

# SREI Infrastructure Finance (SREI IN)

## Getting Its Mojo Back

# BUY

Share Price INR 116  
 12m Price Target INR 160 (+38%)  
 Previous Price Target INR 150

### In-line results

2Q EPS growth of 39% YoY was in line. 1HFY18 EPS forms 46% of our FY18E forecast. Robust disbursements in commercial equipment (CE) business drove consolidated AUM growth of 18% YoY. In CE business, asset quality improved marginally with healthy NIMs. Project finance business, which is not a focus area for the company, reported subdued growth. We revise our FY19 EPS up by 5% to factor in higher loan growth. Maintain BUY with higher TP INR160 after our EPS revision (1.5x FY19E P/BV, 9% ROE).

### Robust growth in CE disbursements

Benefits from pick-up in infrastructure and irrigation-related spending manifested in the form of high volume growth for CE. Disbursements were up 67% YoY for 2Q; this led to AUM growth of 32% YoY. With asset quality issues behind, SREI is focused on higher growth. Net NPLs were 1.5%, down from 3.5% three years back. Margins inched up 45bps YoY to 5.6%. CE loans now account for 65% of consolidated loan book, up from 59% last year. We expect growth momentum in CE loans to continue, supported by aggressive infrastructure spending of the government.

### Selective on project finance

Given the bitter NPL experience in project financing, management sounded cautious in this segment of the business. NPLs in project finance have stabilised from 5% in FY16 to 2.2%. However, growth remains elusive. Project finance business AUM grew 2.9% YoY. Overall consolidated AUM grew 18% YoY.

### Value-unlocking plans

SREI plans to list its CE subsidiary separately to unlock value. It plans to raise growth capital by dilution of 25% stake in CE business. In our view, the move is positive as it will enable SREI to raise capital given strong growth in the CE segment. We forecast steady ROE improvement from 6.1% in FY17 to 9.2% in FY19.

### 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) 137/71  
 3m avg turnover (USDm) 4.3  
 Free float (%) 26.2  
 Issued shares (m) 503  
 Market capitalisation INR58.3B  
 USD900M

### Major shareholders:

Adisri Investment Ltd 60.4%  
 Fidelity Investment Trust 6.9%  
 BNP Paribas Lease Group 5.0%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	13	(5)	48
Relative to index (%)	7	(7)	24

Source: FactSet

FYE Mar (INR m)	FY16A	FY17A	FY18E	FY19E	FY20E
Operating income	9,512	20,534	18,113	21,000	24,431
Pre-provision profit	3,784	11,322	8,343	10,366	12,679
Core net profit	730	2,433	3,507	4,717	6,163
Core EPS (INR)	1	5	7	9	12
Core EPS growth (%)	(49.1)	293.0	38.3	36.6	33.1
Net DPS (INR)	1	1	1	1	1
Core P/E (x)	94.4	24.0	17.4	12.7	9.6
P/BV (x)	1.8	1.3	1.2	1.1	1.0
Net dividend yield (%)	0.4	0.4	0.6	0.8	0.9
Book value (INR)	66	92	98	107	118
ROAE (%)	2.2	6.1	7.3	9.2	10.9
ROAA (%)	0.3	0.8	1.0	1.2	1.4
Consensus net profit	-	-	4,012	5,441	6,949
MKE vs. Consensus (%)	-	-	(12.6)	(13.3)	(11.3)

