

# SREI Infrastructure Finance (SREI IN)

## Proposed deal will boost BV by 35%

### BV accretive deal with BNP Paribas LG

Maintain BUY with TP increased 46% to INR95. TP revision driven by announcement of deal with BNP Paribas Lease Group (BPLG), which will result in a 35% increase in FY17F BV. The deal will result in BPLG holding a 5% stake in SREI (parent) in lieu of its 50% stake in equipment finance JV (SEFL). SREI will benefit on account of 100% consolidation of SEFL, while BPLG will benefit by becoming a shareholder of the parent.

### Deal will lead to SEFL becoming 100% sub

The proposed deal will result in SREI Equipment Finance Ltd. (SEFL) becoming a 100% subsidiary of the parent. Treasury shares (5% of total equity) will be issued to BPLG resulting in no equity dilution. The deal is structured in such a fashion that it is cash neutral. The consideration to be paid to BPLG for its 50% stake in SEFL will match the consideration to be received from them for the 5% stake in SREI.

### BV for FY17F will increase by 35%

Incorporating the proposed transaction into our forecast results in a 35% increase in FY17F BV to INR96 and a 34% increase in EPS to INR6.3. We view the deal as positive for SREI as it will allow greater flexibility in management of the equipment finance business. In our view, BPLG will vacate the two seats on the board of SEFL post the deal.

### Stock still cheap; Value unlocking potential remains

Since our initiation in Jan 2015, SREI's stock price is up 43%. However, we believe its re-rating can continue because of further potential to unlock value from its strategic investments, such as road, social rural network (Sahaj) and industrial parks over time. It has already demonstrated this ability by concluding the sale of its stake in VIOM and the recent BPLG transaction. A revival in infrastructure lending and economic growth will aid loan growth, enable asset monetization, and reduce asset quality stress. Maintain BUY with revised TP of INR95 based on 1.1x FY17F adjusted BV, in-line with peers reporting 8-10% ROE.

FYE Mar (INR m)	FY14A	FY15A	FY16E	FY17E	FY18E
Operating income	9,100	10,862	11,690	17,797	20,235
Pre-provision profit	3,932	4,938	5,259	9,592	11,015
Core net profit	1,385	1,291	1,351	3,239	3,844
Core EPS (INR)	3	2	3	6	7
Core EPS growth (%)	(47.1)	(11.7)	5.0	148.1	19.1
Net DPS (INR)	1	1	1	1	1
Core P/E (x)	23.9	27.0	25.8	10.4	8.7
P/BV (x)	1.1	1.0	1.0	0.7	0.6
Net dividend yield (%)	0.8	0.8	1.2	1.5	1.8
Book value (INR)	62	65	68	96	102
ROAE (%)	4.5	4.0	4.0	7.9	7.7
ROAA (%)	0.6	0.5	0.5	1.0	0.9
Consensus net profit	-	-	1,751	2,410	3,274
MKE vs. Consensus (%)	-	-	(22.8)	34.4	17.4

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# BUY

Share Price	INR 65
12m Price Target	INR 95 (+46%)
Previous Price Target	INR 65

### Company description

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

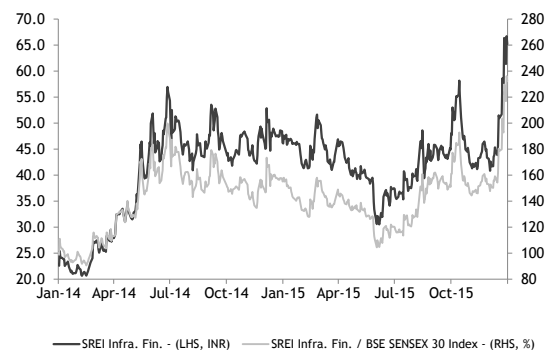
### Statistics

52w high/low (INR)	67/31
3m avg turnover (USDm)	2.8
Free float (%)	26.2
Issued shares (m)	503
Market capitalisation	INR33.6B USD504M

### Major shareholders:

Adisri Commercial Pvt Ltd	58.3%
SREI Growth Trust	9.7%
Fidelity Investment Trust	9.4%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	50	45	41
Relative to index (%)	52	54	50

