HDFC securities

RETAIL RESEARCH

STOCK NOTE January 16, 2015

CAPITAL FIRST LTD (CAPFIRST)

Scrip Code	Industry	CMP	Recommendation	Target	Time Horizon
CAPFIREQNR	NBFC	Rs 392.4	Buy at CMP and add on dips Rs 323 - Rs 340	Rs 476	2-3 quarters

Price Chart

Stock Details	
BSE Code	532938
NSE Code	CAPF
Bloomberg	CAFL IN
Price (Rs) as on Jan 15, 2015	392.4
Equity Capital (Rs Cr)	82.6
Face Value (Rs)	10
Eq. Shares O/s (cr)	8.3
Market Cap (Rs .)	3261.6
Book Value (Rs)	143
Avg. Volume (52 Week)	126132
52 wk H/L (Rs)	(405/126)
Shareholding Pattern	
(As on Sep, 2014)	% Holding
Foreign Promoters	72.66
Institutions	10.33
Non Institutions	17.01

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CapFirst is a fast growing Non Banking Financing Companies providing financing to Retail and Wholesale Business. Besides SME Loans and Mortgages the company also offers Consumer Durable Loans, Two-Wheeler Loans, Loan against Property and Small Business Loans while in Wholesale Business it provides loans majorly to real estate developers. Warburg Pincus a leading global PE firm holds 72.6% in the company. As on FY14, CapFirst had an AUM of Rs 9678 cr.

In the past couple of years, CapFirst has improved its performance with major thrust on retail side of the business. It changed its focus on high risk and high ticket wholesale loans to low risk and high return retail segment. AUMs jumped from Rs 6185 cr in FY12 to more than Rs.10,000 cr in FY15. Proportion of Wholesale to Retail segment stands at 19:81. It also exited its broking business carried on through its subsidiaries last year. While the new management led by Mr Vaidyanthan did a commendable job in scaling up the business, he also concluded the largest Indian buyout by Warburg Pincus. It now holds 71.6% in the company. This backing by the leading global PE firm provides further comfort.

Other factors in favour of CapFirst is the low NPA levels and high PCR which provides the extra buffer even in trying times. The immediate concerns are the low return ratios (ROE at 5.5% and ROA at 0.6%) which will have to improve if the company has to arrive at sustainable levels of performance. We think the management is aware of the difference in ROE and ROA of CapFirst compared to its peers. Apart from the leeway to increase lending due to comfortable CAR, any sustained steps to reduce the above difference could straightaway improve bottom-line and book value boosting valuations.

Indian consumer finance market could witness 17-18% CAGR till 2020. While the market still remains underpenetrated (more than two thirds of households have no liabilities of any sort), the banks and NBFCs have developed diverse products targeted at all segments of the income pyramid, across multiple secured and unsecured loan types. Overall, we think consumer lending can be a significant growth driver for Indian financials in the coming years.

Falling interest rates (as hinted by the latest repo rate cut should accelerate growth in demand for loans and in disbursements. The key beneficiaries from such a movement in the rates environment would be strong retail asset franchisees and wholesale funded entities. We think CapFirst could be one of such entities. We also feel that CapFirst could get better valuations over time as it grows bigger in size (with equity issuances every 6-10 quarters) with clean asset profile and its management keeps proving itself in seizing opportunities and growing profitably.

While Bajaj Finance currently quotes at 3.4-3.5xFY16E BV and 16-17xFY16E EPS, Sundaram Finance quotes at 3.6-3.7xFY16E BV and 19.5-20xFY16E EPS. Though these two players are larger (especially Bajaj Finance) than CapFirst, the difference in their PABV could narrow going forward

The stock at CMP trades at ~2.3x FY16E ABV and 19.5xFY16E EPS. Investors can buy at CMP and add on dips of Rs 323 -Rs 340 (1.9x – 2x FY16ABV and 16-17xFY16E EPS) with the target price of Rs 476 (2.8x FY16E ABV – ~24.0xFY16E EPS) in 2-3 quarters.

Financial Summary

Consolidated Profit &	FY12	FY13	FY14	FY15E	FY16E
NII	161.4	249.8	336.0	495.1	663.2
% chg		54.8%	34.5%	47.3%	34.0%
Non Interest Income	186.3	86.3	86.1	128.7	168.1
% chg		-53.7%	-0.3%	49.5%	30.6%
Total Income	347.7	336.2	422.1	623.8	831.3

% chg		-3.3%	25.6%	47.8%	33.3%
PBT	151.6	51.9	59.1	159.3	217.5
% chg		-65.8%	13.8%	169.7%	36.5%
PAT	105.8	63.1	52.7	126.7	166.4
% chg		-40.4%	-16.6%	140.6%	31.4%
EPS	12.9	7.7	6.4	15.3	20.1
BV	129	136	143	154.7	172.3
ABV	129	135.9	142.3	153.6	170.1
PABV	3.0	2.9	2.8	2.6	2.3

(Source: Company, HDFC sec Research)

Overview

Future Capital Holdings Ltd was incorporated on October 18, 2005 as KB Infin Pvt Ltd. On April 5, 2006 the company became the subsidiary of Pantaloon Retail (India) Ltd. The company was converted into a public limited company with effect from August 21, 2006 and in December 2006, the company name was changed to Future Capital Holdings Ltd. In Nov 2012, the name of the company was changed to Capital First Ltd after the new management came in.

