

## Company

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# Edelweiss Capital (EDEL.BO)

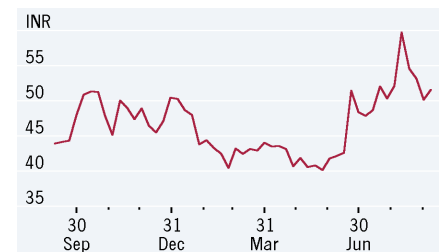
Equity

## Key Takeaways From Management Meetings

- Brokerage to bank?** — EDEL's revenue bias has tilted more toward interest income over recent quarters (44% in 1Q11 vs. 31% a year ago), as management focuses on expanding the lending portfolio and growth in broking and arbitrage segments remains sluggish. Management is keen on a banking license – deems it to be a longer-term necessity for customer franchise, asset growth and funding mix. If made available, this could alter its growth and margin profile.
- Broking: Early signs of a retail revival?** — EDEL estimates retail commission pool at nearly 3x institutional commissions, is seeing some early signs of a pickup in retail volumes and aims to double its own retail commissions in the next 18 months. Recent Anagram acquisition is a strong platform to build the retail business.
- Financing: Mortgages to build growth** — EDEL's credit book (loan against shares) has grown rapidly since 2QFY10; management targets Rs50bn loan book in 3 years (from Rs30bn now). In addition, it is starting new products (loan against property/mortgages), which are likely to add to the book – management targets Rs50bn outstanding in 3 years (Rs8-9bn in first year). Moreover, it is also open to exploring inorganic opportunities to further growth in this segment.
- Asset management: Still scaling down** — EDEL is not expecting to grow its AUMs meaningfully near term, as demand remains sluggish. While it recently raised some off-shore funds (US\$250m), domestic flows remain weak, with no momentum visible near-term. Medium-term plans - keep introducing new products and establish a performance track record, while keeping expenses low.
- Currently in investment mode, returns to follow with a lag** — EDEL will need to invest capital for: a) Growing the lending business; b) Planned life Insurance foray; and c) Building the retail brokerage. We believe these will pay off as these businesses achieve scale, but near term, will likely be a drag on profitability.

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (09 Sep 10)	Rs51.25
Target price	Rs50.00
Expected share price return	-2.4%
Expected dividend yield	1.0%
<b>Expected total return</b>	<b>-1.5%</b>
Market Cap	Rs38,489M US\$828M

### Price Performance (RIC: EDEL.BO, BB: EDEL IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	1,864	2.49	-45.4	20.6	1.8	9.4	0.6
2010A	2,292	3.06	22.8	16.8	1.7	10.5	2.0
2011E	2,505	3.34	9.2	15.4	1.6	10.6	1.0
2012E	2,972	3.96	18.6	12.9	1.4	11.5	1.2
2013E	3,573	4.76	20.2	10.8	1.3	12.5	1.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
<b>Valuation Ratios</b>					
P/E adjusted (x)	20.6	16.8	15.4	12.9	10.8
P/E reported (x)	20.6	16.8	15.4	12.9	10.8
P/BV (x)	1.8	1.7	1.6	1.4	1.3
P/Adjusted BV diluted (x)	1.8	1.7	1.6	1.4	1.3
Dividend yield (%)	0.6	2.0	1.0	1.2	1.2
<b>Per Share Data (Rs)</b>					
EPS adjusted	2.49	3.06	3.34	3.96	4.76
EPS reported	2.49	3.06	3.34	3.96	4.76
BVPS	28.23	30.07	32.83	36.10	40.17
Tangible BVPS	28.23	30.07	32.83	36.10	40.17
Adjusted BVPS diluted	28.23	30.07	32.83	36.10	40.17
DPS	0.30	1.00	0.50	0.60	0.60
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	1,965	1,446	2,056	2,773	3,372
Fees and commissions	731	1,362	1,755	2,134	2,562
Other operating Income	4,959	5,027	5,247	5,806	6,685
<b>Total operating income</b>	<b>7,656</b>	<b>7,835</b>	<b>9,058</b>	<b>10,712</b>	<b>12,619</b>
Total operating expenses	-4,310	-4,413	-4,855	-5,670	-6,532
<b>Oper. profit bef. provisions</b>	<b>3,345</b>	<b>3,422</b>	<b>4,204</b>	<b>5,042</b>	<b>6,087</b>
Bad debt provisions	-55	-94	-150	-195	-244
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>3,290</b>	<b>3,328</b>	<b>4,054</b>	<b>4,847</b>	<b>5,843</b>
Tax	-1,199	-879	-1,338	-1,599	-1,928
Extraord./Min. Int./Pref. Div.	-227	-157	-211	-276	-342
<b>Attributable profit</b>	<b>1,864</b>	<b>2,292</b>	<b>2,505</b>	<b>2,972</b>	<b>3,573</b>
Adjusted earnings	1,864	2,292	2,505	2,972	3,573
<b>Growth Rates (%)</b>					
EPS adjusted	-45.4	22.8	9.2	18.6	20.2
Oper. profit bef. prov.	-26.7	2.3	22.9	19.9	20.7
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>36,102</b>	<b>58,958</b>	<b>75,873</b>	<b>93,608</b>	<b>111,668</b>
Avg interest earning assets	41,367	45,161	64,688	81,595	99,026
Customer loans	11,227	26,369	41,044	51,169	60,544
Gross NPLs	0	0	0	0	0
<b>Liab. &amp; shar. funds</b>	<b>36,102</b>	<b>58,958</b>	<b>75,873</b>	<b>93,608</b>	<b>111,668</b>
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	21,154	22,574	24,647	27,101	30,156
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	9.4	10.5	10.6	11.5	12.5
Net interest margin	4.75	3.20	3.18	3.40	3.41
Cost/income ratio	56.3	56.3	53.6	52.9	51.8
Cash cost/average assets	9.8	9.3	7.2	6.7	6.4
NPLs/customer loans	0.0	0.0	0.0	0.0	0.0
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	0.5	0.5	0.4	0.4	0.4
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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## Edelweiss Capital