Source: FactSet

## Change in forecast

Old vs. New Forecast	FY17E, Old	FY17E, New	Change	FY18E, Old	FY18E, New	Change
<b><u>Income Statement (INRmn)</u></b>						
Net Interest Income	9,661	12,040	24.6%	11,025	15,226	38.1%
Non-Interest Income	4,443	5,757	29.6%	5,167	5,009	-3.1%
<b>Total Income</b>	<b>14,105</b>	<b>17,797</b>	<b>26.2%</b>	<b>16,192</b>	<b>20,235</b>	<b>25.0%</b>
Operating Expenses	7,185	8,205	14.2%	8,044	9,220	14.6%
Pre-provisioning Profits	6,920	9,592	38.6%	8,148	11,015	35.2%
<b>Reported Profits</b>	<b>2,410</b>	<b>3,239</b>	<b>34.4%</b>	<b>3,274</b>	<b>3,844</b>	<b>17.4%</b>
<b><u>Balance Sheet (INRbn)</u></b>						
Borrowings	226	327	45.0%	257	378	47.0%
Loans	237	342	44.6%	258	387	50.0%
Total Assets	277	395	42.6%	312	451	44.9%
<b><u>Key Ratios (%)</u></b>						
NIM (%)	4.20%	4.30%	0.1%	4.30%	4.09%	-0.2%
ROA (%)	0.91%	1.00%	0.1%	1.10%	0.91%	-0.2%
ROE (%)	6.9%	7.9%	1.0%	8.8%	7.7%	-1.1%
EPS (INR.)	4.7	6.3	34.4%	6.4	7.5	17.8%
BV (INR.)	71.0	95.7	34.8%	76.3	102.4	34.2%
Adj. BV (INR)	63.0	83.1	31.9%	67.0	88.9	32.7%
Net NPA (%)	3.00%	2.80%	-0.2%	2.62%	2.64%	0.0%

Source: Company, Maybank Kim Eng

## Impact on FY17 & FY18 financials

- We have incorporated the impact of the proposed transaction into our FY17-18 forecast. Our BV for FY17F has increased by 35% to INR96. Adjusted for NPLs, the BV increases by 32% to INR83.
- EPS will improve by 34% for FY17 to INR6.3 on account of the 100% consolidation of SEFL.
- The balance sheet size of the entity will be INR395b, up 43% vs. pre-deal.
- We forecast an ROE of 8% for FY17F, up from 4% in FY15.

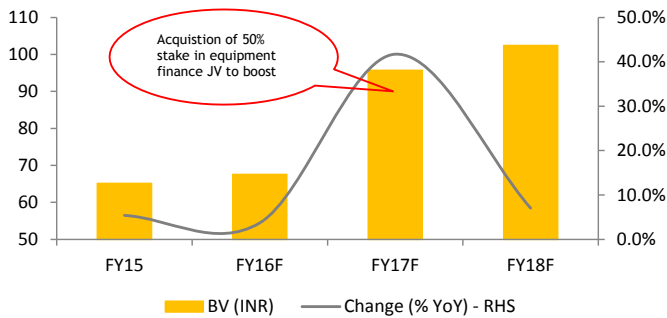
## Contours of the proposed deal

- The transaction will be cash neutral as the consideration paid by BPLG for the acquisition of a 5% stake in SREI will match the consideration that SREI will pay to acquire a 50% stake in SEFL.
- Post the transaction, BPLG will become a minority shareholder with a 5% stake in SREI.
- Treasury shares currently comprise 9.66% of the equity of SREI (48.6 million). An equity share of 5% (25.15 million) will be issued to BPLG out of it, decreasing the treasury shares to 4.66%.
- SEFL will become a 100% subsidiary, which will result in the 100% consolidation of its financials (incremental earnings of INR829m).
- The acquisition price of the shares will be based on SEBI rules (i.e. the higher of: (a) the average of the weekly high and low of the volume weighted average price during the 26 weeks preceding the closing date of the acquisition; and (b) the average of the weekly high and low of the volume weighted average price of the equity shares during the 2 weeks preceding the closing date of the acquisition).

