

SREI Infrastructure Finance (SREI IN)

Equipment Financing Picking Up

2Q17 in line; maintain BUY

2Q EPS met, with 1HFY17 EPS at 43% of our FY17E; we expect a stronger 2H. Commercial-equipment (CE) disbursements grew 35% YoY. Demand by the road and irrigation sectors was strong. Project financing was muted but lower costs of funds lifted NIM. We raise FY18E EPS by 4% for lower credit costs of 0.7%. Asset quality was stable. Value-unlocking potential in subsidiaries remains. Maintain BUY with a higher TP of INR115 after our EPS revision for FY18. This remains based on 1.2x FY18E P/BV, in line with peers with 8-10% ROEs.

Disbursements in equipment financing strong

CE disbursements grew 35% YoY in 1H to make up 60% of its consolidated loan book. SREI maintained its leadership with a 35% market share. CE AUM growth was only 4% YoY due to high repayments of loans disbursed in the last 2-3 years. Higher road-project awards by the government and stronger agricultural-sector spending by the states should underpin this business. We forecast consolidated loan-book growth of 60% for FY17 (impact of erstwhile SREI BNP merger) and 12% YoY for FY18.

Margins expanded further; stable asset quality

CE NIM expanded another 70bps YoY to 5.2%. Lower costs of funds from a replacement of high-cost borrowings lifted NIM. Spreads in project financing contracted 100bps YoY to 1.6% while tougher competition from banks in the refinancing of operational assets pushed rates down. Still, we expect consolidated NIM to expand 20bps over FY16-18 to 4.1%, led by lower funding cost. Asset quality was stable with gross NPLs at 2.6%.

Value-unlocking potential

We estimate ROEs of 9% for FY18E, up from 2% in FY16, on the back of lower credit cost and NIM expansion. Potential value-unlocking of strategic investments such as road projects, its social rural network business (Sahaj) and industrial parks can provide catalysts, in our view. Maintain BUY.

| FYE Mar (INR m) | FY15A | FY16A | FY17E | FY18E | FY19E |
|------------------------|--------|--------|--------|--------|--------|
| Operating income | 10,862 | 9,512 | 17,299 | 16,472 | 19,364 |
| Pre-provision profit | 4,938 | 3,784 | 10,098 | 8,521 | 10,903 |
| Core net profit | 1,294 | 733 | 2,644 | 4,178 | 5,466 |
| Core EPS (INR) | 2 | 1 | 5 | 8 | 11 |
| Core EPS growth (%) | (11.7) | (49.1) | 317.5 | 61.4 | 32.1 |
| Net DPS (INR) | 1 | 1 | 1 | 1 | 1 |
| Core P/E (x) | 36.3 | 71.3 | 17.1 | 10.6 | 8.0 |
| P/BV (x) | 1.3 | 1.3 | 1.0 | 0.9 | 0.8 |
| Net dividend yield (%) | 0.6 | 0.6 | 1.1 | 1.4 | 1.4 |
| Book value (INR) | 65 | 66 | 89 | 96 | 105 |
| ROAE (%) | 4.1 | 2.2 | 6.8 | 9.0 | 10.8 |
| ROAA (%) | 0.5 | 0.3 | 0.8 | 1.1 | 1.2 |
| Consensus net profit | - | - | 2,734 | 4,029 | 5,947 |
| MKE vs. Consensus (%) | - | - | (3.3) | 3.7 | (8.1) |

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BUY

| | |
|-----------------------|----------------|
| Share Price | INR 88 |
| 12m Price Target | INR 115 (+31%) |
| Previous Price Target | INR 110 |