In June 2012, US private equity giant Warburg Pincus agreed to buy a controlling stake in financial services firm Future Capital Holdings for about Rs 800 crore. The move was part of its strategy to tap opportunities in India's capital-starved micro, small and medium enterprises sector. Warburg paid Rs.162 a share to buy 66% stake, valuing the non-banking finance company at Rs 1,050 crore. In addition, Warburg infused Rs 100-crore worth of fresh equity, taking the total investment to ~Rs.800 crore. In March 2012, Warburg bought a stake in AU Financial, a Rajasthan-based NBFC.

The deal also involves a lock-in clause under which Vaidyanathan will remain in the saddle for up to a period of five years. Mr. V. Vaidyanathan holds 3,41,496 Equity Shares in the Company as on March 31, 2014. As on March 31, 2014, JV and Associates LLP, in which Mr. V. Vaidyanathan is a partner, was holding 47,73,795 Equity Shares (5.78% stake) of the Company.

The current promoter of the company is the highly reputed Global Private Equity Fund, Warburg Pincus, USA, with Capital of USD 45 billion (Rs. 2,49,819 crs). Warburg Pincus is a leading and highly reputed global private equity firm. Founded in 1966, Warburg Pincus is among the largest Private Equity firms in the world, and highly renowned for corporate governance. In India, Warburg Pincus has supported and built large and reputed corporations like HDFC Limited, Kotak Mahindra Bank Limited, Bharti Tele-ventures Limited and Ambuja Cements Ltd.

CapFirst is engaged in the business of Loans to MSME, consumer durable loans, gold loans and Corporate loans. As on June 30, 2014 Warburg Pincus, through its affiliates held 71.83% stake in the company out of which Cloverdell Investment Ltd. holds the majority stake of 70.32%. These affiliates are under Warburg Pincus PE Fund XI with fund corpus being US$11.2 billion.

CapFirst has a strong distribution network set up of 164 branches with over 1089 employees spread across 40 cities in India. During FY13 and FY14, the Company scaled up all the MSME and retail finance businesses and the Asset Under Management ('AUM') crossed Rs. 10,000 Cr in the first quarter of FY15.

During May 2013, Capital First Home Finance Pvt. Limited (CFHFPL), a wholly owned subsidiary of Capital First Limited (CFL), received the Housing Finance Company ('HFC') License from National Housing Bank ('NHB'). CFHFPL is now operating as an HFC and growing its housing finance assets gradually.

In September 2013, CFL decided to close its broking business including securities broking, commodities broking and property services to focus on the core lending business focusing on the retail finance. The Company has completed the winding up of the operations related to the broking business and is in the process of surrendering its broking licenses.

Following the first round of investment, Warburg Pincus further infused an additional equity of Rs. 128 Crores of Tier I capital in March 2014 @Rs.153.80 to further the growth plans of the company. Additionally, in March 2014, HDFC Standard Life Insurance Company Limited infused Rs. 50 cr (@Rs.153.80) which again contribute to the Tier-I capital.

Business

MSME FINANCE

MSME Mortgage Loans: This product is the main line of business for the Company and contributes 81% of the total retail assets. Under this product, the Company provides long term secured loans to MSMEs, self-employed individuals and professionals against collateral of Residential or Commercial property. These are monthly amortising products with no Interest or Principal moratorium. The actuarial tenor of the loans is usually about 4-5 years. MSMEs usually prepay these facilities before time, based on their cash accruals. The Company follows a very strict credit approval process with a specific focus on the cash flow analysis of the borrowers to ascertain their repayment capabilities. The Company has a separate credit assessment team, which is independent of the sourcing / sales team, to ensure strong underwriting capability. The average ticket size for this product is Rs 8 - 10 million and the LTV is between 48%-50% at origination. The Company has an extensive footprint across 40 cities to solicit and originate these loans. The AUM for the product has grown significantly to reach Rs 64.06 billion in FY14.

CONSUMER FINANCE

Two Wheeler loans: CapFirst extends Two-Wheeler loans through easy EMIs to self employed customers like small traders, suppliers, shop keepers with good credit profiles as well as salaried employees, usually taking up their first job in the organized sector. These loans are originated through an extensive network of Two Wheeler Dealers. CapFirst has tied up with over 900 Two Wheeler Dealerships across 29 tier-1 and tier-2 cities in India for this purpose. Two Wheeler Loans are relatively small ticket size loans of about Rs 30,000 to Rs 40,000 with door to door tenure of around 2 years. Since inception in October 2011, CapFirst has grown the two wheeler financing business with the help of extensive reach, robust credit processes, quick turnaround and efficient customer services. CapFirst has two wheeler loan assets of Rs 4.52 billion as of March 31, 2014.

