SREI Infra Finance Ltd.

Poised for strong comeback

SREI Infra is a proxy play on the expected revival in infra and industrial capex. With business interests in project financing, equipment financing and banking, project advisory, etc, company's growth and profitability is intrinsically linked to the macro cycle. As we expect cyclical recovery in the economy to receive fillip from improvement in policy environment, Srei Infra seems poised for a strong comeback. On consolidated basis, we expect company to post robust 51% CAGR in earnings over FY14-17 on a modest AUM CAGR of 15%. Sharp recovery in profitability would be driven by cyclical factors (spread expansion and moderation in credit cost) and structural levers (liquidation of investments and product mix shift). RoA/RoE is estimated to recover to 1.6%/11% by FY17. Valuation from bargain levels (FY17 P/ABV at 0.6x and P/E at 5x) is expected to recover ahead of the actual profitability.

Infra financing - growth troughing out, spreads to improve

Over the past two years, Srei's infra financing book has witnessed a steep moderation in growth (13% CAGR over FY12-14) on the back of muted disbursements. Due to policy issues and steep macro slowdown, company has been cautious on releasing disbursements on sanctioned loans (almost reappraising sanctions on draw downs). Srei has a reasonably sized book of Rs114bn, well-diversified across power (33%), transportation (30%), social & commercial (20%), communications (8%) and others (9%). Company's power exposure is largely to generation projects of which 60% is to operational projects. Within exposure to under construction projects, only ~20% (ie ~2.5% of overall book) is to projects that are dependent on external coal/gas linkages. Though company's cautious growth approach is unlike to reverse in the near term, it is expecting a cyclical revival in disbursement growth from fiscal-end. Loan growth should follow the trend in disbursements and therefore accelerate post FY15.

Financial summary

Y/e 31 Mar (Rs m)	FY14	FY15E	FY16E	FY17E
Total operating income	8,130	9,028	11,175	14,584
Yoy growth (%)	(9.3)	11.0	23.8	30.5
Operating profit (pre-provisions)	4,320	4,932	6,424	8,787
Exceptional Item	0	2,000	0	0
Net profit	1,389	3,730	3,257	4,738
yoy growth (%)	(47.3)	168.6	(12.7)	45.4
EPS (Rs)	2.8	7.4	6.5	9.4
Adj. BVPS (Rs)	57.7	64.4	69.2	76.5
P/E (x)	17.4	6.5	7.4	5.1
P/Adj.BV (x)	0.8	0.7	0.7	0.6
ROE (%)	4.0	4.7	8.3	11.2
ROA (%)	0.6	0.7	1.3	1.6
CAR (%)	22.6	25.2	23.5	20.3

Source: Company, India Infoline Research

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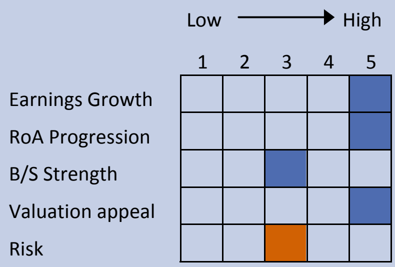
Rating:	**BUY**
Target (2 Years):	**Rs97**
CMP:	**Rs48**
Upside:	**102.1%**

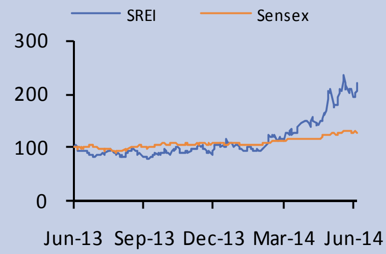
Sector:	**Financials**
Sector view:	**Positive**
Sensex:	25,100
52 Week h/l (Rs):	52.9/17.5
Market cap (Rscr) :	2,465
6m Avg vol ('000Nos):	1,372
Bloomberg code:	SREI
BSE code:	523756
NSE code:	SREINFRA
FV (Rs):	10

