

SREI Infrastructure Finance (SREI IN)

Target Price **INR126.90**
 Current Price **INR78.40**
 % Upside **62%**

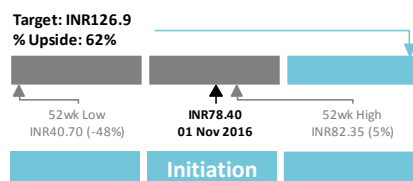
Significant Turnaround Potential

Diversified Financials

India

2 Nov 2016

BUY



Basic Share Information

Market cap	INR39b/US\$0.6b
Daily volume (3mth)	US\$1m
Shares outstanding	480m
Free float	22%
1 yr high	INR82.35
1 yr low	INR40.70
Foreign shareholding	20%
Last HTI contact w/ Co	17 Oct 16

Note: Share price and market data as of 1 November 2016.

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	14.5%	3.5%	74.2%
Absolute USD	14.3%	3.5%	70.4%
Relative to SENSEX	14.3%	3.8%	69.4%



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Earnings Visibility Emerging

Summary: We think SREI Infrastructure Finance is a classic turnaround story. It seems as if everything went wrong for SREI over the last decade, including mistakes by management on capital allocation (i.e., the buyout of Viom (unlisted)) and the firm's heavy funding exposure to the infrastructure sector, which suffered as a result of deterioration in the operating environment. However we believe these problems are unwinding with (1) the sale of the stake in Viom in FY3/16 enhancing the bank's capital position, (2) an improvement in the operating environment for the core construction equipment business, (3) reduced financing costs, which has strengthened the balance sheet, and (4) the purchase of 50% stake in the construction equipment business from joint venture partner BNP Paribas Lease Group (unlisted) (BPLG) in lieu of 5% stake in the holding company. In addition, we see the potential stake sale in Sahaj e-Village (unlisted) and/or in the road asset portfolio as call options. We have a BUY rating on SREI.

Target Price and Catalyst: Our target price of Rs126.90 is based on our sum-of-the-parts (SOTP) analysis, through which we have derived a FY3/18 PBR value for the project finance business of 0.7x and for the construction equipment segment of 1.5x. We expect ROE to rise through FY3/19 on an improvement in net interest margin (NIM) accompanying 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 25% in the three years to FY3/19. With SREI fully consolidating its construction equipment operation, a decline in credit costs and an improvement in NIM in the project finance operation 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 107% over the same period.

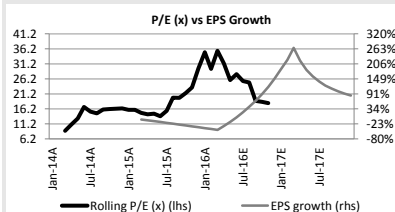
Valuation: Our target price for SREI of Rs126.90 is based on our SOTP analysis, in which we have employed a discounted cash flow (DCF) approach to determine fair valuation for the project finance and construction equipment businesses. The resulting implied FY3/18 PBR multiple for the project finance operation is 0.7x and that for the construction equipment business is 1.5x. On a consolidated basis, our implied fair FY3/18 PBR for SREI is 1.1x.

	Mar-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E	Trend
Net interest income (INRm)	6,615	7,980	16,463	20,127	23,853	▬ ▬ ▬ ▬ ▬
Pre-provisional operating profit (INRm)	4,980	3,784	13,125	12,808	15,776	▬ ▬ ▬ ▬ ▬
Pre-tax profit (INRm)	1,882	1,059	4,142	7,003	9,731	▬ ▬ ▬ ▬ ▬
Net income to ord equity (INRm)	1,300	725	2,734	4,622	6,423	▬ ▬ ▬ ▬ ▬
Net profit growth	(6.2%)	(44.2%)	277.0%	69.1%	39.0%	▬ ▬ ▬ ▬ ▬
P/E (x)	27.32	50.40	13.75	8.13	5.85	▬ ▬ ▬ ▬ ▬
P/B (x)	0.99	1.04	0.74	0.68	0.61	▬ ▬ ▬ ▬ ▬
ROE	3.7%	2.0%	6.3%	8.7%	11.0%	▬ ▬ ▬ ▬ ▬
Dividend yield	0.8%	0.8%	0.8%	0.8%	0.8%	▬ ▬ ▬ ▬ ▬
EPS HTI New (INR)	2.87	1.56	5.70	9.64	13.39	▬ ▬ ▬ ▬ ▬
Consensus EPS (INR)	2.90		3.74	5.53	11.00	▬ ▬ ▬ ▬ ▬
HTI EPS vs Consensus	(1.0%)	na	52.4%	74.5%	21.8%	▬ ▬ ▬ ▬ ▬

Source: Company data, Bloomberg, HTB estimates

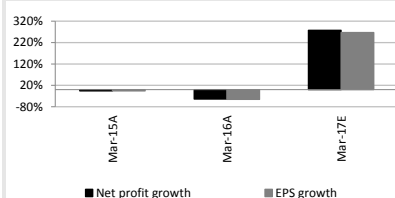
Click [here](#) to download the working model

Valuation



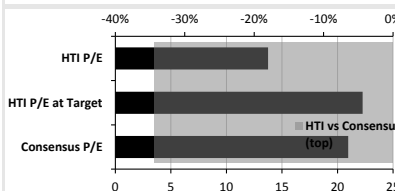
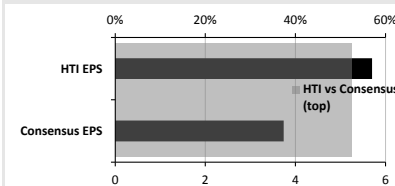
Source: Company data, Bloomberg, HTB estimates

Earnings Trends



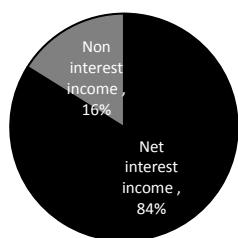
Source: Company data, Bloomberg, HTB estimates

Earnings: HTB vs Consensus



Source: Company data, Bloomberg, HTB estimates

FY3/16 Revenue 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 25% over the three years to FY3/19.
- 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-Q1 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 107% over the three years to FY3/19 driven by the full consolidation of the construction equipment lending business and improved NIM accompanying the reduced parent borrowing levels.
- We project that consolidated ROE rises from 2% in FY3/16 to 11% in FY3/19.
- Following its purchase of BPLG’s 50% stake in SREI Equipment Finance (unlisted) and its full consolidation of the entity from 17 June 2016, we estimate SREI’s consolidated net worth climbs from Rs36bn as of FY3/16 to Rs50bn as of FY3/17.

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-FY3/16, SREI’s project financing loan book was Rs132bn and its construction equipment loan book reached Rs189bn and the firm reported consolidated NP of Rs725mn. 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 40,000 Sahaj Centers around the country. Recently, SREI received authorization from the Reserve Bank of India to set up, own, and operate white label ATMs.

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 25% over the three years to FY3/19. 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 the stake in Viom. We expect construction equipment NIM to be largely stable through FY3/19.

Shareholder Returns

Low **Medium** High

We see consolidated ROE rising from 2% in FY3/16 to 11% in FY3/19, led by an improvement in ROE in the construction equipment business from 5% to 15% during this period accompanying a decline in credit costs. With NIM increasing on reduced borrowing following the sale of the Viom stake, we also see ROE increasing in the project finance operation from 4% in FY3/16 to 7% in FY3/19.

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 in Russia, which accounts for 0.2% of its total assets, and it has a 92.5% stake in SREI Advisors Pte 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 1.4% in FY3/16 to 2.8% by FY3/19

Consolidated OP should reflect the effects of full consolidation of the construction equipment lending business from FY3/17

Profit & Loss (INRm)	Mar-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E
Interest income	29,222	30,918	44,236	47,951	54,679
Interest expense	(22,607)	(22,938)	(27,773)	(27,825)	(30,826)
Net interest income	6,615	7,980	16,463	20,127	23,853
Net other operating income	4,247	1,532	5,164	1,894	1,944
Non interest income	4,247	1,532	5,164	1,894	1,944
Total operating income	10,862	9,512	21,627	22,021	25,797
Staff costs	(1,443)	(1,449)	(2,014)	(2,308)	(2,524)
Other operating costs	(4,439)	(4,279)	(6,488)	(6,905)	(7,498)
Total operating costs	(5,881)	(5,728)	(8,503)	(9,213)	(10,021)
Pre-provisional operating profit	4,980	3,784	13,125	12,808	15,776
Loan impairment losses	(3,098)	(2,725)	(8,983)	(5,804)	(6,045)
Total impairment losses	(3,098)	(2,725)	(8,983)	(5,804)	(6,045)
Operating profit	1,882	1,059	4,142	7,003	9,731
Pre-tax profit	1,882	1,059	4,142	7,003	9,731
Taxation	(670)	(444)	(1,408)	(2,381)	(3,309)
Profit after tax	1,212	615	2,734	4,622	6,423
Minority interests	88	110	-	-	-
Profit after tax & minorities	1,300	725	2,734	4,622	6,423
Net income to ord equity	1,300	725	2,734	4,622	6,423

Source: Company, HTB 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 107% over the three years to FY3/19 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 2% in FY3/16 to 11% in FY3/19.