Company Description

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

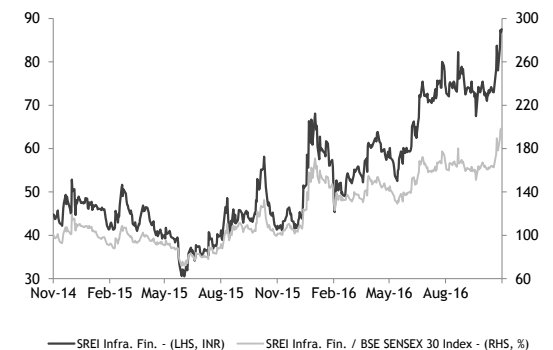
Statistics

| | |
|------------------------|---------------------|
| 52w high/low (INR) | 88/41 |
| 3m avg turnover (USDm) | 1.7 |
| Free float (%) | 26.2 |
| Issued shares (m) | 503 |
| Market capitalisation | INR44.0B USD661M |

Major shareholders:

| | |
|-------------------------------|-------|
| Bharat Connect Ltd. | 23.5% |
| Adisri Investment Ltd. | 17.2% |
| Opulent Venture Capital Trust | 11.5% |

Price Performance



| | -1M | -3M | -12M |
|-----------------------|-----|-----|------|
| Absolute (%) | 16 | 17 | 112 |
| Relative to index (%) | 18 | 18 | 98 |

Source: FactSet

2QFY17 results

| Consolidate Income Statement (INRm) | 2Q16 | 1Q17 | 2Q17 | YoY (%) | QoQ (%) |
|---|--------------|--------------|--------------|---------------|---------------|
| Net Interest Income | 1,690 | 1,430 | 2,840 | 68.0% | 98.6% |
| Fee Income | 240 | 60 | 70 | -70.8% | 16.7% |
| Other income | 200 | 3,940 | 410 | 105.0% | -89.6% |
| Non-Interest income | 440 | 4,000 | 480 | 9.1% | -88.0% |
| Total Income | 2,130 | 5,430 | 3,320 | 55.9% | -38.9% |
| Employee Cost | 389 | 358 | 534 | 37.2% | 49.3% |
| Other Operating Expenses | 531 | 728 | 946 | 78.2% | 30.0% |
| Total Operating Expenses | 920 | 1,086 | 1,480 | 60.9% | 36.3% |
| Operating Profit | 1,210 | 4,345 | 1,840 | 52.1% | -57.6% |
| Total Provisions | 1,020 | 3,629 | 930 | -8.8% | -74.4% |
| PBT | 190 | 716 | 910 | 378.9% | 27.1% |
| Tax | 103 | 207 | 293 | 184.0% | 41.7% |
| PAT (after associate share & minorities) | 117 | 516 | 619 | 430.0% | 19.8% |
| Balance Sheet (INRm) | | | | | |
| Borrowings | 207,300 | 253,120 | 250,780 | 21.0% | -0.9% |
| Consolidated AUM | 362,360 | 354,780 | 365,130 | 0.8% | 2.9% |
| Key Ratios | | | | | |
| Asset quality - Equipment Finance | | | | | |
| Gross NPL (%) | 4.2% | 2.7% | 2.6% | -1.6% | -0.1% |
| Net NPL (%) | 3.2% | 1.9% | 1.8% | -1.4% | -0.1% |
| Asset quality - Project Finance | | | | | |
| Gross NPL (%) | 4.7% | 3.0% | 3.1% | -1.6% | 0.1% |
| Net NPL (%) | 3.6% | 2.0% | 2.1% | -1.5% | 0.1% |
| Profitability | | | | | |
| NIM - Equipment Finance | 4.5% | 4.7% | 5.2% | 0.7% | 0.5% |
| Gross Spread - Project Finance | 2.6% | 1.5% | 1.6% | -1.0% | 0.1% |
| Tax-rate | 54.4% | 28.9% | 32.2% | -22.1% | 3.3% |
| Capital Adequacy - Standalone | | | | | |
| CAR (%) | 18.5% | 19.2% | 19.3% | 0.8% | 0.1% |

