

# SREI Infrastructure Finance (SREI IN)

Member of quant-based [HTI Portfolios](#): Growth

Target Price **Rs137.0**  
 Current Price **Rs104.5**  
 % Upside **31%**

## The Turnaround Has Started

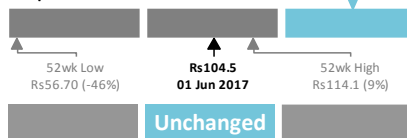
### Diversified Financials

#### India

02 Jun 2017

## BUY

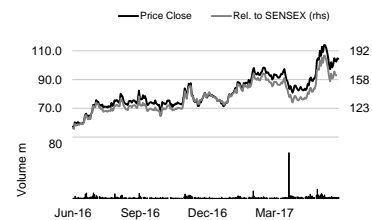
Target: **Rs137.0**  
 % Upside: **31%**



#### Basic Share Information

Market cap	Rs52.57b / US\$0.82b
Daily traded value (3mth)	US\$4.60m
Shares outstanding	479.6m
Free float	22%
1 yr high	Rs114.1
1 yr low	Rs56.70
Share price date	1 Jun 17

#### Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	15%	12.3%	82.5%
Absolute USD	14.5%	16.3%	90.9%
Relative to SENSEX	10.9%	4.8%	65.9%



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### Expect Strong Pickup In Construction Equipment Sales

**Summary:** SREI Infrastructure Finance (SREI) reported a more than three-fold jump in FY3/17 consolidated PAT (Rs2.4bn in FY3/17 versus Rs0.7bn in FY3/16), led by (a) reduction in borrowings on standalone book from Rs146bn as of FY3/16 to Rs132bn as of FY3/17 using the proceeds from sale of Viom (unlisted) stake; (b) return to growth in construction equipment with 28% disbursement growth YoY in FY3/17 and reduction in credit costs (Rs2.5bn in FY3/17 compared to Rs4bn in FY3/16); (c) full consolidation of its construction equipment subsidiary following the purchase of its 50% stake sale in the construction equipment business from joint-venture partner BNP Paribas Lease Group (BPLG; unlisted) in lieu of a 5% stake in the holding company. We reiterate our BUY rating on SREI.

**Target Price and Catalyst:** Our target price of Rs137 is based on our sum-of-the parts (SOTP) analysis, through which we derive a FY3/19 PBR value for the project finance business of 0.7x and for the construction equipment segment of 1.5x. We expect SREI's ROE to rise through FY3/20 on the back of improvement in its net interest margin (NIM) accompanied by reduced borrowing levels. We see this as a key positive catalyst for the share price.

**Earnings:** We forecast a CAGR for disbursements from the construction equipment business of 23% in the three years to FY3/20. With SREI fully consolidating its construction equipment operation, a decline in credit costs, an improvement in NIM in the company's project finance operations as the absolute borrowing level declines following the sale of Viom stake, and the possibility of credit rating upgrade, we project a CAGR for consolidated NP of 50% over the same period.

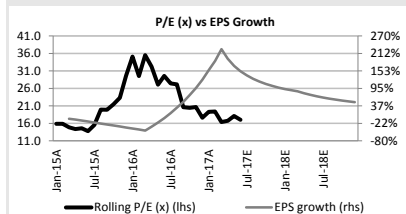
**Valuation:** Our target price for SREI increases to Rs137 from Rs126.9 previously as we roll forward our valuation target year from September 2017 to March 2018. Our valuation is based on an SOTP analysis, in which we have employed a discounted cash flow (DCF) approach to determine fair valuation for SREI's project finance and construction equipment businesses. The resulting implied FY3/19 PBR multiple for the project finance operation is 0.7x and that for the construction equipment business is 1.5x. On a consolidated basis, our implied fair FY3/19 PBR for SREI is 1.1x. In addition, we see the potential IPO of its road asset portfolio (Bharat Road Network) and sale in Sahaj e-Village (unlisted) as potential value accretive options in the future.

	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E	Trend
Net interest income (Rsm)	7,980	15,220	17,904	22,186	26,477	▬ ▬ ▬ ▬ ▬
Pre-provisional operating profit (Rsm)	3,784	11,165	11,839	15,254	18,304	▬ ▬ ▬ ▬ ▬
Pre-tax profit (Rsm)	1,172	3,606	6,818	9,733	12,331	▬ ▬ ▬ ▬ ▬
Net income to ord equity (Rsm)	725	2,432	4,500	6,424	8,139	▬ ▬ ▬ ▬ ▬
Net profit growth	(44.2%)	235.4%	85.0%	42.8%	26.7%	▬ ▬ ▬ ▬ ▬
P/E (x)	67.18	20.61	11.14	7.80	6.16	▬ ▬ ▬ ▬ ▬
P/B (x)	1.38	1.02	0.93	0.83	0.73	▬ ▬ ▬ ▬ ▬
ROE	2.0%	5.7%	8.7%	11.3%	12.7%	▬ ▬ ▬ ▬ ▬
Dividend yield	0.6%	0.6%	0.6%	0.6%	0.6%	▬ ▬ ▬ ▬ ▬
EPS HTI old (Rs)	1.56	5.70	9.64	13.39	-	▬ ▬ ▬ ▬ ▬
EPS HTI New (Rs)	1.56	5.07	9.38	13.40	16.97	▬ ▬ ▬ ▬ ▬
Consensus EPS (Rs)	-	4.87	-	-	10.00	▬ ▬ ▬ ▬ ▬
HTI EPS vs Consensus	na	4.2%	na	na	69.7%	▬ ▬ ▬ ▬ ▬

Source: Company data, Bloomberg, HTI estimates

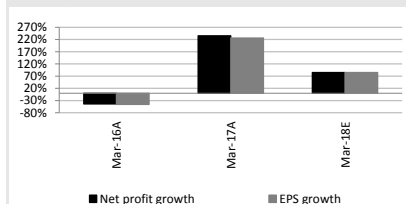
Click [here](#) to download the working model