Our Model Assumptions

We project a CAGR for gross loans in the construction equipment business of 21% over the three years to FY3/19 while the project financing book remains flat

Balance Sheet (INRm)	Mar-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E
Total investments	22,499	21,698	6,930	6,930	6,930
Gross loans	185,413	195,970	274,571	305,352	347,633
Less: Loan impairment allowances	(894)	(1,031)	(3,200)	(3,200)	(3,200)
Net loans	184,519	194,938	271,371	302,152	344,433
Tangible fixed assets	15,513	14,320	21,081	21,081	21,081
Intangible assets	3,077	3,077	3,077	3,077	3,077
Other assets	16,726	12,266	10,290	9,581	8,872
Total assets	242,335	246,299	312,750	342,823	384,394
Short-term debt	135,216	144,601	186,644	211,395	245,543
Long-term debt	68,042	62,126	70,000	70,000	70,000
Borrowings	203,258	206,727	256,644	281,395	315,543
Other liabilities	3,106	3,310	5,589	6,289	7,289
Total liabilities	206,363	210,037	262,233	287,683	322,832
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	30,814	31,218	45,485	50,107	56,530
Total reserves	30,814	31,218	45,485	50,107	56,530
Shareholders' equity	35,846	36,250	50,517	55,140	61,562
Minority interests	126	12	-	-	-
Total equity	35,972	36,262	50,517	55,140	61,562
Total liabilities & shareholders' equity	242,335	246,299	312,750	342,823	384,394

Source: Company, HTB 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 Rs50bn this fiscal year

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 accompanying the full consolidation of the construction equipment lending business and the increased profitability of this business.

Our Model Assumptions

We project shareholders' equity increases 39% YoY in FY3/17 following the full consolidation of the construction equipment business and an improvement in consolidated profitability

Capitalisation	Mar-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E
Common equity tier-1 capital (INRm)	18,607	22,379	20,569	21,492	22,818
Tier 1 capital (INRm)	18,607	22,379	20,569	21,492	22,818
Tier 2 capital (INRm)	9,573	8,995	8,500	8,000	7,500
Total risk-based capital (INRm)	28,180	31,374	29,069	29,492	30,318
Risk weighted assets (INRm)	166,081	178,912	162,234	162,789	162,939
CET1 ratio (Basel III)	11.2%	12.5%	12.7%	13.2%	14.0%
Tier 1 ratio (Basel III)	11.2%	12.5%	12.7%	13.2%	14.0%
Total capital ratio (Basel III)	17.0%	17.5%	17.9%	18.1%	18.6%
Growth					
Gross loans growth	5.6%	5.7%	40.1%	11.2%	13.8%
Total asset growth	2.9%	1.6%	27.0%	9.6%	12.1%
Total liabilities growth	3.0%	1.8%	24.9%	9.7%	12.2%
Total shareholders' equity growth	2.5%	1.1%	39.4%	9.1%	11.6%
Net interest income growth	9.3%	20.6%	106.3%	22.3%	18.5%
Non interest income growth	39.4%	-63.9%	237.1%	-63.3%	2.6%
Operating income growth	19.4%	-12.4%	127.4%	1.8%	17.1%
Operating expenses growth	13.8%	-2.6%	48.4%	8.4%	8.8%
Pre-provision profit growth	26.7%	-24.0%	246.8%	-2.4%	23.2%
Net profit growth	-6.2%	-44.2%	277.0%	69.1%	39.0%
EPS growth	-6.2%	-45.8%	266.5%	69.1%	39.0%
FD EPS growth	-6.2%	-45.8%	266.5%	69.1%	39.0%
BVPS growth	2.5%	-4.5%	39.4%	9.1%	11.6%
DPS growth	3.0%	-5.6%	0.0%	0.0%	0.0%
Margins					
Avg yield on interest earning assets	15.76%	15.78%	16.11%	15.70%	15.73%
Avg cost of interest bearing liabilities	11.12%	11.10%	10.82%	9.89%	9.77%
Net interest spread	4.64%	4.68%	5.29%	5.82%	5.96%
Net interest margin	3.57%	4.07%	6.00%	6.59%	6.86%

Source: Company, HTB estimates

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✓ **Key Cash Flow Takeaway**
We expect SREI's cost of borrowing to decrease as its overall borrowing level drops, which in turn should lead to a credit rating upgrade

The current parent Tier 1 capital ratio appears to be comfortable for SREI and we do not think the firm is likely to require a capital infusion in the near future.

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-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E
EPS (INR)	2.87	1.56	5.70	9.64	13.39
FDEPS (INR)	2.87	1.56	5.70	9.64	13.39
BVPS (INR)	79.1	75.6	105.3	115.0	128.4
DPS (INR)	0.64	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)	452.9	479.6	479.6	479.6	479.6
Key Ratios	Mar-15A	Mar-16A	Mar-17E	Mar-18E	Mar-19E
Key performance indicators					
Net interest income / total income	60.9%	83.9%	76.1%	91.4%	92.5%
Non interest income / total income	39.1%	16.1%	23.9%	8.6%	7.5%
Interest expenses / interest income	77.4%	74.2%	62.8%	58.0%	56.4%
Cost-income ratio	54.1%	60.2%	39.3%	41.8%	38.8%
RONTA	4.1%	2.2%	6.8%	9.3%	11.6%
Leverage (x)	6.76	6.79	6.19	6.22	6.24
Capital / assets	14.8%	14.7%	16.2%	16.1%	16.0%
Capital / total loans	19.3%	18.5%	18.4%	18.1%	17.7%
Fixed assets / shareholders' equity	43.3%	39.5%	41.7%	38.2%	34.2%
Long-term borrowings / total liabilities	33.0%	29.6%	26.7%	24.3%	21.7%
Provision coverage for impaired loans	10.2%	13.1%	33.3%	34.9%	30.7%
Loss reserves as % of avg assets	0.4%	0.4%	1.1%	1.0%	0.9%
Provision-to-loan ratio	0.5%	0.5%	1.2%	1.0%	0.9%
Net / pretax profit	0.69	0.68	0.66	0.66	0.66
ROA	0.5%	0.3%	1.0%	1.4%	1.8%
ROE	3.7%	2.0%	6.3%	8.7%	11.0%
RORWA	0.8%	0.4%	1.6%	2.8%	3.9%
Pre provisional ROAA	2.1%	1.5%	4.7%	3.9%	4.3%
Pre provisional ROAE	14.1%	10.5%	30.3%	24.2%	27.0%
Dividend payout ratio	22.4%	40.1%	10.6%	6.3%	4.5%
Tax rate	35.6%	41.9%	34.0%	34.0%	34.0%
Total liabilities to assets	85.2%	85.3%	83.8%	83.9%	84.0%
Avg assets/avg equity (x)	6.75	6.78	6.44	6.20	6.23
Valuation Measures					
P/E (x)	27.32	50.40	13.75	8.13	5.85
P/B (x)	0.99	1.04	0.74	0.68	0.61
Dividend yield	0.8%	0.8%	0.8%	0.8%	0.8%

Source: Company, HTB estimates

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✓ **Key Driver Takeaway**
Construction equipment ROA should improve from 0.8% in FY3/16 to 2.4% in FY3/19

We expect consolidated ROE to rise from 2% in FY3/16 to 11% in FY3/19, driven mainly by increased profitability and improved capital utilization. We thus see EPS rising sharply from Rs1.6 to Rs13.4 over this period.

We believe SREI’s presence in all segments of the construction equipment life cycle (from the initial asset purchase to the exit from the investment or its resale) gives the firm a sustainable competitive advantage

We expect AUM in SREI’s construction equipment business to rise through FY3/19

SREI’s project financing business is unique in that it offers holistic services that include financial advisory, project advisory, equipment rentals and equipment financing

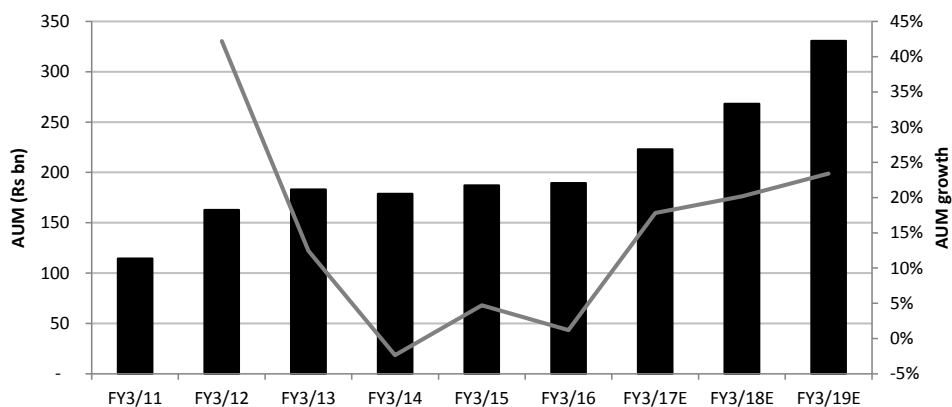
We do not expect AUM in the project finance business to increase during FY3/16–19

Company Outline and Operational Review

Equipment Finance

SREI Equipment Finance, established as 50:50 joint venture between SREI and BPLG, operates in the equipment financing and equipment leasing space, and is now the largest construction and mining equipment financier in India with about 60,000 customers. SREI purchased BPLG’s 50% stake in the joint venture last year and has full ownership of the subsidiary, which now also finances the purchases of IT hardware, health care, and rural equipment (e.g., farm machinery). As of end-FY3/16, SREI Equipment Finance had Rs189bn in AUM and reported NP of Rs1,150mn.