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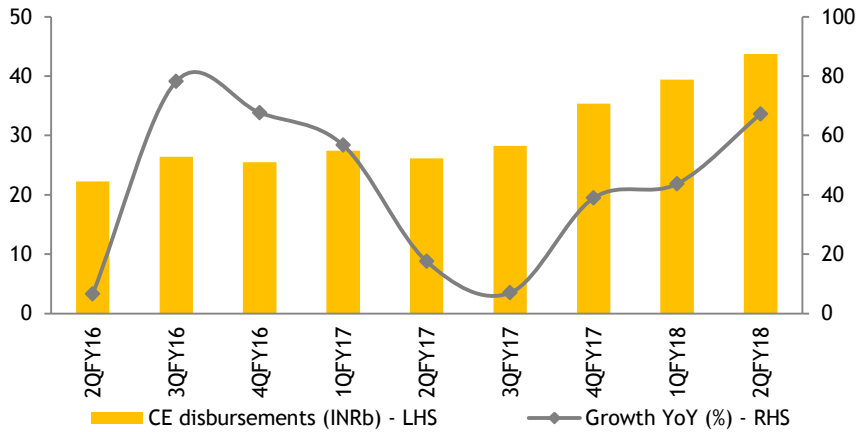
## 2QFY18 results

Consolidate Income Statement (INRm)	2Q17	1Q18	2Q18	YoY (%)	QoQ (%)
Net Interest Income	2,840	3,140	3,360	18.3%	7.0%
Fee Income	70	140	100	42.9%	-28.6%
Other income	410	520	560	36.6%	7.7%
<b>Non-Interest income</b>	<b>480</b>	<b>660</b>	<b>660</b>	<b>37.5%</b>	<b>0.0%</b>
<b>Total Income</b>	<b>3,320</b>	<b>3,800</b>	<b>4,020</b>	<b>21.1%</b>	<b>5.8%</b>
Employee Cost	534	528	510	-4.4%	-3.3%
Other Operating Expenses	946	1,122	1,150	21.5%	2.5%
<b>Total Operating Expenses</b>	<b>1,480</b>	<b>1,650</b>	<b>1,660</b>	<b>12.2%</b>	<b>0.6%</b>
<b>Operating Profit</b>	<b>1,840</b>	<b>2,150</b>	<b>2,360</b>	<b>28.3%</b>	<b>9.8%</b>
Total Provisions	930	970	990	6.5%	2.1%
PBT	910	1,168	1,370	50.5%	17.3%
Tax	293	357	451	53.9%	26.5%
<b>PAT (after associate share &amp; minorities)</b>	<b>619</b>	<b>763</b>	<b>860</b>	<b>39.0%</b>	<b>12.6%</b>
<b>Balance Sheet (INRm)</b>					
Borrowings	250,780	276,280	301,690	20.3%	9.2%
<b>AUM</b>					
Commercial equipment	202,160	234,530	266,600	31.9%	13.7%
Project Finance	139,700	134,970	143,690	2.9%	6.5%
Consolidated AUM	365,130	392,960	431,250	18.1%	9.7%
<b>Disbursements</b>					
Commercial equipment	26,130	39,390	43,700	67.2%	10.9%
Project Finance	8,840	4,670	16,400	85.5%	251.2%
<b>Total disbursements</b>	<b>34,970</b>	<b>44,060</b>	<b>60,100</b>	<b>71.9%</b>	<b>36.4%</b>
<b>Key Ratios</b>					
<b>Asset quality - Equipment Finance</b>					
Gross NPL (%)	2.6%	2.3%	2.1%	-52bps	-22bps
Net NPL (%)	1.8%	1.6%	1.5%	-33bps	-13bps
<b>Asset quality - Project Finance</b>					
Gross NPL (%)	3.1%	1.8%	2.2%	-90bps	40bps
Net NPL (%)	2.1%	1.1%	1.4%	-70bps	30bps
<b>Profitability</b>					
NIM - Equipment Finance	5.2%	5.7%	5.6%	45bps	-10bps
Gross Spread - Project Finance	1.6%	1.7%	1.8%	20bps	10bps
Tax-rate	32.2%	30.5%	32.9%	71bps	241bps
<b>Capital Adequacy - Standalone</b>					
CAR (%)	19.3%	19.1%	18.1%	-120bps	-100bps

