

SREI Infrastructure Finance (SREI IN)

Steady Improvements

1Q in line; maintain BUY with higher TP

1QFY18 PAT of INR763m forms 22% of our FY18E, in line. Strong 48% YoY growth was led by healthy commercial-equipment (CE) disbursements, NIM expansion and stable asset quality. As expected, project finance remained a drag, with disbursements down 56% YoY. Overall AUM grew 11% YoY. We expect further CE momentum from a recent pick-up in India's infrastructure spending. Maintain BUY with a higher TP of INR150, now based on 1.5x FY19E P/BV, from 1.3x. This represents a 30% premium to its 10-year average on the back of its improving loan growth.

Equipment business picking up

CE disbursements grew 44% YoY, although this did not translate into strong AUM growth owing to higher repayments. CE AUM grew 10% to INR227b to form 63% of SREI's AUM mix. NIM expanded 70bps QoQ to 5.7%, from improved lending yields. Management hopes that by focusing on CE, loans will grow by double digits this year. Our forecasts are 10-12% YoY loan growth for FY18-19E.

Asset quality improved

Gross NPLs for CE dropped to 2.3% from 2.4% the last quarter. In project financing, they dropped to 1.8% from 3.2%. This was aided by a recovery of one large account of INR1.4b. Provisions were high because of a change in regulatory norms for standard-asset provisions to 40bps from 35bps of loans and new NPL-recognition norms of 90 days past due from 120 days.

Value-unlocking at subsidiaries

We forecast an ROE of 8.8% for FY19E, up from 6.1% in FY17, on the back of lower credit costs and higher loan growth. With improved loan growth and asset quality, we see room for a re-rating. Potential value-unlocking of strategic investments such as road projects and the social rural network (Sahaj) can provide further catalysts, in our view.

FYE Mar (INR m)	FY16A	FY17A	FY18E	FY19E	FY20E
Operating income	9,512	20,534	18,169	20,662	23,756
Pre-provision profit	3,784	11,322	8,368	9,985	12,121
Core net profit	730	2,433	3,531	4,513	5,760
Core EPS (INR)	1	5	7	9	11
Core EPS growth (%)	(49.1)	293.0	39.3	29.6	30.1
Net DPS (INR)	1	1	1	1	1
Core P/E (x)	111.5	28.4	20.4	15.7	12.1
P/BV (x)	2.1	1.5	1.4	1.3	1.2
Net dividend yield (%)	0.4	0.4	0.5	0.7	0.7
Book value (INR)	66	92	98	106	116
ROAE (%)	2.2	6.1	7.4	8.8	10.3
ROAA (%)	0.3	0.8	1.0	1.2	1.3
Consensus net profit	-	-	3,068	3,769	5,171
MKE vs. Consensus (%)	-	-	15.1	19.7	11.4

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BUY

Share Price	INR 137
12m Price Target	INR 150 (+10%)
Previous Price Target	INR 135

Company Description

SREI Infrastructure Finance is a non-banking finance company, which is engaged in equipment financing and project financing.

Statistics

52w high/low (INR)	137/68
3m avg turnover (USDm)	4.8
Free float (%)	26.2
Issued shares (m)	503
Market capitalisation	INR68.8B
	USD1.1B

Major shareholders:

Adisri Investment Ltd (Promoters)	60.8%
Fidelity Investment Trust	8.3%
SBI Magnum Taxgain	2.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	16	59	92
Relative to index (%)	13	46	66

Source: FactSet

Healthy CE offset weak project finance

1QFY18 AUM grew 11% YoY. Consolidated PAT grew 48% YoY to INR763m. Net interest income was up 119% YoY and 46% QoQ. CE disbursements were up 44% YoY while project-finance disbursements were down 56% YoY due to a lack of demand from power sector.