Figure 1: SREI Construction Equipment AUM

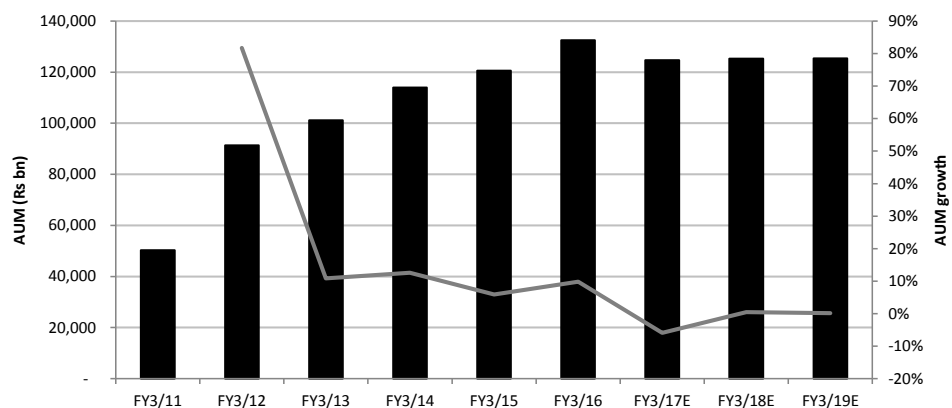


Source: Company data, Haitong Bank estimates

Project Finance

SREI Project Finance operation is a non-banking financial company (NBFC) that extends financing for infrastructure projects including for roads, bridges, ports, telecommunications, water supply, waste management, SEZs, agri-infrastructure, warehousing, and renewable energy. AUM for this business increased at a compound annual rate of 9% over the three years to FY3/16 to Rs132bn. In addition to core financing operation, SREI Project Finance is unique for the wide range of project support that it provides, including financial advisory, project advisory, equipment rental and equipment financing services.

Figure 2: SREI Project Finance AUM



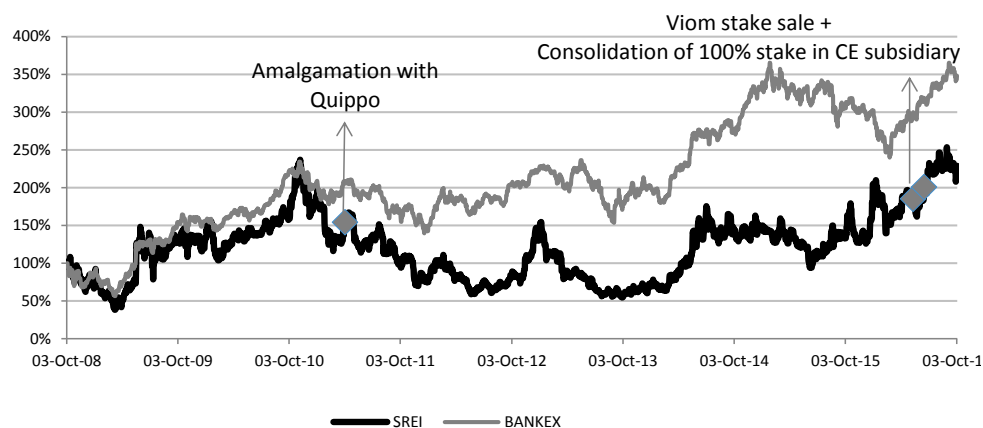
Source: Company data, Haitong Bank estimates

Over the past eight years, SREI's stock has underperformed BANKEK

SREI Has Underperformed Sector

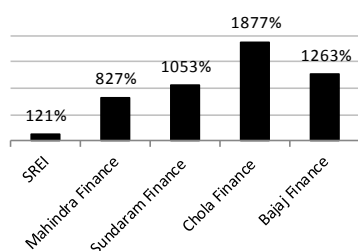
SREI's stock has underperformed BANKEK for the most of the past eight years, although over the past year the stock has narrowed the gap with the index (see Figure 3). SREI has also been significantly outperformed by its NBFC peers over the past few years (see Figure 4).

Figure 3: SREI Share Price versus BANKEK



Source: Company data, Bloomberg,

Figure 4: Absolute Share Price Performance for SREI and NBFC Peers over Past Eight Years



Source: Company data, Bloomberg

We believe the relatively poor performance of SREI's shares is attributable to concerns about the company's capital allocation, which investors believe has stressed the balance sheet. The stock's underperformance versus BANKEK started in FY3/11. During 2010-13, SREI made a series of equity investments in infrastructure assets including roads, telecom towers and SEZs. The largest of these investments was the merger with Quippo Infrastructure Equipment. This amalgamation caused Quippo's subsidiaries to become SREI investments, and as a result SREI ended up with an 18.5% stake in Viom, the second-largest tower company in India (including Rs16bn in direct equity investment and Rs11bn in quasi equity). This pushed SREI's total equity investment in infrastructure businesses outside of its core finance operation to 98% of its standalone net worth. In addition, as all of these projects were still in their investment phases, they were not generating any returns.

Figure 5: SREI-Quippo Merger (Rs mn)

Date of amalgamation	Mar 4, 2011
SREI Standalone Networth (FY10)	7,901
SREI Standalone Networth (FY11)	25,531
SREI CAR (FY10)	22%
SREI CAR (FY11)	29%
Quippo's businesses	Telecom towers Construction equipment rental Energy rental Oil & Gas Infra
Swap ratio	3 equity shares of SREI for 2 equity shares of Quippo
Promoter holding (Dec'10)	30.0%
Promoter holding (Mar'11)	46.2%

Source: Company data
Note: CAR = Capital adequacy ratio

As a result of the high leverage on its balance sheet, SREI's credit profile deteriorated

Figure 7: SREI Standalone Book Credit Rating

	Borrowings/ equity	Credit Rating	Borrowing costs
FY3/10	4.5x	AA	10.2%
FY3/11	2.1x	AA	9.8%
FY3/12	3.8x	AA	12.5%
FY3/13	4.2x	AA-	12.5%
FY3/14	4.8x	AA-	12.7%
FY3/15	5.0x	AA-	11.3%
FY3/16	5.3x	A+	11.1%

Source: Company data, Bloomberg

Because borrowing was used to fund equity investments, borrowing exceeded balance sheet loans for SREI...

The situation worsened for SREI when the operating and investment climate in the infrastructure space started to deteriorate after 2012. This hampered SREI's ability to liquidate these assets, so the firm had to hold them longer than it had initially anticipated.

Figure 6: Equity investments by SREI (Rs mn)

	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	Comments
Standalone Network	7,901	25,531	25,820	26,475	26,774	27,380	27,651	
Equity investments								
Subsidiaries	475	4,571	4,607	4,512	4,504	3,742	3,752	
Joint venture	250	250	749	1,747	1,747	1,747	1,747	Srei Equipment Finance Limited
Associates	-	-	-	115	115	910	912	Sahaj e-Village + Attivo Economic zone
Viom	1,000	13,782	13,848	13,848	15,980	15,980	15,980	Investment in Viom has been sold
Srei Treasury Stock	185	185	185	185	185	185	185	Shares of SREI Infrastructure
Others	451	250	250	250	202	202	886	Equity investments in road projects and others
Units of VC funds	4,593	5,761	6,327	6,467	4,000	2,736	699	
Equity - Quoted	74	39	39	38	38	19	19	IMFA (Rs17mn)
Equity - Unquoted	206	206	206	206	206	206	-	
Mutual funds and others	24	10	10	-	-	-	-	
Total	7,258	25,054	26,221	27,368	26,977	25,727	24,180	

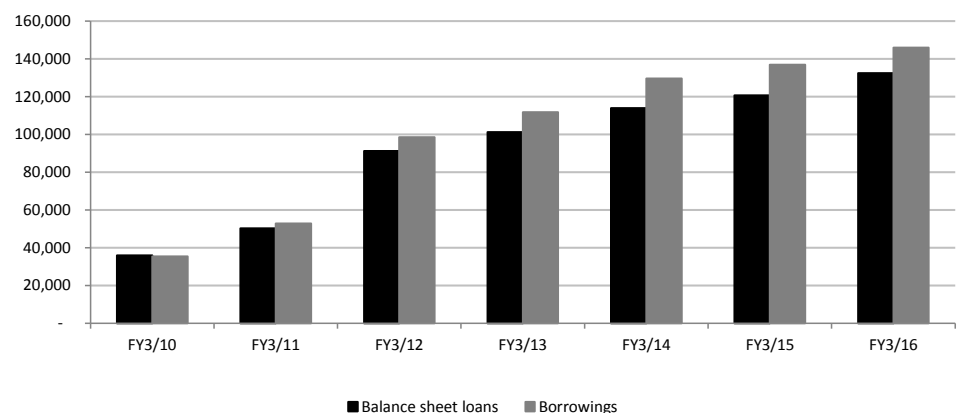
Source: Company data

As a result of the high leverage on its balance sheet, SREI's credit profile deteriorated (see Figure 7). This caused its cost of borrowing to surge 290bps from 9.8% in FY3/11 to 12.7% in FY3/14. The interest yield rose by just 80bps during FY3/11–14 as this borrowing was used to make non-core investments that were not generating any interest income (in contrast, the HDFC Bank (HDFCB IN) base rate increased by 130bps over this period).

Specifically the credit rating from CARE Ratings for SREI's non-convertible debentures (NCDs) fell from 'AA' in FY3/11 to 'AA-' in FY3/14. Its NCD rating then dropped further to 'A+' in FY3/16. As a result, the spread deteriorated from 4.7% in FY3/11 to 2.7% in FY3/14. Consequently, NIM fell from 3.3% in FY3/11 to 0.9% in FY3/14.

The balance sheet became inefficient as borrowing was used to fund the equity investments. This borrowing exceeded the balance sheet loans, which pushed NIM below the core business spread.

