COMPANY RESEARCH | Initiation

Maybank Kim Eng

January 30, 2015

SREI Infrastructure Finance (SREI IN)

Share Price: INR46	MCap (USD): 378M	India	BUY (New)
Target Price: INR70 (+51%)	ADTV (USD): 1.0M	Diversified Financials	

Back to basics

- **Initiate at BUY and TP of INR70 based on 1x FY16E P/BV.**
- **Deleveraging of balance sheet, revival in infrastructure lending, softening of interest rates, and stabilisation of asset quality, are key catalysts. Management's plans to restrict investments up to 35-40% of net worth vs. 80% currently indicate its desire to focus on core lending business.**
- **Trading at an inexpensive 0.7x FY16E P/BV. Forecast ROE of 10% by FY17 (+500bps). Re-rating is imminent.**

Has multiple levers for staging successful comeback

Our positive view on SREI's business stems from the following factors: i) The company is well positioned to capture the gamut of opportunities emerging in the infrastructure and equipment financing space as the government is focused on reforms. We expect the equipment financing business to lead the revival in loan growth. That said, the project financing business will continue to grow steadily; ii) SREI's plans to divest its stake in the telecom business (VIOM) augurs well for its balance sheet. The current book value of its VIOM investment is INR16b (45% of net worth); iii) NIMs will recover sharply, driven by deployment of funds realized from the disposal of investments, fall in interest rates, and low interest income reversal and iv) The asset quality cycle has improved; we expect a correction in incremental credit costs as well.

Return ratios set to improve, valuations undemanding

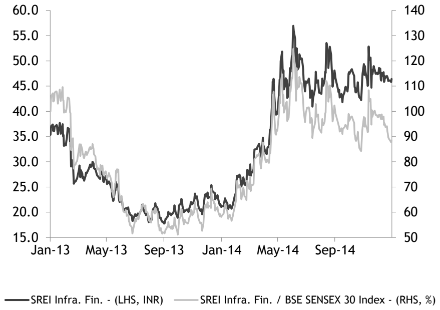
We forecast strong earnings CAGR of 35% for FY14-17E. EPS for FY16E at INR5.1 is expected to grow at 62% YoY, driven by the divestment of stakes. Earnings growth during FY14-17E would be underpinned by a forecast 12% loan growth, NIM expansion of 90bps to 4%, and reduction in credit costs to 1% by FY17 from 1.4% in FY15E. We expect ROE to gradually rise to 10% by FY17 from 5% in FY14. SREI is trading at an undemanding 0.7x FY16E P/BV. Improvement in return ratios will lead to a re-rating.

FYE Mar (INR m)	FY13A	FY14A	FY15E	FY16E	FY17E
Operating income	9,742.7	9,100.2	10,452.9	11,776.7	13,980.9
Pre-provision profit	3,717.7	3,931.8	5,346.9	6,156.2	7,724.3
Core net profit	2,641.8	1,385.1	1,601.7	2,581.1	3,438.5
Core EPS (INR)	5	3	3	5	7
Core EPS growth (%)	111.2	(47.1)	15.8	61.5	33.3
Net DPS (INR)	1	1	1	1	1
Core P/E (x)	9.0	17.0	14.7	9.1	6.8
P/BV (x)	0.8	0.8	0.7	0.7	0.6
Net dividend yield (%)	1.7	1.1	1.1	1.6	2.2
Book value (INR)	60	62	64	69	74
ROAE (%)	9.2	4.5	5.0	7.7	9.6
ROAA (%)	1.3	0.6	0.6	1.0	1.2

Key Data

52w high/low (INR)	57/21
3m avg turnover (USDm)	1.0
Free float (%)	26.2
Issued shares (m)	503
Market capitalization	INR23.3B
Major shareholders:	
-Bharat Connect Ltd.	23.5%
-Adisri Investment Ltd.	17.2%
-Opulent Venture Capital Trust	11.5%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(2.6)	(2.1)	117.3
Relative to index (%)	(10.1)	(10.6)	51.2

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	0	0	0
	Maybank	**Consensus**	**% +/-**
Target Price (INR)	70	na	na
'15 PATMI (INRm)	1,602	na	na
'16 PATMI (INRm)	2,581	na	na

Source: FactSet; Maybank

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SEE PAGE 31 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

Investment thesis

Emergence of financing opportunities to drive loan growth

We forecast 12% loan growth for the consolidated entity during FY14-17E. Loan growth stood at 6% as of FY14. We believe the equipment financing business (42% of loans) will recover ahead of project financing. Removal of the ban on the mining sector and a pick-up in growth in the road sector will further strengthen the company's prospects. Diversification of book to used vehicles, medical equipment financing, and IT will also aid loan growth. The company's project financing business (58% of loans), however, will grow steadily. Emerging opportunities in infrastructure lending, driven by various initiatives announced by the government, will prove to be a big positive in the future.

Monetisation of assets will provide fillip, future investments holding to be restricted

Management has spelt out its divestment strategy vis-à-vis some key investments made in the telecom business (VIOM network) and a few other road assets. The current book value of investments in VIOM stands at INR16b. Increased divestment will strengthen the company's balance sheet. We have assumed divestment at book value in FY16 and the decline in borrowings is also expected to be along similar lines. This would reduce cost of borrowings. Management intends to restrict future investment holdings to 35-40% of net worth from 80% in FY14.

Asset-quality stress to ease

SREI BNP's asset quality was affected as a result of reduced cash flows among equipment owners, who suffered the most from the economic slowdown and ban in the mining sector. Although the asset quality of the project financing book has remained relatively stable, the current NPL relates to a few lumpy accounts. The consolidated gross NPL inched up from 1% in FY11 to 3.3% in FY14. We believe the asset quality in both the segments is set to ease on the back of a pick-up in the economy, resumption of mining activity, and award of new projects in the road sector. We forecast consolidated net NPLs to correct to 1.8% by FY17 (FY14: 2.8%), with a credit cost of 100bps vs. 140bps in FY15E.

Margins to expand as funding costs fall

We forecast NIM expansion of 90bps to 4% in the next two years. Our view is based on: i) The deployment of funds realized from the sale of investments will reduce funding costs; ii) SREI will benefit from softening of interest rates and easing of liquidity because it is wholesale funded; iii) low interest income reversal, which stems from stable asset quality, and iv) diversification of loan book to high-yielding assets such as used commercial vehicles and a diversified source of borrowings such as retail non-convertible debentures (NCDs) will boost NIM.

Return ratios set to improve, inexpensive valuations

We expect SREI's ROE to improve by 500bps over FY14-17 to 10%. An improvement in return ratios, pickup in growth, and stabilization of asset quality will lead to the re-rating of the stock. Players in infrastructure lending are trading at 1-2x forward P/BV, whereas vehicle financers are trading at 2-3x forward P/BV. SREI is trading at an inexpensive 0.7x FY16 P/BV. We expect SREI's multiples to re-rate along with an improvement in ROE and the pick-up in growth.

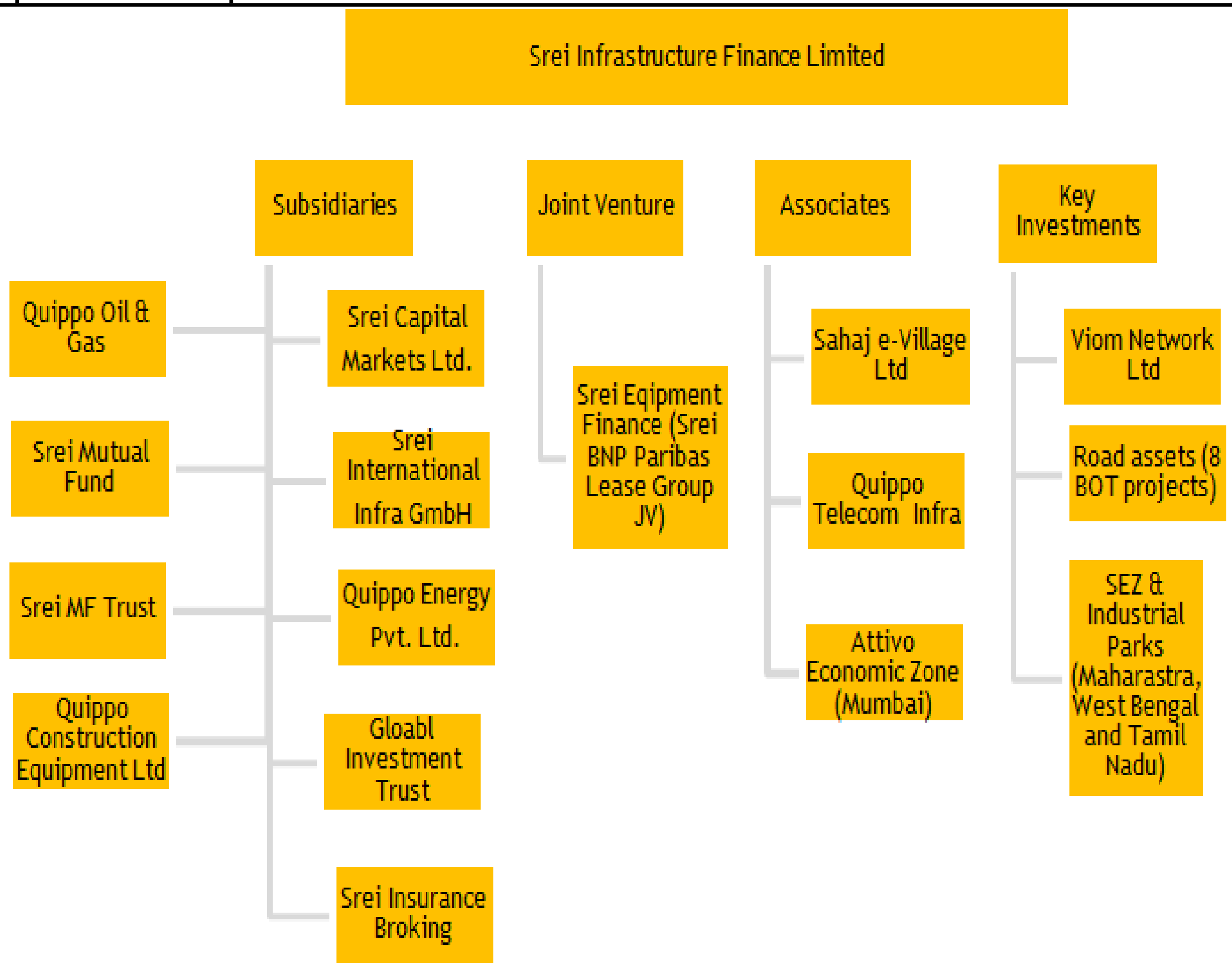
SREI: Leading equipment & project financer