Gold Loans: The Company provides Loans against Gold Jewellery to customers. The loan size is usually Rs 1,00,000 to Rs 1,20,000. The Loan to Value is 75% on the value of the jewellery. The Company distributes Gold Loans through its extensive network of branches spread across 22 tier-1 and tier-2 cities in 10 states. Since inception in January 2011, the Gold Loan book steadily grown and reached an AUM of Rs 5.75 billion by FY14. During the first quarter of FY14, the Gold Prices dropped by more than 15% in a week to reach below Rs 2,400 per gm. Yet due to the stringent lending policy, risk control and robust processes, the Company did not face any principal loss in the Gold Loan portfolio.

Consumer Durable Loans: CapFirst provides financing for purchasing consumer electronics goods like LED, LCD, TVs, Washing Machines, Laptops, Furniture to salaried and self-employed customers which can be repaid through easy EMIs. From a distribution point of view, this is a highly fragmented market. CapFirst has tied up with all leading consumer durable manufacturers to offer this product and has grown the business with the help of extensive reach, robust credit processes, quick turn-around and efficient customer services. With the implementation of the new loan management system, improved processes and automated credit assessment capabilities, CapFirst developed the unique capability of providing a credit decision within 3 minutes at the dealership/ store that the customer has approached for a consumer durable loan. The average ticket size of such loan is between Rs 15,000 and Rs 20,000. Since inception in FY10, the loan book of Consumer Durable financing has grown to Rs 3.59 billion by FY14.

WHOLESALE SEGMENT

CapFirst's wholesale lending largely includes senior secured credit offering to reputed real estate developers. For loans to real estate, the Company escrows the receivables from sale of flats, and takes first charge on property with significant asset cover of 2.5 - 5 times of receivables. By the end of FY14, the wholesale credit AUM stood at Rs 17.96 billion, which was lower than the loan book of Rs 19.50 billion as of March 31, 2013, which in turn was lower than the loan book of Rs 27.25 billion as of March 31, 2012. The Company believes that the lending to this segment is inherently riskier because of the lumpy nature of the business owing to relatively larger ticket size. Hence the Company is focusing only on select deals which meet the stringent credit criteria of the company. The Company is purely looking at deals on an opportunistic basis.

Subsidiaries

Subsidiaries (FY14-Rs cr))	Turnover	PBT	PAT	Investments
CF Investment Advisory	3.5	3.7	2.6	1.1
CF First Commodities	4.3	1.4	0.6	0.0
CF Home Finance	4.1	2.6	1.7	0.0
CF Securities	8.2	-6.1	-6.1	28.3
Anchor Trading & Investment	0.0	2.4	2.5	0.0

During FY14, CF Home Finance a Wholly Owned Subsidiary of the Company has received the Certificate of Registration from National Housing Bank to commence business of housing finance institution without accepting public deposits. In FY14, the Board of Directors of Subsidiary Companies namely CF Securities Limited (CFSL) and CF Commodities Limited (CFCL) had decided to close down the security & commodity broking operations, respectively, and also approved the surrender of the licenses availed for conducting the broking businesses of both the subsidiaries except for National Spot Exchange Limited.

Shareholding pattern

Particulars (%)	Sep-13	Dec-13	Mar-14	June-14	Sep-14
Foreign Promoters	71.96	71.99	71.99	71.83	71.66
FII	0.94	0.94	0.79	2.02	3.66
DII	0.16	0.16	4.08	6.91	6.67
Non Institutions	26.94	26.91	23.14	19.24	18.01
Bodies Corporate	18.27	18.27	15.66	9.77	7.84
Total	100.0	100.0	100.0	100.0	100.0