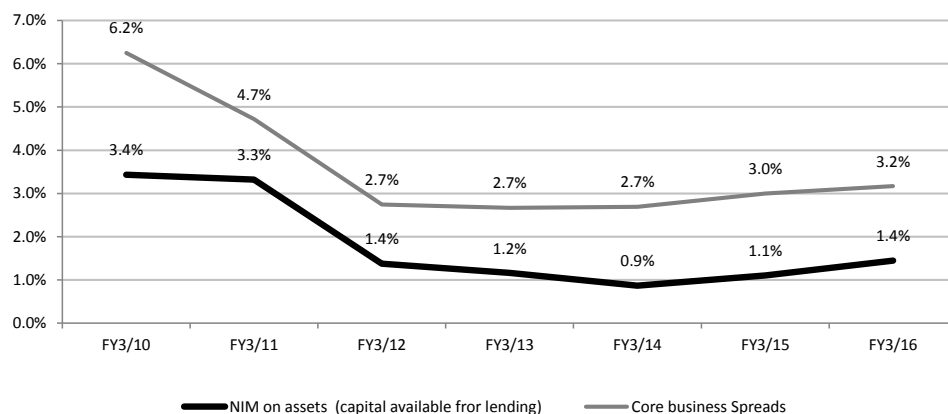
Figure 8: SREI Balance Sheet Loans and Borrowing Amount for Standalone Book (Rs mn)



Source: Company data, Bloomberg

...which pushed NIM below the core business spread

Figure 9: SREI NIM for Standalone Book and Core Business Spread

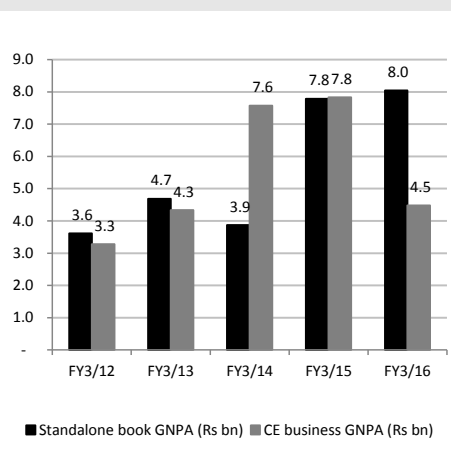


Source: Company data, Bloomberg

The situation was further exacerbated by the difficulties in the infrastructure sector. The downturn in the infrastructure operating environment was characterized by a variety of defaults including in the power sector and for road projects. This in turn resulted in a sharp increase in nonperforming assets for SREI (see Figure 10). The firm has responded by writing-off loans over the past couple of years, particularly in its construction equipment operation (see Figure 11).

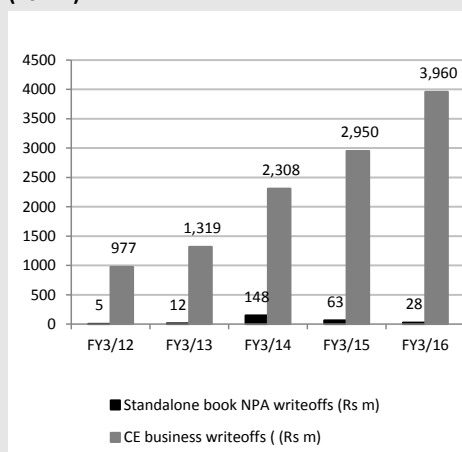
Over the past couple of years, the company has aggressively written off loans from its construction equipment book and in Q1 FY3/17, it wrote off some loans from its standalone book too

Figure 10: SREI NPA (RS bn)



Source: Company data, Bloomberg

Figure 11: SREI Write-offs of Nonstandard Assets (Rs mn)



Source: Company data, Bloomberg

Over the past 12 months, the problems of the past appear to be starting to unwind

Business Turning Around

SREI’s questionable capital allocation and its aggressive strategy combined with an unfavorable operating environment led to a poor performance for the company. Over the past 12 months, however, we have seen signs that the problems of the past are beginning to unwind, starting with the sale of Viom stake. We expect business for the company to turn around over the next couple of years.

Viom Stake Sale Has Freed Up Equity

The proceeds from the sale of its Viom stake totaled Rs29bn for SREI, including equity and quasi equity. As a result of the sale, SREI has reduced its borrowing and capital has been freed up for the core business (see Figures 12–13).

Following the sale of its stake in Viom, SREI's strategic investments have declined substantially...

...and its equity available for lending has increased significantly

The company is looking to reduce its funding costs by using a wide spectrum of lenders

Figure 12: SREI Strategic Investments (Rs mn)

	FY3/15	FY3/16	Jun'16
Communication (Viom)	15,980	15,980	-
Transportation	4,560	3,070	5,480
Energy	150	150	150
Rural IT	150	130	130
Others	230	1,230	1,230
Total	21,070	20,560	6,990

Source: Company data

Figure 13: Free Equity in SREI's Standalone Book (Rs mn)

Standalone book	FY3/15	FY3/16	Jun'16
Networth (A)	27,380	27,651	27,280
Investments in subs/asso/ JV (B)	6,399	6,411	8,550
Strategic Investments (C)	21,070	20,560	6,990
Free equity (A-B-C)	(89)	680	11,740

Source: Company data

Figure 14: SREI Balance Sheet Loans as Percentage of Capital Available for Lending

<i>(in Rs m unless stated)</i>	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16
Equity	7,901	25,531	25,820	26,475	26,774	27,380	27,651
Equity + Borrowings	43,283	78,428	124,293	138,260	156,376	164,340	173,643
Investments in subs/JV/asso.	725	4,821	5,356	6,374	6,366	6,399	6,411
Capital available for lending	42,558	73,606	118,938	131,885	150,010	157,942	167,232
Balance sheet loans	35,922	50,240	91,297	101,186	113,920	120,622	132,496
Non core investments	1,731	14,277	14,343	14,341	16,426	16,408	16,885
B/S loans as % of capital available for lending	84%	68%	77%	77%	76%	76%	79%

Source: Company data, Bloomberg

Reduction in Borrowing to Improve Credit Rating and Lower Funding Costs

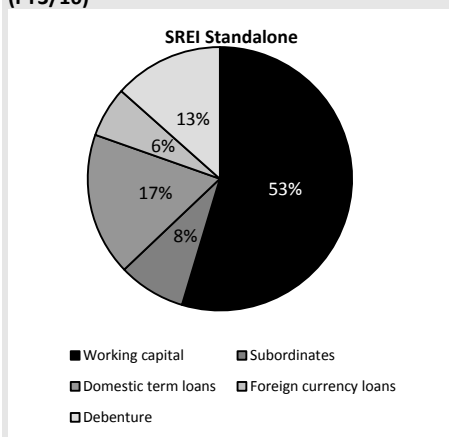
Currently the major source of funding for SREI is wholesale funding through banks. The consortium for the construction equipment business includes 37 banks while that for the standalone book (mainly project finance) includes 30 banks. The company is looking to reduce its funding costs by diversifying its loans through a wide spectrum of lenders. SREI also recently issued NCDs with a maximum annual coupon of 10% aggregating to Rs2.5bn. This should help improve its borrowing costs.

We believe SREI’s construction equipment finance business has sustainable competitive advantages

In our view, the company’s balance sheet utilization in its construction equipment business has been excellent

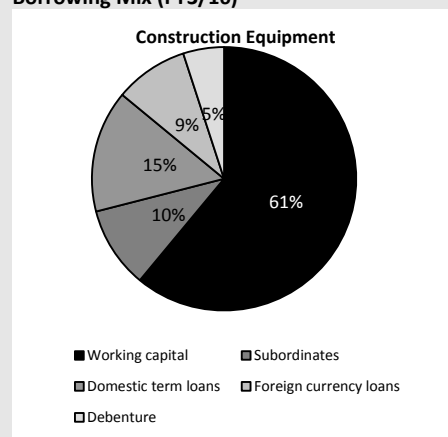
Earthmoving equipment dominates construction equipment volumes

Figure 15: SREI Standalone Borrowing Mix (FY3/16)



Source: Company data

Figure 16: SREI Construction Equipment Business Borrowing Mix (FY3/16)



Source: Company data

Operational Changes

Not only is the operating environment improving significantly in SREI’s core equipment financing business, but the company has also adopted a strategy of not exposing the balance sheet excessively to infrastructure assets, as was the case in the last cycle.

SREI enjoys competitive advantages in its construction equipment finance business stemming from its presence in all segments of the construction equipment life cycle (from the initial asset purchase to the exit from the investment or its resale). The company has tie-ups with all the leading construction equipment makers, which gives it an edge in purchasing the assets, and it understands the segment well due to its 25 years of experience in the business. These assets are used primarily by construction and mining companies and given its project financing exposure and its equity interest in road projects, SREI is able to deploy its construction equipment assets efficiently and quickly. SREI has 32 stock yards for maintaining and refurbishing its assets, which improves their residual value. At the end of the equipment lifecycle, SREI offers valuation and inspection services and related financing.

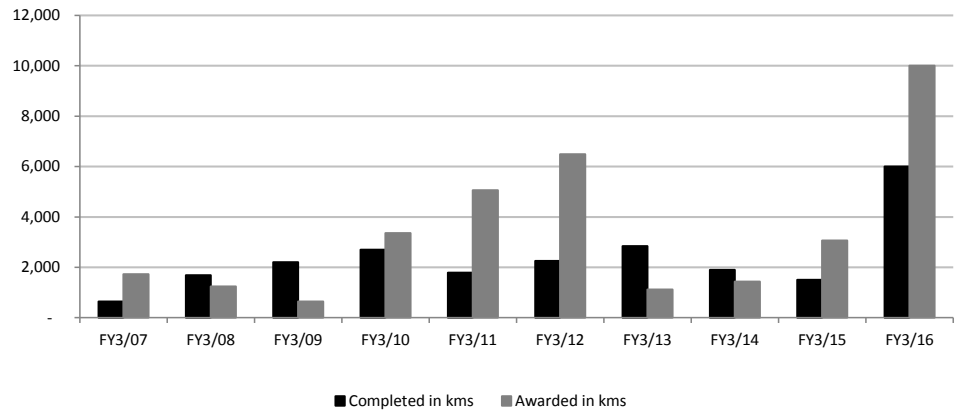
On-balance-sheet loans as percentage of capital available for lending reached 113% in FY3/16, which in our view indicates that balance sheet utilization in the construction equipment business is excellent. This ratio exceeded 100% each year during FY3/10–16, which signifies better efficiency for SREI than that at peer NBFCs (in FY3/16, the ratio at Sundaram Finance (SUF IN) was 96% and that at Mahindra & Mahindra Financial Services (MMFS IN) was 104%). Due to demand for securitization, off-balance-sheet loans as a percentage of SREI’s total construction equipment AUM has been high (16% in FY3/16). Thanks to the lofty on-balance-sheet utilization and its securitization of assets, NIM on total assets for the construction equipment business (i.e., its capital available for lending) is significantly above its spread (for FY3/16, the construction equipment business spread was 4.5% and the NIM on its balance sheet was 8.0%).