Valuation



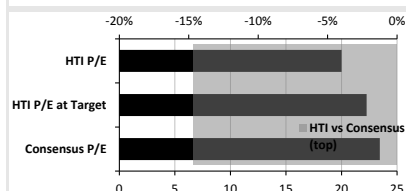
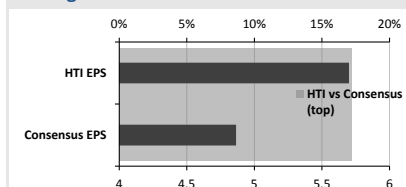
Source: Company data, Bloomberg, HTI estimates

Earnings Trends



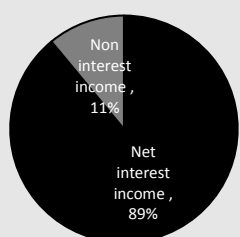
Source: Company data, Bloomberg, HTI estimates

Earnings: HTI vs Consensus



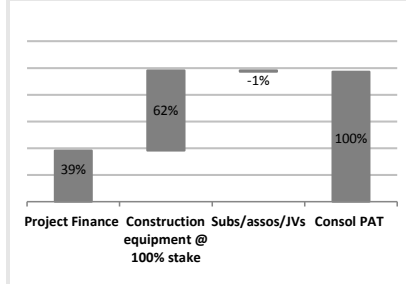
Source: Company data, Bloomberg, HTI estimates

FY3/17 Revenue Breakdown



Source: Company data

FY3/17 Consolidated NP Breakdown



Source: Company data

Investment Thesis

BUY

- SREI is a market leader in the construction equipment lending business in India with a market share of about 30%. The construction equipment business has picked up with Q1 FY3/17 volume up 58% YoY. We forecast a CAGR for SREI’s construction equipment disbursements of 23% over the three years to FY3/20.
- Capital allocated to non-core investments has decreased substantially following the firm’s sale of its stake in Viom in FY3/16.
- Using the proceeds from the Viom stake sale, SREI’s parent borrowing was reduced from Rs146bn at end-FY3/16 to Rs132bn at end of FY3/17. This should improve NIM on the standalone balance sheet (mainly in the project finance business).
- We see the possibility of a credit rating upgrade for the parent, which would likely lower SREI’s borrowing costs and improve its NIM further.
- We forecast a CAGR for consolidated NP of 50% over the three years to FY3/20 and project consolidated ROE to rise from 6% in FY3/17 to 13% in FY3/20.

Company Snapshot

SREI Infrastructure Finance is an integrated infrastructure solutions firm that provides infrastructure project financing (including for telecom towers, roads, and special economic zones (SEZs), infrastructure equipment financing (chiefly for construction equipment), asset management services and advisory services. The company was incorporated in 1989 in Kolkata and completed its IPO in 1992. As of end-FY3/17, SREI’s project financing loan book was Rs124bn and its construction equipment loan book reached Rs210bn and the firm reported consolidated NP of Rs2.4bn. The company also has an interest in Sahaj (unlisted) which aims to bridge the digital divide between urban and rural India through the operation of about Sahaj Centers around the country.

## Key Investment Metrics

### Revenue Growth

Low Medium **High**

SREI's construction equipment business has picked up and we forecast a CAGR for construction equipment disbursements of 23% over the three years to FY3/20. In the project finance business, management is not looking to expand its loan book and instead plans to sell down any additional advances that it may make.

### Profit Margins

Low Medium **High**

Parent NIM has been depressed due to SREI's high level of borrowing. However we project standalone NIM improves over our forecast period as borrowing declines following the sale of its stake in Viom.

### Shareholder Returns

Low **Medium** High

We see consolidated ROE rising from 6% in FY3/17 to 17% in FY3/20, led by an improvement in ROE in the construction equipment business from 5% to 15% during this period accompanied by a decline in credit costs. With NIM increasing on the back of reduced borrowing following the sale of the Viom stake, we also see ROE increasing in the project finance operation from 5% in FY3/17 to 11% in FY3/20.

### Balance Sheet Risks

High **Medium** Low

In our view, balance sheet risk has decreased significantly since the sale of the Viom tower assets. Investments in non-core road assets remain a concern, however.

## Barriers to Entry

Low **Medium** High

We believe SREI's established presence across the entire infrastructure value chain gives it a competitive advantage in India's infrastructure finance industry.

## International Exposure/Breakdown

High Medium **Low**

SREI currently has three foreign subsidiaries. The firm has a 92.5% stake in SREI International Infrastructure Service GmbH in Germany, which accounts for 0.2% of SREI's total assets, it has a 59.4% stake in Zao SREI Leasing (unlisted) in Russia, which accounts for 0.2% of its total assets, and it has a 92.5% stake in SREI Advisors Pte (unlisted) in Singapore which accounts for 0.003% of its total assets.

## FX Exposure

High Medium **Low**

In FY3/16, SREI had no forex earnings and its foreign expenditures totaled Rs1bn (this compares with Rs1.4mn and Rs838mn, respectively, in FY3/15). The company has drawn €13.2mn during the year from its €40mn credit line at the European Investment Bank (unlisted) for climate change mitigation projects. SREI has also signed an agreement with Deutsche Bank (DBK GR) for a US\$30mn line of credit from which it used US\$18mn in FY3/15, with the balance likely to be drawn down in FY3/17.

## Corporate Governance

Low **Medium** High

Investors have raised concerns about the amalgamation with Quippo Infrastructure Equipment (unlisted) and about the SREI's capital allocation in the past. However, with sale of the Viom stake in FY3/16, SREI's investments in non-core assets have decreased substantially. Moreover key shareholders increased their stake in the company by 5% in FY3/16.