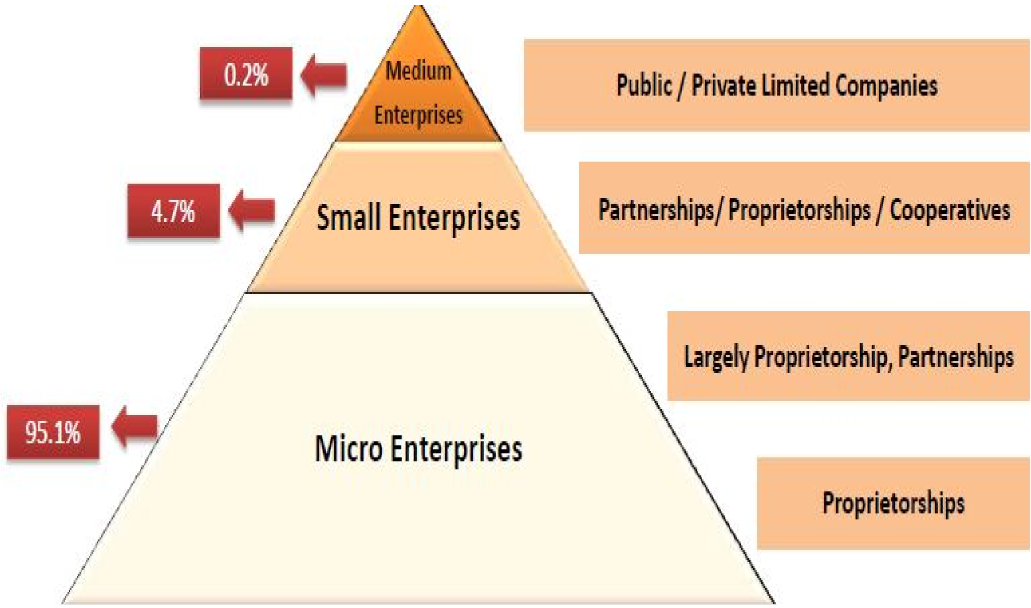
Foreign Promoters hold 71.66% as on Sep 14 and has come down gradually from 71.96% a year ago (mainly due to ESOPs issued in the interim). Stake of institutions in the company has gone up from 1.1% in Sept 2013 to 10.33% now. FIIs have upped their stake from 0.94% to 3.66% a year ago while Domestic Institutions hold 6.67% as on Sep 14. Bodies Corporate hold 7.8% as on Sep 14. Among non-promoter shareholders with more than 1% stake in the company, JV & Associates LLP (a firm in which V Vaidyanathan is a partner) hold 5.8%, Hdfc Standard Life Insurance 3.9%, Government Pension Fund 1.6% DSP Blackrock 1.5% among others.

Industry

MSME segment in India

There are more than 30 million Micro, Small and Medium enterprises (MSME) across India employing more than 70 million people. MSMEs account for 45% of the Indian Industrial output and 40% of the total exports. MSMEs are contributing to more than 15% of India's GDP currently.

% of total number of MSME players in India



MSME sector, especially the unorganized micro and small enterprises, lack in support from the existing ecosystem, owing to their small scale which in turn is an impediment to their growth.

Financing need of MSMEs

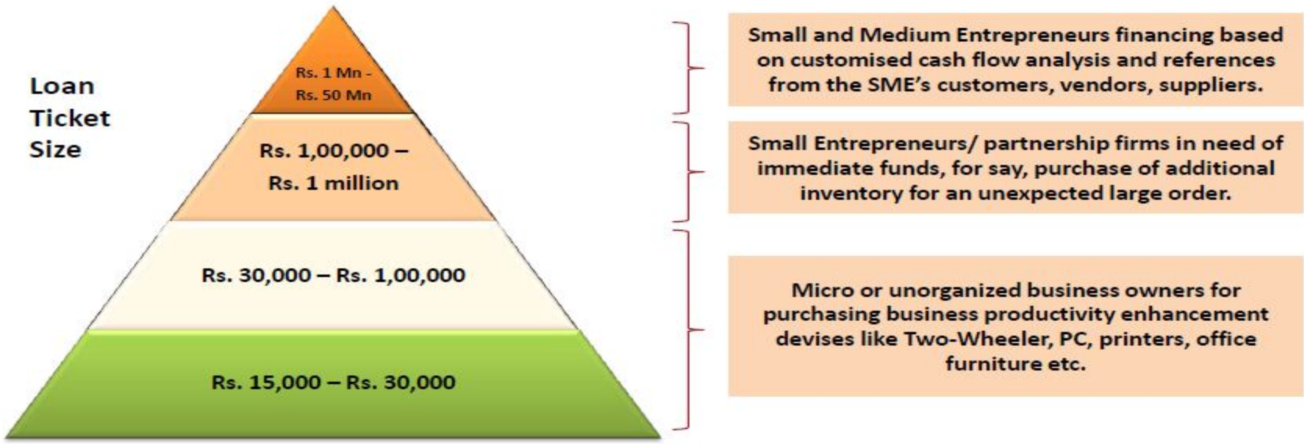
MSMEs require timely capital though short and long term loans apart from seed capital. IFC has estimated the financing (debt) demand for the MSME segment to be more than Rs 26 trillion for India per year. MSMEs generally rely on their own funds like savings, retained earnings, sale of assets, loan from family members, relatives, community as well as unconventional and unregulated moneylenders for their entrepreneurial ventures. Access to formal bank finance is difficult for SMEs but this is particularly for small, micro and unorganized players. Lenders too face challenges in lending because of informal business practices, large cash/parallel economy in this segment, difficulty in evaluating creditworthiness lack of proper financial reporting and relatively high cost of credit appraisal for low ticket loans. The conventional credit approach may be not be effective while assessing the credit worthiness of these MSME players.