SREI is a leading infrastructure and commercial equipment financer in India with INR334b worth of assets under management (AUM). Its two key business verticals include: **i) SREI BNP PARIBAS (SREI BNP):** It is a 50:50 JV between SREI and BNP PARIBAS. It is India's largest construction equipment financer with a 30% market share. Its outstanding AUM stands at INR180b. **ii) SREI Infrastructure Finance (SREI Infra):** The project finance business rest in the standalone entity. It is engaged in the business of financing power, road, telecom, and airports. It was accorded Infrastructure Finance Company (IFC) status by RBI. Total AUM as on Sep'14 is INR123b.

Sahaj is an associate company (48.3% holding) engaged in operations of Common Service Centre (CSC) with more than 27,000 centres across six states. The company is engaged in providing government services to customers and works as a business correspondent (BC) for banks.

SREI has investments of INR22b in VIOM and BOT road assets. It has ventured into development of Special Economic Zone (SEZ) and Industrial parks in Maharashtra, West Bengal, and Tamil Nadu.

Group structure snapshot



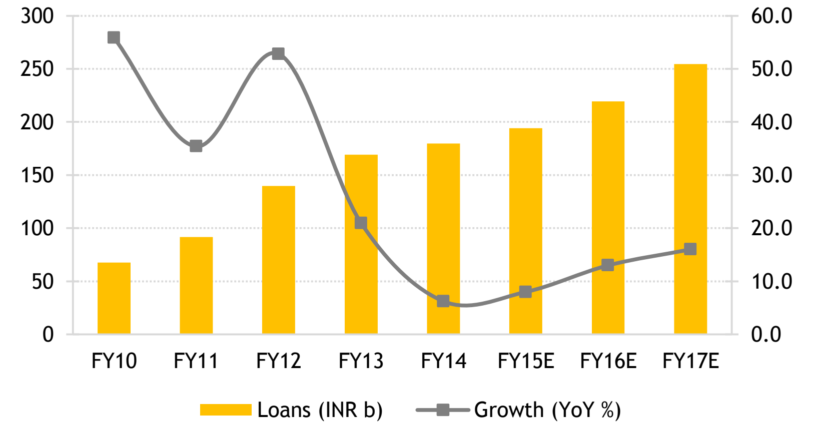
Source: Company, KESI

Loan growth to recover

SREI's loan growth in the past two years has suffered as project and equipment financing slowed down. Loans grew at a 48% CAGR during FY09-12, but corrected to just 6% in FY14. Project financing (58% of consolidated loan book) has relied heavily on refinancing opportunities to drive growth. Equipment financing (42% of loans) suffered because of a slowdown in infrastructure and mining projects.

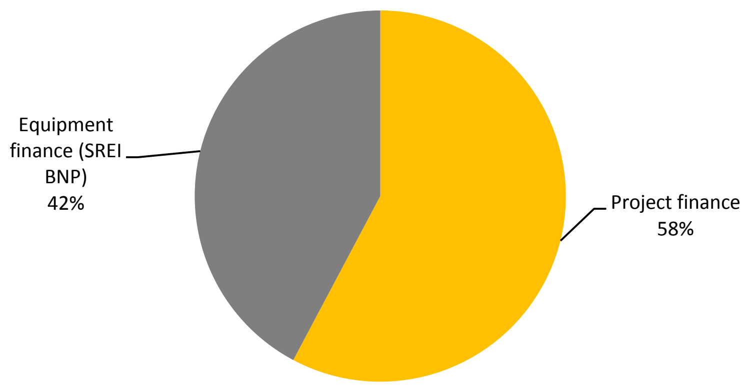
The new government has emphasized on infrastructure creation, which should result in a pick-up in the project finance book in the medium term. Easing of environment norms and resolution of mining related issues will result in a pick-up in the equipment financing business. We expect the consolidated loans to grow at a 12% CAGR during FY14-17E. Loan growth would be driven by the equipment financing business, which would grow at a 15% CAGR. The project financing business would grow at 10% CAGR.

Loan growth expected to recover



Source: Company, KESI

Loan mix (2QFY15)



Source: Company, KESI

SREI BNP: gain from investment cycle uptick

SREI BNP is the market leader in the commercial equipment financing business and has 30% market share. It partners with the majority of equipment manufacturers, which include domestic and international producers, to drive more loan growth. Its customer profile includes fleet owners, small operators, and project owners. It has managed to maintain its market share in the segment with the help of value-added services it provides to customers. It offers services such as equipment financing, rental, valuation, and auction of vehicles, which a bank would not offer. The outstanding loans as on Sep'14 stood at INR180b. This business suffered the most in the past few years because of a slowdown in infrastructure projects and ban on mining activity. Disbursements were down 27% YoY in FY14.

The trend witnessed a pick up following the formation of a new government and pick up in the economy. In 1HFY15, disbursements were up 7% YoY. Early indications reveal that the equipment financing business is witnessing a pickup. Creation of new infrastructure, removal of the mining ban, and pick-up in the investment cycle will gain increased traction and lead to positive trends for this business.

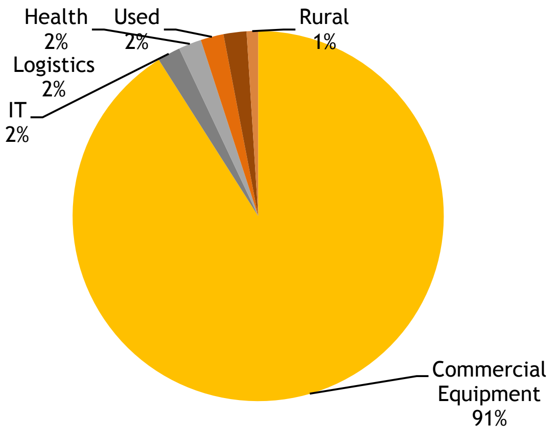
SREI BNP has started to diversify the loan book with the addition of new products such as IT, healthcare, used CE financing, and logistics financing. Even though the current proportion of these new businesses is less than 10%, management intends to increase the proportion to 20-25% in the next three to four years. We believe the loan growth in FY15 will remain soft. The full impact of economic improvement will be visible in FY16-17. We forecast a loan growth of 15% CAGR during FY14-17 for SREI BNP.

Product-wise snapshot of SREI BNP

Product	Commercial Equipment	IT	Health Care	Used	Logistic	Rural
Target Segment	Medium & large customers, project owners, large fleet owners, first-time owners & first-time buyers	Large corporate & IT companies, OEMs, banking & financial institutions	Hospitals & diagnostic centre	Retail, SME players (used equipment for construction, mining equipment & technology)	Commercial Vehicle	Contract farmers, tractor owners
Average ticket size (INR m)	2 to 24	9	25	1	3	0.4
Average repayment period (months)	40 to 51	26	53	32	40	50
Yield (%)	13.5 to 14.5	14	14	19	14	20

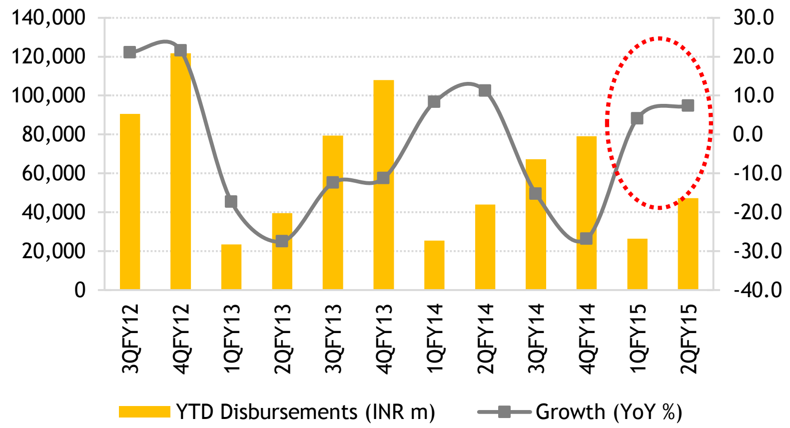
Source: Company, KESI

Loan mix (2QFY15)



