

Rating Rationale

March 04, 2022 | Mumbai

Edelweiss Alternative Asset Advisors Limited

Rating reaffirmed at 'CRISIL PPMLD AA- r / Negative'

Rating Action

Rs.300 Crore Long Term Principal Protected Market Linked Debentures	CRISIL PPMLD AA- r /Negative (Reaffirmed)
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1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has reaffirmed its '**CRISIL PPMLD AA-r/Negative**' rating to the Rs 300 crore long-term principal-protected market-linked debentures of Edelweiss Alternative Asset Advisors Ltd (EAAA; part of the Edelweiss group).

The ratings continue to reflect the adequate capitalisation level of the group, supported by multiple rounds of capital raising; the diversified business profile with presence across lending, asset management, wealth management, broking, asset reconstruction and insurance segments; and demonstrated ability to build significant presence in multiple lines of business, which should continue to support earnings. The group also maintains adequate liquidity on an ongoing basis.

The continuation of the 'Negative' outlook reflects the challenges in profitability and asset quality that the group has been facing largely on account of stress on its wholesale lending book. The retail lending book was also impacted amid the Covid-19 pandemic. Trends in profitability and asset quality, over the medium term, will be key monitorables.

Despite the challenging macro environment for non-banking companies, the group has been able to raise capital from marquee global investors. During the last quarter of fiscal 2021, the group concluded the sale of its majority stake in Edelweiss Wealth Management (EWM; comprising wealth management and capital markets business) to PAG (Pacific Alliance Group, Asia-focused alternative investment managers) for Rs 2,366 crore. As on December 31, 2021, PAG holds 55.84% of the business, while the Edelweiss group holds 44.16% (increased from 38.5% as on September 30, 2021). Between March and November 2019, the group raised Rs 1,334 crore (in aggregate) from Caisse de depot et placement du Quebec (CDPQ), Kora Management (Kora; a US-based investment firm) and Sanaka Growth SPV I Ltd (part of Sanaka Capital). It had also raised Rs 268 crore in October 2021, by divesting its 61% stake in the insurance broking venture to Arthur Gallagher. The latter now holds 91% in the insurance broking venture of the Edelweiss group and will acquire the balance 9% in the current fiscal.

These stake sales have helped absorb asset-side risk. Despite business losses in fiscals 2020 and 2021, networth has been steady at Rs 8,542 crore as on March 31, 2021 (Rs 8,715 crore as on March 31, 2019). With decline in borrowings, gearing also reduced to around 3 times from around 4 times over the same period. Networth and gearing stood at Rs 8,663 crore and 2.8 times, respectively, as on December 31, 2021.

The group has diversified business interests in financial services domain. Over the years, It has significantly scaled up operations of its non-lending businesses, including the asset reconstruction company (ARC), asset management and wealth management, which now contribute a higher share of revenue and profits and are likely to support the overall earnings profile going forward.

The group also maintains adequate liquidity. The overnight on-balance-sheet liquidity (including cash, liquid investments and treasury assets) stood at around Rs 1,900 crore and unutilised bank lines at Rs 300 crore as on January 31, 2022. The group also has other liquid assets (investments and securities-based lending) that can be accessed, if necessary. This was Rs 3,050 crore as on January 31, 2022. The group raised Rs 7,565 crore in fiscal 2021 and Rs 5,873 crore from April to January 31, 2022 through bank loans, securitisation, structured NCDs and retail bonds.

As for asset quality, overall reported gross stage III assets in the lending business improved to 4.89% as on December 31, 2021, from 7.7% as on March 31, 2021 (5.3% in the previous year). On an absolute basis, stage III assets reduced to Rs 657 crore as on December 31, 2021, from Rs 1,182 crore as on March 31, 2021 (Rs 1,114 crore, a year earlier), supported by write-offs and sale to ARCs worth Rs 382 crore during the first nine months of fiscal 2022, and Rs 2,047 crore in fiscal 2021. The group had also restructured 3.7% of its portfolio in line with the Resolution Framework for Covid-19-related stress (restructuring 2.0), released by the Reserve Bank of India (RBI) August 2020.