Investment Rationale

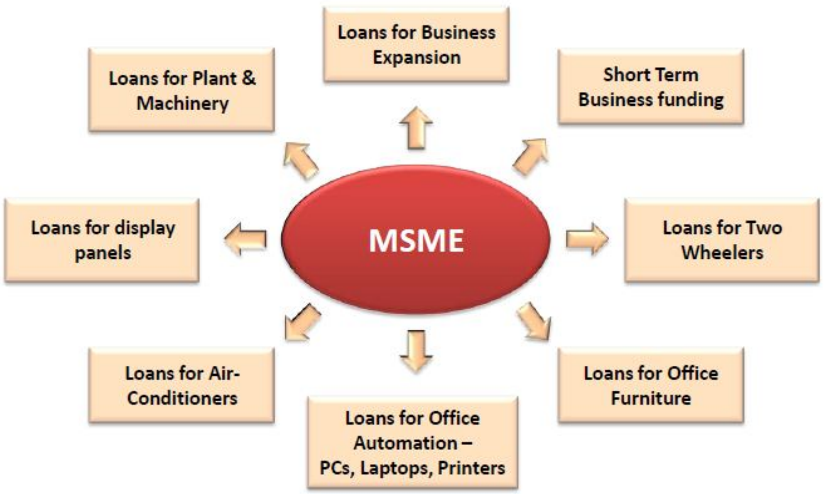
Specialized Player in MSME financing ...creating a niche for itself

Post change in management, Mr Vaidyanathan (MD) came up with major upheavals in the AUM structure resulting in more focus towards retail financing. In FY10, AUMs of the company were more in the proportion of 90% wholesale and 10% retail which gradually shifted to 19% wholesale and 81% in retail in FY14 with significant focus on SME. He also concluded India's largest management buyout with Warburg Pincus in FY12-FY13. Warburg's investment in CapFirst indicates the model sustainability of the company and also the confidence the PE firm has in the growth of the company.

CapFirst offers different financing options to different categories of MSMEs catering to their financing needs at different stages of the business life cycle. It is a specialized MSME Financing player with credit evaluation methodology for this segment.



Since inception, CFL has financed more than 750,000 MSME customers till date. CapFirst offerings include



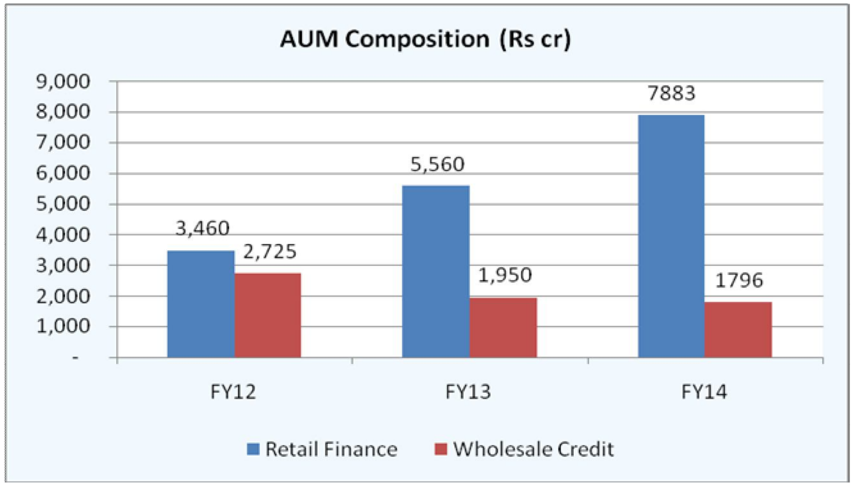
Focusing on Retail Finance to build up AUM

In the last 3 years CapFirst has focused on expanding its retail finance (SME & Consumer) segment which has reflected in the pick-up in AUM during this period. Retail finance has gone up from Rs 3460 cr in FY12 to Rs 7883 cr in FY14 with its proportion increasing from 56% to 81% in this period. Wholesale credit has come down from 44% to 19% during the same period. CapFirst was initially the holding company under Future Group as a diverse financial service provider engaged in corporate promoter financing, providing treasury functions, Investment advisory services, broking, etc. CapFirst in due course hived off certain divisions to enable greater focus on retail financing through MSME and consumer financing.

Streamlining of operations and shifting its focus towards financing was a step in the right direction - more so in a sluggish economic environment. Big ticket corporate credit & treasury and investment advisory services lacked consistency in earnings due to its overreliance on economic growth. This strategy of shifting focus reflected in the robust loan growth in last three years.

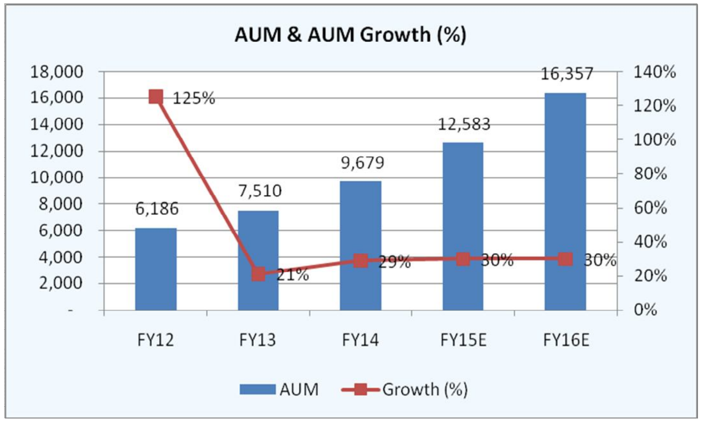
There is significant competition in the financial sector for a player looking to diversify and enter into new lines of credit. Consumer confidence is influenced and enhanced by the company's brand value and experience in the industry. Under-penetration is another key opportunity for entry. CapFirst chose the latter strategy and opted SME financing as an entry point to retail financing. In addition, adding high yielding products under consumer financing increased scope for diversification and aid margin expansion. The total loan AUM grew at 52% CAGR during FY12-14, with SME financing becoming the largest segment with 66% share in the total loan AUM. Moreover, shifting to retail finance also brought NPAs at nominal levels. The change was spearheaded by the current managing director who has a track record of successfully building the retail financing of one of the country's prominent finance house.