Price as on June 27, 2014

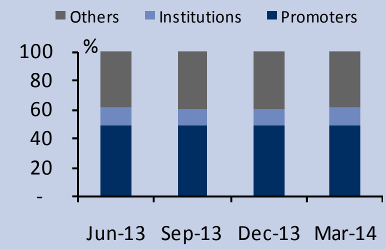
Company rating grid



Share price trend



Share holding pattern



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With average tenure of loans at about four years and more than 50% borrowings being working capital loans from banks, the spreads in the business are exposed to interest rate risk. Consequently, spreads contracted over the past two years as funding cost escalated due to tight liquidity conditions and rate upcycle. Therefore, spreads should start to improve from here on as liquidity situation has already eased and rates are likely to come down. Company intends to reduce the share of bank working capital loans in total borrowings to 40-45% over the next three years and replace it with longer-term cheaper funds.

Spreads to improve as liquidity situation has already eased and rates are likely to decline

Additionally planned liquidation of equity investments in VIOM Networks (14% stake purchased for Rs16bn) and BOT assets (Rs3.5bn across 8 projects) will unlock substantial capital which will be deployed for lending therefore improving loan/borrowings ratio and margins. The management intends to bring down strategic investments to 25% of networth by FY17 from 65% currently. As the company has already initiated the process of stake sale in VIOM, we have factored it in our projections. Conservatively, we have valued VIOM at discount to Bharti Infratel valuation (10x FY14 EBITDA) despite its superior tenancy ratio/profitability (2.2x/54% EBITDA) and growth prospects (robust order book). Consequently, we estimate SREI to realize ~Rs16-17bn from the stake sale. Improving valuation of BOT projects should also help the company in exiting from its four operational projects profitably.

Planned liquidation of equity investments in VIOM Networks and BOT assets to further aid margin

Estimate SREI to realize ~Rs16-17bn from VIOM stake sale

Equipment financing business - to revert to mid/peak cycle RoAs

Srei BNP Paribas (a 50:50 JV) is the largest construction & mining equipment financier in India with over ~30 % market share. Company has an AUM of Rs183bn which is well distributed regionally. On account of sharp slowdown in the mainstay construction/mining equipment financing segment, Srei BNP's AUM has only marginally grown over the past two years (disbursement growth has been in negative zone). In recent years, company has entered into new segments such as financing of used equipments, IT products, medical equipments, etc to offset slowdown in new equipment financing. Srei BNP has been particularly focusing on used equipment financing due to better risk-return as compared to new equipment financing. Its share in AUM is at 2-3% and is likely to reach 10-12% by FY17. Leveraging on BNP's relationships with global vendors, company is well-poised to address the huge market opportunity in healthcare space.

Srei BNP Paribas is the largest construction & mining equipment financier in India with over ~30 % market share

Focusing on used equipment financing due to better risk-return as compared to new equipment financing

Though, we expect growth in new equipment financing to recover ahead of the macro recovery, Srei BNP's product mix will continue to shift towards better yielding used equipment financing (~19% v/s ~14% for new) and other segments. This along with gradual decline in funding cost (50%+ borrowings is working capital loans from banks) should lead to steady improvement in NIM. In terms of asset quality, the business has likely seen the worst with gross NPLs increasing substantially during FY14 (from 2.8% to 4.8%). Company expects NPL levels to start coming off from H2 FY15 on the back of improvement in economic activity as many accounts will get upgraded. Reversal in provisioning on such accounts along with moderation in new NPL accrual rate should drive a material decline in credit cost over the next two years. Aided by margin expansion and lower NPL provisioning, we believe that Srei BNP's RoA will improve from current 1.5% to 2.5-3% by FY17.