The group had aligned stage III assets with gross NPAs and reported stage III assets to factor in impact of RBI's clarification on recognition and calculation of NPAs released on November 12, 2021.

The group continues to move towards an asset-light model through sell-down of wholesale assets and co-lending arrangements in the retail lending business. In wholesale finance, it is shifting the assets to a fund platform, which will

provide completion finance to projects. Although, the group has already concluded transactions aggregating over Rs 2,500 crore in the past 18 months, the overall sell-down has been lower than anticipated., nevertheless, the group is in discussions for concluding additional transactions.

The increased stress in the loan book and consequent rise in provisions, including management overlay, had impacted the group's earnings profile during fiscals 2021 and 2020; however, credit cost has normalised during the nine months through fiscal 2022. On a consolidated basis, while the group reported net profit of Rs 254 crore in fiscal 2021 (loss of Rs 2,044 crore in fiscal 2020), it was primarily due to a one-off gain from stake sale in the wealth management business. Excluding this one-off gain, the group would have reported net loss in fiscal 2021 as well. For nine months ended fiscal 2022, the group reported net profit of Rs 146 crore after reducing wealth management shareholder's profit of Rs 21 crore, compared to loss of Rs 382 crore during corresponding period of previous fiscal.

Improvement in asset quality and profitability will be key rating sensitivity factors.

Analytical Approach

For arriving at the ratings, CRISIL Ratings has combined the business and financial risk profiles of Edelweiss Financial Services Ltd (EFSL), its subsidiaries (including EAAA) and associates in the wealth management business. This is because all these entities have significant operational, financial and managerial linkages, and operate under a common Edelweiss brand.

Please refer Annexure - List of Entities Consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

Adequate capitalisation, supported by multiple capital raises

The Edelweiss group has demonstrated its ability to raise capital from global investors across businesses, despite the tough macro environment. The group has raised Rs 4,008 crore (of which Rs 40 crore is expected in the last quarter of fiscal 2022), over the past 36 months across the lending, wealth management and asset management businesses. This has helped maintain the capital position, despite elevated credit cost and absorb asset-side risk.

With the scale-down of the lending business in the past few quarters, borrowings have also come down. With this, gearing has improved to 2.8 times as on December 31, 2021 (~3 times as on March 31, 2021) from ~4 times as on March 31, 2020.

Diversified financial services player, with demonstrated ability to build significant competitive positions across businesses

The Edelweiss group is a diversified financial services player, present in five verticals i.e., credit (wholesale and retail), insurance (life and general), asset management (AMC and alternate asset management), asset reconstruction and wealth management. The group has attained sizeable scale in many of these businesses over a period, which is likely to lend greater stability to earnings over time.

In the lending business of book size of Rs 13,424 crore as on December 31, 2021 (Rs 13,719 crore as on September 30, 2021 and Rs 15,279 crore as on March 31, 2021), excluding capital deployed in distressed assets credit, the group plans to focus on increasing the granularity of the loan book. As part of this strategy, it will focus on growing the retail book (~52% of total credit book as on December 31, 2021) comprising primarily of mortgage and micro, small and medium enterprises (MSME) loans. Growth in the wholesale credit book is expected to be predominantly through the fund structure.

In the distressed assets segment, Edelweiss ARC is the largest ARC in India, with total securities receipts managed at Rs 41,814 crore as on December 31, 2021 (vis-à-vis Rs 40,800 crore as on March 31, 2021). From being largely corporate focused, the group has, in the recent past, started focusing on retail and MSME segments. The share of retail is expected to grow, over the medium term, from 11% as on December 31, 2021.

Scale and profit of fee-based businesses have also increased in the past few fiscals. The group has an established franchise in institutional broking and investment banking, and growing reach in the retail broking, wealth management and asset management segments.

Assets under advice in the global wealth management business were Rs 1,93,500 crore (Rs 1,55,000 crore as on March 31, 2021) and assets under management (AUM) in the asset management business were Rs 1,12,100 crore (of which Rs 82,000 crore are mutual fund assets and Rs 30,200 crore are alternative assets) as on December 31, 2021. The group is among the larger players in the alternate assets space.