Source: Company

Change in forecast

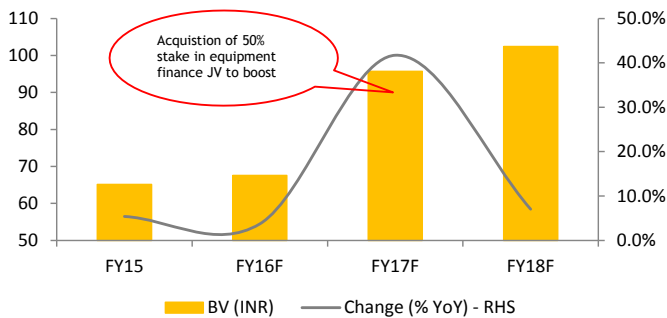
| Old vs. New Estimates | FY17E, Old | FY17E, New | Change | FY18E, Old | FY18E, New | Change |
|--|---------------|---------------|--------------|---------------|---------------|--------------|
| <u>Income Statement (INRmn)</u> | | | | | | |
| Net Interest Income | 10,700 | 10,652 | -0.4% | 14,085 | 14,090 | 0.0% |
| Non-Interest Income | 6,339 | 6,646 | 4.8% | 2,778 | 2,382 | -14.2% |
| Total Income | 17,039 | 17,299 | 1.5% | 16,863 | 16,472 | -2.3% |
| Operating Expenses | 7,586 | 7,201 | -5.1% | 8,506 | 7,951 | -6.5% |
| Loan Loss Provisions | 5,181 | 5,757 | 11.1% | 2,309 | 2,249 | -2.6% |
| Pre-provisioning Profits | 9,454 | 10,098 | 6.8% | 8,357 | 8,521 | 2.0% |
| Reported Profits | 2,798 | 2,644 | -5.5% | 4,029 | 4,178 | 3.7% |
| <u>Balance Sheet (INRbn)</u> | | | | | | |
| Borrowings | 318 | 312 | -1.8% | 355 | 348 | -2.0% |
| Loans | 315 | 309 | -1.7% | 353 | 347 | -1.7% |
| Total Assets | 379 | 373 | -1.6% | 421 | 414 | -1.7% |
| <u>Key Ratios (%)</u> | | | | | | |
| NIM (%) | 3.94% | 3.90% | 0.0% | 4.13% | 4.10% | 0.0% |
| ROA (%) | 0.89% | 0.85% | 0.0% | 1.01% | 1.07% | 0.1% |
| ROE (%) | 7.2% | 6.8% | -0.4% | 8.7% | 9.0% | 0.3% |
| EPS (Rs.) | 5.4 | 5.1 | -5.6% | 8.0 | 8.3 | 3.7% |
| BV (Rs.) | 89.2 | 88.9 | -0.3% | 95.8 | 95.8 | 0.0% |
| Adj. BV (Rs) | 80.0 | 80.5 | 0.6% | 87.4 | 88.6 | 1.4% |
| Net NPA (%) | 2.20% | 2.04% | -0.2% | 1.80% | 1.57% | -0.2% |

Source: Company, Maybank KE

Company Proposition

- India's leading financier to the infrastructure sector. Beneficiary of a pickup in government awarding new projects in the infrastructure space.
- Asset quality stress peaked out; incremental NPLs lower as CE demand witnessing uptick.
- Value unlocking potential in road projects (7 projects worth INR5.5b), 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%

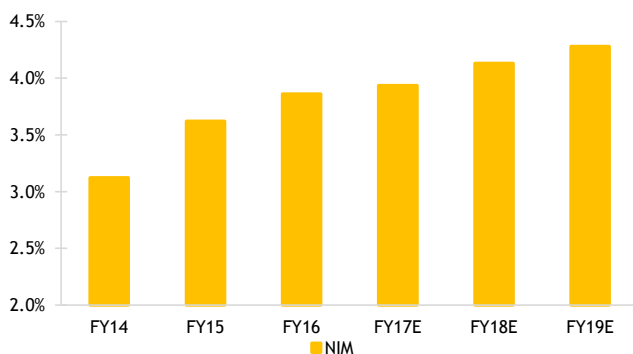


Source: Company, Maybank Kim Eng

Financial Metrics

- NIM to improve by 30bps from FY3.9% to 4.2% in FY19F, because of changes in loan mix to high yielding loans and repayment of high cost debt.
- Credit cost to drop from 2.0% in FY17 to 0.7% in FY18 on lower NPL accretion. Improvement in economic growth to aid asset quality recovery.
- We forecast ROE improvement from 2% in FY16 to 9% in FY18E on NIM improvement and lower credit cost.

