**5,202**	**5,200**	**5,918**	**6,440**
-Financial Services	37	76	91	110	132
-Pharma	3,757	3,929	5,109	5,809	6,309
-DRG	980	1,197	0	0	0
EBIT (Pre-exceptional)	**24,838**	**31,380**	**12,688**	**18,394**	**24,632**
-Financial Services	19,897	24,431	3,462	9,971	14,750
-Pharma	4,244	5,880	9,227	8,423	9,882
-DRG	697	1,069	0	0	0
Interest exp of Pharma and DRG	5,721	6,688	4,449	3,150	3,150
Unallocated Income/(expenses)	521	83	939	300	300
Core PBT (pre-exceptional)	**19,638**	**24,775**	**9,179**	**15,544**	**21,782**
Exceptional Items	0	-4,656	0	0	0
Reported PBT	**19,638**	**20,119**	**9,179**	**15,544**	**21,782**
Taxes	-28,764	8,611	19,604	3,917	5,489
Profit after taxes (PAT)	**48,402**	**11,507**	**-10,426**	**11,627**	**16,293**
Share of associates and JV (including MI)	2,801	3,194	4,896	2,798	3,339
PAT after share of associates and JV	**51,203**	**14,701**	**-5,530**	**14,424**	**19,632**
PAT from discontinued operations	**0**	**0**	**5,745**	**0**	**0**
Net profit for the period	**51,203**	**14,701**	**214**	**14,424**	**19,632**

Note: FY19 numbers have not been restated
Source: Company data, I-Sec research

Table 3: Balance sheet (Consolidated)

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Equity share capital	361	370	451	451	507
Reserves & Surplus (including OCI)	2,65,263	2,71,870	3,05,260	3,16,527	3,30,832
Shareholders' equity	**2,65,624**	**2,72,240**	**3,05,711**	**3,16,978**	**3,31,340**
Minority Interest	120	90	0	0	0
Total equity	**2,65,744**	**2,72,330**	**3,05,711**	**3,16,978**	**3,31,340**
Borrowings	4,41,608	5,60,400	4,20,550	3,80,078	4,15,925
Other liabilities	20,652	23,400	22,829	37,737	49,937
Total Liabilities	**7,28,004**	**8,56,130**	**7,49,090**	**7,34,793**	**7,97,202**
Cash and cash equivalents	24,670	9,190	47,710	40,000	40,000
Loans	**4,21,680**	**5,66,240**	**5,09,630**	**4,84,149**	**5,32,563**
Investments	93,304	94,440	63,400	69,440	69,440
Goodwill	56,326	59,396	11,390	11,390	11,390
Fixed Assets	57,402	57,510	57,940	63,734	68,833
Deferred tax assets	42,444	40,685	23,720	23,720	23,720
Other assets	32,179	28,670	35,300	42,360	51,256
Total Assets	**7,28,004**	**8,56,130**	**7,49,090**	**7,34,793**	**7,97,202**

Note: FY19 numbers have not been restated
Source: Company data, I-Sec research

Table 4: Key ratios (Consolidated)

(Year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Growth ratios (%)					
Core PBT	48.7	26.2	-63.0	69.3	40.1
PAT	347.3	-76.2	-190.6	-211.5	40.1
EPS	291.6	-72.0	-130.9	-360.8	21.0
Debt-to-equity (x)	**1.7**	**2.1**	**1.4**	**1.2**	**1.3**
Profitability ratios (%)					
EBITDA Margin - Pharma	**18.5**	**20.5**	**26.5**	**23.4**	**23.8**
Return ratios & capital management					
RoAA (%)	8.5	1.9	-0.7	1.9	2.6
RoAE (%)	24.7	5.5	-1.9	4.6	6.1
Payout ratio (%)	8.8	38.0	-57.1	21.9	27.1
Valuation ratios					
DPS (Rs)	25.0	28.0	14.0	14.0	21.0
EPS (Rs)	284.1	79.5	-24.5	64.0	77.4
Price to Earnings	3.3	11.6	-37.7	14.4	11.9
BVPS (Rs)	1,474	1,472	1,355	1,405	1,306
Price to Book	0.6	0.6	0.7	0.7	0.7
Dividend yield (%)	2.7	3.0	1.5	1.5	2.3

Source: Company data, I-Sec research

Table 5: Profit and loss statement (Financial Services)