Furthermore, the life and general insurance businesses are gaining scale and are also expected to break even over the medium term.

Weakness:

Asset quality remains vulnerable

Overall stage III assets ratio rose to 4.9% (Rs 657 crore) as on December 31, 2021, from 4.5% (Rs 617 crore) as on September 30, 2021; yet remained below 7.7% reported as on March 31, 2021 (Rs 1,182 crore). This is largely attributed to the clarification on recognition and calculation) released by the RBI on November 12, 2021, as the group has also aligned the stage III assets with gross NPAs; without considering the impact; on a like-to-like basis, the stage III assets have reduced.

Stage III assets in the retail book increased to Rs 303 crore as on December 31, 2021 (4.30%) from Rs 243 crore (3.4%) as on September 30, 2021; however, remains below March 2021 levels of Rs 316 crore (Rs 3.9% as on March 31, 2021 and

1.2% a year earlier). The reported stage III assets ratio in the wholesale book improved to 5.5% (Rs 354 Crore) as on December 31, 2021 as against 5.7% (Rs 374 crore) and 12% (Rs 866 crore) as on September 30, 2021 and March 31, 2021 respectively.

Despite this, asset quality of the wholesale book remains vulnerable due to its exposure to the real estate segment and stressed mid-tier borrowers in structured credit. While the group is in the process of gradually running down the wholesale book, this still contributed about 48% of the total loan book as on December 31, 2021 (47% as on March 31, 2021). Also, the wholesale loan book remains concentrated with 10 largest loans constituting ~39% of the wholesale portfolio. Nevertheless, the group has reasonable collateral cover for its wholesale loans and has also built strong recovery capabilities.

Any sharp weakening of asset quality, specifically in the wholesale lending book, will impact profitability as well as capitalisation and remains a key rating monitorable.

Lower profitability than peers

Profitability has been lower than those of other large, financial sector groups. It was significantly impacted in fiscals 2021 and 2020, on account of higher credit cost.

The group reported net profit of Rs 254 crore in fiscal 2021, supported by one-off income as compared to loss of Rs 2,044 crore in fiscal 2020. Consequently, return on assets (annualised) and return on equity (annualised) improved to 0.5% and 3.0%, respectively, in fiscal 2021 (negative 3.4% and negative 23.7%, respectively, in fiscal 2020). The group reported net profit in the three consecutive quarters of fiscal 2022, with net profit (excluding minority shareholder's share in profit) of Rs 146 crore for the first nine months of fiscal 2022 (loss of Rs 363 crore during the corresponding period of the previous fiscal). Furthermore, with continued provisioning, the provision coverage ratio has improved to 52% for the nine months ended December 31, 2021, from 47% as on March 31, 2021.

Around 20% of the capital (equity plus borrowings) is employed in businesses or investments that are either low-yielding or loss-making at this point. The group has a large investment portfolio under its balance sheet management unit (BMU), which is used for managing liquidity. This largely comprises government securities, fixed deposits, liquid mutual fund units and corporate bonds, which have a low return on capital employed. Furthermore, the life and general insurance businesses remain loss-making, given their long gestation periods. Breakeven in the insurance businesses, will benefit overall profitability over the medium term.

As the group is diversified, each business vertical contributes to overall profitability. The non-credit business now contributes significantly to the total profit after tax (PAT) given the group's established position in these businesses. This should also support the overall earnings profile. Also, most of the businesses have been reporting profits from the last quarter of fiscal 2021 and gradual improvement in profitability is expected over the medium term.

Liquidity : Adequate

As a policy, the group maintains a liquidity cushion of 9-10% of the balance sheet. There was a liquidity cushion (including cash, liquid investments and treasury assets) of around Rs 1,900 crore and unutilised bank lines of around Rs 300 crore as on January 31, 2022. The group also has other liquid assets (investments and securities-based lending book), which can be accessed if necessary. These were Rs 3,050 crore. As on January 31, 2022, the overall liquidity was adequate to meet the debt obligation maturing over the next four months till May 31, 2022. The maturity profile of assets and liabilities continue to be well-matched.