Product mix shift and gradual decline in funding cost should lead to steady improvement in NIM

Company expects NPL levels to start coming off from H2 FY15 on the back of improvement in economic activity

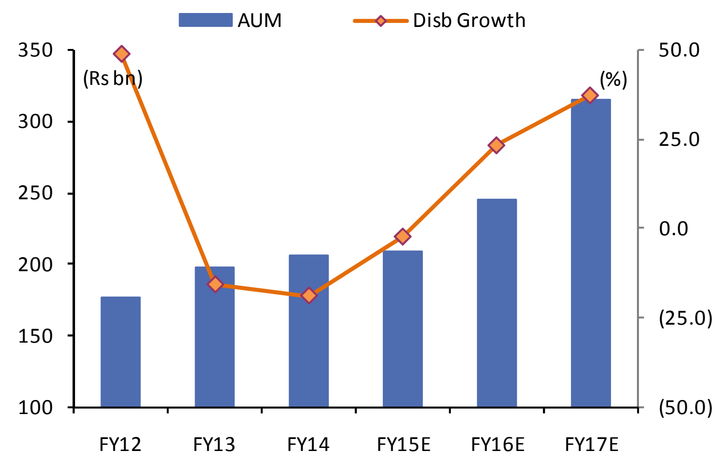
Valuation recovery to lead actual profitability recovery

Srei Infra to post robust 51% CAGR in earnings over FY14-17 on a modest AUM CAGR of 15%

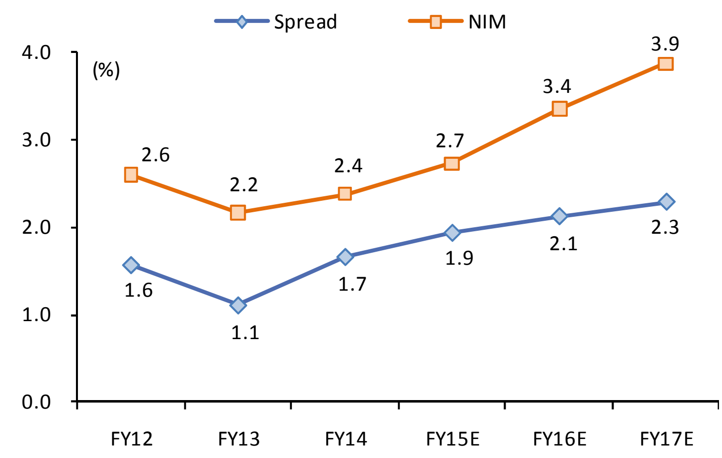
Consol RoE to improve to 11-12% by FY17

On consolidated basis, we expect Srei Infra to post robust 51% CAGR in earnings over FY14-17 on a modest AUM CAGR of 15%. A sharp recovery in profitability driven by cyclical factors (spread expansion and moderation in credit cost) and structural levers (liquidation of investments and product mix shift) will be the main story. We estimate consolidated RoE to improve from currently depressed 4-5% to 11-12% by FY17 on the back of sharp RoA recovery from 0.6% to 1.6%. During such phases of turnaround, typically, valuation recovers ahead of the actual profitability. Based on our FY17 estimates, Srei Infra's valuation is at a bargain level of 0.6x P/ABV and 5x P/E.