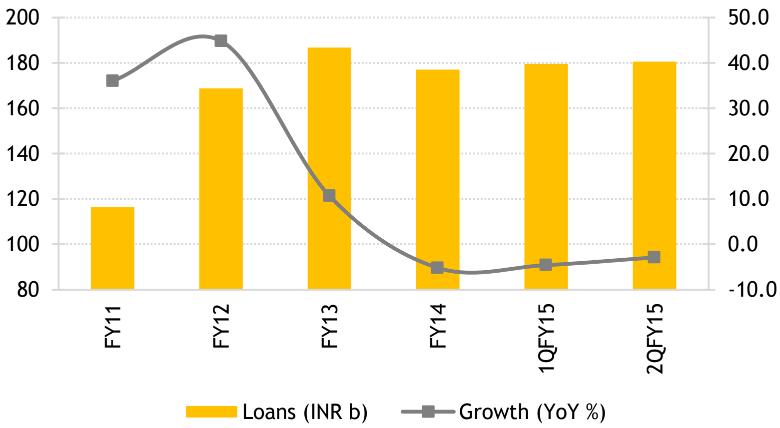
Source: Company, KESI

Disbursements witnessing modest pickup



Source: Company, KESI

Loan growth bottoming out



Source: Company, KESI

SREI BNP has strong relationship with OEMs

Source: Company

SREI Infra: growth at measured pace

In the project financing business, the key segments in which SREI lends include power projects (32% of loans), the transport sector (27% of loans), and social and commercial infrastructure projects (21% of loans). This business witnessed strong growth during FY11-12 (63% CAGR), led by new power and road sector loans. However, in the past two years, growth has suffered owing to a variety of issues such as availability of fuel, land, and a lack of government clearance for new projects. Disbursements in fresh loans have been negative in the past two years.

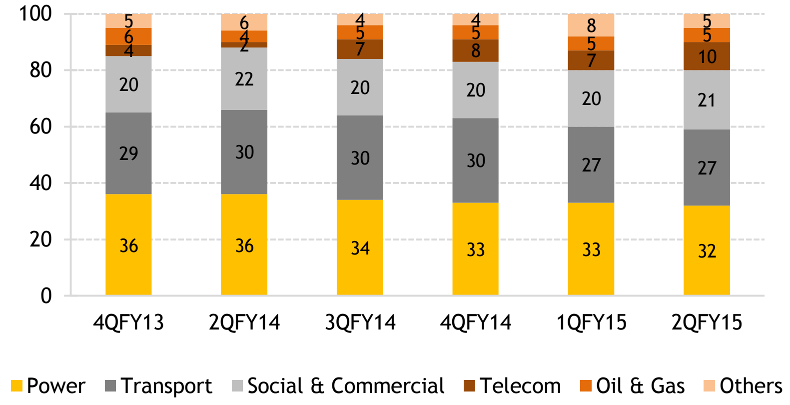
Within the power sector, 60% of the loans are towards operating assets and only 8% of the loans are for projects, which require linkages to coal or gas. Most of the power segment loans are of a small size (100-200MW) for the producer’s captive consumption. SREI has minimal exposure to stressed projects or distribution companies in the power space.

The focus in the project-sector lending business is to enhance profitability rather than chase growth. Advisory fee income has grown from 80bps of loans to 120bps of loans. Incrementally, the focus is on profitability instead of aggressive loan growth.

Asset quality in the project finance business has remained largely stable with gross NPLs of 2.4%. The NPLs in the business are lumpy in nature and relate to a few accounts only. The focus of management is on recovery of NPLs, as was visible in the case of the loan given to *Kingfisher Airlines*. The company was able to realize the full amount of its investment in the troubled airline. We expect stable trends to continue with a gradual improvement in asset quality trends. We do not foresee any major asset quality risk in the business.

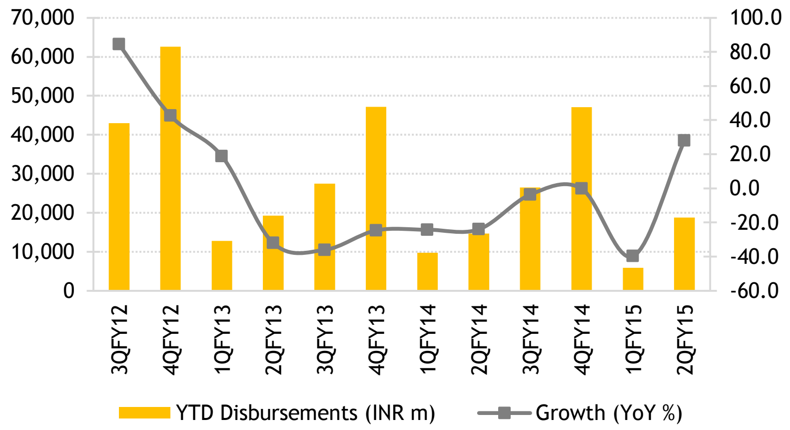
We expect the project lending business to remain muted in the near term. Steps taken by the government in the infrastructure space to garner more private sector investment will take a considerable amount of time to translate into strong loan growth. We forecast a measured pace of growth at 10% CAGR over FY15-17.

Loan mix (2QFY15)



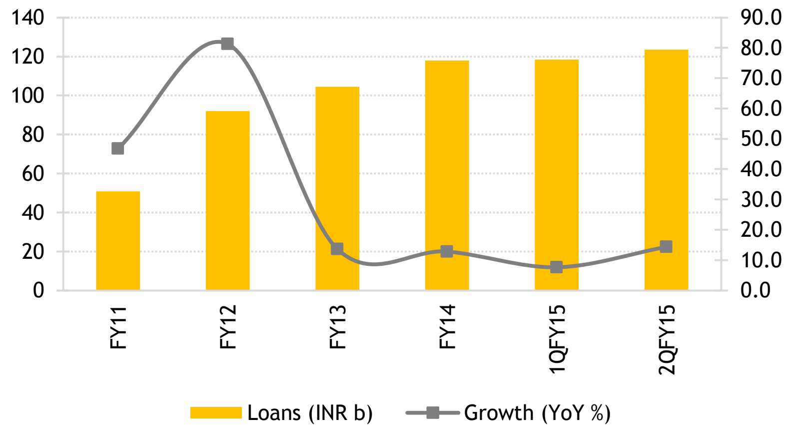
Source: Company, KESI

Disbursements witnessed pickup in the last quarter



Source: Company, KESI

Loan growth witnessing pickup



Source: Company, KESI

Govt's reformist approach will bolster growth

We list below a few reforms that would enable investments to pick up in key sectors such as power, roads and mining.

Coal sector: The government has adopted ordinance route for auctions of coal block licences cancelled by the Supreme Court of India. The process of auctioning of coal blocks is likely to conclude in Apr'15. This would ensure adequate supply to power generation companies without hampering their operations. SREI will benefit as the health of power companies improve and fresh demand for investment from the sector gains traction.

Mining sector: In the mining sector the government promulgated the Mining & Mineral Development Ordinance in Jan'15. Under this the government is likely to auction 199 mines of various minerals. Similarly, resumption of mining activities for iron ore and other minerals in the states of Goa, Karnataka and Odisha would benefit the sector. With pick up in mining activity the equipment finance business would benefit a lot.

Land reforms: The process of amendment of the Land Acquisition Act is under way via the ordinance route. The government plans to make acquisition of land for key infrastructure projects easier. The aim is to bring down the time for acquisition of land for speedy implementation of projects. Road sector would benefit on account of the proposed amendments by the government.

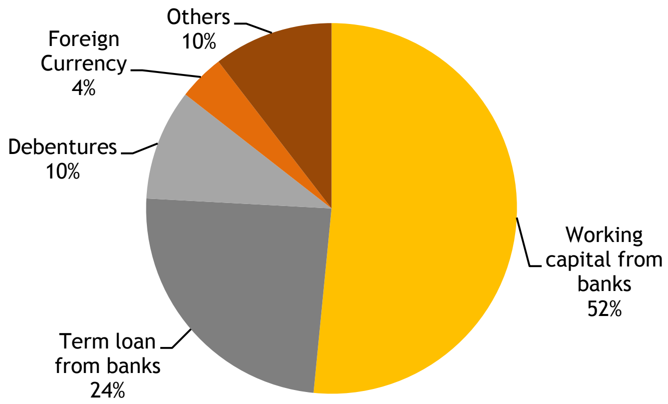
Environmental clearance: The government has been proactive in clearance of stalled projects which were stuck due to lack of environment and forest clearance. The government has already begun the process of web-based approval of projects requiring the environment ministry's consent. Faster clearance of projects would help with a pick-up in demand for infrastructure loans.

Funding: wholesale funded, to benefit in falling interest rate cycle

SREI is largely dependent on banks to fund its requirements. Working capital and term loans from banks account for 70-75% of overall borrowings. Other sources of funding include non-convertible debentures (NCD) at 10% of borrowings and foreign currency loans at 4% of borrowings. The borrowing profile of the project finance and equipment finance businesses is also on similar lines with bank funding being the major source. In terms of the average tenure, the borrowings largely match the loan tenure in both segments of the business without any major ALM mismatch.