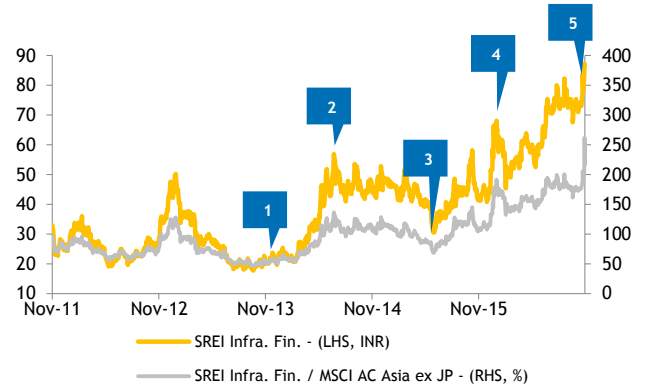
NIM to inch up on repayment of debt and change in mix



Source: Company

Price Drivers

Historical share price



Source: Company, Maybank Kim Eng

1. Slowdown in infrastructure lending and increase in NPLs weighed on the stock price.
2. New government's plan to increase infrastructure spending led to optimising of infrastructure financiers.
3. Delay in monetisation of telecom tower business (VIOM) pushed the stock price down.
4. Announcement of transaction to acquire 50% of JV with BNP Paribas. BV and EPS accretive deal led to rally in the stock price.
5. 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 FY17-18F.

Downside

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

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| FYE 31 Mar | FY15A | FY16A | FY17E | FY18E | FY19E |
|------------------------|-------|-------|-------|-------|-------|
| Key Metrics | | | | | |
| Core P/E (x) | 36.3 | 71.3 | 17.1 | 10.6 | 8.0 |
| Core FD P/E (x) | 36.3 | 71.3 | 17.1 | 10.6 | 8.0 |
| P/BV (x) | 1.3 | 1.3 | 1.0 | 0.9 | 0.8 |
| P/NTA (x) | 1.3 | 1.3 | 1.0 | 0.9 | 0.8 |
| Net dividend yield (%) | 0.6 | 0.6 | 1.1 | 1.4 | 1.4 |

INCOME STATEMENT (INR m)

| | | | | | |
|----------------------------------|------------------|------------------|------------------|------------------|------------------|
| Interest income | 30,195.7 | 31,475.7 | 37,941.4 | 47,998.5 | 54,089.7 |
| Interest expense | (22,741.5) | (23,107.5) | (27,288.9) | (33,908.9) | (37,661.7) |
| Net interest income | 7,454.2 | 8,368.2 | 10,652.5 | 14,089.6 | 16,428.1 |
| Net insurance income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net fees and commission | 1,613.4 | 502.5 | 658.8 | 790.5 | 948.6 |
| Other income | 1,794.1 | 641.2 | 5,987.3 | 1,592.0 | 1,987.8 |
| Total non-interest income | 3,407.5 | 1,143.7 | 6,646.1 | 2,382.5 | 2,936.4 |
| Operating income | 10,861.7 | 9,511.9 | 17,298.5 | 16,472.1 | 19,364.4 |
| Staff costs | (1,442.9) | (1,448.6) | (2,017.6) | (2,219.3) | (2,441.2) |
| Other operating expenses | (4,481.2) | (4,279.1) | (5,183.4) | (5,731.7) | (6,020.6) |
| Operating expenses | (5,924.1) | (5,727.7) | (7,200.9) | (7,951.1) | (8,461.9) |
| Pre-provision profit | 4,937.6 | 3,784.2 | 10,097.6 | 8,521.1 | 10,902.6 |
| Loan impairment allowances | (2,962.8) | (2,712.5) | (5,757.1) | (2,248.5) | (2,618.3) |
| Other allowances | (92.8) | (12.3) | (462.3) | (12.3) | (12.3) |
| Associates & JV income | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Pretax profit | 1,886.9 | 1,064.3 | 3,880.7 | 6,262.7 | 8,274.5 |
| Income tax | (670.4) | (444.1) | (1,299.2) | (2,097.2) | (2,771.1) |
| Minorities | 77.1 | 112.4 | 62.4 | 12.4 | (37.6) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 1,293.6 | 732.6 | 2,643.9 | 4,178.0 | 5,465.8 |
| Core net profit | 1,293.6 | 732.6 | 2,643.9 | 4,178.0 | 5,465.8 |