1QFY18 results

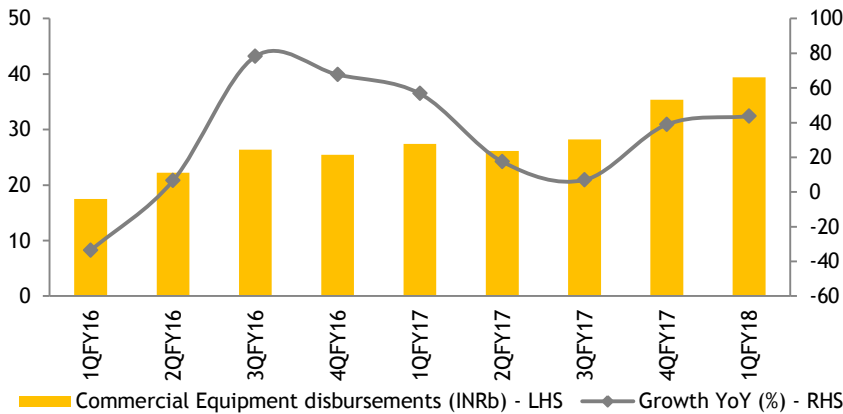
Consolidate Income Statement (INRm)	1Q17	4Q17	1Q18	YoY (%)	QoQ (%)
Net Interest Income	1,430	2,150	3,140	119.6%	46.0%
Fee Income	60	130	140	133.3%	7.7%
Other income	3,940	2,390	520	-86.8%	-78.2%
Non-Interest income	4,000	2,520	660	-83.5%	-73.8%
Total Income	5,430	4,670	3,800	-30.0%	-18.6%
Employee Cost	358	556	528	47.6%	-5.2%
Other Operating Expenses	728	664	1,122	54.2%	69.1%
Total Operating Expenses	1,086	1,220	1,650	52.0%	35.2%
Operating Profit	4,345	3,450	2,150	-50.5%	-37.7%
Total Provisions	3,629	2,450	970	-73.3%	-60.4%
PBT	716	991	1,168	63.2%	17.9%
Tax	207	358	357	72.4%	-0.2%
PAT (after associate share & minorities)	516	630	763	47.9%	21.2%
Balance Sheet (INRm)					
Borrowings	253,120	262,040	276,280	9.1%	5.4%
Consolidated AUM	354,780	376,830	392,960	10.8%	4.3%
Disbursements					
Commercial equipment	27,410	35,380	39,390	43.7%	11.3%
Project Finance	10,510	19,640	4,670	-55.6%	-76.2%
Total disbursements	37,920	55,020	44,060	16.2%	-19.9%
Key Ratios					
Asset quality - Equipment Finance					
Gross NPL (%)	2.7%	2.4%	2.3%	-0.4%	-0.1%
Net NPL (%)	1.9%	1.7%	1.6%	-0.3%	-0.1%
Asset quality - Project Finance					
Gross NPL (%)	3.0%	3.2%	1.8%	-1.2%	-1.4%
Net NPL (%)	2.0%	2.0%	1.1%	-0.9%	-0.9%
Profitability					
NIM - Equipment Finance	4.7%	5.0%	5.7%	1.0%	0.7%
Gross Spread - Project Finance	1.5%	1.6%	1.7%	0.2%	0.1%
Tax-rate	28.9%	36.1%	30.5%	1.6%	-5.5%
Capital Adequacy - Standalone					
CAR (%)	19.2%	18.9%	18.9%	-0.3%	0.0%

Source: Company

CE continued to benefit from higher spending on roads, ports and irrigation projects. SREI expanded its market share to 35% from 33%, at the expense of the smaller players. This was helped by its Wider distribution reach amongst small transport operators. We forecast CE disbursement growth of 35-40% YoY for FY18-20E.

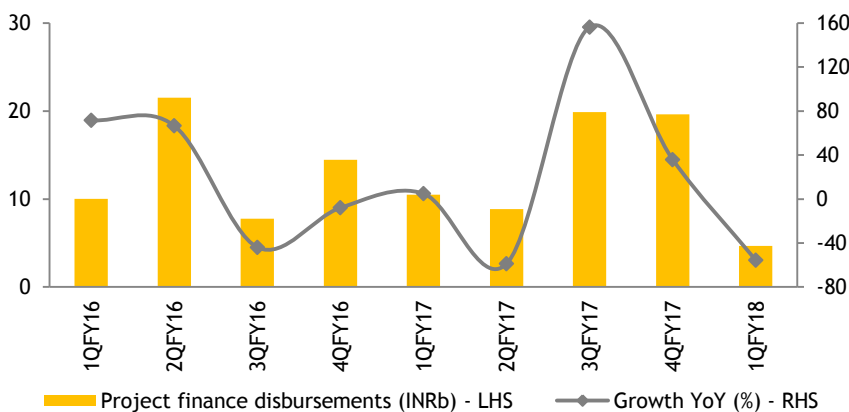
Management has been cautious on project financing due to bad NPL experiences in the past. As expected, this business remained a drag on AUM, with disbursements down 56% YoY.