## Our Model Assumptions

We expect parent NIM to improve from 2.6% in FY3/17 to 3.1% by FY3/20

Profit & Loss (Rsm)	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Interest income	30,918	41,500	45,345	52,456	61,737
Interest expense	(22,938)	(26,280)	(27,441)	(30,270)	(35,260)
Net interest income	7,980	15,220	17,904	22,186	26,477
Net other operating income	1,532	5,157	2,700	2,900	2,900
<b>Non interest income</b>	<b>1,532</b>	<b>5,157</b>	<b>2,700</b>	<b>2,900</b>	<b>2,900</b>
<b>Total operating income</b>	<b>9,512</b>	<b>20,377</b>	<b>20,604</b>	<b>25,086</b>	<b>29,377</b>
Staff costs	(1,449)	(2,016)	(2,112)	(2,528)	(3,021)
Other operating costs	(4,279)	(7,197)	(6,653)	(7,305)	(8,052)
<b>Total operating costs</b>	<b>(5,728)</b>	<b>(9,212)</b>	<b>(8,765)</b>	<b>(9,832)</b>	<b>(11,073)</b>
<b>Pre-provisional operating profit</b>	<b>3,784</b>	<b>11,165</b>	<b>11,839</b>	<b>15,254</b>	<b>18,304</b>
Loan impairment losses	(2,725)	(7,721)	(5,022)	(5,520)	(5,973)
Total impairment losses	(2,725)	(7,721)	(5,022)	(5,520)	(5,973)
<b>Operating profit</b>	<b>1,059</b>	<b>3,444</b>	<b>6,818</b>	<b>9,733</b>	<b>12,331</b>
Income from associates	112	6	-	-	-
Other gains/losses		156			
<b>Pre-tax profit</b>	<b>1,172</b>	<b>3,606</b>	<b>6,818</b>	<b>9,733</b>	<b>12,331</b>
Taxation	(444)	(1,173)	(2,318)	(3,309)	(4,193)
<b>Profit after tax</b>	<b>728</b>	<b>2,433</b>	<b>4,500</b>	<b>6,424</b>	<b>8,139</b>
Minority interests	(3)	(1)	-	-	-
<b>Profit after tax &amp; minorities</b>	<b>725</b>	<b>2,432</b>	<b>4,500</b>	<b>6,424</b>	<b>8,139</b>
<b>Net income to ord equity</b>	<b>725</b>	<b>2,432</b>	<b>4,500</b>	<b>6,424</b>	<b>8,139</b>

Source: Company, HTI estimates

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## Key P/L Takeaway

With the improvement in NIM that we project as borrowing declines following the Viom stake sale, a credit rating upgrade seems likely for SREI which would lower its borrowing costs

We forecast a CAGR for consolidated NP of 50% over the three years to FY3/20 supported by the full consolidation of the construction equipment lending business and reduced parent borrowing levels, which should boost NIM. We thus anticipate a rise in consolidated ROE from 6% in FY3/17 to 13% in FY3/20.

## Our Model Assumptions

We project a CAGR for gross loans in the construction equipment business of 23% over the three years to FY3/20

Balance Sheet (Rsm)	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Total investments	21,698	12,819	12,297	12,297	12,297
Gross loans	195,970	267,579	307,236	360,819	420,150
Less: Loan impairment allowances	(1,031)	(1,165)	(3,200)	(3,300)	(3,500)
Net loans	194,938	266,414	304,036	357,519	416,650
Tangible fixed assets	14,320	30,087	20,639	20,639	20,639
Intangible assets	3,077	2,840	2,840	2,840	2,840
Other assets	12,266	1,684	7,837	7,128	12,818
<b>Total assets</b>	<b>246,299</b>	<b>313,844</b>	<b>347,649</b>	<b>400,422</b>	<b>465,243</b>
Short-term debt	144,601	169,568	198,535	243,884	300,566
Long-term debt	62,126	89,126	89,126	89,126	89,126
Borrowings	206,727	258,694	287,660	333,010	389,692
Other liabilities	3,310	5,958	6,301	7,301	7,301
<b>Total liabilities</b>	<b>210,037</b>	<b>264,652</b>	<b>293,962</b>	<b>340,311</b>	<b>396,993</b>
Equity capital	5,032	5,032	5,032	5,032	5,032
Common stocks	5,032	5,032	5,032	5,032	5,032
Share capital and share premium	5,032	5,032	5,032	5,032	5,032
Other reserves	31,218	44,155	48,655	55,079	63,217
<b>Total reserves</b>	<b>31,218</b>	<b>44,155</b>	<b>48,655</b>	<b>55,079</b>	<b>63,217</b>
<b>Shareholders' equity</b>	<b>36,250</b>	<b>49,187</b>	<b>53,687</b>	<b>60,111</b>	<b>68,250</b>
Minority interests	12	5	-	-	-
<b>Total equity</b>	<b>36,262</b>	<b>49,193</b>	<b>53,687</b>	<b>60,111</b>	<b>68,250</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>246,299</b>	<b>313,845</b>	<b>347,649</b>	<b>400,422</b>	<b>465,243</b>

Source: Company, HTI estimates

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✓ **Key B/S Takeaway**

We expect SREI's consolidated net worth to increase from Rs36bn at end-FY3/16 to Rs68bn by FY3/20

Following the sale of its stake in Viom, SREI's total investments decreased substantially. We also expect the consolidated balance sheet to improve due to reduced borrowing. We see SREI's consolidated net worth increasing accompanied by the full consolidation of the construction equipment lending business and the increased profitability of this business.

## Our Model Assumptions

Shareholders' equity increased 36% YoY in FY3/17 following the full consolidation of the construction equipment business and an improvement in consolidated profitability

Capitalisation	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
Common equity tier-1 capital (Rsm)	22,379	20,491	21,974	23,853	26,301
Tier 1 capital (Rsm)	22,379	20,491	21,974	23,853	26,301
Tier 2 capital (Rsm)	8,995	8,500	8,000	7,500	7,500
Total risk-based capital (Rsm)	31,374	28,991	29,974	31,353	33,801
Risk weighted assets (Rsm)	178,912	171,013	173,459	185,098	198,743
CET1 ratio (Basel III)	12.5%	12.0%	12.7%	12.9%	13.2%
Tier 1 ratio (Basel III)	12.5%	12.0%	12.7%	12.9%	13.2%
Total capital ratio (Basel III)	17.5%	17.0%	17.3%	16.9%	17.0%
<b>Growth</b>					
Gross loans growth	5.7%	36.5%	14.8%	17.4%	16.4%
Total asset growth	1.6%	27.4%	10.8%	15.2%	16.2%
Total liabilities growth	1.8%	26.0%	11.1%	15.8%	16.7%
Total shareholders' equity growth	1.1%	35.7%	9.1%	12.0%	13.5%
Net interest income growth	20.6%	90.7%	17.6%	23.9%	19.3%
Non interest income growth	-63.9%	236.6%	-47.6%	7.4%	0.0%
Operating income growth	-12.4%	114.2%	1.1%	21.8%	17.1%
Operating expenses growth	-2.6%	60.8%	-4.9%	12.2%	12.6%
Pre-provision profit growth	-24.0%	195.0%	6.0%	28.8%	20.0%
Net profit growth	-44.2%	235.4%	85.0%	42.8%	26.7%
EPS growth	-45.8%	226.0%	85.0%	42.8%	26.7%
FD EPS growth	-45.8%	226.0%	85.0%	42.8%	26.7%
BVPS growth	-4.5%	35.7%	9.1%	12.0%	13.5%
DPS growth	-5.6%	0.0%	0.0%	0.0%	0.0%
<b>Margins</b>					
Avg yield on interest earning assets	15.78%	15.51%	14.76%	14.54%	14.69%
Avg cost of interest bearing liabilities	11.10%	10.16%	9.54%	9.09%	9.05%
Net interest spread	4.68%	5.35%	5.22%	5.45%	5.65%
Net interest margin	4.07%	5.69%	5.83%	6.15%	6.30%