Source: Company

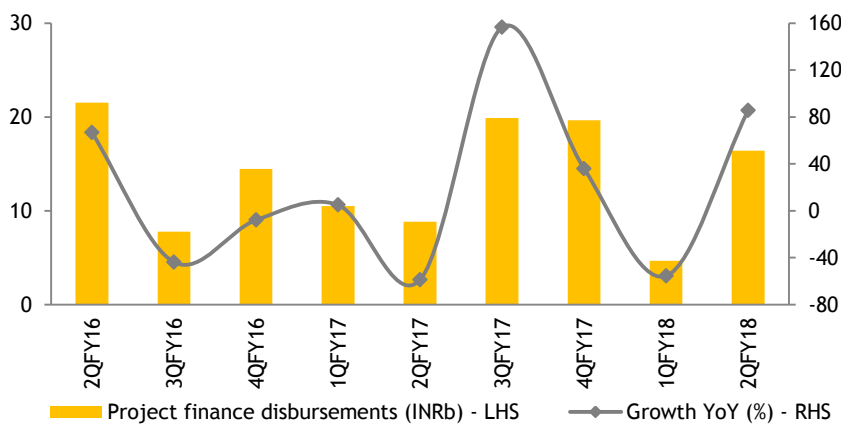
Indian construction equipment industry is expected to grow rapidly given the government’s thrust on infrastructure. Higher spending on roads, ports and irrigation projects will drive demand for commercial equipment. We expect CE segment to drive consolidated loan growth at 14% CAGR over FY18-20.