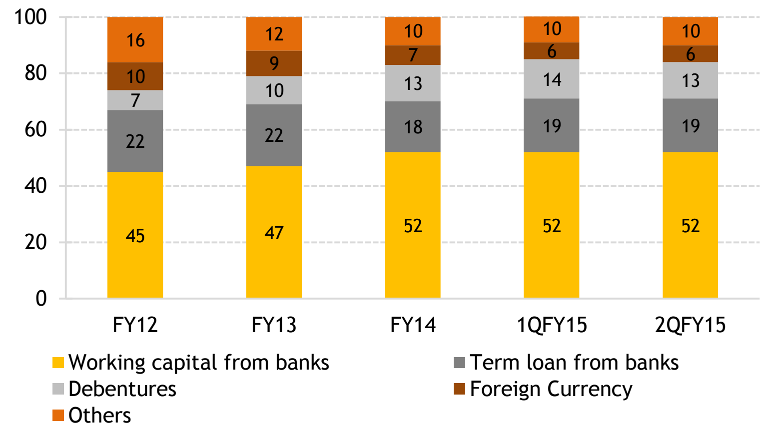
According to management, efforts are underway to reduce reliance on banks and tap alternate sources of funding such as money from retail sources. We believe it will be difficult to change the mix in the short to medium term. We expect bank funding to remain the major contributor for now. Given the wholesale nature of funding, we expect SREI to benefit in a falling interest rate environment. Comfortable liquidity conditions should also provide stability to NIMs.

Consolidated funding mix (Sep'14)



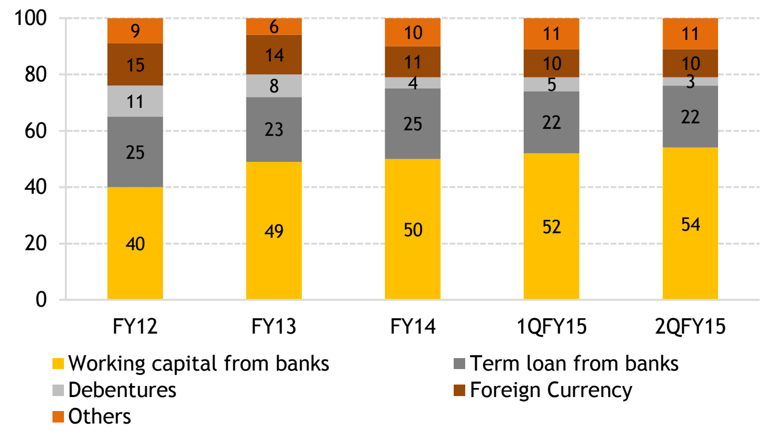
Source: Company, KESI

Borrowing mix of SREI Infra standalone



Source: Company, KESI

Borrowing mix of SREI BNP



Source: Company, KESI

Asset quality cycle peaked, better trends ahead

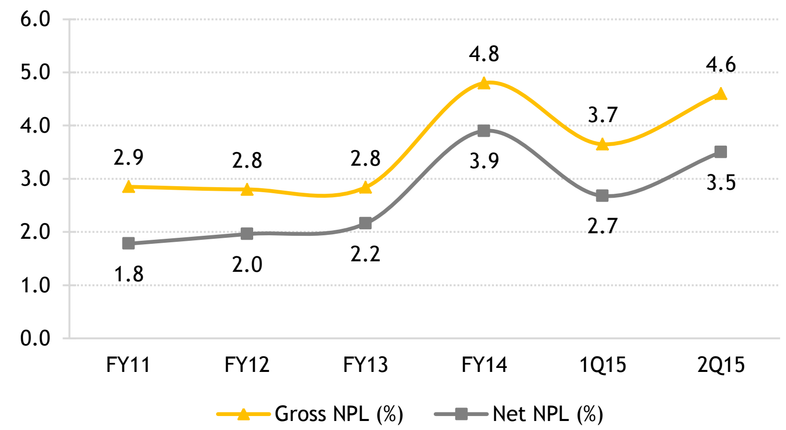
Asset quality deteriorated in the past five years with gross NPLs increasing from 0.9% of loans to 3.3% in FY14. Deterioration was witnessed in both segments of the business, but was more pronounced in the equipment financing business. SREI BNP's gross NPLs jumped from 2.9% in FY11 to 4.6% in Sep'14. A slowdown in the economy and the ban in the mining sector affected asset quality significantly. Issues vis-à-vis land acquisition and environment clearance have affected cash flows of borrowers whose equipment was deployed in transportation related sectors.

We believe the worst in terms of asset quality stress is over for SREI. In the project finance business, 60% of the power sector exposure is to operational projects. SREI Infra has negligible exposure in stressed sub segments such as gas-based projects or state distribution companies. Moreover, the focus is on small projects of 100-150MW, which are largely used by the borrowers for captive purposes. With a reformist government at the helm, immense effort has already gone into resolution of impaired projects. Revival in the economy will reduce incremental stress as well.

Similarly, in the equipment financing business, the cash flows of borrowers have seen moderate improvement in the past two quarters. With a pickup in the investment cycle, removal of the ban in the mining sector, and revival of infrastructure projects, SREI BNP's asset quality will also witness a gradual improvement. Diversification of its loan book to other areas of lending such as medical equipment financing and IT would help to reduce concentration risks.

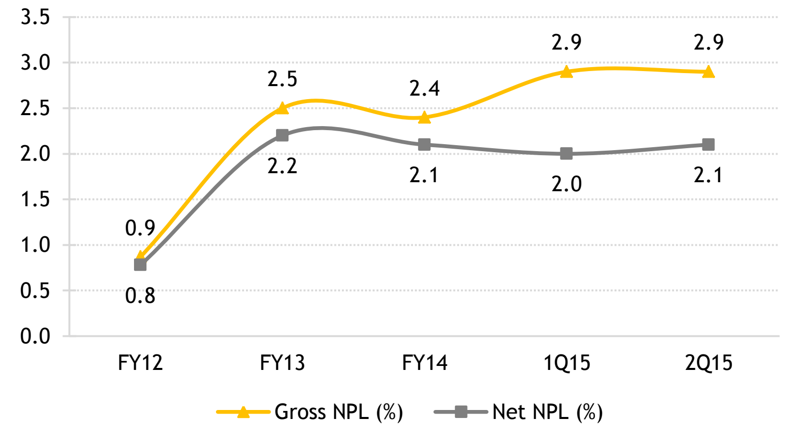
We expect the gross NPLs for the consolidated book to peak out in FY15 to 3.5%. We factor in a drop in delinquency leading to gross NPLs of 2.8% by FY17. We forecast increase in provision coverage ratio to c.40% by FY17 from 15% in FY14. Consequently, our credit cost estimates are elevated at 100bps for FY16-17.

SREI BNP gross NPLs (based on total assets)



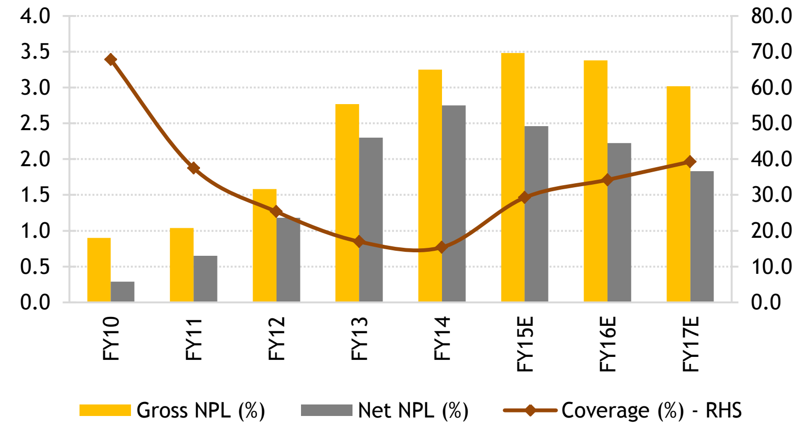
Source: Company, KESI

SREI Infra gross NPLs (based on total assets)