CE disbursements grew a sparkling 44% YoY...



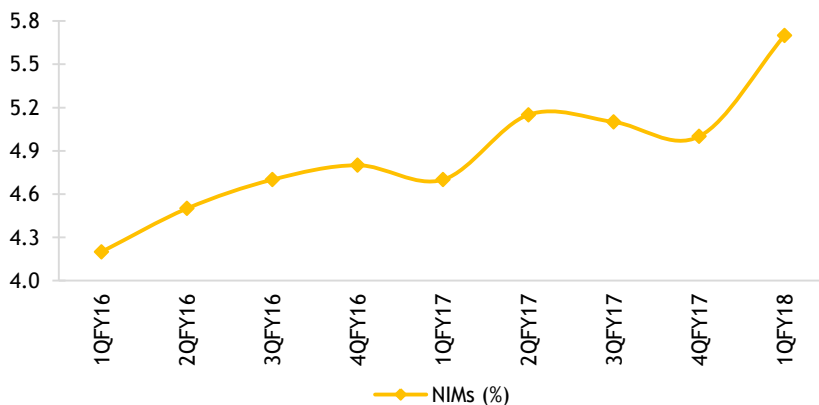
Source: Company

...making up for a 56% YoY slide in project-finance disbursements



Source: Company

CE NIM also improved 70bps QoQ to 5.7%

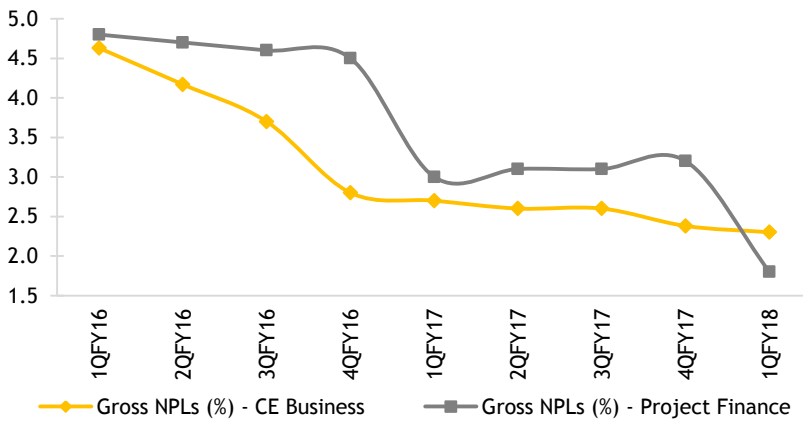


Source: Company

Asset quality improved

Gross CE NPLs were down to 2.3% from 2.4% the last quarter. Project finance’s dropped to 1.8% from 3.2%. We estimate 1.2% credit costs for FY18E, down from 2.6% in FY17. Management expects further 50-100bp reductions in the coming two quarters, considering possible improvements in companies’ credit ratings by rating agencies.