**During 2QFY18, CE disbursement picked up to INR43.7b, +67% YoY**



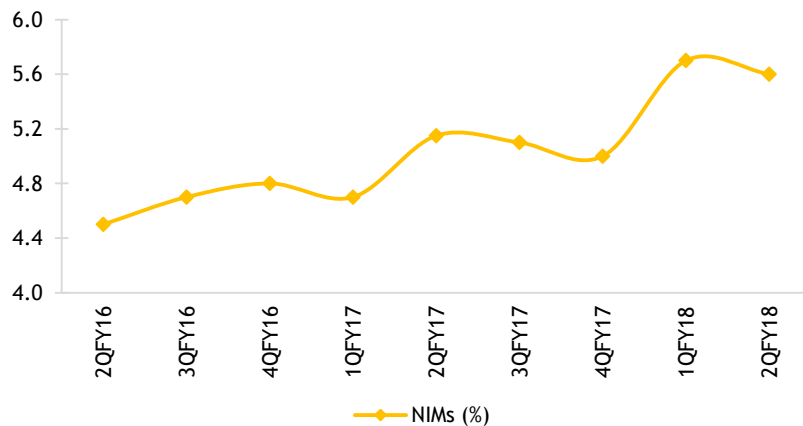
Source: Company

**Project finance disbursement increased to INR16.4b, +86% YoY**



Source: Company

**CE segment NIM expanded to 5.6% by 45bps YoY**



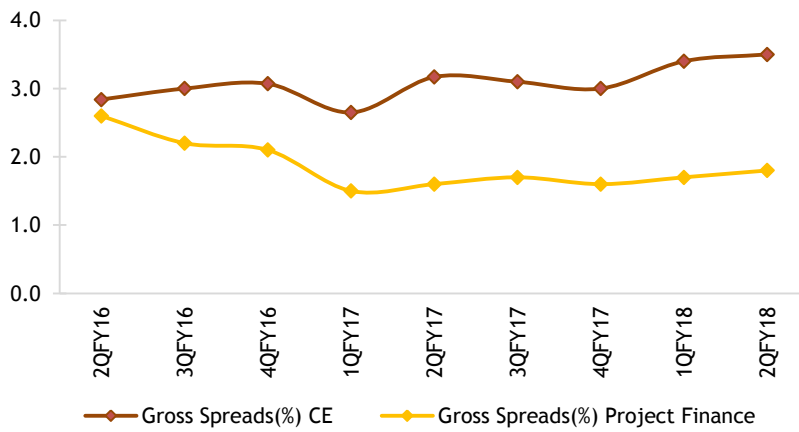
Source: Company

**For CE business, asset quality remained stable**



Source: Company

**Gross spread expanded by 10bps for both businesses**



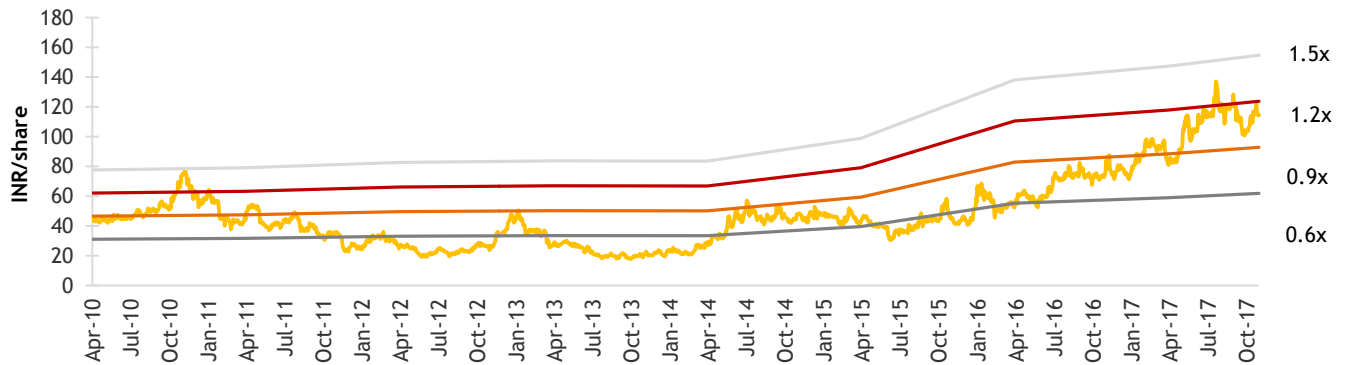
Source: Company

## Change in forecasts

Old vs. New Estimates	FY18E, Old	FY18E, New	Change	FY19E, Old	FY19E, New	Change
<b><u>Income Statement (INRmn)</u></b>						
Net Interest Income	14,892	14,886	0.0%	16,362	16,766	2.5%
Non-Interest Income	3,277	3,227	-1.5%	4,300	4,235	-1.5%
<b>Total Income</b>	<b>18,169</b>	<b>18,113</b>	<b>-0.3%</b>	<b>20,662</b>	<b>21,000</b>	<b>1.6%</b>
Operating Expenses	9,801	9,770	-0.3%	10,677	10,634	-0.4%
Loan Loss Provisions	3,352	3,362	0.3%	3,483	3,561	2.2%
Pre-provisioning Profits	8,368	8,343	-0.3%	9,985	10,366	3.8%
<b>Reported Profits</b>	<b>3,531</b>	<b>3,507</b>	<b>-0.7%</b>	<b>4,513</b>	<b>4,717</b>	<b>4.5%</b>
<b><u>Balance Sheet (INRbn)</u></b>						
Borrowings	292	294	0.4%	334	338	1.4%
Loans	282	287	1.8%	316	327	3.6%
Total Assets	358	360	0.3%	405	410	1.2%
<b><u>Key Ratios (%)</u></b>						
ROA (%)	1.0%	1.0%	0.0%	1.2%	1.2%	0.0%
ROE (%)	7.4%	7.3%	0.0%	8.8%	9.2%	0.4%
EPS (INR)	6.7	6.7	-0.7%	8.7	9.1	4.7%
BV (INR)	98.3	98.2	0.0%	106.2	106.6	0.3%
Adj. BV (INR)	91.6	92.1	0.5%	99.6	100.9	1.2%
Net NPA (%)	1.8%	1.6%	-0.2%	1.6%	1.3%	-0.3%