BALANCE SHEET (INR m)

| | | | | | |
|---------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Cash & deposits with banks | 5,747.6 | 6,641.5 | 10,111.6 | 11,325.0 | 13,023.8 |
| 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 | 192,054.4 | 203,244.8 | 309,438.2 | 346,570.7 | 398,556.4 |
| Central bank deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investment in associates/JVs | 22,499.4 | 21,698.2 | 18,566.3 | 19,061.4 | 21,920.6 |
| Insurance assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Fixed assets | 15,513.4 | 14,319.7 | 18,778.8 | 18,392.5 | 19,879.8 |
| Intangible assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other assets | 10,047.0 | 6,394.8 | 13,080.2 | 15,593.2 | 11,569.3 |
| Total assets | 245,861.8 | 252,299.0 | 369,975.0 | 410,942.8 | 464,949.8 |
| 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 | 15,691.4 | 16,466.6 | 25,280.5 | 27,162.5 | 29,860.0 |
| Other securities in issue | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other borrowings | 187,566.2 | 190,260.2 | 286,675.8 | 321,076.9 | 366,027.7 |
| Insurance liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other liabilities | 9,709.7 | 12,387.5 | 13,278.8 | 14,492.2 | 16,091.7 |
| Total liabilities | 212,967.3 | 219,114.3 | 325,235.2 | 362,731.6 | 411,979.4 |
| Share capital | 5,032.4 | 5,032.4 | 5,032.4 | 5,032.4 | 5,032.4 |
| Reserves | 27,736.5 | 28,140.3 | 39,695.4 | 43,166.8 | 47,926.0 |
| Shareholders' funds | 32,768.9 | 33,172.7 | 44,727.8 | 48,199.2 | 52,958.4 |
| Preference shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Minority interest | 125.6 | 12.0 | 12.0 | 12.0 | 12.0 |
| Total equity | 32,894.5 | 33,184.7 | 44,739.8 | 48,211.2 | 52,970.4 |
| Total liabilities & equity | 245,861.8 | 252,299.0 | 369,975.0 | 410,942.8 | 464,949.8 |