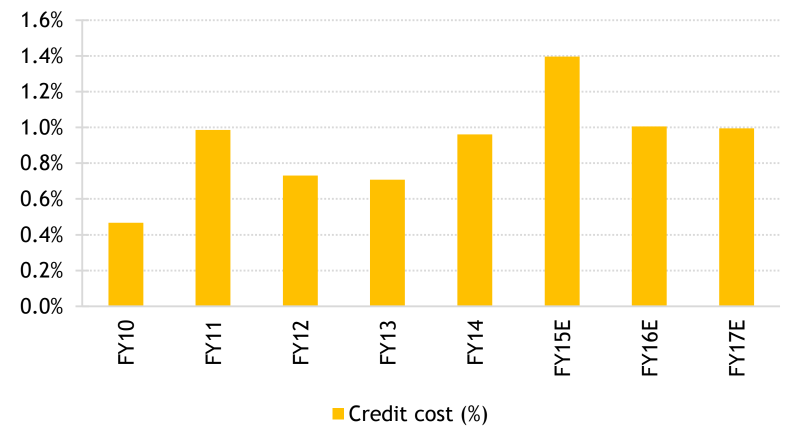
Source: Company, KESI

Consolidated gross NPLs



Source: Company, KESI

Credit cost will drop with improvement in asset quality

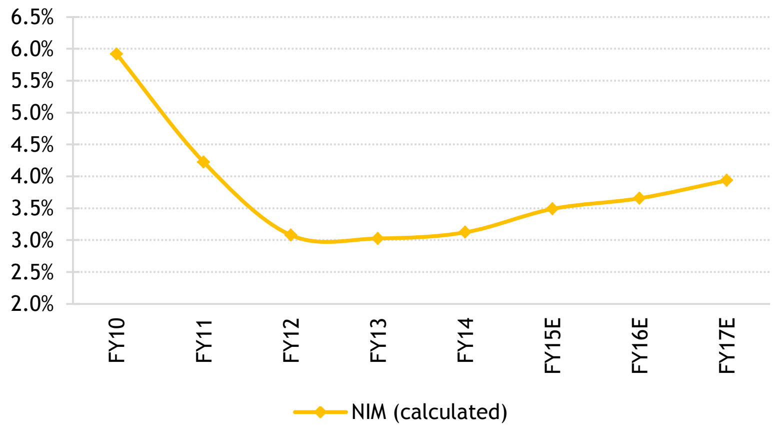


Source: Company, KESI

NIM: benefit from deleveraging and benign rates

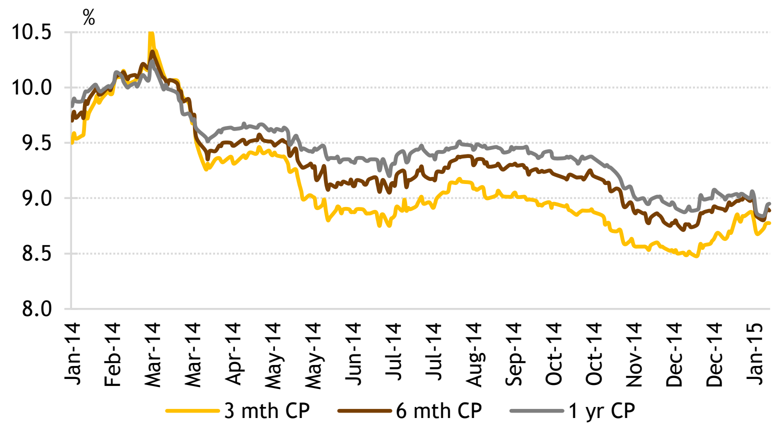
SREI's margins will benefit from numerous levers: i) Monetisation of investments would reduce the borrowing requirement, which in turn would lead to NIM expansion. We have assumed the sale of investments at book value in FY16, thus reducing the borrowings by a similar amount, ii) Being wholesale funded, decline in systemic interest rates and easing of liquidity will help NIM expansion, iii) Diversification in the assets book and liability mix would also aid NIM expansion, iv) Lower asset quality stress would reduce the interest income reversal considerably. We forecast NIM expansion of 90bps in the next three years from 310bps to 400bps by FY17.

NIMs to expand over FY15-17E



Source: Company, KESI

Interest rates trending downward



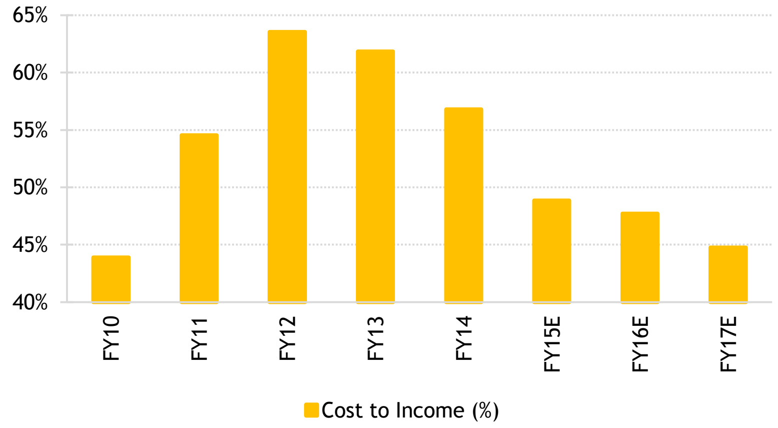
Source: Company, KESI

Cost-income to improve, tax rates to normalise at 33.5%

SREI's cost-income ratio deteriorated from 44% in FY10 to 62% by FY13 because of its shrinking topline. Cost-containment measures such as staff retrenchments and an efficiency drive improved this ratio to 57% in FY14. The company has started to employ more personnel in equipment lending and diversified into new products. We expect its cost-income ratio to improve 12.4 ppts to 45% by FY17F, led by strong revenue growth. We factor in gradual increases in opex as it builds capability in new products.

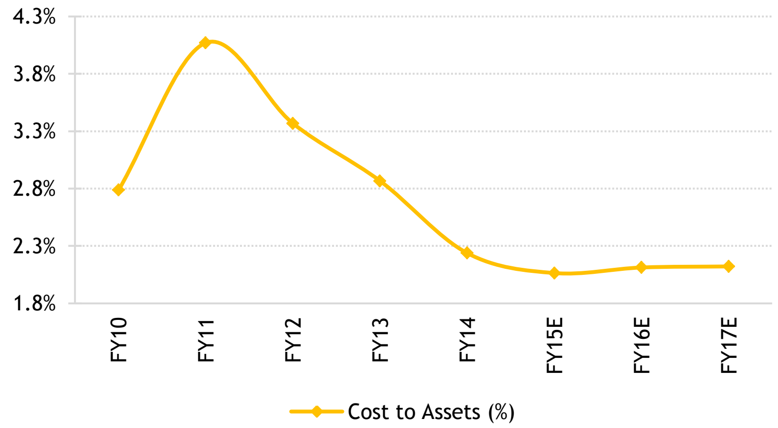
Tax rates for SREI have been higher than the industry, at c.40%, owes to tax payments related to previous years. Management expects rates to normalise to an industry average of 33.5% in FY16-17. We have factored in industry tax rates for FY16-17.

Cost-income to improve steadily



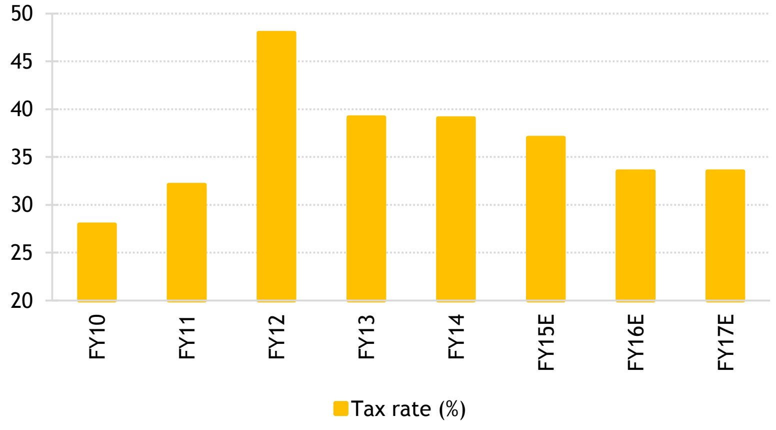
Source: Company, KESI

Cost-asset ratio set to drop



Source: Company, KESI

Tax rates to normalise at 33.5%



Source: Company, KESI

Monetisation of investments to provide fillip

A monetisation of investments would reduce its cost of funds and improve earnings. SREI has invested in: i) a minority stake in a telecom business, VIOM Network; ii) eight BOT road projects; iii) special economic zones (SEZs) in three states; and iv) rural community service centres (CSCs) through an associate, *Sahaj*. Management plans to sell some of these to redeploy cash to interest-earning assets. Its largest investment is VIOM, with a book value of INR16b. Management is confident of monetising this in FY16. ***We have factored in VIOM's monetisation at cost in our forecasts for FY16***. Consequently, our funding-requirement numbers are lower by this amount.

VIOM Network - telecom infrastructure

VIOM is a JV between Tata Teleservices with a 54% holding and SREI with 14.5%. Other shareholders are Macquarie SBI Infrastructure Fund, GIC Investments Singapore, IDFC Private Equity and Oman Investment Fund, with a combined 31.5% stake. VIOM is India's largest independent telecom infrastructure service provider. SREI's cost of investment was INR16b. A sale of this investment above book value would be value-accretive.

Even if SREI decides not to sell out, a better operating environment for telecom companies should boost VIOM's performance in the next couple of years. VIOM may consider an IPO to provide an exit to shareholders.

VIOM increased its number of towers at a 40% CAGR over FY08-14 to 42,000. Its tenancy ratio, which had dropped during the period of telecom-licence cancellations, has picked up to 2.3x. This beats the industry average of 1.7x. Its revenue dependence on Tata Tele also shrank from 41% in FY11 to 36% by Sep'14. Tenancies in favour of incumbents improved from 12% to 22% over the period. FY14 EBITDA was INR17.6b with an EBITDA margin of 56%. Cash profits were INR9b. Debt narrowed by INR17b in the past four years to INR65b as of Sep'14.

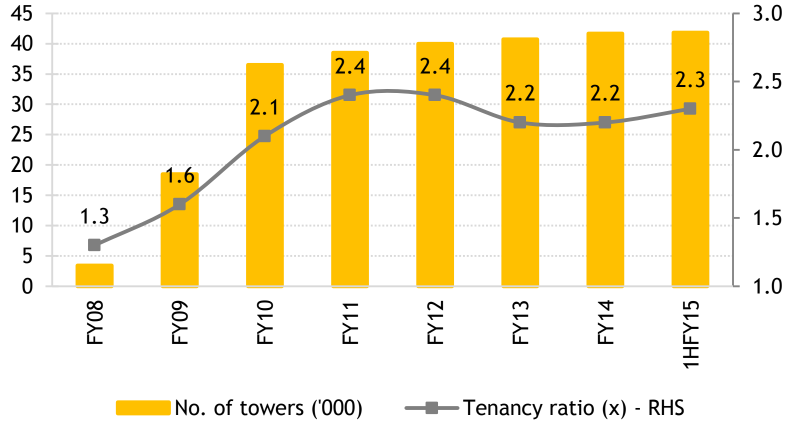
The largest tower operator in the country, Bharti Infratel (BHIN), trades at 15x FY14 EV/EBITDA. We value SREI's stake in VIOM at book value which comes up to a very conservative 6.5x FY14 EV/EBITDA. VIOM has a higher tenancy ratio of 2.2x than BHIN's 2x and higher EBITDA margins of 56% vs BHIN's 41%. We believe it could be monetised at a premium to book, which would be value-accretive to SREI.