Source: Company, HTI estimates

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#### Key B/S Takeaway

The current statutory capital ratio appears to be comfortable for SREI on both the Standalone as well as Construction equipment book

Consolidated NIM should rise significantly over the next three years thanks to the improvement in NIM in the standalone book.

## Our Model Assumptions

We see the dividend per share remaining constant over the next few years

Per Share Data	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
EPS (Rs)	1.56	5.07	9.38	13.40	16.97
FDEPS (Rs)	1.56	5.07	9.38	13.40	16.97
BVPS (Rs)	75.6	102.6	112.0	125.3	142.3
DPS (Rs)	0.61	0.61	0.61	0.61	0.61
Shares in issue (million)	503.0	503.0	503.0	503.0	503.0
Year end adjusted shares in issue (m)	479.6	479.6	479.6	479.6	479.6
Key Ratios	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Mar-20E
<b>Key performance indicators</b>					
Net interest income / total income	83.9%	74.7%	86.9%	88.4%	90.1%
Non interest income / total income	16.1%	25.3%	13.1%	11.6%	9.9%
Interest expenses / interest income	74.2%	63.3%	60.5%	57.7%	57.1%
Cost-income ratio	60.2%	45.2%	42.5%	39.2%	37.7%
RONTA	2.2%	6.1%	9.3%	11.9%	13.3%
Leverage (x)	6.79	6.38	6.48	6.66	6.82
Capital / assets	14.7%	15.7%	15.4%	15.0%	14.7%
Capital / total loans	18.5%	18.4%	17.5%	16.7%	16.2%
Fixed assets / shareholders' equity	39.5%	61.2%	38.4%	34.3%	30.2%
Long-term borrowings / total liabilities	29.6%	33.7%	30.3%	26.2%	22.5%
Provision coverage for impaired loans	13.1%	12.4%	34.7%	30.5%	27.8%
Loss reserves as % of avg assets	0.4%	0.4%	1.0%	0.9%	0.8%
Provision-to-loan ratio	0.5%	0.4%	1.0%	0.9%	0.8%
Net / pretax profit	0.62	0.67	0.66	0.66	0.66
ROA	0.3%	0.9%	1.4%	1.7%	1.9%
ROE	2.0%	5.7%	8.7%	11.3%	12.7%
RORWA	0.4%	1.4%	2.6%	3.6%	4.2%
Pre provisional ROAA	1.5%	4.0%	3.6%	4.1%	4.2%
Pre provisional ROAE	10.5%	26.1%	23.0%	26.8%	28.5%
Dividend payout ratio	40.1%	12.0%	6.5%	4.5%	3.6%
Tax rate	37.9%	32.5%	34.0%	34.0%	34.0%
Total liabilities to assets	85.3%	84.3%	84.6%	85.0%	85.3%
Avg assets/avg equity (x)	6.78	6.56	6.43	6.57	6.74
<b>Valuation Measures</b>					
P/E (x)	67.18	20.61	11.14	7.80	6.16
P/B (x)	1.38	1.02	0.93	0.83	0.73
Dividend yield	0.6%	0.6%	0.6%	0.6%	0.6%

Source: Company, HTI estimates

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✓ **Key Driver Takeaway**  
Construction equipment ROA should improve from 0.9% in FY3/17 to 1.9% in FY3/20

We expect consolidated ROE to rise from 6% in FY3/17 to 13% in FY3/20, driven mainly by increased profitability and improved capital utilization. We thus see EPS rising sharply from Rs5.1 in FY3/17 to Rs16.97 in FY3/20.

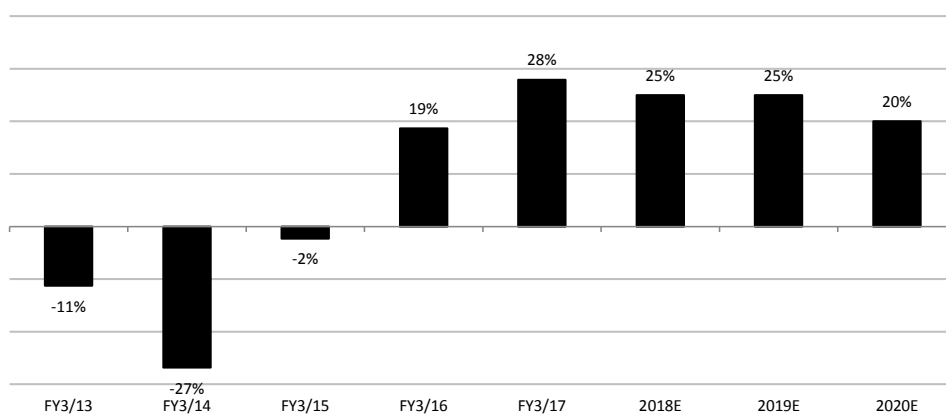
Top six manufacturers contribute to 70–75% of the total annual sales for SREI Construction equipment