## Company Proposition

- India's leading financier to the infrastructure sector. Beneficiary of a pickup in government awarding new projects in the infrastructure space.
- Proposed transaction with BNP Paribas will result in a 35% increase in net worth and a 34% increase in FY17F EPS.
- Successful completion of the sale of its telecom tower business (VIOM) to result in substantial interest savings.
- Value unlocking potential in road projects (8 projects worth INR5b), social rural infrastructure (Sahaj), and industrial parks.
- Focus on diversification of lending book to new areas, such as health care equipment, technology infrastructure, and used vehicles to de-risk the business.

### Acquisition of stake in JV to lift BV by 35%

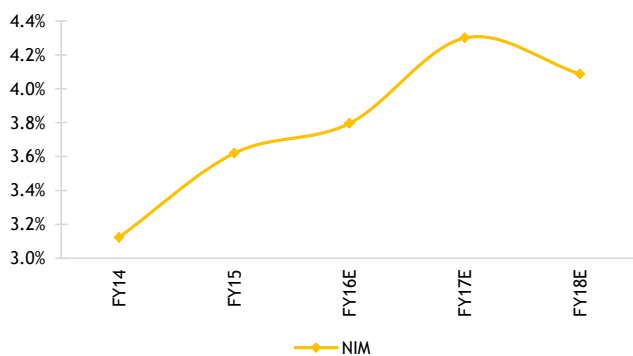


Source: Company, Maybank Kim Eng

## Financial Metrics

- NIM to improve by 50bps to 4.3% in FY17F, because the amount realised by stake sale in VIOM (INR18b) will be used to retire debt.
- Credit cost to drop from 1.8% in FY17 to 1.5% on lower NPL accretion. Improvement in economic growth to aid asset quality recovery.
- We forecast ROE improvement from 4% in FY15 to 8% in FY17F on NIM improvement and lower credit cost.

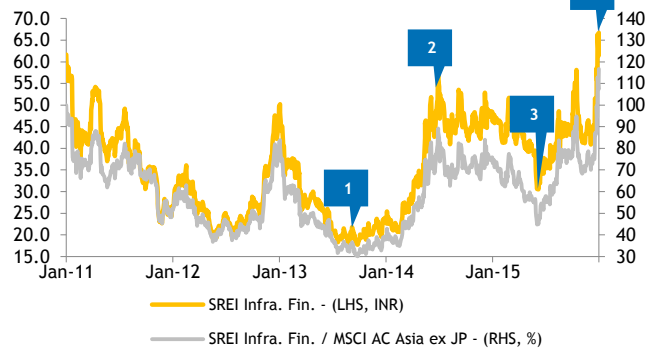
### NIM to inch up on repayment of debt



Source: Company

## Price Drivers

### Chart Header



Source: Company, Maybank Kim Eng

- 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.

## 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 FY17-18F.

### Downside

- Failure to complete the proposed transaction with BNP Paribas could be negative.
- Delay in realisation of amount from sale of stake in VIOM could impact NIM recovery.
- Delay in pick up infrastructure lending could hamper the loan growth revival.

FYE 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
<b>Key Metrics</b>					
Core P/E (x)	23.9	27.0	25.8	10.4	8.7
Core FD P/E (x)	23.9	27.0	25.8	10.4	8.7
P/BV (x)	1.1	1.0	1.0	0.7	0.6
P/NTA (x)	1.1	1.0	1.0	0.7	0.6
Net dividend yield (%)	0.8	0.8	1.2	1.5	1.8