Consol AUM* to witness 15% CAGR over FY14-17

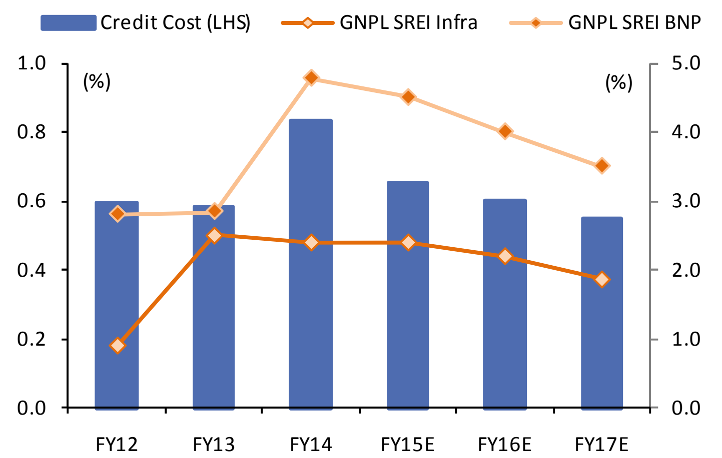


Spreads and NIM to materially improve

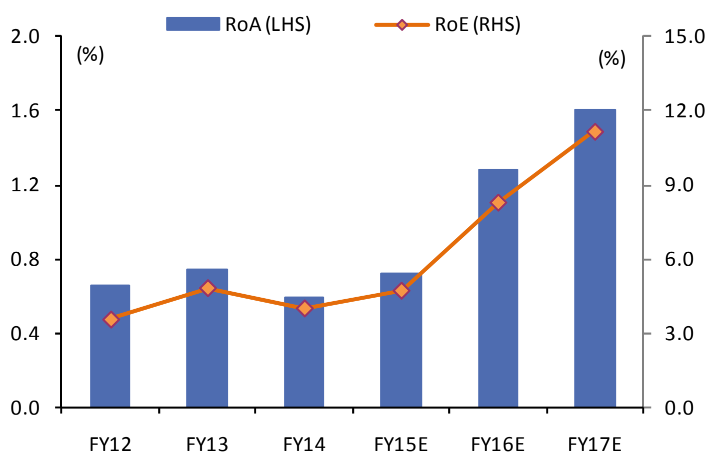


Source: Company, India Infoline Research
**Consol AUM = Srei Infra + 50% of Srei BNP AUM*

Asset quality to improve; credit cost to trend lower



Steep recovery estimated in profitability



Source: Company, India Infoline Research

Strategic Equity Investments	Rs bn	VIOM - Telecom Infra (FY14E)		Road BOT Asset Portfolio	
Telecom Infra – VIOM	15.98	Total No of Towers	41,689	Total No of Projects	8
BOT Road Assets	3.49	Tenancy	2.2x	No of Projects operational	4
Rural IT – Sahaj	0.25	Revenue (Rs bn)	46.29	Total Lane Kms	3264
Other Investments	0.15	EBIDTA Margin (%)	54.0	Lane Km operational	1190
Total	19.87	Cash Profit (Rs bn)	9.29	Lane Km non operational	2074

Source: Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs mn)	FY14	FY15E	FY16E	FY17E
Income from Operatns	27,930	28,776	31,099	37,763
Interest expense	(23,120)	(23,103)	(23,475)	(26,938)
Net interest income	**4,810**	**5,673**	**7,624**	**10,825**
Non-interest income	3,320	3,356	3,551	3,759
Total op income	**8,130**	**9,028**	**11,175**	**14,584**
Total op expenses	(3,810)	(4,096)	(4,751)	(5,796)
Op profit (pre-prov)	**4,320**	**4,932**	**6,424**	**8,787**
Provisions	(1,680)	(1,352)	(1,364)	(1,539)
Forex MTM	(380)	(266)	(213)	(192)
Exceptional Items	0	2,000	0	0
Profit before tax	**2,260**	**5,315**	**4,847**	**7,056**
Taxes	(881)	(1,594)	(1,599)	(2,329)
Minority Interest	10	10	10	10
Net profit	**1,389**	**3,730**	**3,257**	**4,738**