Among the latest developments, Capital First Home Finance Private Limited (CFHPL) a subsidiary of CapFirst received the licence from the National Housing Bank (NHB) for commencement of Housing Finance Business during Q1FY14. CFHFPL has already started originating home loans in FY14. This is positive, considering the priorities for housing schemes by the new government. The growth opportunity left with CapFirst is in the underserved segment in the country unlike other NBFCs. Exploring businesses which have been left out by banks and where it can develop a competitive advantage will continue to deliver the company healthy growth. With the successful transformation in business model, CapFirst can be expected to grow better in the coming years.



Aggressive expansion in AUMs planned

CapFirst targets to build its loan AUM (Assets Under Management) to Rs170bn by FY16E from Rs97bn at 33% CAGR with the revamped business model. The total loan book grew at 25% CAGR during FY12-14 with the transformation. New business model with greater focus on retail financing bring in scalability through various new segments launched in the last 3 years. Relatively younger segments promises sustained growth momentum in the loan book through scale. Company has stated that it wanted to build AUM of Rs 25000-Rs 30000 by FY19 (FY14 AUM – Rs 9679 cr). This can be attained if the company has maintains a y-o-y growth of 25% till FY19.



SME Loans (through mortgage) is the main line of business and contributes 81% of the retail assets and 66% of total AUM. It has been the major growth driver in the company's loan book since its launch in FY11 growing at 200% CAGR over the period. Being an underpenetrated segment and healthy demand there is huge potential left with the segment which will help drive the AUM. The segment which eyes the working capital requirement of SMEs is likely to benefit from an economy revival. Also the recently launched housing finance business would benefit from the affordable housing mooted by the government.

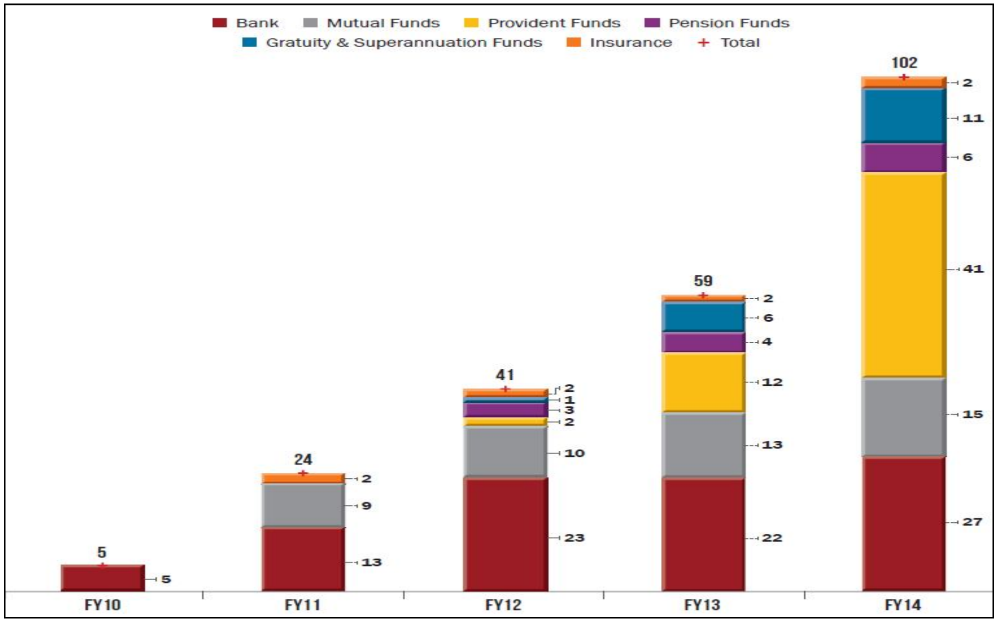
Loan growth to be maintained with retail loan mix & borrowing options helping to sustain NIMs

In Q2FY15 CapFirst's loan book continued to expand at a strong pace (up 42% y-o-y) driven by loans to SME and retail segments. The overall AUMs expanded by 34% y-o-y to Rs 11,047 cr. Consequently, the proportion of SME and retail AUMs expanded to 84% from 81% in FY2014. Within the retail segment, products like consumer durables and two-wheelers showed strong growth. The company has seen healthy traction in the festive season (mainly in consumer durables and two-wheelers) which should contribute to a strong loan growth.