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Interest Income	48,212	69,331	76,925	72,049	71,170
Interest Expense	24,062	37,410	47,295	40,949	37,970
Net interest income	**24,150**	**31,921**	**29,629**	**31,100**	**33,200**
Non-interest and fee income	1,604	1,304	-431	391	489
Total Income (Net of interest expenses)	**25,754**	**33,225**	**29,199**	**31,491**	**33,688**
Operating expenses	3,470	5,550	6,990	6,613	6,738
PPoP	**22,284**	**27,675**	**22,209**	**24,878**	**26,951**
Provisions & contingencies	2,387	3,244	18,747	14,907	12,201
Profit before tax (PBT)	**19,897**	**24,431**	**3,462**	**9,971**	**14,750**
Tax expenses	6,964	8,551	872	2,513	3,717
Tax rate (%)	35.0%	35.0%	25.2%	25.2%	25.2%
Profit after tax (PAT)	**12,933**	**15,880**	**2,589**	**7,458**	**11,033**

Note: FY19 numbers have not been restated
Source: Company data, I-Sec research

Table 6: Balance sheet (Financial Services)

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Shareholders' equity	97,250	1,14,420	1,55,990	1,60,291	1,65,998
Borrowings	3,59,825	4,46,238	3,98,320	3,20,087	3,70,282
Other liabilities	0	27,205	29,889	20,922	14,645
Total Liabilities	**4,52,196**	**5,87,863**	**5,84,199**	**5,01,300**	**5,50,925**
Loan book	4,21,680	5,66,240	5,09,630	4,84,149	5,32,563
Other assets	30,516	21,623	74,569	17,151	18,361
Total Assets	**4,52,196**	**5,87,863**	**5,84,199**	**5,01,300**	**5,50,925**

Note: FY19 numbers have not been restated
Source: Company data, I-Sec research

Table 7: Key ratios (Financial Services)

(Year ending Mar 31)

	FY18	FY19	FY20P	FY21E	FY22E
Loan book (Rs mn)	4,21,680	5,66,240	5,09,630	4,84,149	5,32,563
Loan book growth (%)	69	34	-10	-5	10
Growth (%)					
Net interest income	56.5	32.2	-7.2	5.0	6.8
Operating expenses	8.2	59.9	26.0	-5.4	1.9
PPoP	55.1	24.2	-19.8	12.0	8.3
Provisions	54.0	35.9	478.0	-20.5	-18.2
PBT	55.3	22.8	-85.8	188.0	47.9
PAT	55.3	22.8	-83.7	188.0	47.9
Yields, interest costs and spreads (%)					
Avg. yield on loans	14.4	14.0	14.3	14.5	14.0
Avg. cost of funds	8.1	9.3	11.2	11.4	11.0
Interest Spreads	6.2	4.8	3.1	3.1	3.0
NIM (on AUM)	7.2	6.5	5.5	6.3	6.5
Operating efficiencies					
Cost to income ratio (%)	13.5	16.7	23.9	21.0	20.0
Op.costs/avg AUM (%)	1.0	1.1	1.3	1.3	1.3
Capital Structure					
Debt-Equity ratio	3.7	3.9	2.6	2.0	2.2
Provisioning					
GNPA estimate (% of on-book AUM)	0.3	0.9	2.4	4.0	5.0
Coverage ratio [total provisions as % AUM]	1.8	1.9	5.8	8.0	9.5
Credit costs as % of average AUM	0.7	0.7	3.5	3.0	2.4
Return ratios & capital management					
RoAA (%)	3.6	3.1	0.4	1.4	2.1
RoAE (%)	19.9	15.0	1.9	4.7	6.8

Source: Company data, I-Sec research

Table 8: DuPont Analysis (Financial Services)

(%)	FY18	FY19	FY20P	FY21E	FY22E
Interest earned	13.5	13.3	13.1	13.3	13.5
Interest expended	6.7	7.2	8.1	7.5	7.2
Net Interest Income	**6.7**	**6.1**	**5.1**	**5.7**	**6.3**
Non-Interest Income	0.4	0.3	(0.1)	0.1	0.1
Total Income	**7.2**	**6.4**	**5.0**	**5.8**	**6.4**
Total operating expenses	1.0	1.1	1.2	1.2	1.3
PPoP	**6.2**	**5.3**	**3.8**	**4.6**	**5.1**
Credit cost	0.7	0.6	3.2	2.7	2.3
Profit before tax	**5.6**	**4.7**	**0.6**	**1.8**	**2.8**
Tax	1.9	1.6	0.1	0.5	0.7
RoA	**3.6**	**3.1**	**0.4**	**1.4**	**2.1**
Effective leverage (AA/ AE)	*5.5*	*4.9*	*4.3*	*3.4*	*3.2*
RoE	**19.9**	**15.0**	**1.9**	**4.7**	**6.8**

Source: Company data, I-Sec research

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