Demand for construction equipment is highly correlated to investment in the infrastructure sector. As investment gains momentum, we expect growth in SREI’s construction equipment business to improve substantially. In the difficult markets of the past three years, several banks and NBFCs exited the construction equipment financing business. However, SREI stayed the course standing by its dealers, its customers and the manufacturers, and as a result it has strengthened its overall market position.

Earthmoving equipment dominates construction equipment volumes. In Q1 FY3/17, it accounted for about 81% of the total. Backhoe loaders, a subset of earthmoving equipment, constituted 60% of earthmoving equipment, and crawler excavators constituted 32% in Q1. Construction equipment volume rose 58% YoY industrywide in Q1, with earthmoving equipment volumes up by 59% YoY during this period.

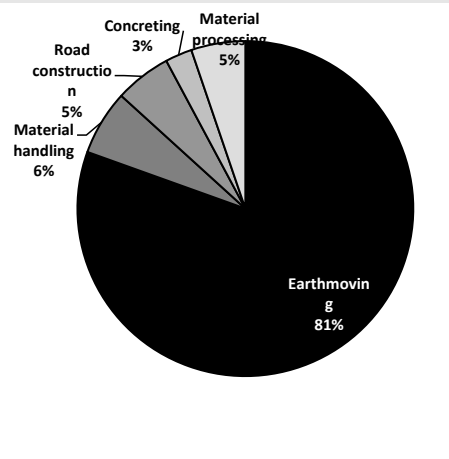
The highways completed and awarded by the National Highways Authority of India increased significantly in FY3/16

Figure 17: Highways Completed and Awarded by the National Highways Authority of India



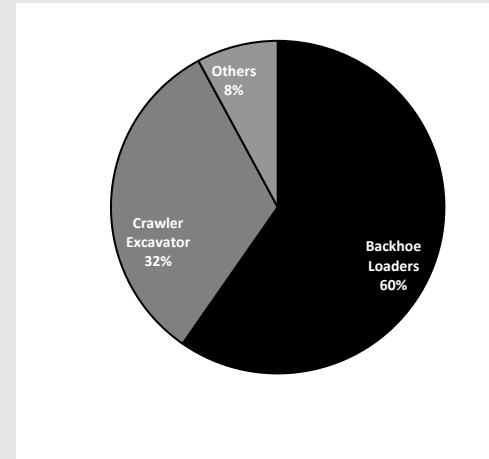
Source: Company data, Bloomberg.

Figure 18: Construction Equipment Industry Volume Breakdown (Q1 FY3/17)



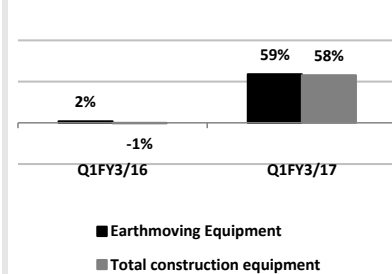
Source: Company data

Figure 19: Earthmoving Equipment Industry Volume Breakdown (Q1 FY3/17)



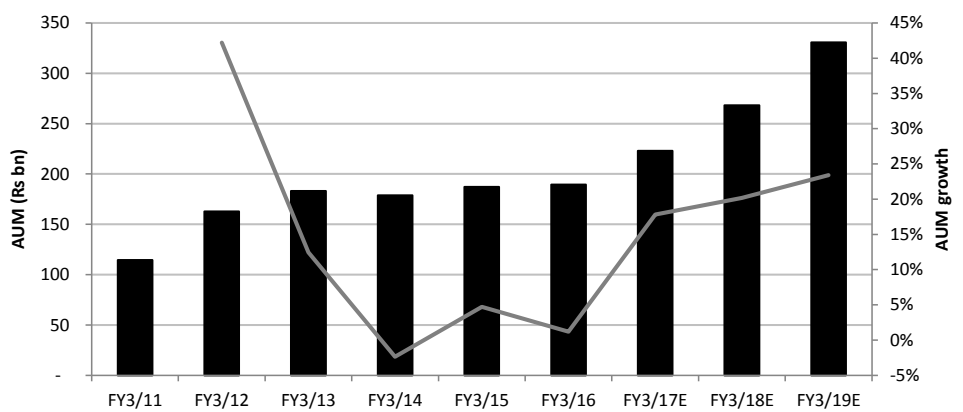
Source: Company data

Figure 20: Construction Equipment Industry Volume (%YoY)



Source: Indian Construction Equipment Manufacturers' Association

Figure 21: SREI Construction Equipment AUM

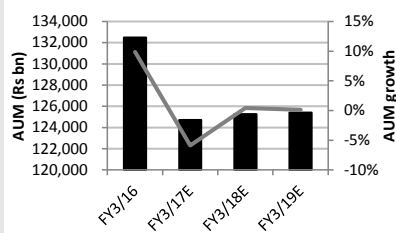


Source: Company data, Haitong Bank estimates

BPLG sold its entire holding in the joint venture in lieu of 5% equity in the parent company, allowing SREI to regain its 100% stake in the construction equipment operation

Project finance NIM should improve thanks to a reduction in borrowing levels following the company's sale of its Viom stake, but we do not expect AUM to rise in FY3/18–19

Figure 22: SREI Project Finance AUM



Source: Company data, Haitong Bank estimates

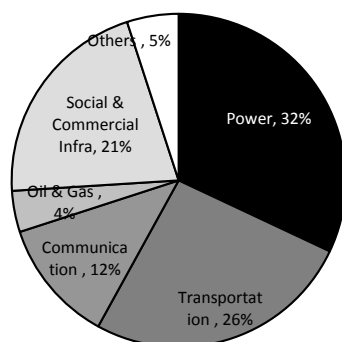
Purchase of Construction Equipment Stake from BPLG

BPLG sold its 50% stake in SREI Equipment Finance to SREI in lieu of 5% equity in the parent company and SREI Equipment Finance became a 100% subsidiary of SREI from 17 June 2016. This allowed SREI to regain direct control of the fund-based segment of its infrastructure operation. We expect SREI's 100% consolidation of the equipment finance business and profits to enhance shareholder value.

SREI Not Looking to Grow Project Finance Book

SREI Project Finance is an NBFC that extends financing for infrastructure projects including for roads, bridges, ports, telecommunications, water supply, waste management, SEZs, agri-infrastructure, warehousing, and renewable energy. AUM for this business increased at a compound annual rate of 9% over the three years to FY3/16 to Rs132bn. In addition to the core financing operation, SREI Project Finance is unique for the wide range of project support that it provides, including financial advisory, project advisory, equipment rental and equipment financing services.

Figure 23: SREI Project Finance Loan Book (FY3/16)



Source: Company data

Figure 24: SREI Project Finance Loan Book for Power Segment

	FY16
Power	32.0%
1. Generation	30.0%
a. Operational	18.0%
b. Under Construction	12.0%
i. Renewable	1.0%
ii. Captive	6.0%
iii. IPP/Merchant	5.0%
---> Captive Fuel	2.6%
---> Linkage Coal/ G	2.4%
2. T&D	2.0%

Source: Company data

Strategic Opportunities

Call Option 1: Sahaj

Sahaj e-Village (unlisted), a venture initiative of SREI, aims to bridge the digital divide between urban and rural India. Sahaj has established 40,768 touch points in the Indian states of Assam, Bihar, Odisha, Tamil Nadu, Uttar Pradesh, Maharashtra, Rajasthan, Himachal, Jharkhand, Delhi, Tripura and West Bengal that support the information technology requirements of rural villages with a range of services for (1) e-governance (including government-to-consumer (G2C), unique identification number (UID)-related and, bill collection services), (2) e-commerce (including insurance, mutual funds, financial inclusion (business correspondent (BC) model), mobile and direct-to-home (DTH) recharges, product sales and distribution) and (3) e-learning.

Sahaj has the largest network of common service centers in India (a share of 28% as of FY3/16) offering G2C, business-to-consumer, and financial inclusion services in 12 Indian states

Figure 25: Sahaj Services

Financial Inclusion	Basic Banking, micro insurance, pensions and savings
e-Governance	IT Projects and G2C Services
Education	e-Learning of Computer courses, K-12 Supplementary Learning, Competitive Exam Preparation, Open Univ. Admissions
Health	Tele-Consultation
Empowerment	Skill building and job linkages
Services	Aadhar Card, PAN, Voter ID etc
e-Commerce	FMCG, CD, Apparel
Utility Services	Electricity Bills, Mobile/DTH Recharge, Renewals and EMI payments
B2B	Market Research, Rural Activations, OOH

Source: Company data

Operating Model of Sahaj

All the Sahaj retail outlets operate as franchises (i.e., retail outlets at the gram panchayat (local government) and village levels in each state, known locally as *Sahaj Mitr*) or star franchises (i.e., retail outlets at the metro, district headquarters and tehsil (county government) levels and hubs that serve as logistics and distribution centers, known locally as *Param Mitr*). Franchisees manage the day-to-day operations of the stores. All capex and operating expenses are borne by the franchisees. In turn, Sahaj is responsible for project management, quality assurance, infrastructure setup, franchisee training, and access to new services and content at the retail outlets.