VIOM's financial snapshot

INRb	FY11	FY12	FY13	FY14	1HFY15
Revenue - service income	29.6	32.5	33.0	29.5	15.6
Revenue - pass-through	14.1	15.4	16.5	16.8	8.5
Total revenue	**43.7**	**47.8**	**49.5**	**46.3**	**24.1**
EBITDA	**13.6**	**15.5**	**18.6**	**17.6**	**8.6**
Cash profit	5.6	5.7	8.9	9.2	4.7
Total debt	**81.3**	**80.5**	**73.8**	**64.2**	**65.6**
EBITDA margin (without pass-through)	**46%**	**48%**	**54%**	**56%**	**55%**

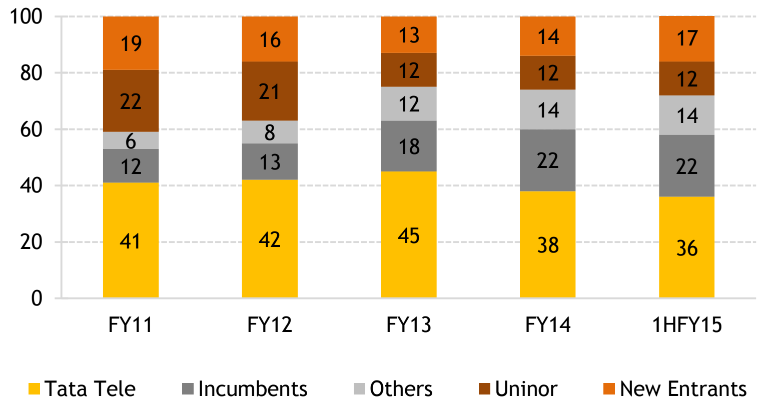
Source: Company, KESI

VIOM's towers and tenancy ratio



Source: Company, KESI

VIOM's tenancy mix (%)



Source: Company, KESI

BOT road assets: Churning of projects to book gains

SREI plans to have a portfolio of operational and under-construction road projects. The idea is to churn this portfolio for gains on investment. It currently has eight road projects in seven states in India with 3,264 lane kilometres. Of these, 1,190 kilometres are operational. The rest are under construction. Their book value is INR5.5b. Management plans to monetise some of the projects in the medium term.

Projects in which SREI has significant stakes

Road BOT assets	
No. of projects	8
Operational projects	4
Under-construction projects	4
Total lanes (KM)	3,264
Operational lanes (KM)	1,190
Under-construction lanes (KM)	2,074
Gross revenue realised per lane Km in 2Q15 (INRm)	0.5

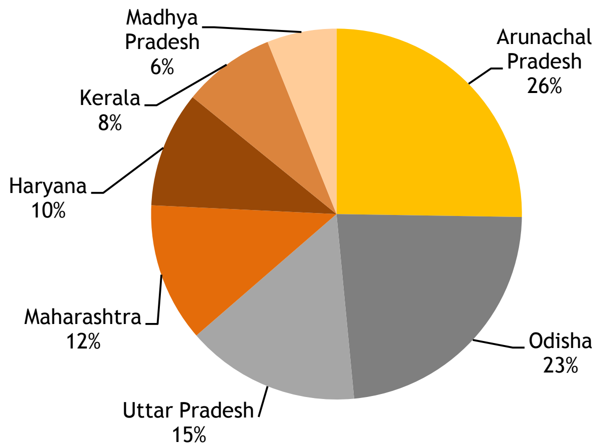
Source: Company, KESI

Operational projects

Particulars	State	Project cost (INRm)	Toll collection in FY14 (INRm)
4/6 Laning of Thirssur	Kerala	7,260	800
4 Laning of Indore - Ujjain	Madhya Pradesh	3,400	200
4 Laning of Rohtak-Bawal	Haryana	9,930	330
6 Laning of Chandikhole Bhubaneswar	Odisha	15,870	780

Source: Company, KESI

Geographic distribution of BOT road assets (lane KMs)



Source: Company, KESI

SEZs/industrial parks: Gains on value-unlocking

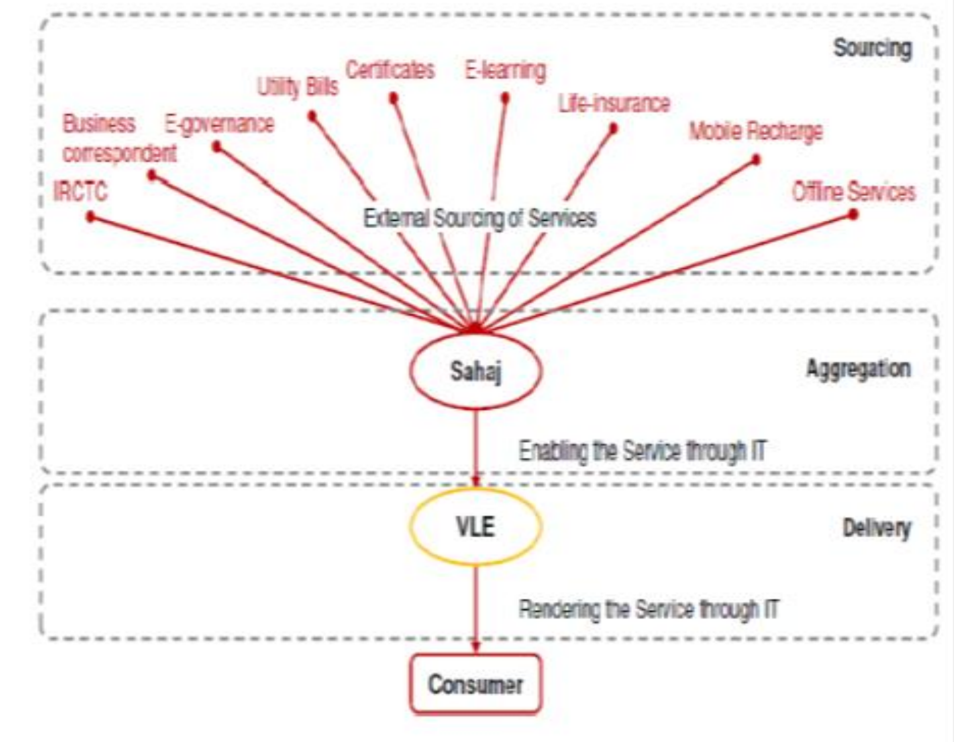
SREI has investments in SEZs and industrial parks in Maharashtra, West Bengal and Tamil Nadu. It has acquired 345 acres of the 550 required for its Maharashtra project. In Tamil Nadu, it has acquired 2,158 acres. In West Bengal, it has acquired 133 acres out of the 550 it needs to build an auto industrial park. All these can potentially provide handsome gains in post-development sales.

Sahaj (rural CSCs): Deep value-creation underway

SREI holds a 48% associate stake in Sahaj. This company operates 27,000 rural community service centres across six states in India, covering 280m people. These CSCs offer a gamut of products to their customers, including G2C (government to consumer), B2C and e-learning services. They also act as business correspondents for banks. We expect Sahaj to benefit from a direct benefits programme under the government, a scheme in which it may act as a correspondent.

Even though financial contributions are miniscule, we believe Sahaj offers long-term value-creation potential, either through stake sales or a listing.

Sahaj's business model



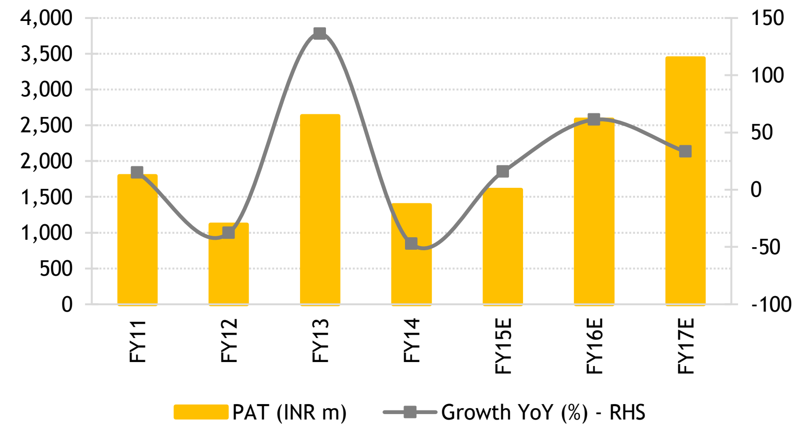
Source: Company

Earnings to gain momentum, ROEs to improve

We forecast a strong 35% earnings CAGR for SREI for FY14-17E. We expect its EPS to grow 61% YoY in FY16E to INR5.1 and 33% YoY in FY17E to INR6.8. Leading this would be: i) Stake sales in investments, potentially lowering its borrowing and funding costs; ii) A 90bp NIM expansion over FY14-17E on redeployment of funds to interest-earning assets; changes in its mix of loans and softening interest rates; iii) Asset-quality stabilisation, which should lower its credit costs. We think credit costs could drop from 1.4% in FY15F to 1% by FY16F-17E; and iv) A normalisation of tax rates from 39% in FY14 to 33.5% for FY16F-17E.

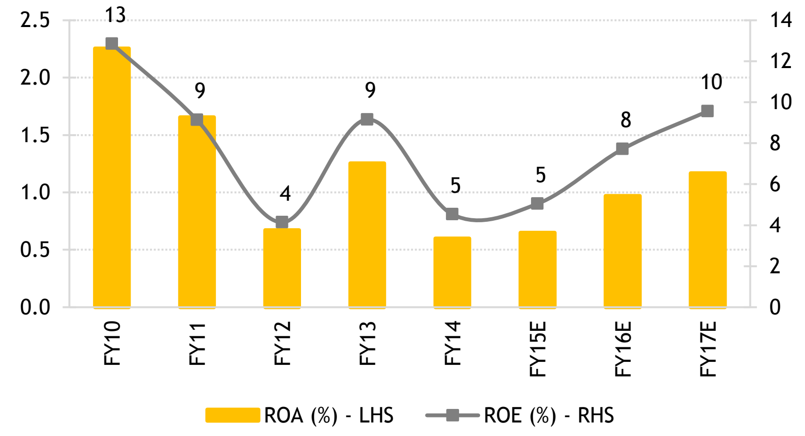
We expect ROEs to expand from 4.5% in FY14 to 10% by FY17E through strong earnings growth and investment monetisation in FY16.

Earnings growth in the next two years



Source: Company, KESI

ROEs to recover by 500bps over FY14-17E to 10%



Source: Company, KESI

Deep value, initiate with BUY

Sentiment on the stock has been buffeted by a slowdown in infrastructure rollout. Management's investment in VICOM also weighed on the stock after the cancellation of telecom licences. However, with its clear intent on restricting investments to 35-40% of its net worth and the sale of investments in telecom and road assets, balance sheet should improve. The stock used to trade at over 1.5x P/BV prior to the economic slowdown and its telecom investments in FY08-09. We believe it can recover some of its lost ground by returning to its core lending business.

We believe the stock's steep discount to IDFC is in large part a function of its lower return ratios. With better ROEs, we expect a stock re-rating. Improvements in the economic environment and acceleration in the government's infrastructure programme should augur well, and with the conversion of IDFC into a bank, we believe SREI is uniquely positioned to capture any uptick in infrastructure lending.

We value it using consolidated book value. Our TP of INR70 is based on 1x FY16E P/BV for a 10% ROE. SREI trades at 0.7x FY16E P/BV.

Even if we were to value SREI Infra and SREI BNP separately and its investments at cost, our TP would be higher at INR81.

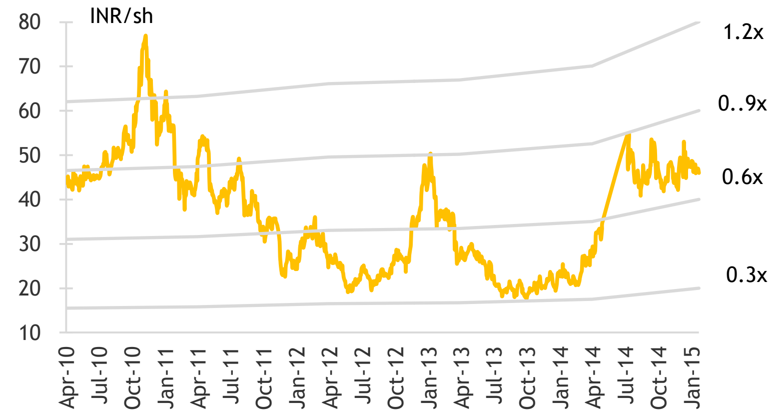
SOTP valuation

Particulars	Value (INRm)	Comments
SREI Infra (standalone)*	27,073	0.9x FY16E P/BV for 8% ROE
SREI BNP (50% for JV)	13,745	1.2x FY16E P/BV for 14% ROE
Total value	**40,818**	
Value per share (INR)	**81**	

Source: Company, KESI

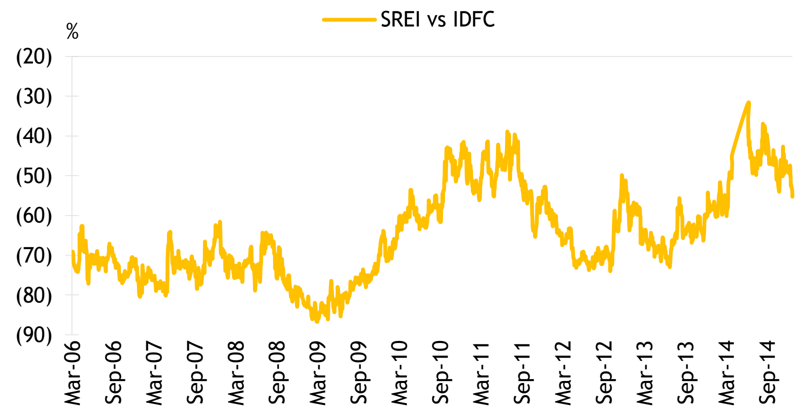
Note: *SREI standalone includes the value of investments held in VIOM and road assets.

Trades at undemanding P/BV valuations



Source: Company, KESI, Bloomberg

P/BV at a discount to IDFC



Source: Company, KESI, Bloomberg

Comparative valuations*

Company	BB Ticker	ROA (%)		ROE (%)		EPS growth (%)		P/BV (x)		PER (x)	
		FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
SREI Infra Finance	SREI	0.6	1.0	5.0	7.7	16	62	0.7	0.7	14.9	9.2
Infra finance Cos.											
IDFC	IDFC	2.3	2.4	11.3	11.2	-12	9	1.6	1.5	15.0	13.8
L&T Finance	LTFH	1.6	1.6	12.8	13.9	25	22	1.8	1.6	16.0	13.1
Power Finance	POWF	2.9	2.8	20.3	19.9	12	14	1.2	1.0	6.1	5.3
Rural Electrification	RECL	3.3	3.2	24.0	22.8	17	12	1.3	1.1	5.7	5.1
PTC Financial	PTCIF	3.7	3.5	16.9	20.0	31	36	2.4	2.1	13.7	10.1
Vehicle finance Cos.											
Mahindra Finance	MMFS	2.4	2.7	15.0	17.0	-7	29	2.7	2.4	18.6	14.4
Chola Finance	CIFC	1.8	2.0	15.8	16.7	9	25	2.7	2.3	18.2	14.5
Shriram Transport	SHTF	2.5	2.8	15.6	16.8	4	25	2.7	2.3	18.4	14.7
Magma Finance	MGMA	1.2	1.4	11.8	13.9	20	31	1.2	1.1	11.3	8.7
Sundaram Finance	SUF	2.9	3.0	18.8	18.9	10	16	5.7	4.9	32.3	27.8

Source: Company, KESI, Bloomberg

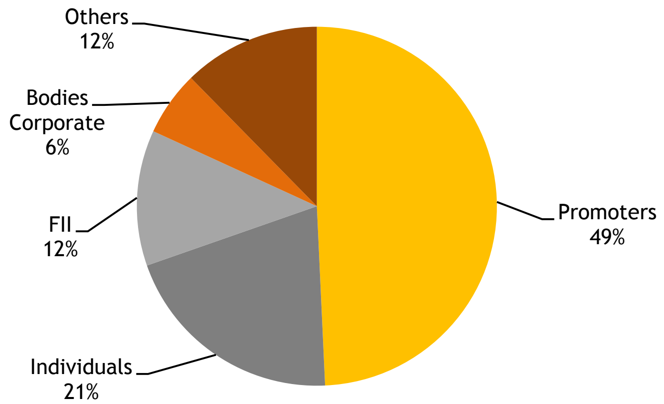
*Note: Bloomberg consensus estimates used for comparative valuations.

DuPont analysis (%)

Particulars	FY12	FY13	FY14	FY15E	FY16E	FY17E
NII / Assets (%)	2.45	2.50	2.64	2.94	3.11	3.39
Other Income / Assets (%)	2.85	2.14	1.30	1.29	1.32	1.35
Total Income / Assets (%)	5.30	4.64	3.94	4.23	4.43	4.74
Cost to Assets (%)	3.37	2.87	2.24	2.06	2.11	2.12
PPP / Assets (%)	1.93	1.77	1.70	2.16	2.31	2.62
Provisions / Assets (%)	0.51	0.52	0.73	1.14	0.86	0.87
PBT / Assets (%)	1.42	1.25	0.98	1.02	1.45	1.75
Tax Rate (%)	48.0	39.2	39.1	37.0	33.5	33.5
ROA (%)	**0.67**	**1.25**	**0.60**	**0.65**	**0.97**	**1.17**
Leverage (x)	6.2	7.3	7.5	7.8	7.9	8.2
ROE (%)	**4.1**	**9.2**	**4.5**	**5.0**	**7.7**	**9.6**

Source: Company, KESI

Shareholdings as of Dec 2014



Source: Company, BSE India

Institutional holdings as of Dec'14

Investor	Holding (%)
Fidelity	9.98
MV SCIF Mauritius	0.31
Dimensional Emerging Markets Value Fund	0.30
Vanguard Total International	0.30
Wisdom Tree	0.21
Blackrock	0.15