Company's shift to retail financing has opened door for diversification through the launch of new products. While mortgage and SME loan account for the largest share in retail loan book other consumer categories of gold loan, consumer durable and two wheeler loans which are contributing lesser to the whole AUM basket presently can be expected to scale up further. The loan to value (LTV) and yield differs between various products. SME & mortgage financing provides long-term secured loans to SMEs, self-employed individuals and professionals against collateral of residential or commercial property. In addition, company provides loans against gold jewellery for personal uses and also traders and small businesses for short-term business requirements. It provides two-wheeler financing through EMIs to self - employed customers like small traders, suppliers, shop keepers with good credit profiles, and salaried employees. Two-wheeler loans are relatively small ticket size loans of about Rs30,000 - Rs40,000 with an average tenure of around 2 years. It provides financing for consumer electronic goods through EMIs to salaried and self-employed customers with average tenure of around 8 months. Capital First Home Finance Private

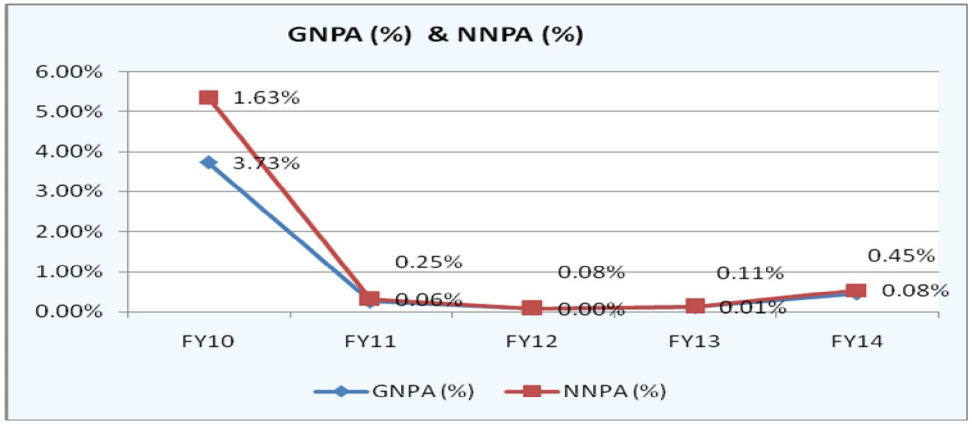
Limited (CFHPL) a subsidiary of CAPF received National Housing Bank (NHB) license for Housing Finance Business during Q1FY14. CFHFPL has already started originating home loans in FY14. On the wholesale side company provides promoter financing and senior secured debt on projects backed by escrow of cash flows.

FY14 NIM stood at 5.4% improving 150bps since FY11 low of 3.9%. Introduction of high margin retail loans with robust loan growth and low cost long term borrowing composition helped CapFirst expand its NIM. Going forward, stability of earnings from maturing loan book will influence the margins. The company has access to a wide range of funding options, including mutual funds, provident funds, banks - through NCDs, CPs and long term loans. CapFirst enjoys a high long term credit rating of AA+ for its NCDs and subordinate debts since FY13, a 3notch rating upgrade (A+ in FY10) in 3 years. This helps the company raise debt capital at competitive rates. With borrowing costs likely to remain at current levels driven by favourable mix of bank borrowing & long term debt instruments, NIM are expected to remain stable.



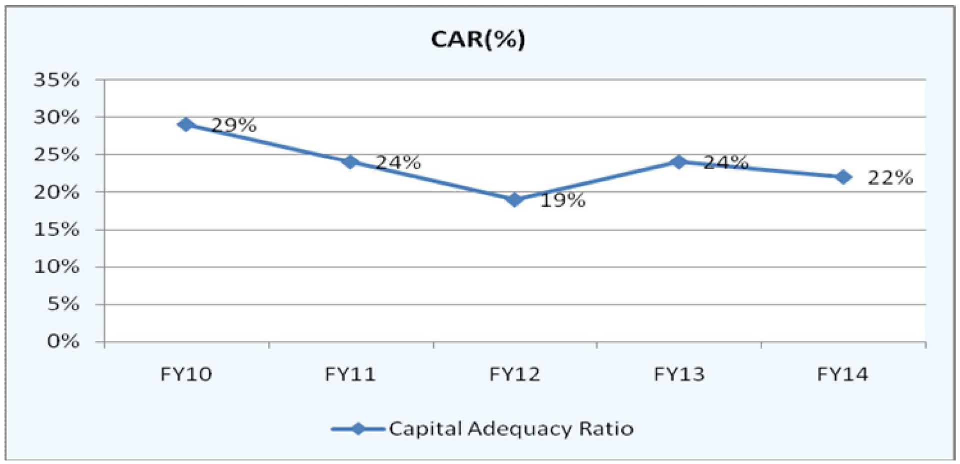
Asset quality stable

Rigorous and robust credit assessment processes in CapFirst help in maintaining the high asset quality and low NPA levels. In Mortgages, about 37% of the total applications are disbursed after passing through several levels of scrutiny mainly centered on cash flow evaluation, credit bureau and reference checks. FY14 GNPA and NNPA stood at 0.45% and 0.08% respectively, improving ~330bps and ~150bps since FY10 on GNPA of 3.73% and NNPA% of 1.63%. When the loan growth was robust at 40% during FY10-14 and even with the entry into relatively new segments, CapFirst efficiently maintained the asset quality. The relatively low ticket size retail loans leaves CapFirst a fair amount of control over credit assessment & collection and help maintain high asset quality.