In working with the franchisee, Sahaj serves as a BC and in that capacity receives fixed monthly remuneration from the banks. It also receives a variable income stream in the form of transaction fees from banks, e-governance and e-commerce partners. One time transaction fees are derived from account opening and UID generation while steady fees are generated from BC transactions (such as when deposits, withdrawals, and remittances are made), G2C transactions (e.g., when utility bills are paid), and B2C transactions (e.g., mobile and DTH recharges and product sales).

Sahaj reduced the contribution of government support to its top line to zero in FY3/16

In absolute terms, revenue for Sahaj did not increase significantly during FY3/11–16. However, the company did reduce the level of government support to its top line from Rs495mn in FY3/11 to zero in FY3/16.

Figure 26: Sahaj Income Statement

Rs m	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16
Revenue	635	804	796	815	708	658
Government support	495	510	431	229	73	-
Sale of goods less excise	38	28	82	64	22	8
Sale of services	80	250	267	477	566	577
Financial services	-	-	-	-	85	64
E-learning services	-	-	-	-	25	17
Consumer utility & public services	-	-	-	-	61	62
Financial inclusion services	-	-	-	-	13	10
Skill development & placement	-	-	-	-	97	196
Other Government projects	-	-	-	-	279	224
Other services	-	-	-	-	1	4
Other operating revenue	22	15	15	45	47	74
Cost of services sold	172	186	256	355	347	368
Gross profit	463	618	540	461	361	291
Employee expenses	248	367	430	412	320	249
EBITDA	216	251	110	48	41	42
D&A	35	44	58	90	101	89
EBIT	180	206	52	(42)	(60)	(47)
Interest expenses	168	240	300	277	270	243
Other expenses	267	222	268	259	282	183
Other income	9	20	178	355	186	117
Exceptional expense	-	-	-	-	53	-
PBT	(245)	(235)	(338)	(223)	(480)	(356)
Tax	-	-	-	-	-	-
PAT	(245)	(235)	(338)	(223)	(480)	(356)

Source: Company data

Call Option 2: Road Asset Portfolio

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 eight total projects in which SREI has a significant economic interest, five are already operational covering 1,690km, and an additional 760km is under construction. Total revenue from road assets exceeded Rs4bn in FY3/16.

Five of the eight road projects in which SREI has a significant economic interest are already operational

Figure 27: 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
Total			61.0	2.6	4.2

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 Rs725mn in FY3/16 to Rs6,423mn in FY3/19 thanks mainly to consolidation of the construction equipment business from 50% to 100% from FY3/17 and an improvement in ROE in both the project finance and construction equipment businesses.

Figure 28: DuPont Analysis of SREI's Standalone Book (Mainly Project Finance Business)

	FY3/14	FY3/15	FY3/16	FY3/17E	FY3/18E	FY3/19E
NII	0.9%	1.1%	1.4%	2.0%	2.7%	2.8%
Other Income	1.1%	1.5%	0.6%	3.2%	1.2%	1.2%
Total Income	1.9%	2.6%	2.1%	5.2%	3.9%	4.0%
Employee cost	0.3%	0.3%	0.3%	0.3%	0.4%	0.4%
Opex	0.6%	0.5%	0.4%	0.5%	0.6%	0.6%
Depreciation	1.2%	0.3%	0.3%	0.4%	0.4%	0.4%
Credit cost	0.2%	0.7%	0.4%	2.7%	1.3%	0.8%
PBT	-0.3%	0.9%	0.6%	1.3%	1.2%	1.6%
Tax	0.2%	0.2%	0.1%	0.4%	0.4%	0.6%
RoA	-0.5%	0.7%	0.5%	0.9%	0.8%	1.1%
RoE	-3.8%	5.4%	3.9%	6.5%	5.8%	7.3%
Leverage (x)	7.0	7.4	7.7	7.6	7.1	6.8

Source: Company data, Haitong Bank estimates

We expect project finance ROA to improve from 0.5% in FY3/16 to 1.1% in FY3/19, driven by an increase in NIM in this business from 1.4% to 2.8% over this period

We forecast a rise in ROE in the construction equipment business from 5.1% in FY3/16 to 15.1% in FY3/19

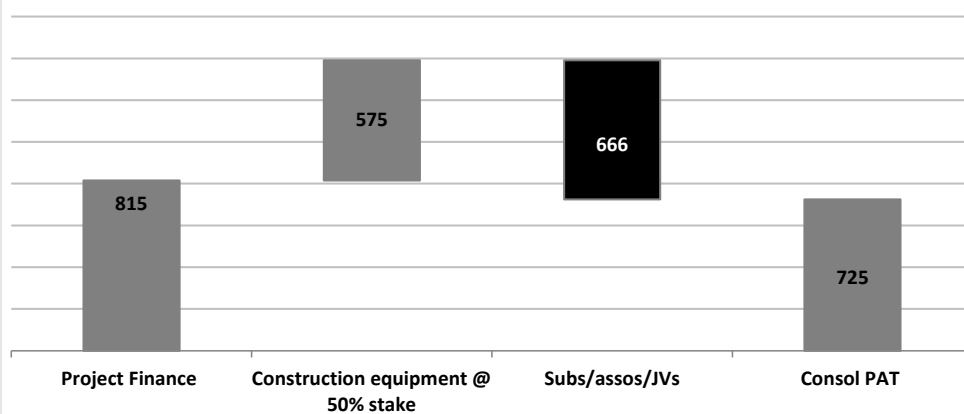
We forecast consolidated NP surges from Rs725mn in FY3/16 to Rs6,423mn in FY3/19

Figure 29: DuPont Analysis of SREI's Construction Equipment Subsidiary

	FY3/14	FY3/15	FY3/16	FY3/17E	FY3/18E	FY3/19E
NII	6.7%	7.4%	8.0%	9.0%	9.5%	9.7%
Other Income	0.4%	0.3%	0.1%	0.1%	0.1%	0.1%
Total Income	7.1%	7.7%	8.1%	9.1%	9.6%	9.8%
Employee cost	0.6%	0.9%	1.0%	1.0%	1.0%	0.9%
Opex	0.9%	1.1%	1.2%	1.2%	1.2%	1.2%
Depreciation	1.6%	1.9%	2.2%	2.3%	2.0%	1.6%
Credit costs	1.7%	2.2%	2.7%	3.2%	2.3%	2.4%
PBT	2.3%	1.5%	1.1%	1.4%	3.1%	3.6%
Tax	0.9%	0.5%	0.3%	0.5%	1.0%	1.2%
RoA	1.5%	1.0%	0.8%	0.9%	2.0%	2.4%
RoE	11.4%	7.1%	5.1%	5.5%	12.3%	15.1%
Leverage (x)	7.7	7.1	6.5	6.0	6.1	6.4

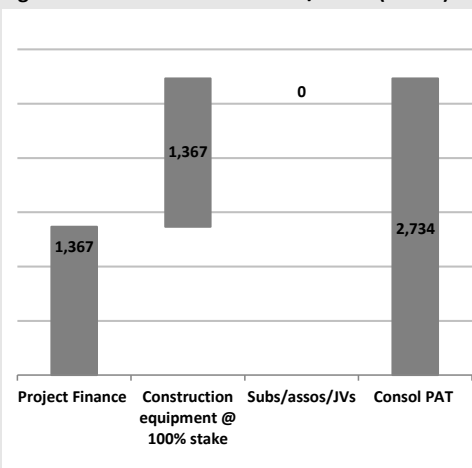
Source: Company data, Haitong Bank estimates

Figure 30: SREI Consolidated FY3/16 NP (Rs mn)



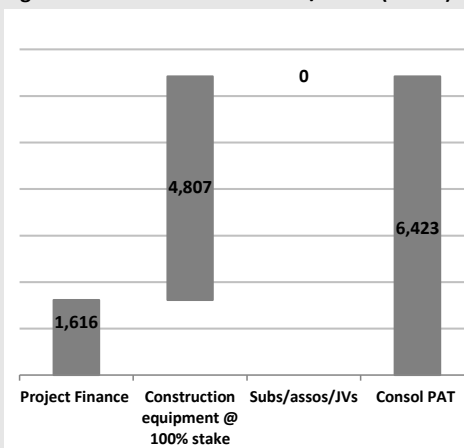
Source: Company data

Figure 31: SREI Consolidated FY3/17 NP (Rs mn)



Source: Company data, Bloomberg, HTB estimates

Figure 32: SREI Consolidated FY3/19 NP (Rs mn)



Source: Company data, Bloomberg, HTB estimates

Valuation Comment

Our target price for SREI of Rs126.90 is based on SOTP analysis, in which we have employed DCF methodology to determine valuation for the project finance and construction equipment businesses. Through our analysis, the implied FY3/18 PBRs for these businesses are 0.7x and 1.5x, respectively.

Figure 33: Valuation of SREI's Project Finance Business

All figures in Rs bn

Year	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	TV	
PAT	1.4	1.2	1.6	1.8	2.0	2.2	2.4	2.6	2.9	3.2	3.6	3.7
% growth			33%	10%	10%	10%	10%	10%	11%	11%	11%	3%
RoE (average)	7%	6%	6%	7%	8%	9%	9%	10%	11%	11%	12%	13%
Reinvestment rate				20%	20%	20%	20%	20%	20%	20%	20%	20%
FCFF	0.6	1.6	1.4	1.6	1.7	1.9	2.1	2.3	2.6	2.8	2.9	
Discount factor	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3		
Present Value	0.5	1.3	1.0	1.0	0.9	0.9	0.9	0.8	0.8	0.8	7.0	
Valuation	16.0											
Implied FY18 P/B	0.7x											
Cost of Equity	14.5%											
Cost of Equity (TV)	14.0%											
TV growth	2.5%											
Fractional year	0.5											

Source: Company data, Bloomberg, Haitong Bank estimates

Figure 34: Valuation of SREI's Construction Equipment Business

All figures in bn

Year	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	TV	
PAT	1.4	3.4	4.8	6.0	7.5	9.0	10.8	13.0	14.3	15.7	17.3	18.0
% growth	19%	149%	41%	25%	25%	20%	20%	20%	10%	10%	10%	4%
RoE (average)	6%	12%	13%	15%	16%	17%	18%	18%	18%	18%	18%	15%
Reinvestment rate		247%	117%	108%	71%	67%	111%	56%	56%	56%	27%	
FCFF	-2.0	-7.0	-1.0	-0.6	2.6	3.6	-1.4	6.3	7.0	7.7	13.2	
Discount factor	0.9	0.8	0.7	0.6	0.6	0.5	0.4	0.4	0.3	0.3		
Present Value	(1.9)	(5.8)	(0.7)	(0.4)	1.5	1.8	(0.6)	2.5	2.4	2.3	44.0	
Valuation	44.9											
Implied FY18 P/B	1.5x											
Cost of Equity	13.5%											
Cost of Equity (TV)	13.0%											
TV growth	4.0%											
Fractional year	0.5											

Source: Company data, Bloomberg, Haitong Bank estimates

Figure 35: SOTP Valuation for SREI

	Valuation (Rs m)	% stake of Srei	Value to Srei (Rs m)	Price/ share (Rs)	Implied valuation
Project Finance	15,983	100%	15,983	33	0.7x FY18 Adj. BV
Construction Equipment Finance	44,869	100%	44,869	94	1.5x FY18 Adj. BV
Total				127	

Source: Company data, Haitong Bank 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, Kotak Mahindra Bank (KMB IN) and Indusind Bank (IIB IN) have a significant presence in construction equipment lending.

Figure 36: SREI Subsidiaries, Associates and Joint Ventures (excluding Construction Equipment Joint Venture) as of FY3/16

Subsidiaries	% shareholding	Networth attributable to SREI (Rs m)	Total PAT (Rs m)	PAT attributable to SREI (Rs m)
Domestic				
Srei Capital Markets	100%	62	0	0
Srei Alternative Investment Managers	100%	129	11	11
Bengal Srei Infrastructure Development Ltd.	51%	0	1	1
Srei Forex Ltd.	100%	4	0	0
Controlla Electrotech Pvt Ltd	100%	(36)	(4)	(4)
Srei Infrastructure Advisors Ltd.	100%	2	(0)	(0)
Srei Mutual Fund Asset Management Pvt. Ltd.	100%	109	5	5
Srei Mutual Fund Trust Pvt. Ltd.	100%	(0)	(0)	(0)
Srei Insurance Broking Pvt Ltd.	100%	32	0	0
Hyderabad Information Technology Venture Enterprises Ltd.	51%	4	(0)	(0)
Cyberabad Trustee Company Pvt. Ltd.	51%	0	0	0
Quippo Oil & Gas Infrastructure	100%	(156)	(301)	(301)
Quippo Energy	100%	(39)	2	2
Srei Asset Reconstruction Private Limited	100%	1	0	0
Quippo Drilling International Private Limited	100%	0	-	-
International				
Srei International Infrastructure Service	93%	319	(19)	(17)
ZAO SREI Leasing	59%	17	(263)	(156)
Srei Advisors	93%	7	(1)	(1)
Total		455	(569)	(462)
Associates and JV (ex. Srei Equipment)				
Sahaj e-Village Limited	49%	(774)	(358)	(177)
Attivo Economic Zone (Mumbai) Private Limited	49%	412	(0)	(0)
Total		(362)	(358)	(177)
Total Subs + Asso + JV		93	(927)	(639)

Source: Company data

Figure 37: SREI Parent Balance Sheet Analysis

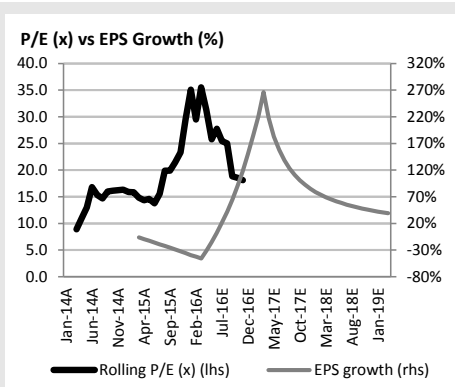
<i>(in Rs m unless stated)</i>	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17E	FY3/18E	FY3/19E
Equity	7,901	25,531	25,820	26,475	26,774	27,380	27,651	28,728	29,651	30,976
Borrowings	35,382	52,896	98,473	111,784	129,601	136,960	145,992	128,364	127,986	126,808
Investments in subs/JV/asso.	725	4,821	5,356	6,374	6,366	6,399	6,411	8,159	8,159	8,159
Capital available for lending	42,558	73,606	118,938	131,885	150,010	157,942	167,232	148,932	149,479	149,626
Balance sheet loans	35,922	50,240	91,297	101,186	113,920	120,622	132,496	124,704	125,250	125,398
Non core investments	1,731	14,277	14,343	14,341	16,426	16,408	16,885			
B/S loans as % of capital available for lending	84%	68%	77%	77%	76%	76%	79%	84%	84%	84%
Yields on On balance sheet loans	16.4%	14.6%	15.3%	15.2%	15.4%	14.3%	14.3%	14.0%	14.0%	14.0%
Finance costs	10.2%	9.8%	12.5%	12.5%	12.7%	11.3%	11.1%	10.8%	10.5%	10.5%
Core business Spreads	6.2%	4.7%	2.7%	2.7%	2.7%	3.0%	3.2%	3.2%	3.5%	3.5%
NIM on balance sheet loans	6.1%	4.5%	1.9%	1.5%	1.1%	1.5%	1.9%	2.5%	3.2%	3.3%
NIM on assets (capital available for lending)	3.4%	3.3%	1.4%	1.2%	0.9%	1.1%	1.4%	2.0%	2.7%	2.8%
Credit rating for NCDs (CARE)	AA	AA	AA	AA-	AA-	AA-	A+			
Repo rate	6.25%	8.50%	8.50%	7.50%	8.00%	7.50%	6.75%			
HDFC Bank base rate	7.25%	8.70%	9.80%	9.60%	10.00%	9.85%	9.30%			

Source: Company data, Haitong Bank estimates

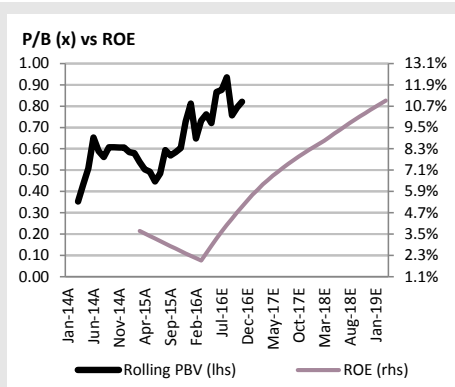
Figure 38: SREI Construction Equipment Business Balance Sheet Analysis

<i>(in Rs m unless stated)</i>	FY3/10	FY3/11	FY3/12	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17E	FY3/18E	FY3/19E
Equity + Borrowings	66,505	88,763	117,140	154,176	151,925	152,740	141,760	154,367	182,903	223,036
Investments in JV and subsidiaries and associates	(2)	(1)	-	-	-	-	-	-	-	-
Capital available for lending	66,507	88,764	117,140	154,176	151,925	152,740	141,760	154,367	182,903	223,036
Total AUM	85,918	114,517	162,843	183,082	178,738	187,150	189,365	223,096	268,106	330,826
Balance sheet loans	69,443	92,974	116,919	154,801	158,348	166,620	160,005	178,477	214,485	264,661
Off Balance sheet loans	16,475	21,543	45,924	28,281	20,390	20,530	29,360	44,619	53,621	66,165
On balance sheet loans as % of capital available for lending	104%	105%	100%	100%	104%	109%	113%	116%	117%	119%
Off balance sheet as % of total AUM	19%	19%	28%	15%	11%	11%	16%	20%	20%	20%
Yields on On balance sheet loans	12.5%	14.7%	17.3%	16.8%	16.4%	15.8%	15.9%	15.5%	15.5%	15.5%
Finance costs	9.6%	9.7%	11.5%	11.5%	11.5%	11.0%	11.4%	10.5%	10.2%	10.2%
Core business Spreads	2.9%	4.9%	5.8%	5.4%	4.9%	4.8%	4.5%	5.0%	5.3%	5.3%
NIM on balance sheet loans	4.8%	6.6%	7.4%	6.8%	6.6%	6.9%	7.2%	7.8%	8.2%	8.2%
NIM on assets (capital available for lending)	5.0%	6.9%	7.5%	6.8%	6.7%	7.4%	8.0%	9.0%	9.5%	9.7%

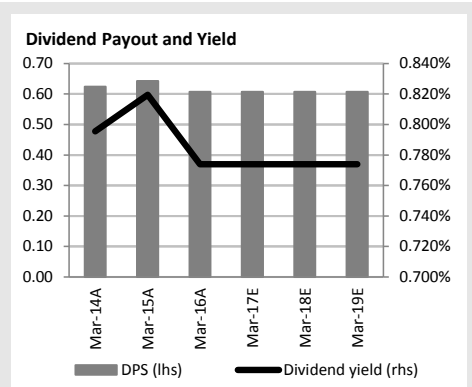
Source: Company data, Haitong Bank estimates