Asset quality improved as NPLs fell

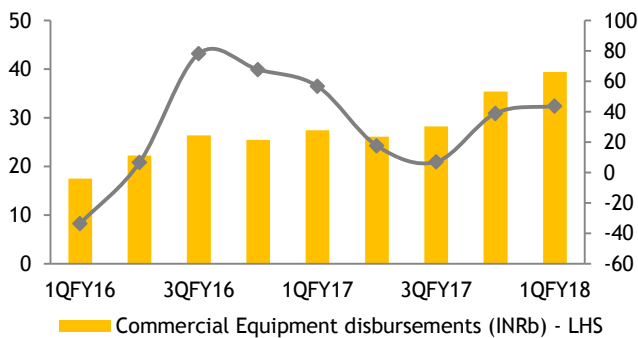


Source: Company

Value Proposition

- India's leading financier to the infrastructure sector. In commercial equipment lending the company has largest market share at 35%.
- CE business is the key driver for loan growth as CE demand picking up; asset quality is improving
- Value unlocking potential in road projects (7 projects worth INR9.1b), social rural infrastructure (Sahaj), and industrial parks.
- Beneficiary of a pickup in government awarding new projects in the infrastructure space.
- Focus on diversification of lending book to new areas, such as health care equipment, technology infrastructure, and used vehicles to de-risk the business

CE disbursement was healthy

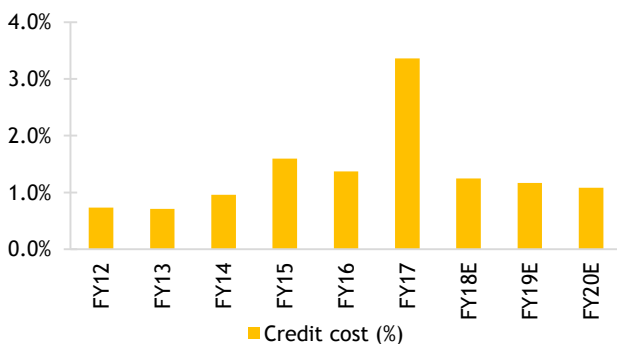


Source: Company

Financial Metrics

- Credit cost to drop from 2.6% in FY17 to 1.2% in FY18 on lower NPL accretion. Improvement in economic growth to aid asset quality recovery.
- Loan growth to pick up from 6% to 10% YoY in FY18E. CE will be the key driver for growth.
- Fee income witnessing strong momentum as demand for equipment on rental improves.
- We forecast ROE improvement from 2.2% in FY16 to 8.8% in FY19E on lower credit cost, higher loan growth and better fee income growth.

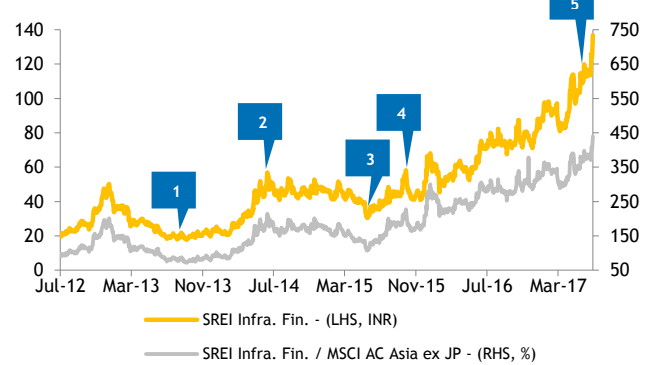
Fall in credit cost due to improving asset quality



Source: Company, Maybank KE

Price Drivers

Historical share price trend



Source: Company, Maybank Kim Eng, Factset

- Slowdown in infrastructure lending and increase in NPLs weighed on the stock price.
- New government's plan to increase infrastructure spending led to optimising of infrastructure financiers.
- Delay in monetisation of telecom tower business (VIOM) pushed the stock price down.
- Announcement of transaction to acquire 50% of JV with BNP Paribas. BV and EPS accretive deal led to rally in the stock price.
- Pick up in commercial equipment sales volume leading to improving outlook on loan growth.

Swing Factors

Upside

- Strong recovery in infrastructure lending can push the loan growth higher than expected.
- Stake sale in road projects investments at higher than expected valuations.
- Better than expected NPLs in FY18-19E.

Downside

- Delay in pick up infrastructure lending could hamper the loan growth revival.
- Delay in monetisation on investments in road and rural network projects.