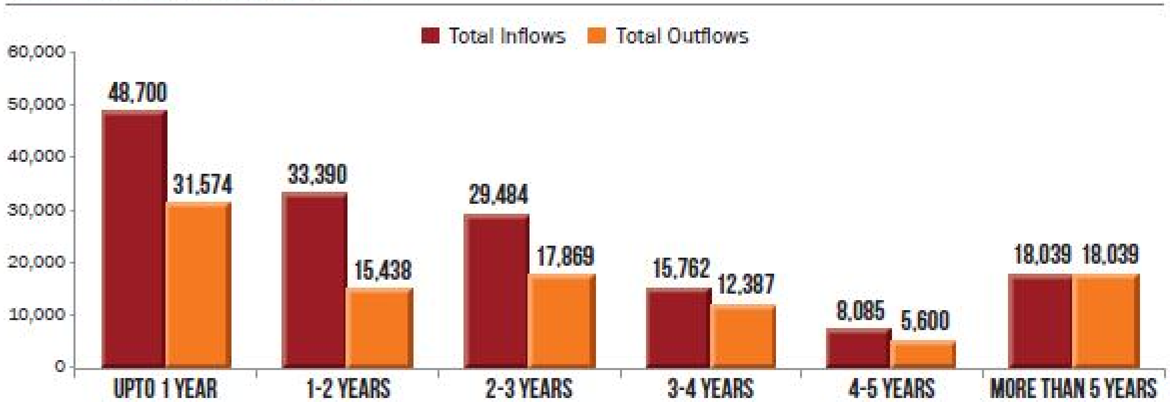
Capital Adequacy and ALM comfortable

CapFirst's capital adequacy has consistently been high relative to the regulatory norms. In Q4FY14, CapFirst raised Rs 178 cr through preferential equity issue of 11.6mn shares (dilution of 16%) at Rs 153 per share to parent Warburg Pincus and HDFC Standard Life. While the equity infusion was to increase the CAR and for future growth plans. CAR, post the issue is 22% against the RBI stipulated 15%, which leaves a comfortable cushion for expanding asset base and reduce risk of any further equity dilution in the near term.



CapFirst's prudent asset - liability management (ALM) follow 100% matching of all assets & liabilities. As a prudent Asset Management Strategy, to protect itself from liquidity risks, the Company follows a policy of matched funding, whereby all assets are entirely funded by corresponding liabilities of similar maturities on an actuarial basis. Floating rate loans are funded by floating rate liabilities to cover interest rate risks. It runs a positive mismatch in all the maturity buckets of structural liquidity analysis as the maturing assets are higher than the maturing liabilities. Company uses commercial papers (CP) instruments sparingly to maintain asset-liability matching. CAPF has CP limits of Rs9bn, and interest rates for CP are often lower than longer term funding lines by 100-150 bps.

Asset Liability Management



Quarterly Review

In Q2FY15, CapFirst reported NII of Rs 125.2 cr, up 57.7% y-o-y and 13.4% q-o-q. Fee income has gone up 28.7% y-o-y and down 12.2% q-o-q to Rs 29.6 cr. Operating expenses have gone up 17.5% y-o-y and 1% q-o-q to Rs 91.3 cr. Provisions have gone up 65.2% y-o-y and 2.3% q-o-q to Rs 21.8 cr. PAT has gone up from Rs 7.2 cr to Rs 27.1 cr y-o-y.

CapFirst's loan book continued to expand at a strong pace (up 42% y-o-y) driven by loans to the small and medium enterprises (SME) and retail segments. The overall assets under management (AUMs) expanded by 34% y-o-y to Rs 11,047 cr. Consequently, the proportion of SME and retail AUMs expanded to 84% from 81% in FY2014.

Risks/Concern:

- CAPF's loan book has high retail loan mix, which are directly impacted by the consumer spending.
- Company's NPAs so far have been benign. Any significant deterioration in asset quality could impact company's performance. Correction in gold prices could also impact provisioning in the future.
- Any change in the borrowing composition that might influence the interest cost to rise and influence margin.
- Dilution risk through further equity infusion to fund capital.
- ROE of CapFirst has been consistently subdued in the past and lags behinds peers. Its ROA too is on the lower side. Improvement in return ratios is needed for better business performance.
- One of the Subsidiary of the Company has exposure to National Spot Exchange Limited (NSEL) of Rs.7,365.20 lakhs with respect to trade relationship of its clients with NSEL. