Srei Infrastructure Finance

View: Positive

Bracing up for a turn-around; scope for significant re-rating ahead

CMP: Rs55

Key points

- Srei Infrastructure Finance (Srei), which has turned cautious in the past couple of years due to an economic slowdown, is likely to return to growth path gradually over the next two to three years. A revival in the economy coupled with the new government's focus on infrastructure augurs well for the project finance and equipment finance segments.
- The profitability and return ratios of the company are expected to improve led by traction in the operating income and recovery from the NPAs (reversal of provisions will boost earnings). The company expects to reduce the borrowing cost and focus on high yielding products (used construction equipment) to enhance margins. On a normalised basis, the company expects the RoE and the RoA to improve to 12% and 1.5% over the next two to three years.
- Value unlocking from strategic investments (investment of Rs1,600 crore in Viom Networks for a 14% stake and that of Rs350 crore in road projects) would also result in significant re-rating of the stock. It has close to 65% of its net worth in strategic investments (it targets to bring it down to 25% in FY2015) and the monetisation of investments would free up huge capital that could be deployed in its core lending business.
- The stock currently trades at 0.7x FY2016E consolidated book value which is at quite a discount to the other NBFCs and in line with the valuations of the mid-sized PSU banks. Given the revival in the economy, Srei's specialisation in the infrastructure sector could fuel loan growth while value unlocking from investments could leave considerable scope for the re-rating of its valuation multiples. We have a positive outlook on stock and expect 20-25% gains over the next four to six months.

Valuation

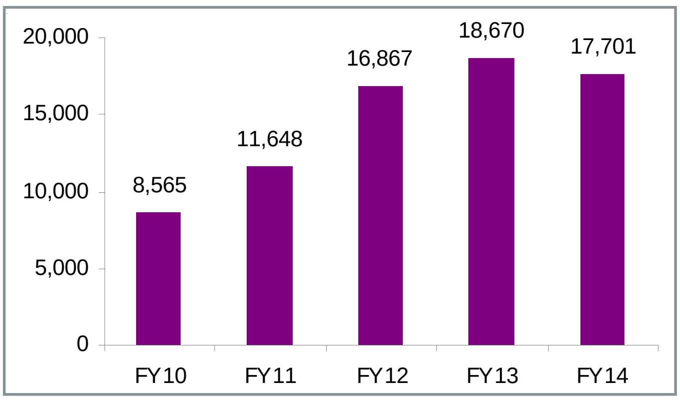
Particulars	FY2012	FY2013	FY2014	FY2015E	FY2016E
Net interest income (Rs cr)	371	405	481	547	653
Net profit (Rs cr)	112	264	139	201	256
EPS (Rs)	2.2	5.3	2.8	4.0	5.1
EPS growth (%)	-71.3	136.4	-47.4	44.9	27.2
P/E (x)	24.4	10.3	19.6	13.6	10.7
Book value (Rs/share)	54.0	58.5	60.5	72.8	76.9
P/BV (x)	1.0	0.9	0.9	0.7	0.7
RoAE (%)	3.5	8.0	4.0	5.6	6.8
RoAA (%)	0.6	1.2	0.6	0.8	0.9

Likely gains from sale of strategic investments are not factored in estimates

Equipment finance book—NPA pressures to ease, growth to pick up

The equipment finance business (assets under management [AUM] of Rs18,307 crore) had slowed in the past couple of years due to a weak economic environment. However, the sentiments have improved and demand is likely to pick up towards H2FY2015 which should result in a stronger growth in loans over the next two to three years. Srei-BNP has tie-ups with leading global brands which will help to scale up as the market improves. In addition, the company has started focusing on financing used construction equipment (CE) which command higher yields and have a huge market to expand (post-2005 vehicles). It plans to increase the proportion of used CE loans to 12% of book by FY2017 from 2% currently. While the non-performing assets (NPAs) increased in FY2014 (since the payments from clients were withheld due to the general election), the worst seems to be over and the company has already made provisions that are expected to reverse over FY2015-16 and will cushion profitability.

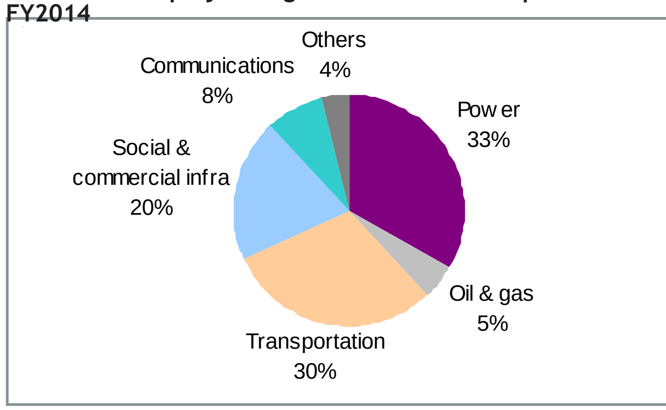
Equipment finance loan book (Rs cr)



Infrastructure projects book—revival in economy and focused spending in infra to fuel growth

Due to a slowdown in the economy and a cautious stance taken by the company the infrastructure book has declined since FY2012 (AUM of Rs11,354 crore as of FY2014). The company's loan book is mainly spread across power (33% of book), transport (30%) and social and commercial infrastructure (20% of book) segments. While the margins have come off in the past few quarters, the improving liquidity and reliance on non-bank funds (non-convertible debentures, tax-free bonds) could cushion the net interest margin. Going ahead, the government's focus on building infrastructure and Srei's domain specialisation across infrastructure spectrum (power, ports, roads, transport, and telecommunications) should help to grow book at a healthy rate.