### Company description

Edelweiss, founded in 1995, started as a niche investment bank that focused on private-equity syndications. It was co-founded by Rashesh Shah, MD and CEO, and Venkat Ramaswamy, ED and Co-head - Investment Banking. Edelweiss has over the years built a diversified product offering in the institutional segment through broking and investment-banking services, backed by a strong treasury and arbitrage trading portfolio. Edelweiss also offers financing against shares, asset and wealth management, and insurance broking. It operates its various businesses directly and through various subsidiaries, which are consolidated under the parent.

### Investment strategy

We rate Edelweiss Sell/Medium Risk. Edelweiss is among the largest institutional brokerages in India and enjoys a favorable market positioning and a strong management team. In a rising equity market this should create strong leverage in its operating revenues. Moreover, it has a large capital base, which can be leveraged quickly to be deployed in its market leading arbitrage business.

However, capital market volumes in India have continued to be fragmented due to a changing product mix and increasing competitive intensity and have pressured profitability for leading players. Moreover, Edelweiss has a relatively smaller retail franchise, which we believe will likely be the next upside leg for market turnover (as institutional turnover has already been strong) and can impact Edelweiss' competitive positioning. Edelweiss' arbitrage trading business has also continued to attract lower turnover and profitability which is expected to remain a drag on overall profitability. Moreover, we expect cost pressures to increase going forward, leading to possible declines in profit margins.

### Valuation

Our target price of Rs50 is based on a price to earnings approach. We value brokerages/related businesses at a slight discount to broader market earnings multiples in the current environment. We believe that such cyclical businesses should trade at a discount to the market during a strong market environment and vice versa. In the current market environment, we use 15x 1yr Fwd PE to value Edelweiss' overall business (in line with our multiples for other players in the sector). Our target multiple is at a 10-15% discount to the broader Sensex multiple (we argue that brokerages should trade at discounts in a strong market and vice versa). This values Edelweiss at Rs50 per share.

### Risks

We rate Edelweiss Medium Risk, though our quantitative risk-rating system, which tracks 260-day historical share-price volatility, suggests Low Risk. We prefer Medium Risk to Low Risk because Edelweiss' revenues continue to be closely linked to capital market growth and volatility. Upside risks to our target price include: a) higher than expected growth in brokerage volumes; b) better

than expected returns on the treasury portfolio; and c) higher than anticipated upsides on the launch/amalgamation of new retail brokerage platform.

# Appendix A-1

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#### Ratings and Target Price History

#### Fundamental Research

Analyst: Manish Chowdhary, CFA

Covered since April 17 2008



Chart current as of 4 September 2010

	Date	Rating	Target Price	Closing Price
1	16-Apr-08	*3H	*76.00	79.29
2	15-Jul-08	3H	*46.00	48.17

	Date	Rating	Target Price	Closing Price
3	8-Dec-08	3H	*24.00	24.50
4	4-Jun-09	*1M	*61.20	50.17

	Date	Rating	Target Price	Closing Price
5	4-Aug-10	*3M	*50.00	52.18

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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