**INCOME STATEMENT (INR m)**

Interest income	29,596.2	30,190.2	31,335.1	41,266.3	52,569.1
Interest expense	(23,502.8)	(22,741.5)	(23,318.2)	(29,226.2)	(37,342.6)
<b>Net interest income</b>	<b>6,093.4</b>	<b>7,448.7</b>	<b>8,016.9</b>	<b>12,040.1</b>	<b>15,226.5</b>
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	1,425.8	1,620.0	1,701.0	2,230.0	2,497.6
Other income	1,581.0	1,793.0	1,972.3	3,527.0	2,510.9
<b>Total non-interest income</b>	<b>3,006.8</b>	<b>3,413.0</b>	<b>3,673.3</b>	<b>5,757.0</b>	<b>5,008.6</b>
<b>Operating income</b>	<b>9,100.2</b>	<b>10,861.7</b>	<b>11,690.2</b>	<b>17,797.1</b>	<b>20,235.0</b>
Staff costs	(1,294.4)	(1,442.9)	(1,705.3)	(2,318.5)	(2,608.3)
Other operating expenses	(3,874.0)	(4,481.2)	(4,725.9)	(5,886.6)	(6,611.5)
<b>Operating expenses</b>	<b>(5,168.4)</b>	<b>(5,924.1)</b>	<b>(6,431.1)</b>	<b>(8,205.1)</b>	<b>(9,219.9)</b>
<b>Pre-provision profit</b>	<b>3,931.8</b>	<b>4,937.6</b>	<b>5,259.1</b>	<b>9,592.0</b>	<b>11,015.2</b>
Loan impairment allowances	(1,637.1)	(2,706.2)	(3,133.6)	(4,828.0)	(5,341.8)
Other allowances	(39.1)	(349.4)	(209.4)	(9.4)	(9.4)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>2,256.2</b>	<b>1,884.4</b>	<b>1,916.1</b>	<b>4,754.6</b>	<b>5,663.9</b>
Income tax	(881.1)	(670.4)	(641.9)	(1,592.8)	(1,897.4)
Minorities	10.0	77.1	77.1	77.1	77.1
Discontinued operations	0.0	0.0	0.0	0.0	0.0
<b>Reported net profit</b>	<b>1,385.1</b>	<b>1,291.1</b>	<b>1,351.3</b>	<b>3,238.9</b>	<b>3,843.6</b>
<b>Core net profit</b>	<b>1,385.1</b>	<b>1,291.1</b>	<b>1,351.3</b>	<b>3,238.9</b>	<b>3,843.6</b>

**BALANCE SHEET (INR m)**

Cash & deposits with banks	5,637.2	5,747.6	14,384.9	8,896.1	9,279.3
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	179,789.0	192,054.4	205,498.2	342,158.0	386,638.5
Central bank deposits	0.0	0.0	0.0	0.0	0.0
Investment in associates/JVs	24,196.4	22,499.4	8,219.9	9,409.3	11,599.2
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	17,146.3	15,513.4	17,992.3	27,558.9	31,302.7
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other assets	12,404.7	6,542.5	8,430.0	4,611.3	10,351.8
<b>Total assets</b>	<b>239,173.6</b>	<b>242,357.3</b>	<b>254,525.4</b>	<b>392,633.6</b>	<b>449,171.5</b>
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	15,486.4	15,691.4	16,466.6	27,094.5	30,323.3
Other securities in issue	0.0	0.0	0.0	0.0	0.0
Other borrowings	182,186.6	187,566.2	193,193.2	299,784.8	347,750.3
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	10,110.0	6,205.2	10,753.7	17,465.3	19,422.4
<b>Total liabilities</b>	<b>207,783.0</b>	<b>209,462.8</b>	<b>220,413.4</b>	<b>344,344.6</b>	<b>397,496.1</b>
Share capital	5,032.4	5,032.4	5,032.4	5,032.4	5,032.4
Reserves	26,061.4	27,736.5	28,953.9	43,131.0	46,517.3
Shareholders' funds	31,093.8	32,768.9	33,986.3	48,163.4	51,549.7
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	296.8	125.6	125.6	125.6	125.6
Total equity	31,390.6	32,894.5	34,111.9	48,289.0	51,675.3
<b>Total liabilities &amp; equity</b>	<b>239,173.6</b>	<b>242,357.3</b>	<b>254,525.4</b>	<b>392,633.6</b>	<b>449,171.5</b>