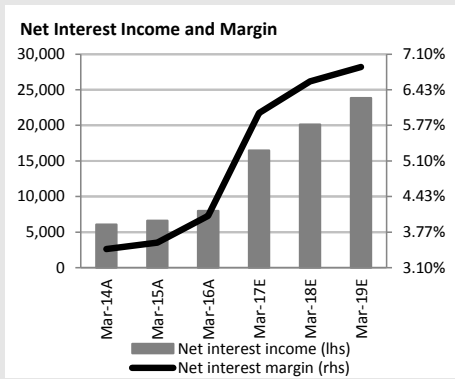
Source: Company data, Bloomberg, Haitong Bank estimates



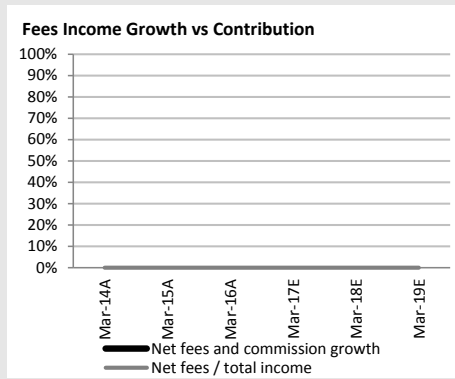
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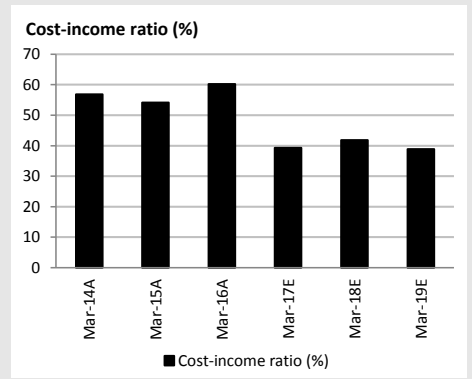
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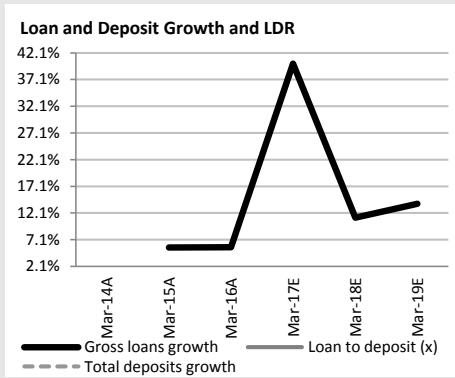
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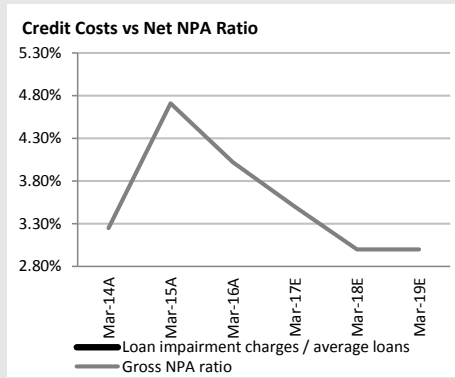
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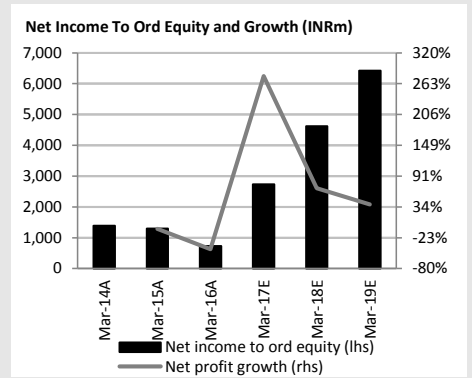
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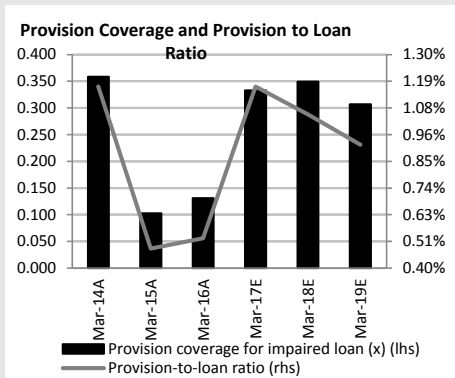
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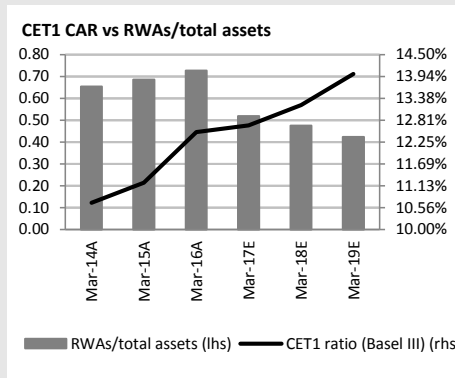
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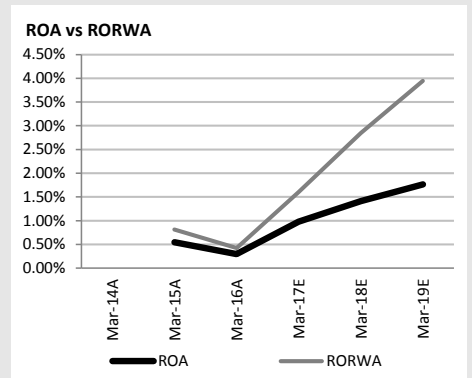
Source: Company data, Bloomberg, Haitong Bank estimates



Source: Company data, Bloomberg, Haitong Bank estimates



Source: Company data, Bloomberg, Haitong Bank estimates



Source: Company data, Bloomberg, Haitong Bank estimates

Revenue Growth

SREI's construction equipment business has picked up and we forecast a CAGR for construction equipment disbursements of 25% over the three years to FY3/19. 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 the stake in Viom. We expect construction equipment NIM to be stable through FY3/19.

Shareholder Returns

We see consolidated ROE rising from 2% in FY3/16 to 11% in FY3/19, led by an improvement in ROE in the construction equipment business from 5% to 15% during this period accompanying a decline in credit costs. With NIM increasing on reduced borrowing following the sale of the Viom stake, we also see ROE increasing the project finance operation from 4% in FY3/16 to 7% in FY3/19.

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 107% during FY3/16–19

Investment Thesis – Target Price – Share Price Catalysts

We think SREI is a classic turnaround story. It seems as if everything went wrong for SREI over the last decade, including mistakes by management on capital allocation (i.e., the buyout of Viom) and the firm's heavy funding exposure to the infrastructure sector which suffered as a result of deterioration in the operating environment. However we believe these problems are unwinding with (1) the sale of the stake in Viom in FY3/16 enhancing the bank's capital position, (2) an improvement in the operating environment for the core construction equipment business, (3) reduced financing costs, which has strengthened the balance sheet, and (4) the purchase of 50% stake in the construction equipment business from BPLG in lieu of 5% stake in the holding company. In addition, we see the potential stake sale in Sahaj and/or in the road asset portfolio as call options. We have a BUY rating on SREI with a target price of Rs126.90, based on our SOTP analysis, through which we have derived a FY3/18 PBR value for the project finance business of 0.7x and for the construction equipment segment of 1.5x. We expect ROE to rise through FY3/19 on an improvement in NIM accompanying reduced borrowing levels. We see this as a key positive catalyst for the share price.

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Haitong Securities India Private Limited coverage as of 1 Sept 2016

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 Bajaj Auto (BJAUT IN)
 Balkrishna Industries (BIL IN)
 Bharat Forge (BHFC IN)
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 Exide (EXID IN)
 Hero Motocorp (HMCL IN)
 Mahindra & Mahindra (MM IN)
 Maruti Suzuki (MSIL IN)
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 ICICI Bank (ICICIB IN)
 HDFC Limited (HDFC IN)
 Shriram Transport Finance (SHTF IN)
 Kotak Mahindra Bank (KMB IN)
 Bank of Baroda (BOB IN)
 Indusind Bank (IIB IN)
 Punjab National Bank (PNB IN)
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 Yes Bank (YES IN)
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 JSW Steel (JSTL IN)
 NMDC (NMDC IN)
 SAIL (SAIL IN)
 Tata Steel (TATA IN)
 Vedanta (VEDL IN)
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 Berger Paints (BRGR IN)
 Finolex Industries (FNXP IN)
 JK Cement (JKCE IN)
 Kajaria Ceramics (KJC IN)
 Prism Cement (PRSC IN)
 Shree Cement (SRCM IN)
 Supreme Industries (SI IN)
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 BHEL (BHEL IN)
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 Siemens India (SIEM IN)
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 V-Guard Industries (VGRD IN)
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 Gateway Striparks (GDPL IN)
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 Britannia Industries (BRIT IN)
 Colgate-Palmolive India (CLGT IN)
 Dabur India (DABUR IN)
 Emami (HMN IN)
 Godrej Consumer Products (GCPL IN)
 GSK Consumer (SKB IN)
 Hindustan Unilever (HUVR IN)
 ITC (ITC IN)
 Marico (MRCO IN)
 Nestle India (NEST IN)
 Titan (TTAN IN)
 Bata India (BATA IN)
 Jubilant Foodworks (JUBI IN)

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 Dr Reddy's (DRRD IN)
 Fortis Healthcare (FORH IN)
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 Lupin (LPC IN)
 Natco Pharma (NTCPH IN)
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 HCL Technologies (HCLT IN)
 Wipro (WPRO IN)
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 Infosys (INFO IN)
 Just Dial (JUST IN)
 MindTree (MTCL IN)
 Persistent Systems (PSYS IN)
 Tech Mahindra (TECHM IN)
Sumeet Surana
 Cyient (CYL IN)
 eClerx Services (ECLX IN)
 Hexaware Technologies (HEXW IN)
 KPIT Cummins (KPIT IN)
 Mphasis (MPHL IN)
 Navneet Education (NEU IN)
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