Outlook Negative

The 'Negative' outlook factors in challenges faced by the Edelweiss group due to stressed assets in its credit business, especially in its wholesale lending book, and their impact on profitability.

Rating Sensitivity factors

Upward factors

- Significant improvement in the group's asset quality with stage III assets ratio less than 3% on sustained basis, coupled with reduction in level of stressed assets
- Demonstration of profitability across businesses

Downward factors

- Continued pressure on profitability, with sustained losses (negative PAT excluding one-off gains)
- Deterioration in asset quality of the Edelweiss group
- Funding access challenges with limited fundraising by the group
- Lack of progress on planned scale-down of wholesale portfolio

About the Company

EAAA was incorporated in 2008 and is an investment manager. The company manages alternate assets business of the Edelweiss group and provides non-binding advisory services to certain offshore funds under the group. EAAA is 91% held by Edelweiss Securities and Investments Pvt Ltd and its ultimate holding company is EFSL. As on December 30, 2021, the company's total AUM or assets under advice was Rs 30,200 crore and had total assets of Rs 195 crore.

EAAA reported PAT of Rs 15 crore on total income of Rs 144 crore for fiscal 2021, against profit of Rs 18 crore on total income of Rs 137 crore for fiscal 2020. During the nine months of fiscal 2022, the company reported net profit of Rs 29 crore on total income of Rs 146.7 crore.

About the Group

The Edelweiss group comprised 48 subsidiaries and associates as on March 31, 2021. The number of companies has come down from 74 as on March 31, 2016, and may come down further over the next few quarters (subject to requisite approvals). The group had 293 offices (including 10 international offices in 6 locations) in around 136 cities as on December 31, 2021. Furthermore, as part of streamlining its operating structure, the group has restructured the businesses into five verticals namely credit, insurance, asset management, asset reconstruction and wealth management.

The group is present across various financial services businesses, including loans to corporates and individuals, mortgage finance - loans against property and small-ticket housing loans, MSME finance, institutional and retail equity broking, corporate finance and advisory, wealth management, third-party financial products distribution, alternative and domestic asset management, and life and general insurance. In addition, the BMU focuses on liquidity and asset-liability management.

The group reported PAT of Rs 254 crore on total income of Rs 10,849 crore for fiscal 2021, against net loss of Rs 2,044 crore and total income of Rs 9,603 crore in fiscal 2020. During the nine months of fiscal 2022, the group reported net profit of Rs 167 crore on total income of Rs 5,389 crore, compared to net loss of Rs 382 crore and total income of Rs 6,367 crore during corresponding period in previous fiscal.

Key Financial Indicators : EFSL (consolidated)

As on/For period ended December 31		2021	2020
Total assets	Rs crore	44108	53438
Total income	Rs crore	5389	6367
PAT (before minority interest)	Rs crore	167	-382
PAT (after minority interest)	Rs crore	146	-363
Stage III assets	%	4.9	6.19
Gearing	Times	2.8	3.6
Return on assets	%	0.5	-0.9

Any other information: Not applicable

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity level	Rating assigned
NA	Long-term principal-protected market-linked debentures*	NA	NA	NA	300	Highly complex	CRISIL PPMLD AA-r/Negative

*Yet to be issued

Annexure – List of entities consolidated (as on December 31, 2021, as per IndAS)

Names of Entities Consolidated	Extent of Consolidation	Rationale for Consolidation
ECL Finance Ltd	Full	Subsidiary
Edelweiss Rural & Corporate Services Ltd	Full	Subsidiary
Edelweiss Asset Reconstruction Company Ltd	Full	Subsidiary
Edelweiss Housing Finance Ltd	Full	Subsidiary
Edelweiss Retail Finance Ltd	Full	Subsidiary
Edel Finance Company Ltd	Full	Subsidiary
Edelweiss Asset Management Ltd	Full	Subsidiary
EdelGive Foundation	Full	Subsidiary
Edelweiss Tokio Life Insurance Company Ltd	Full	Subsidiary
Edelweiss General Insurance Company Ltd	Full	Subsidiary