### Company Outline and Operational Review

#### Construction Equipment Business To Continue To Grow Strongly

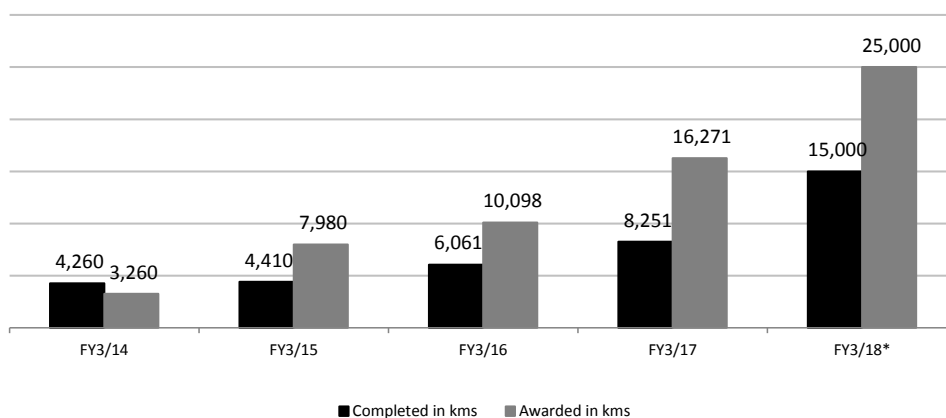
SREI’s construction equipment subsidiary has seen a pickup in disbursements in the last two years. The infrastructure budget allocation for FY3/18 increased to around Rs4trn from planned allocation of Rs2.2trn in FY3/17. Sale of key equipment such as excavators and backhoes grew by around 30% in FY3/17. About 90% of total company portfolio is in construction and mining equipment, placing SREI in a strong position to reap the benefits of this growth.

Figure 1: Construction Equipment Disbursements Growth For SREI Infrastructure



Source: Company data, HTI estimates

Figure 2: Highways Completed and Awarded by the National Highways Authority of India

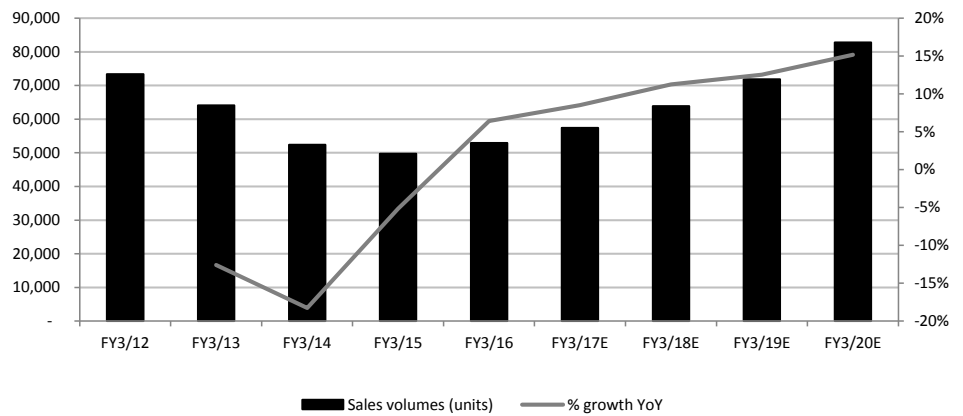


Source: MoRTH (Indian Ministry of Road Transport and Highways)

Note: \*Expected

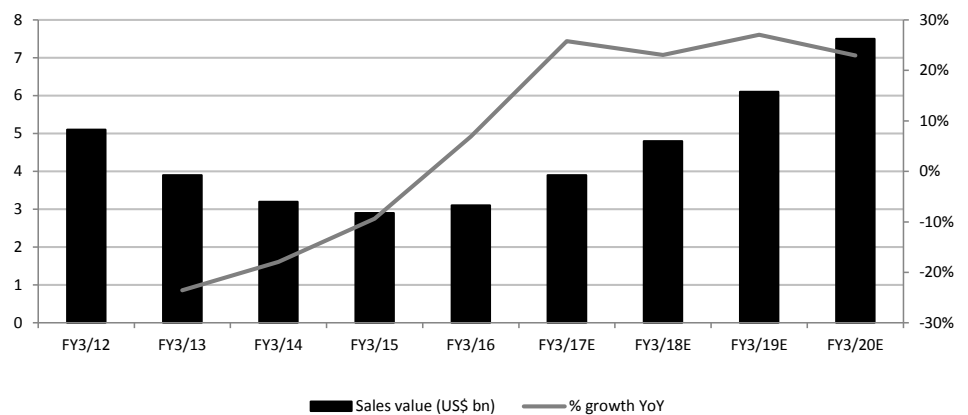


**Figure 3: Construction Equipment Sales Volume**



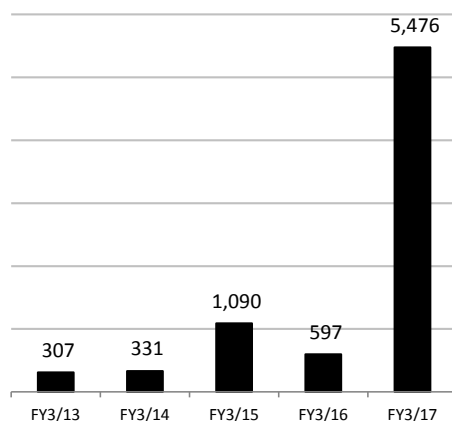
Source: Feedback estimates

**Figure 4: Construction Equipment Sales Value (US\$ bn)**

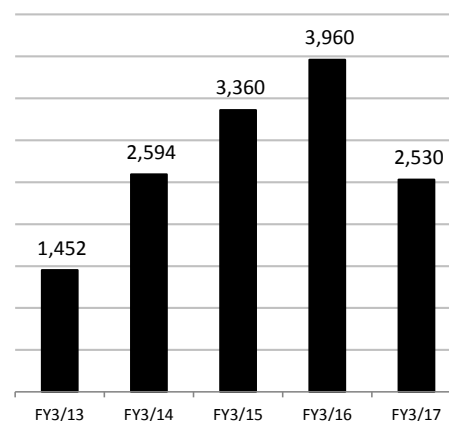


Source: ICEMA Vision 2020 (2010-2016); ICEMA research Global construction equipment industry, Feb 2013 (2000-2009 IBEF Report on Indian CE, Nov 2016)

**SREI has been providing for its NPAs significantly in its infrastructure and construction equipment subsidiary:** It has provided for around Rs7.8bn in credit costs via provisions and write-offs over FY3/13–17 in the standalone book, whereas in the construction equipment subsidiary, it has provided close to Rs14bn over FY3/13–17. We believe that SREI has provided significantly for most of the assets that had turned bad in its books and expect the credit costs to be lower over the next three-year period from FY3/18–20.