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
Core P/E (x)	111.5	28.4	20.4	15.7	12.1
Core FD P/E (x)	nm	28.4	20.4	15.7	12.1
P/BV (x)	2.1	1.5	1.4	1.3	1.2
P/NTA (x)	2.1	1.5	1.4	1.3	1.2
Net dividend yield (%)	0.4	0.4	0.5	0.7	0.7
INCOME STATEMENT (INR m)					
Interest income	31,475.7	39,280.0	45,417.5	50,198.0	56,230.0
Interest expense	(23,107.5)	(26,279.7)	(30,525.8)	(33,836.0)	(37,970.7)
Net interest income	8,368.2	13,000.3	14,891.7	16,362.0	18,259.3
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	502.5	332.3	448.6	583.2	729.0
Other income	641.2	7,201.5	2,828.2	3,717.0	4,767.2
Total non-interest income	1,143.7	7,533.8	3,276.8	4,300.2	5,496.2
Operating income	9,511.9	20,534.1	18,168.5	20,662.2	23,755.5
Staff costs	(1,448.6)	(2,015.6)	(2,146.6)	(2,326.9)	(2,522.4)
Other operating expenses	(4,279.1)	(7,196.8)	(7,654.0)	(8,350.3)	(9,112.1)
Operating expenses	(5,727.7)	(9,212.4)	(9,800.6)	(10,677.3)	(11,634.4)
Pre-provision profit	3,784.2	11,321.7	8,367.9	9,985.0	12,121.1
Loan impairment allowances	(2,712.5)	(7,720.7)	(3,351.8)	(3,483.5)	(3,665.4)
Other allowances	(12.3)	0.0	0.0	0.0	0.0
Associates & JV income	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Pretax profit	1,061.3	3,600.5	5,015.6	6,501.0	8,455.2
Income tax	(444.1)	(1,173.3)	(1,634.4)	(2,118.4)	(2,755.1)
Minorities	112.4	5.5	150.0	130.0	60.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	729.6	2,432.7	3,531.2	4,512.6	5,760.1
Core net profit	729.6	2,432.7	3,531.2	4,512.6	5,760.1
BALANCE SHEET (INR m)					
Cash & deposits with banks	6,641.5	9,320.0	10,252.0	11,482.2	13,089.8
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	0.0	0.0	0.0	0.0	0.0
Dealing securities	0.0	0.0	0.0	0.0	0.0
Available-for-sale securities	0.0	0.0	0.0	0.0	0.0
Investment securities	0.0	0.0	0.0	0.0	0.0
Loans & advances	203,244.8	256,320.0	281,952.0	315,786.2	359,996.3
Central bank deposits	0.0	0.0	0.0	0.0	0.0
Investment in associates/ JVs	21,698.2	12,819.0	11,986.3	12,635.1	13,504.1
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	14,319.7	30,087.7	31,431.5	34,538.4	38,148.6
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other assets	6,394.8	22,532.3	20,027.9	27,739.4	32,800.9
Total assets	252,299.0	331,079.0	355,649.6	402,181.4	457,539.6
Deposits from customers	0.0	0.0	0.0	0.0	0.0
Deposits from banks & FIs	0.0	0.0	0.0	0.0	0.0
Derivatives financial instruments	0.0	0.0	0.0	0.0	0.0
Subordinated debt	17,239.4	24,485.4	26,293.7	28,885.5	31,736.6
Other securities in issue	0.0	0.0	0.0	0.0	0.0
Other borrowings	189,487.4	237,556.2	266,062.9	304,642.1	350,338.4
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	12,387.5	22,683.7	13,820.3	15,198.4	16,837.9
Total liabilities	219,114.3	284,725.3	306,176.9	348,726.0	398,912.9
Share capital	5,032.4	5,032.4	5,032.4	5,032.4	5,032.4
Reserves	28,140.3	41,315.4	44,434.4	48,417.1	53,588.4
Shareholders' funds	33,172.7	46,347.8	49,466.8	53,449.5	58,620.8
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	12.0	5.9	5.9	5.9	5.9
Total equity	33,184.7	46,353.7	49,472.7	53,455.4	58,626.7
Total liabilities & equity	252,299.0	331,079.0	355,649.6	402,181.4	457,539.6