Source: Maybank Kim Eng

## 1-year forward P/BV band: SREI has room for re-rating with ROE improvement

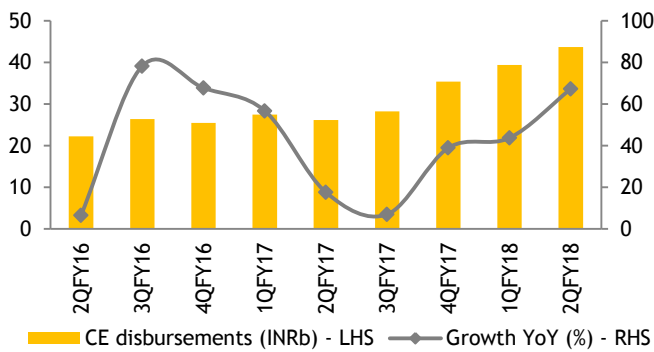


Source: Company, Bloomberg, Maybank Kim Eng

## 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 by separate listing of CE business, 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

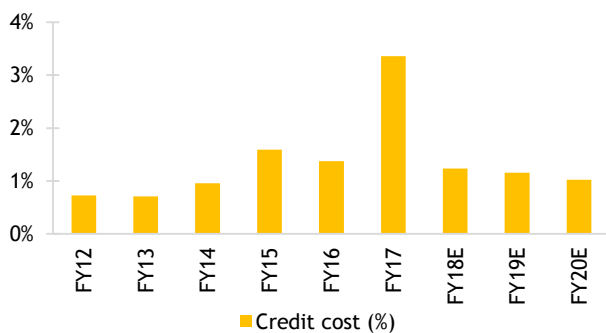


Source: Company

## Financial Metrics

- Credit cost to drop from 3.4% 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 12% 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 6.1% in FY17 to 9.2% in FY19E on lower credit cost, higher loan growth and better fee income growth

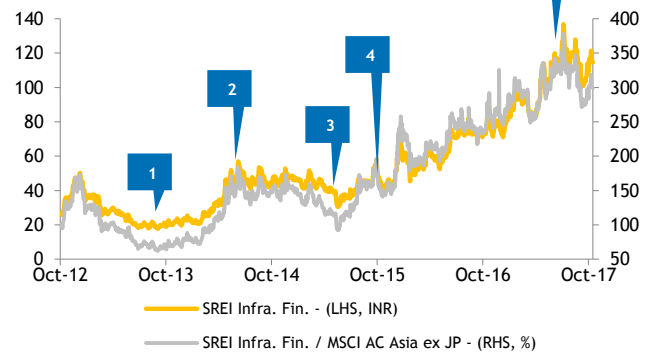
### Credit cost is expected to fall to 1% by FY20



Source: Company

## Price Drivers

### Historical share price trend



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.
- 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.
- Better than expected NPLs in FY18-19E.