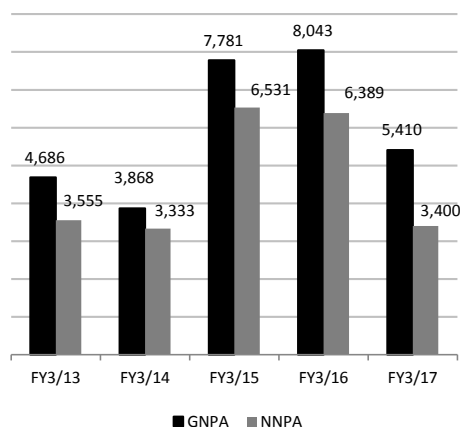
**Figure 5: Credit Costs In Standalone Book (Infrastructure lending business)**

Source: Company data

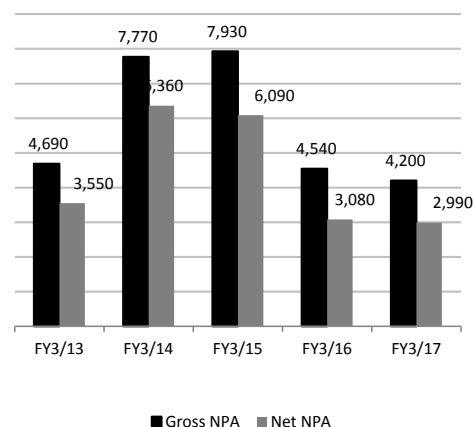
**Figure 6: Credit Costs In Construction Equipment Subsidiary**

Source: Company data

Gross non-performing assets (GNPA) for both standalone book as well as construction equipment book declined in FY3/17 from their peak levels.

**Figure 7: GNPA in Standalone Book (Rs mn)**

Source: Company data

**Figure 8: GNPA in Construction Equipment Subsidiary (Rs mn)**

Source: Company data

**Bharat Road Network IPO Could Be Value Accretive**

SREI has a well-diversified portfolio of build operate and transfer (BOT) road assets in Madhya Pradesh, Maharashtra, Uttar Pradesh, Kerala, Arunachal Pradesh, Odisha and Haryana. Of the seven total projects in which SREI has a significant economic interest, five are already operational covering 1,690km, and an additional 760km is under construction.

SREI filed draft red herring prospectus (DRHP) of Bharat Road Network Limited (BRNL) with SEBI on 16 February 2017. Monetization of its investments in roads assets can act as a key positive catalyst for the share price. Moreover, if the incoming cash is used to pay down borrowings then interest costs would reduce and profitability would improve further.

**Figure 9: Investment in Road Assets**

Subsidiaries	Status	% holding	Equity	Warrants	OCPID	Unsecured loan	Total
Solapur Tollways	Under construction	99.0%	5	-	-	-	2,322
Orissa Steel Expressway	Currently under foreclosure proceedings	59.4%	465	-	-	-	465
				-	-	-	
<b>Associates</b>							
Guruvaayoor Infrastructure	Operational under COD	49.0%	828	-	731	348	1,907
Ghaziabad Aligarh Expressway	Operational under Provisional COD	39.0%	757	1,363	-	-	2,119
Kurukshehra Expressway	Operational under Provisional COD	35.9%	973	-	931	29	1,933
Mahakaleshwar Tollways	Operational under COD	48.0%	500	-	294	-	794
Shree Jagannath Expressways	Operational under Provisional COD	40.0%	591	-	-	573	1,164
<b>Total capital invested</b>							<b>10,705</b>
<b>Total equity invested</b>							<b>9,755</b>

Source: MoRTH (Indian Ministry of Road Transport and Highways)

\*Expected

**Figure 10: Toll Road Projects In Which SREI Has Significant Economic Interest**

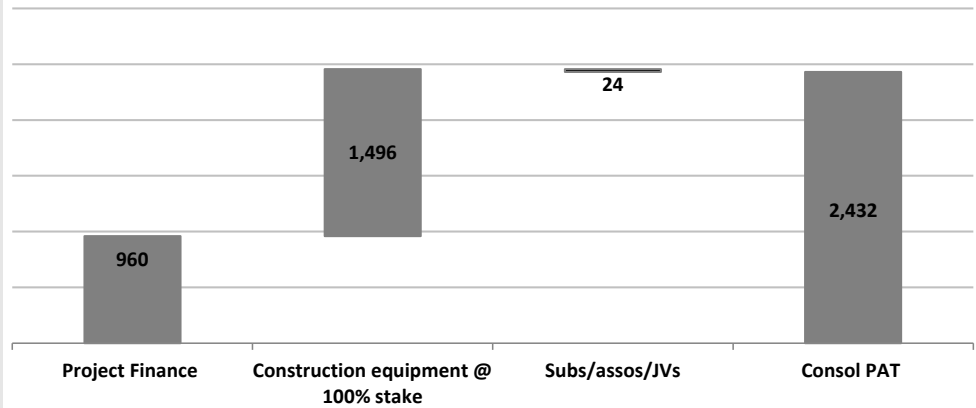
Operational	State	Project COD	Project cost (Rs bn)	FY3/15 Toll (Rs bn)	FY3/16 Toll (Rs bn)
Thrissur - Angamali, NH-47	Kerala	Dec-11	7.3	1.0	1.0
Indore – Ujjain Road on SH-27	Madhya Pradesh	Nov-10	3.3	0.2	0.2
Rohtak-Bawal section of NH-71	Haryana	Sep-13	10.4	0.7	0.8
Ghaziabad-Aligarh Section of NH – 91	Uttar Pradesh	Sep'16	22.0	0.0	1.3
Chandikhole Bhubaneswar Section of NH-5	Odisha	Aug-16	18.0	0.8	0.8
<b>Total</b>			<b>61.0</b>	<b>2.6</b>	<b>4.2</b>
Under construction	State	Project COD	Project cost (Rs bn)	FY3/15 Toll (Rs bn)	FY3/16 Toll (Rs bn)
Rimuli-Roxy-Rajamunda Section of NH 215	Odisha	Jun-18	9.6	na	na
Solapur Maharashtra/ Karnataka Border Section of NH-9	Maharashtra	Jun-17	8.8	na	na

Source: Company data

**We Project Substantial Jump in NP**

We expect net profit to rise significantly from around Rs2.4bn in FY3/17 to Rs8.1bn in FY3/20 thanks mainly to consolidation of the construction equipment business from 50% to 100% in FY3/17 and an improvement in ROE in both the project finance and construction equipment businesses.