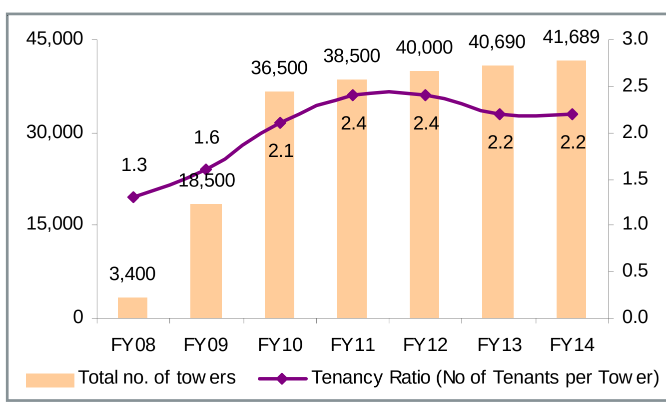
Infrastructure project segment-wise loan composition—FY2014



Value unlocking from telecom infrastructure (Viom)

Srei has strategic investments to the tune of Rs2,000 crore mainly in telecommunications (telecom; ie Viom Networks, about Rs1,600 crore) and road projects (about Rs350 crore). In Viom Networks Srei has a 14% stake (other investors include Tata Teleservices, Macquarie-SBI fund etc) which is a among the biggest telecom infrastructure company, with 41,689 towers and leading telecom players as its customers. The tenacity of the Viom Networks towers is also among the highest (2.2x vs the industry average of 1.7x) in the industry. The company plans to liquidate its stake either through a stake sale or listing and that is likely to happen within the current financial year. Comparing Viom Networks with the other tower companies, even on a conservative basis it should yield a valuation of around 10x earnings before interest, tax, depreciation and amortisation (EBITDA; FY2014 EBITDA at Rs1,803 crore) which adds significant value to Srei's stake. We believe the divestment of the Viom Networks stake will free capital that can be deployed in loans, thereby improving the return on equity (RoE).

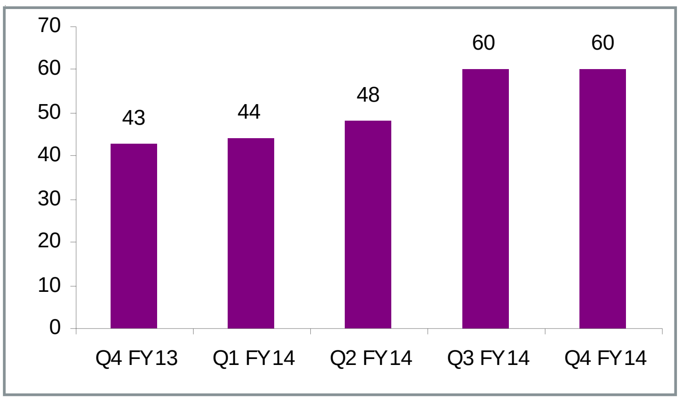
Scalability and tenancy ratio



Road projects—increase in operational projects

Srei has investments to the tune of Rs350 crore in road projects covering 5,400km of roads with portfolio of build-operate-transfer (BOT) and annuity projects spread across seven states. Out of the total eight road projects four projects are operational and two more projects (BOT) will get operational in FY2015. The company has exited one road project in FY2014 for cash flow of Rs70 crore of which Rs10 crore of profit was taken in FY2014 and the remaining Rs10 crore will come in FY2015. According to the management the traffic in these projects is largely in line with the expectations and is expected to improve going ahead.

Toll collection (Rs cr)



E-Sahaj

E-Sahaj is a unique business platform focused on rural and semi-urban areas having 27,224 common service centres across six states. The company has a robust technology platform for delivering services in the banking, financial services and insurance, government to citizen, business to consumer, e-learning and other major services. Since non-banking finance companies (NBFCs) are permitted to act as business correspondents for banks and there are other financial inclusion opportunities, this business can add value for the company in the long term.

Valuations and outlook

The stock currently trades at 0.7x FY2016E consolidated book value which is at quite a discount to the other NBFCs and in line with the valuations of the mid-sized public sector banks. Given the revival in the economy, Srei's specialisation in the infrastructure sector could fuel loan growth while value unlocking from investments could leave considerable scope for the re-rating of its valuation multiples. We have a positive outlook on stock and expect 20-25% gains over the next four to six months.

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