Allium Finance Private Ltd	Full	Subsidiary
Edelcap Securities Ltd	Full	Subsidiary
Edelweiss Securities and Investment Pvt Ltd	Full	Subsidiary
ECap Equities Ltd	Full	Subsidiary
Edel Investments Ltd	Full	Subsidiary
EC Commodity Ltd	Full	Subsidiary
Aster Commodities DMCC	Full	Subsidiary
EC International Ltd	Full	Subsidiary
Edel Land Ltd	Full	Subsidiary
Edelweiss Comtrade Ltd d	Full	Subsidiary
Edelweiss Multi Strategy Fund Advisors LLP	Full	Subsidiary
Edelweiss Gallagher Insurance Brokers Ltd	Full	Subsidiary
Edelweiss Private Equity Tech Fund	Full	Subsidiary
Edelweiss Value and Growth Fund	Full	Subsidiary
India Credit Investment Fund II	Full	Subsidiary
EAAA LLC	Full	Subsidiary
Edelweiss Alternative Asset Advisors Ltd	Full	Subsidiary
Edelweiss Alternative Asset Advisors Pte. Ltd	Full	Subsidiary
Edelweiss Investment Adviser Ltd	Full	Subsidiary
Edelweiss Resolution Advisors LLP	Full	Subsidiary
EW Special Opportunities Advisors LLC	Full	Subsidiary
Edelweiss Trusteeship Company Ltd	Full	Subsidiary
Edelweiss International (Singapore) Pte. Ltd	Full	Subsidiary
Edelweiss Capital Services Ltd	Full	Subsidiary
Edelweiss Real Assets Managers Limited	Full	Subsidiary
Sekura India Management Limited	Full	Subsidiary
Edelweiss Securities Limited	Proportionate	Associate
Edelweiss Finance & Investments Limited	Proportionate	Associate
Edelweiss Broking Limited	Proportionate	Associate
Edelweiss Custodial Services Limited	Proportionate	Associate

Edelweiss Financial Services Inc	Proportionate	Associate
Edelweiss Investment Advisors Private Limited	Proportionate	Associate
Edelweiss Securities (Hong Kong) Private Limited	Proportionate	Associate
Edelweiss Financial Services (UK) Limited	Proportionate	Associate
Edelweiss Securities (IFSC) Limited	Proportionate	Associate
ESL Securities Limited	Proportionate	Associate

Annexure - Rating History for last 3 Years

	Current			2022 (History)		2021		2020		2019		Start of 2019
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Long Term Principal Protected Market Linked Debentures	LT	300.0	CRISIL PPMLD AA- r /Negative	31-01-22	CRISIL PPMLD AA- r /Negative		--		--		--	--

All amounts are in Rs.Cr.

Criteria Details

Links to related criteria
Rating Criteria for Finance Companies
CRISILs Criteria for rating short term debt
Criteria for Notching up Stand Alone Ratings of Companies based on Group Support
CRISILs Criteria for Consolidation

Media Relations	Analytical Contacts	Customer Service Helpdesk
Pankaj Rawat Media Relations CRISIL Limited B: +91 22 3342 3000 pankaj.rawat@crsil.com	Krishnan Sitaraman Senior Director and Deputy Chief Ratings Officer CRISIL Ratings Limited D:+91 22 3342 8070 krishnan.sitaraman@crsil.com	Timings: 10.00 am to 7.00 pm Toll free Number:1800 267 1301 For a copy of Rationales / Rating Reports: CRISILratingdesk@crsil.com
Naireen Ahmed Media Relations CRISIL Limited D: +91 22 3342 1818 B: +91 22 3342 3000 naireen.ahmed@crsil.com	Subhasri Narayanan Director CRISIL Ratings Limited D:+91 22 3342 3403 subhasri.narayanan@crsil.com	For Analytical queries: ratingsinvestordesk@crsil.com
	Leena Gupta Senior Rating Analyst CRISIL Ratings Limited B:+91 22 3342 3000 Leena.Gupta@crsil.com	

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