**Figure 11: SREI Consolidated FY3/17 NP (Rs mn)**



Source: Company data

**Figure 12: SREI Consolidated FY3/20 NP (Rs mn)**



Source: HTI estimates

### Valuation Comment

Our target price for SREI of Rs137 is based on SOTP analysis, in which we have used DCF methodology to determine valuation for the project finance and construction equipment businesses. Through our analysis, the implied FY3/19 PBRs for these businesses are 0.7x and 1.5x, respectively.

**Figure 13: SOTP Valuation for SREI**

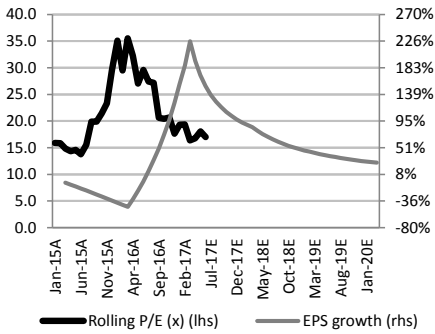
	Valuation (Rs m)	% stake of Srei	Value to Srei (Rs m)	Price/ share (Rs)	Implied valuation
Project Finance	17,036	100%	17,036	35.5	0.7x FY19 Adj. BV
Construction Equipment Finance	48,788	100%	48,788	101.5	1.5x FY19 Adj. BV
<b>Total</b>				<b>137.0</b>	

Source: Company data, HTI estimates

### Risks to Rating and Target Price

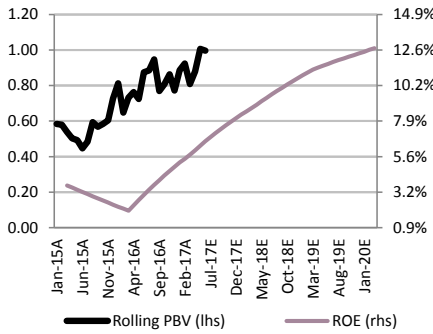
We see the main risks to our rating and target price as a poor investment climate, lack of government reforms in the infrastructure domain, and a delay in SREI's monetization of its investments in Sahaj and in roads assets. Competition from banks in construction equipment financing may increase as the banks search for other avenues of growth on the corporate book front. Currently HDFC Bank (HDFCB IN), Kotak Mahindra Bank (KMB IN) and Indusind Bank (IIB IN) have significant presence in construction equipment lending.

P/E (x) vs EPS Growth (%)



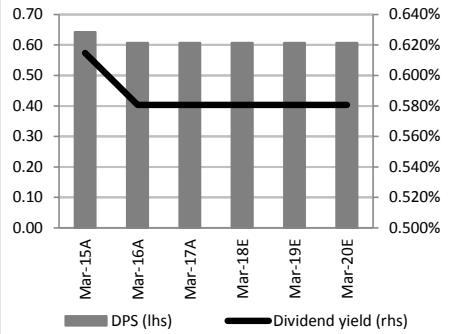
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



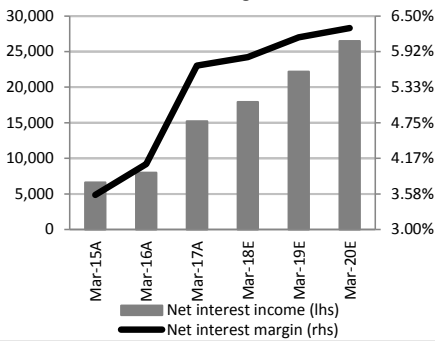
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield



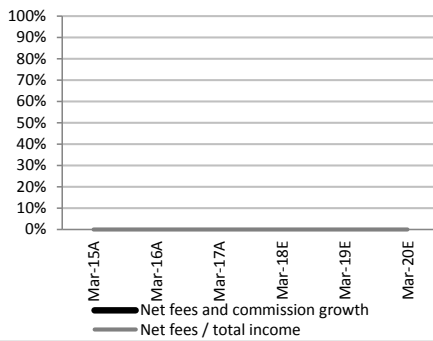
Source: Company data, Bloomberg, HTI estimates

Net Interest Income and Margin



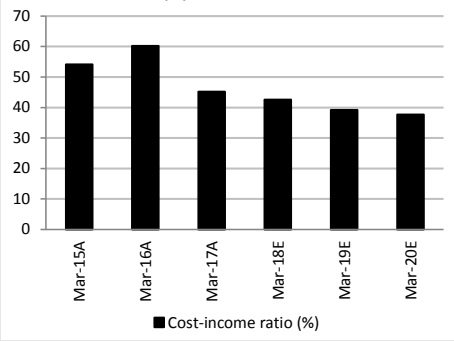
Source: Company data, Bloomberg, HTI estimates

Fees Income Growth vs Contribution



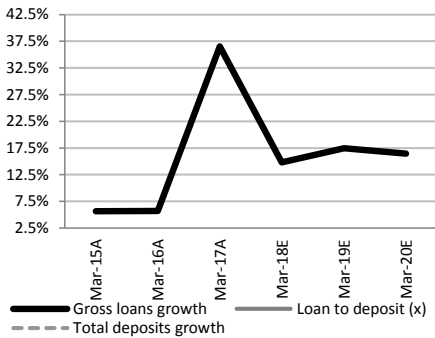
Source: Company data, Bloomberg, HTI estimates

Cost-income ratio (%)



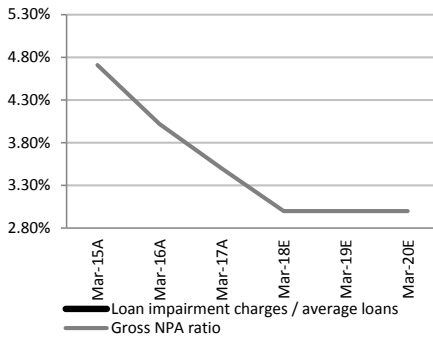
Source: Company data, Bloomberg, HTI estimates