Source: Company

Promoters & Board of Directors

Promoters

Name & Designation	Profile
Hemant Kanoria Chairman & Managing Director	Over 34 years of experience in industry, trade and financial services. Chairman of FICCI National Committee on Infrastructure and presently council member of Indo-German Chamber of Commerce. Has been on Board of Governors of Indian Institute of Management – Kolkata. Member of Regional Direct Taxes Advisory Committee, Government of India and served as president of Calcutta Chamber of Commerce.
Sunil Kanoria Vice Chairman	Chartered Accountant with more than 26 years of experience in financial services. Presently senior vice-president of The Associated Chambers of Commerce & Industry of India, member of Central Direct Taxes Advisory Committee and governing body member of the Construction Industry Development Council.
Independent directors	
Salil K Gupta Chief Mentor & Independent Director	More than 56 years of experience. Former chairman of West Bengal Industrial Development Corporation Ltd, a leading state financial institution. Also served as president of The Institute of Chartered Accountants of India.
Saud Ibne Siddique Non-Executive Director	Over 30 years of global infrastructure financing experience. Worked with International Finance Corporation, the private-sector arm of World Bank, for more than 16 years, in Washington DC. During 2004-07, he was based in Hong Kong and was head of business development for infrastructure projects in East Asia and Pacific. Also served as CEO and board member of a listed water infrastructure fund in Singapore.
Dr. S. C. Jha Independent Director	Former director and chief economist of Asian Development Bank, Manila and president of Bihar Economic Association. Also a member of the Economic Advisory Council to the Prime Minister and chairman, Special Task Force on Bihar.
S. Rajagopal Independent Director	Former chairman & managing director of Bank of India and Indian Bank. More than 41 years of banking experience.
S. Chatterjee Independent Director	Over 46 years of experience in commercial and investment banking. Was executive director of Axis Bank Ltd. He has extensive exposure to international banking with SBI.
Sujitendra Krishna Deb Independent Director	Chartered Accountant with over 43 years of experience in assurance and business advisory services with big-four firm in India, where he was a partner for over two decades. Experience in due diligence, valuation and internal audits, among others.
Dr. Punita Kumar Sinha Independent Director	Doctorate from Wharton School, University of Pennsylvania. Over 23 years of experience in asset management in international and emerging markets. Served as senior managing director of The Blackstone Group LP and chief investment officer of Blackstone Asia Advisors L.L.C. Also CIO and senior portfolio manager of NYSE-listed India Fund Inc. and Asia Tigers Fund Inc.

Source: Company

Risks

Poor investment climate and lack of government reforms

The biggest risk for SREI is delays in the investment cycle and stalled execution of key government reforms. Its loan growth may not be revived and asset quality may be compromised. The recovery of both its equipment-financing and project-lending businesses is closely linked to a pick-up in investments by corporates and the government.

Delays in balance-sheet deleveraging

If SREI is unable to monetise its investments in telecom and road assets, the pressure on its balance sheet could lift its funding costs further. It may also need to raise capital to sustain growth. NIM expansion on a redeployment of funds to earning assets would also not happen.

Competition from banks

Lending by banks at slender margins to increase market share in equipment financing can potentially disrupt this business. In the past, banks had been aggressive in chasing market share. Given their lower costs of funds, fierce competition can retard growth and squash spreads.

FYE 31 Mar	FY13A	FY14A	FY15E	FY16E	FY17E
Key Metrics					
Core P/E (x)	9.0	17.0	14.7	9.1	6.8
Core FD P/E (x)	na	na	na	na	na
P/BV (x)	0.8	0.8	0.7	0.7	0.6
P/NTA (x)	na	na	na	na	na
Net dividend yield (%)	1.7	1.1	1.1	1.6	2.2
INCOME STATEMENT (INR m)					
Interest income	26,606.2	29,596.2	31,770.1	34,382.5	38,730.0
Interest expense	(21,356.5)	(23,502.8)	(24,501.9)	(26,117.5)	(28,733.7)
Net interest income	**5,249.7**	**6,093.4**	**7,268.3**	**8,265.0**	**9,996.3**
Net insurance income	0.0	0.0	0.0	0.0	0.0
Net fees and commission	1,303.4	1,425.8	1,532.7	1,716.7	1,957.0
Other income	3,189.6	1,581.0	1,651.9	1,795.0	2,027.6
Total non-interest income	**4,493.0**	**3,006.8**	**3,184.7**	**3,511.7**	**3,984.6**
Operating income	**9,742.7**	**9,100.2**	**10,452.9**	**11,776.7**	**13,980.9**
Staff costs	(1,614.4)	(1,294.4)	(1,230.8)	(1,389.3)	(1,604.7)
Other operating expenses	(4,410.6)	(3,874.0)	(3,875.2)	(4,231.1)	(4,651.9)
Operating expenses	**(6,025.0)**	**(5,168.4)**	**(5,106.1)**	**(5,620.4)**	**(6,256.6)**
Pre-provision profit	**3,717.7**	**3,931.8**	**5,346.9**	**6,156.2**	**7,724.3**
Loan impairment allowances	(1,035.4)	(1,637.1)	(2,610.9)	(2,080.5)	(2,359.3)
Other allowances	(59.5)	(39.1)	(209.4)	(209.4)	(209.4)
Associates & JV income	0.0	0.0	0.0	0.0	0.0
Pretax profit	**3,627.8**	**2,256.2**	**2,526.6**	**3,866.3**	**5,155.6**
Income tax	(1,027.1)	(881.1)	(934.8)	(1,295.2)	(1,727.1)
Minorities	41.1	10.0	10.0	10.0	10.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	**2,641.8**	**1,385.1**	**1,601.7**	**2,581.1**	**3,438.5**
Core net profit	**2,641.8**	**1,385.1**	**1,601.7**	**2,581.1**	**3,438.5**
BALANCE SHEET (INR m)					
Cash & deposits with banks	5,798.5	5,637.2	6,088.2	6,879.6	7,980.4
Sec. under resale agreements	0.0	0.0	0.0	0.0	0.0
Derivatives financial assets	0.0	0.0	0.0	0.0	0.0
Dealing securities	0.0	0.0	0.0	0.0	0.0
Available-for-sale securities	0.0	0.0	0.0	0.0	0.0
Investment securities	0.0	0.0	0.0	0.0	0.0
Loans & advances	169,231.0	179,789.0	194,172.1	219,414.5	254,520.8
Central bank deposits	0.0	0.0	0.0	0.0	0.0
Investment in associates/JVs	24,789.5	24,196.4	26,132.1	14,261.9	17,816.5
Insurance assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	14,923.2	17,146.3	18,193.5	19,540.0	21,979.2
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other assets	7,974.3	12,404.7	10,977.7	16,323.0	10,843.3
Total assets	**222,716.5**	**239,173.6**	**255,563.6**	**276,419.1**	**313,140.2**
Deposits from customers	0.0	0.0	0.0	0.0	0.0
Deposits from banks & FIs	0.0	0.0	0.0	0.0	0.0
Derivatives financial instruments	0.0	0.0	0.0	0.0	0.0
Subordinated debt	13,699.4	15,486.4	17,322.3	19,721.1	22,846.5
Other securities in issue	0.0	0.0	0.0	0.0	0.0
Other borrowings	169,115.9	182,186.6	194,939.7	210,534.8	240,009.7
Insurance liabilities	0.0	0.0	0.0	0.0	0.0
Other liabilities	9,531.4	10,110.0	10,603.7	11,325.7	12,596.8
Total liabilities	**192,346.7**	**207,783.0**	**222,865.7**	**241,581.6**	**275,453.1**
Share capital	5,032.4	5,032.4	5,032.4	5,032.4	5,032.4
Reserves	25,063.2	26,061.4	27,368.7	29,508.2	32,358.0
Shareholders' funds	30,095.6	31,093.8	32,401.1	34,540.6	37,390.4
Preference shares	0.0	0.0	0.0	0.0	0.0
Minority interest	274.2	296.8	296.8	296.8	296.8
Total equity	30,369.8	31,390.6	32,697.9	34,837.4	37,687.2
Total liabilities & equity	**222,716.5**	**239,173.6**	**255,563.6**	**276,419.1**	**313,140.2**

Note: Shareholder’s funds is net of Goodwill

FYE 31 Mar	FY13A	FY14A	FY15E	FY16E	FY17E
Key Ratios					
Growth (%)					
Net interest income	29.0	16.1	19.3	13.7	20.9
Non-interest income	(5.3)	(33.1)	5.9	10.3	13.5
Operating expenses	7.6	(14.2)	(1.2)	10.1	11.3
Pre-provision profit	15.7	5.8	36.0	15.1	25.5
Core net profit	137.1	(47.6)	15.6	61.1	33.2
Gross loans	22.4	6.7	8.2	12.9	15.6
Customer deposits	na	na	na	na	na
Total assets	12.7	7.4	6.9	8.2	13.3
Profitability (%)					
Non-int. income/Total income	46.1	33.0	30.5	29.8	28.5
Average lending yields	15.34	15.17	15.25	15.41	15.55
Average cost of funds	12.49	12.35	11.95	11.80	11.65
Net interest margin	3.03	3.12	3.49	3.70	4.01
Net income margin	2.85	2.81	3.30	3.61	3.89
Cost/income	61.8	56.8	48.8	47.7	44.8
Liquidity (%)					
Loans/customer deposits	nm	nm	nm	nm	nm
Asset quality (%)					
Net NPL	2.3	2.8	2.5	2.2	1.8
Gross NPL	2.8	3.3	3.5	3.4	3.0
(SP+GP)/average gross loans	0.7	1.0	1.4	1.0	1.0
Loan loss coverage	17.0	15.4	30.0	35.0	40.0
Capital adequacy (%)					
CET1	na	na	na	na	na
Tier 1 capital	14.3	10.7	10.6	10.9	10.4
Risk-weighted capital	21.7	17.8	16.2	17.1	16.7
Returns (%)					
ROAE	9.2	4.5	5.0	7.7	9.6
ROAA	1.3	0.6	0.6	1.0	1.2
Shareholders equity/assets	13.5	13.0	12.7	12.5	11.9

Source: Company; Maybank

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