### Downside

- Delay in a pick-up in 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
<b>Key Metrics</b>					
Core P/E (x)	94.4	24.0	17.4	12.7	9.6
Core FD P/E (x)	94.4	24.0	17.4	12.7	9.6
P/BV (x)	1.8	1.3	1.2	1.1	1.0
P/NTA (x)	1.8	1.3	1.2	1.1	1.0
Net dividend yield (%)	0.4	0.4	0.6	0.8	0.9
<b>INCOME STATEMENT (INR m)</b>					
Interest income	31,475.7	39,280.0	45,477.0	50,912.1	57,706.8
Interest expense	(23,107.5)	(26,279.7)	(30,591.2)	(34,146.3)	(38,652.3)
<b>Net interest income</b>	<b>8,368.2</b>	<b>13,000.3</b>	<b>14,885.8</b>	<b>16,765.8</b>	<b>19,054.5</b>
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	2,778.8	3,651.3	4,647.7
<b>Total non-interest income</b>	<b>1,143.7</b>	<b>7,533.8</b>	<b>3,227.4</b>	<b>4,234.5</b>	<b>5,376.7</b>
<b>Operating income</b>	<b>9,511.9</b>	<b>20,534.1</b>	<b>18,113.2</b>	<b>21,000.3</b>	<b>24,431.2</b>
Staff costs	(1,448.6)	(2,015.6)	(2,116.4)	(2,268.8)	(2,454.8)
Other operating expenses	(4,279.1)	(7,196.8)	(7,654.0)	(8,365.4)	(9,297.7)
<b>Operating expenses</b>	<b>(5,727.7)</b>	<b>(9,212.4)</b>	<b>(9,770.4)</b>	<b>(10,634.1)</b>	<b>(11,752.5)</b>
<b>Pre-provision profit</b>	<b>3,784.2</b>	<b>11,321.7</b>	<b>8,342.8</b>	<b>10,366.2</b>	<b>12,678.7</b>
Loan impairment allowances	(2,712.5)	(7,720.7)	(3,362.3)	(3,561.4)	(3,624.6)
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)
<b>Pretax profit</b>	<b>1,061.3</b>	<b>3,600.5</b>	<b>4,979.9</b>	<b>6,804.3</b>	<b>9,053.6</b>
Income tax	(444.1)	(1,173.3)	(1,622.8)	(2,217.2)	(2,950.1)
Minorities	112.4	5.5	150.0	130.0	60.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
<b>Reported net profit</b>	<b>729.6</b>	<b>2,432.7</b>	<b>3,507.2</b>	<b>4,717.1</b>	<b>6,163.5</b>
<b>Core net profit</b>	<b>729.6</b>	<b>2,432.7</b>	<b>3,507.2</b>	<b>4,717.1</b>	<b>6,163.5</b>
<b>BALANCE SHEET (INR m)</b>					
Cash & deposits with banks	6,641.5	9,320.0	10,438.4	11,899.8	13,803.7
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	287,078.4	327,269.4	379,632.5
Central bank deposits	0.0	0.0	0.0	0.0	0.0
Investment in associates/JVs	21,698.2	12,819.0	12,204.2	13,094.6	14,240.7
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	14,319.7	30,087.7	31,537.5	34,957.1	38,911.4
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other assets	6,394.8	22,532.3	15,590.4	19,836.3	20,100.5
<b>Total assets</b>	<b>252,299.0</b>	<b>331,079.0</b>	<b>356,848.9</b>	<b>407,057.2</b>	<b>466,688.8</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	17,239.4	24,485.4	26,293.7	29,403.9	32,306.8
Other securities in issue	0.0	0.0	0.0	0.0	0.0
Other borrowings	189,487.4	237,556.2	267,250.7	308,674.6	358,062.5
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	12,387.5	22,683.7	13,855.8	15,342.8	17,108.9
<b>Total liabilities</b>	<b>219,114.3</b>	<b>284,725.3</b>	<b>307,400.2</b>	<b>353,421.3</b>	<b>407,478.2</b>
Share capital	5,032.4	5,032.4	5,032.4	5,032.4	5,032.4
Reserves	28,140.3	41,315.4	44,410.4	48,597.6	54,172.3
Shareholders' funds	33,172.7	46,347.8	49,442.8	53,630.0	59,204.7
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	12.0	5.9	5.9	5.9	5.9
<b>Total equity</b>	<b>33,184.7</b>	<b>46,353.7</b>	<b>49,448.7</b>	<b>53,635.9</b>	<b>59,210.6</b>
<b>Total liabilities &amp; equity</b>	<b>252,299.0</b>	<b>331,079.0</b>	<b>356,848.9</b>	<b>407,057.2</b>	<b>466,688.8</b>