Loan and Deposit Growth and LDR



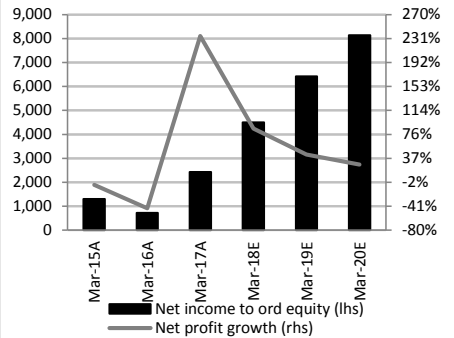
Source: Company data, Bloomberg, HTI estimates

Credit Costs vs Net NPA Ratio



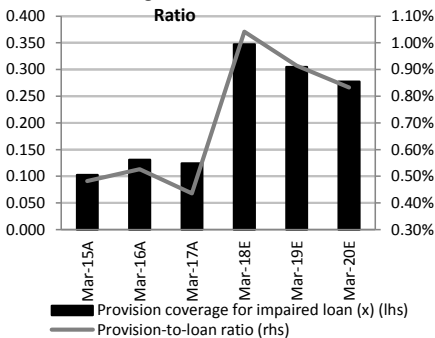
Source: Company data, Bloomberg, HTI estimates

Net Income To Ord Equity and Growth (Rsm)



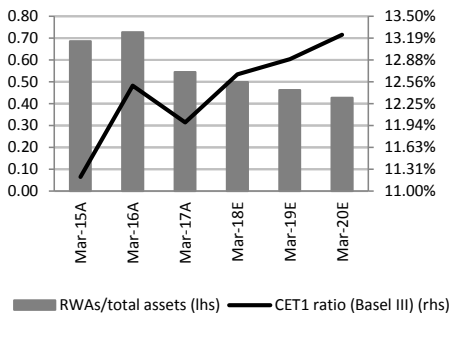
Source: Company data, Bloomberg, HTI estimates

Provision Coverage and Provision to Loan Ratio



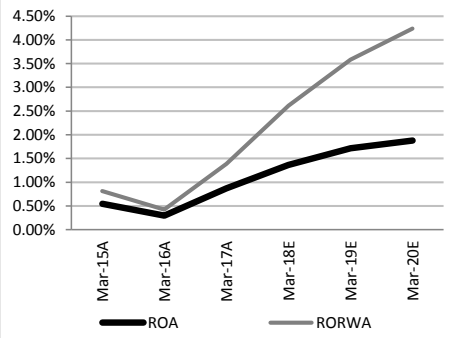
Source: Company data, Bloomberg, HTI estimates

CET1 CAR vs RWAs/total assets



Source: Company data, Bloomberg, HTI estimates

ROA vs RORWA



Source: Company data, Bloomberg, HTI estimates

### Revenue Growth

SREI's construction equipment business has picked up and we forecast a CAGR for construction equipment disbursements of 23% over the three years to FY3/20. In the project finance business, management is not looking to expand its loan book and instead plans to sell down any additional advances that it may make.

### Profit Margins

Parent NIM has been depressed due to SREI's high level of borrowing. However we project standalone NIM improves over our forecast period as borrowing declines following the sale of its stake in Viom.

### Shareholder Returns

We see consolidated ROE rising from 6% in FY3/17 to 17% in FY3/20, led by an improvement in ROE in the construction equipment business from 5% to 15% during this period accompanied by a decline in credit costs. With NIM increasing on the back of reduced borrowing following the sale of the Viom stake, we also see ROE increasing in the project finance operation from 5% in FY3/17 to 11% in FY3/20.

### Balance Sheet Risks

In our view, balance sheet risk has decreased significantly since the sale of the Viom tower assets. Investments in non-core road assets remain a concern, however.



#### Key Takeaway

We forecast a CAGR for consolidated NP of 50% over the three years to FY3/20

### Investment Thesis – Target Price – Share Price Catalysts

SREI Infrastructure Finance (SREI) reported a more than three-fold jump in FY3/17 consolidated PAT (Rs2.4bn in FY3/17 versus Rs0.7bn in FY3/16), led by (a) reduction in borrowings on standalone book from Rs146bn as of FY3/16 to Rs132bn as of FY3/17 using the proceeds from sale of Viom (unlisted) stake; (b) return to growth in construction equipment with 28% disbursement growth YoY in FY3/17 and reduction in credit costs (Rs2.5bn in FY3/17 compared to Rs4bn in FY3/16); (c) full consolidation of its construction equipment subsidiary following the purchase of its 50% stake sale in the construction equipment business from joint-venture partner BNP Paribas Lease Group (unlisted) (BPLG) in lieu of a 5% stake in the holding company. We reiterate our BUY rating on SREI.

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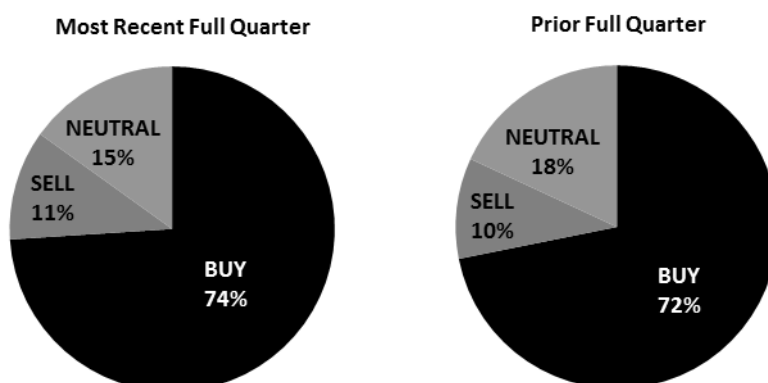
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NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2016-11-02	Buy	126.9	83.9

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

**Business Growth**

This is the metric which matches the top line in our report.

**Business profit**

This is the metric which best represents operating profit in our report

**Shareholder Returns**

Return on Equity

**Balance Sheet Risk**

Net Debt to Equity