FYE 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
<b>Key Ratios</b>					
<b>Growth (%)</b>					
Net interest income	16.1	22.2	7.6	50.2	26.5
Non-interest income	(33.1)	13.5	7.6	56.7	(13.0)
Operating expenses	(14.2)	14.6	8.6	27.6	12.4
Pre-provision profit	5.8	25.6	6.5	82.4	14.8
Core net profit	(47.6)	(6.8)	4.7	139.7	18.7
Gross loans	6.7	8.4	7.1	64.8	13.0
Customer deposits	na	na	na	na	na
Total assets	7.4	1.3	5.0	54.3	14.4
<b>Profitability (%)</b>					
Non-int. income/Total income	33.0	31.4	31.4	32.3	24.8
Average lending yields	15.17	14.67	14.84	14.74	14.11
Average financing yields	15.17	14.67	14.84	14.74	14.11
Average cost of funds	12.35	11.34	11.29	10.89	10.59
Net interest margin	3.12	3.62	3.80	4.30	4.09
Net income margin	2.81	3.33	3.54	3.84	3.52
Cost/income	56.8	54.5	55.0	46.1	45.6
<b>Liquidity (%)</b>					
Loans/customer deposits	nm	nm	nm	nm	nm
<b>Asset quality (%)</b>					
Net NPL	2.8	3.6	3.6	2.8	2.6
Gross NPL	3.3	4.8	4.9	3.8	3.8
Gross NPF	3.3	4.8	4.9	3.8	3.8
(SP+GP)/average gross loans	1.0	1.5	1.6	1.8	1.5
(SP+GP)/average gross financing	1.0	1.5	1.6	1.8	1.5
Loan loss coverage	15.4	25.0	28.0	28.0	32.0
<b>Capital adequacy (%)</b>					
CET1	10.7	11.3	11.6	10.7	10.0
Tier 1 capital	10.7	11.3	11.6	10.7	10.0
Risk-weighted capital	17.8	16.7	17.2	16.7	15.9
<b>Returns (%)</b>					
ROAE	4.5	4.0	4.0	7.9	7.7
ROAA	0.6	0.5	0.5	1.0	0.9
Shareholders equity/assets	13.0	13.5	13.4	12.3	11.5

Source: Company; Maybank

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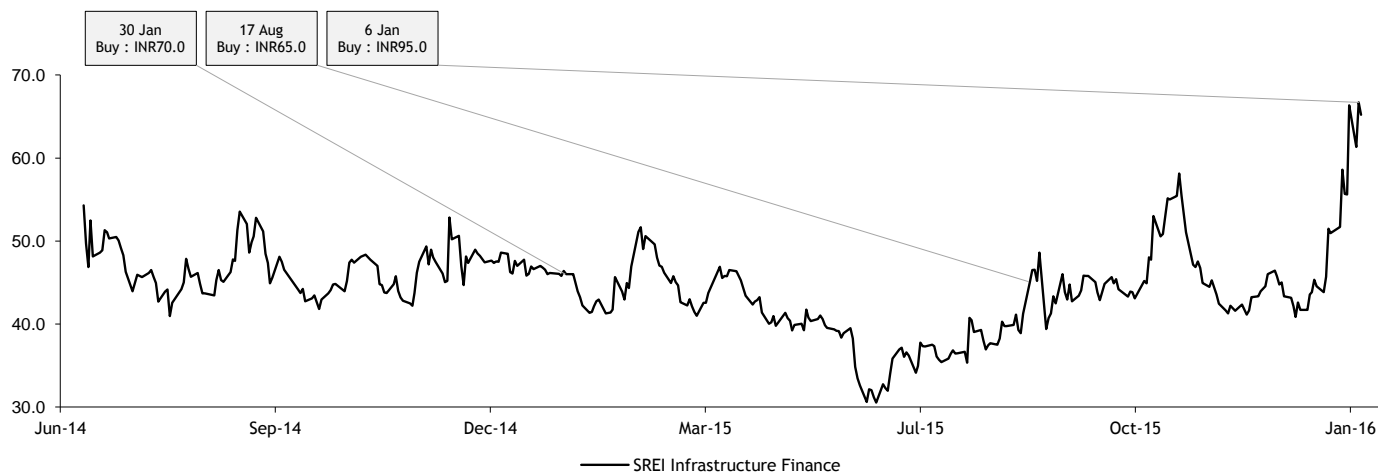
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