Balance sheet

Y/e 31 Mar (Rs mn)	FY14	FY15E	FY16E	FY17E
Equity Capital	5,032	5,032	5,032	5,032
Reserves	29,936	32,939	35,470	39,335
Shareholder's funds	**34,969**	**37,972**	**40,502**	**44,367**
Minority interest	**297**	**341**	**410**	**492**
Long-term borrow	71,037	68,195	77,742	94,846
Deferred tax liab	1,831	2,059	2,368	2,724
Other long-term liab	800	899	1,034	1,190
Long term provi	1,526	1,678	1,930	2,219
Total non-curr liab	**75,192**	**72,832**	**83,075**	**100,978**
Short Term Borrow	106,086	101,842	116,100	141,642
Trade payables	1,832	2,015	2,317	2,665
Other current liab	24,153	23,187	26,433	32,248
Short term prov	520	520	520	520
Total current liab	**132,591**	**127,564**	**145,371**	**177,076**
Equity + Liab	**243,048**	**238,710**	**269,357**	**322,912**
Fixed Assets	17,146	18,004	18,904	19,849
Goodwill	3,875	3,875	3,875	3,875
Non-current inv	20,763	4,783	4,783	4,783
Deferred tax assets	205	246	295	354
Long-term loans/adv	113,165	114,297	133,727	171,171
Other non-curr asset	1,837	2,204	2,645	3,174
Total non-curr asset	**156,990**	**143,408**	**164,228**	**203,205**
Current investments	3,434	3,777	4,155	4,570
Inventories	105	105	105	105
Trade receivables	2,125	2,337	2,804	3,365
Cash and cash equiv	5,637	6,849	6,331	7,695
Short-term loans	11,608	12,769	15,322	19,919
Other current assets	63,150	69,465	76,412	84,053
Total Current assets	**86,058**	**95,301**	**105,129**	**119,707**
Total Assets	**243,048**	**238,709**	**269,357**	**322,912**

Key ratios

Y/e 31 Mar	FY14	FY15E	FY16E	FY17E
Growth matrix (%)				
Net interest income	18.8	17.9	34.4	42.0
Total op income	(9.3)	11.0	23.8	30.5
Op profit (pre-prov)	3.8	14.2	30.2	36.8
Net profit	(47.3)	168.6	(12.7)	45.4
Advances	6.6	1.8	17.3	28.2
Borrowings	12.0	(3.9)	14.0	22.0
Total assets	7.3	(1.8)	12.8	19.9
Profitability Ratios (%)				
NIM	2.4	2.7	3.4	3.9
Non-int inc/Total inc	40.8	37.2	31.8	25.8
Return on Avg Equity	4.0	4.7	8.3	11.2
Return on Avg Assets	0.6	0.7	1.3	1.6
Per share ratios (Rs)				
EPS	2.8	7.4	6.5	9.4
Adj.BVPS	57.7	64.4	69.2	76.5
DPS	0.5	1.3	1.3	1.5
Valuation ratios (x)				
P/E	17.4	6.5	7.4	5.1
P/Adj.BVPS	0.8	0.7	0.7	0.6
Other key ratios (%)				
Loans/Borrowings	107.1	98.3	97.7	97.7
Cost/Income	46.9	45.4	42.5	39.7
CAR	23.6	25.4	23.5	20.1
Tier-I capital	15.0	16.1	14.6	12.5
Gross NPLs/Loans	2.4	2.4	2.2	1.9
Credit Cost	0.8	0.7	0.6	0.6
Net NPLs/Net loans	2.1	2.0	1.8	1.4
Tax rate	39.0	30.0	33.0	33.0
Dividend yield	1.0	2.6	2.6	3.1

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IIFL Research won 3 awards at India's Best Market Analyst Awards 2013 by Zee Business for Banking, Oil & Gas and Pharma.

'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards

- D&B Decide with Confidence 2012 – BEST BROKING HOUSE WITH GLOBAL PRESENCE
- Zee Business 2009 & 2012 – BEST MARKET ANALYST
- D&B Decide with Confidence 2009 – FASTEST GROWING LARGE BROKING HOUSE
- ASIAMONEY BROKERS POLL 2009 – BEST BROKERAGE, INDIA
- FinanceAsia COUNTRY AWARDS FOR ACHIEVEMENT 2008 – BEST BROKER, INDIA
- ASIAMONEY BROKERS POLL 2008 – MOST IMPROVED, INDIA

Recommendation parameters for fundamental reports:

BUY – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

SELL – Absolute return below -10%

Call Failure - In case of a Buy report, if the stock falls 20% below the recommended price on a closing basis, unless otherwise specified by the analyst; or, in case of a Sell report, if the stock rises 20% above the recommended price on a closing basis, unless otherwise specified by the analyst

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