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
<b>Key Ratios</b>					
<b>Growth (%)</b>					
Net interest income	12.3	55.4	14.5	12.6	13.7
Non-interest income	(66.4)	558.7	(57.2)	31.2	27.0
Operating expenses	(3.3)	60.8	6.1	8.8	10.5
Pre-provision profit	(23.4)	199.2	(26.3)	24.3	22.3
Core net profit	(43.5)	233.4	44.2	34.5	30.7
Gross loans	5.1	24.8	11.7	13.8	15.8
Customer deposits	na	na	na	na	na
Total assets	2.6	31.2	7.8	14.1	14.6
<b>Profitability (%)</b>					
Non-int. income/Total income	12.0	36.7	17.8	20.2	22.0
Average lending yields	14.53	16.09	16.16	16.06	15.84
Average financing yields	14.53	16.09	16.16	16.06	15.84
Average cost of funds	11.27	11.21	11.01	10.81	10.61
Net interest margin	3.86	5.33	5.29	5.29	5.23
Net income margin	3.25	4.88	5.15	5.25	5.23
Cost/income	60.2	44.9	53.9	50.6	48.1
<b>Liquidity (%)</b>					
Loans/customer deposits	nm	nm	nm	nm	nm
<b>Asset quality (%)</b>					
Net NPL	3.1	2.0	1.6	1.3	1.1
Gross NPL	4.0	2.9	2.7	2.5	2.3
Gross NPF	4.0	2.9	2.7	2.5	2.3
(SP+GP)/average gross loans	1.4	3.4	1.2	1.2	1.0
(SP+GP)/average gross financing	1.4	3.4	1.2	1.2	1.0
Loan loss coverage	23.1	33.4	40.4	48.4	53.4
<b>Capital adequacy (%)</b>					
CET1	12.5	13.8	12.0	11.5	11.0
Tier 1 capital	12.5	13.8	12.0	11.5	11.0
Risk-weighted capital	17.5	18.9	18.5	17.7	17.1
<b>Returns (%)</b>					
ROAE	2.2	6.1	7.3	9.2	10.9
ROAA	0.3	0.8	1.0	1.2	1.4
Shareholders equity/assets	13.1	14.0	13.9	13.2	12.7

Source: Company; Maybank



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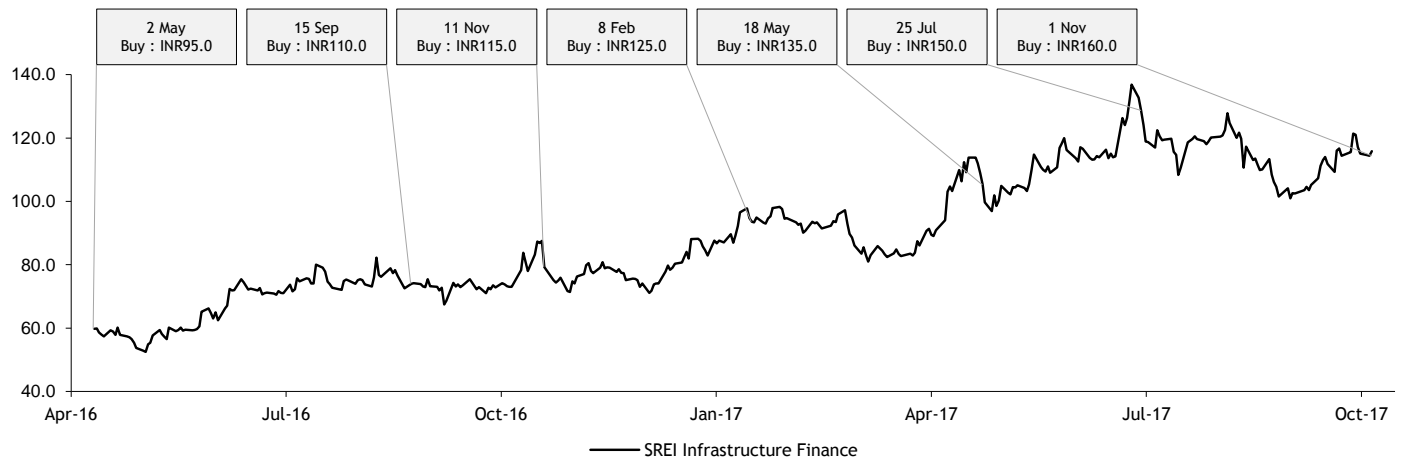
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