| FYE 31 Mar | FY15A | FY16A | FY17E | FY18E | FY19E |
|---------------------------------|-------|--------|-------|--------|-------|
| Key Ratios | | | | | |
| Growth (%) | | | | | |
| Net interest income | 22.3 | 12.3 | 27.3 | 32.3 | 16.6 |
| Non-interest income | 13.3 | (66.4) | 481.1 | (64.2) | 23.2 |
| Operating expenses | 14.6 | (3.3) | 25.7 | 10.4 | 6.4 |
| Pre-provision profit | 25.6 | (23.4) | 166.8 | (15.6) | 27.9 |
| Core net profit | (6.8) | (43.4) | 260.9 | 58.0 | 30.8 |
| Gross loans | 8.3 | 5.1 | 50.9 | 11.6 | 14.8 |
| Customer deposits | na | na | na | na | na |
| Total assets | 2.8 | 2.6 | 46.6 | 11.1 | 13.1 |
| Profitability (%) | | | | | |
| Non-int. income/Total income | 31.4 | 12.0 | 38.4 | 14.5 | 15.2 |
| Average lending yields | 14.67 | 14.53 | 13.88 | 13.96 | 13.87 |
| Average financing yields | 14.67 | 14.53 | 13.88 | 13.96 | 13.87 |
| Average cost of funds | 11.34 | 11.27 | 10.52 | 10.27 | 10.12 |
| Net interest margin | 3.62 | 3.86 | 3.90 | 4.10 | 4.21 |
| Net income margin | 3.33 | 3.25 | 3.36 | 3.69 | 3.75 |
| Cost/income | 54.5 | 60.2 | 41.6 | 48.3 | 43.7 |
| Liquidity (%) | | | | | |
| Loans/customer deposits | nm | nm | nm | nm | nm |
| Asset quality (%) | | | | | |
| Net NPL | 3.8 | 3.1 | 2.0 | 1.6 | 1.3 |
| Gross NPL | 4.7 | 4.0 | 3.1 | 2.7 | 2.6 |
| Gross NPF | 4.7 | 4.0 | 3.1 | 2.7 | 2.6 |
| (SP+GP)/average gross loans | 1.6 | 1.4 | 2.2 | 0.7 | 0.7 |
| (SP+GP)/average gross financing | 1.6 | 1.4 | 2.2 | 0.7 | 0.7 |
| Loan loss coverage | 18.5 | 23.1 | 35.0 | 43.0 | 50.0 |
| Capital adequacy (%) | | | | | |
| CET1 | 11.2 | 12.5 | 10.5 | 10.2 | 9.9 |
| Tier 1 capital | 11.2 | 12.5 | 10.5 | 10.2 | 9.9 |
| Risk-weighted capital | 17.0 | 17.5 | 16.5 | 15.9 | 15.5 |
| Returns (%) | | | | | |
| ROAE | 4.1 | 2.2 | 6.8 | 9.0 | 10.8 |
| ROAA | 0.5 | 0.3 | 0.8 | 1.1 | 1.2 |
| Shareholders equity/assets | 13.3 | 13.1 | 12.1 | 11.7 | 11.4 |

Source: Company; Maybank

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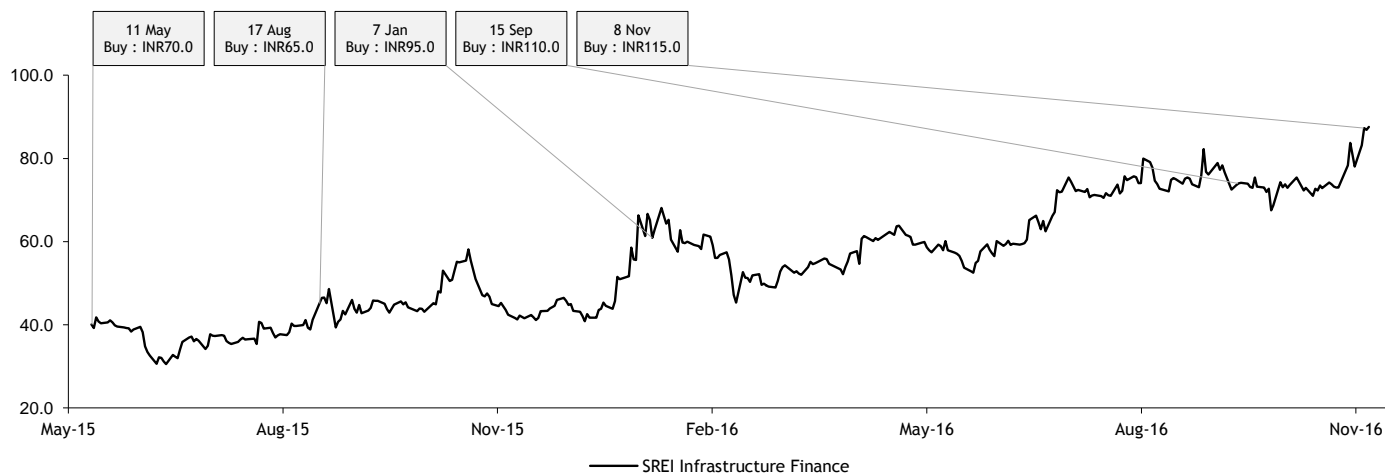
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