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth (%)					
Net interest income	12.3	55.4	14.5	9.9	11.6
Non-interest income	(66.4)	558.7	(56.5)	31.2	27.8
Operating expenses	(3.3)	60.8	6.4	8.9	9.0
Pre-provision profit	(23.4)	199.2	(26.1)	19.3	21.4
Core net profit	(43.5)	233.4	45.2	27.8	27.6
Gross loans	5.1	24.8	9.9	11.8	13.8
Customer deposits	na	na	na	na	na
Total assets	2.6	31.2	7.4	13.1	13.8
Profitability (%)					
Non-int. income/Total income	12.0	36.7	18.0	20.8	23.1
Average lending yields	14.53	16.09	16.30	16.28	16.15
Average financing yields	14.53	16.09	16.30	16.28	16.15
Average cost of funds	11.27	11.21	11.01	10.81	10.61
Net interest margin	3.86	5.33	5.34	5.31	5.25
Net income margin	3.25	4.88	5.28	5.47	5.54
Cost/income	60.2	44.9	53.9	51.7	49.0
Liquidity (%)					
Loans/customer deposits	nm	nm	nm	nm	nm
Asset quality (%)					
Net NPL	3.1	2.0	1.8	1.6	1.3
Gross NPL	4.0	2.9	2.9	2.7	2.5
Gross NPF	4.0	2.9	2.9	2.7	2.5
(SP+GP)/average gross loans	1.4	3.4	1.2	1.2	1.1
(SP+GP)/average gross financing	1.4	3.4	1.2	1.2	1.1
Loan loss coverage	23.1	33.4	38.4	43.4	48.4
Capital adequacy (%)					
CET1	12.5	13.8	12.1	11.6	11.1
Tier 1 capital	12.5	13.8	12.1	11.6	11.1
Risk-weighted capital	17.5	18.9	18.5	17.8	17.2
Returns (%)					
ROAE	2.2	6.1	7.4	8.8	10.3
ROAA	0.3	0.8	1.0	1.2	1.3
Shareholders equity/assets	13.1	14.0	13.9	13.3	12.8

Source: Company; Maybank

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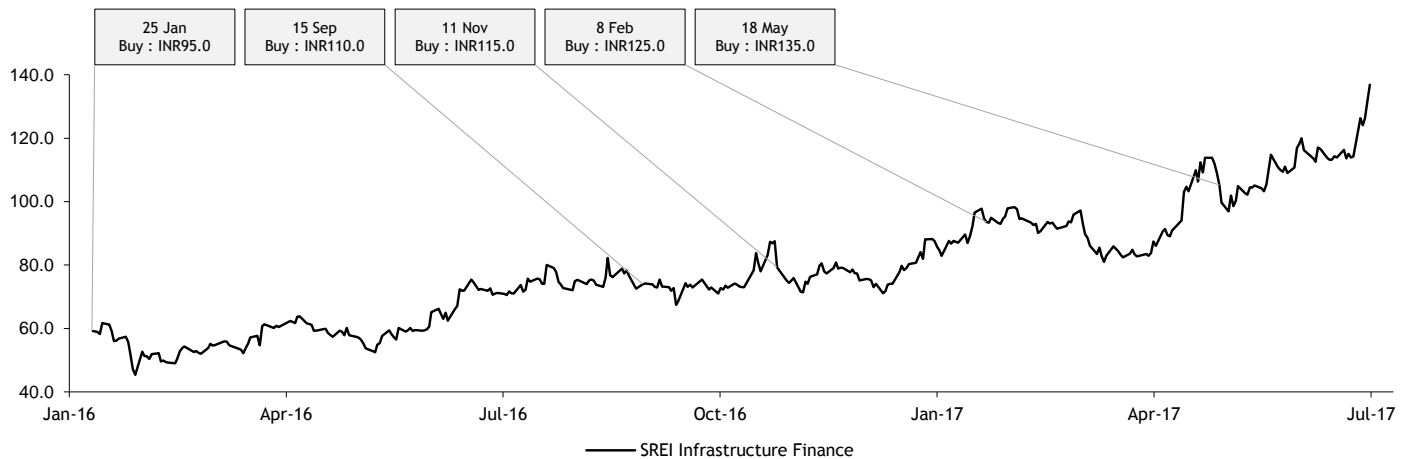
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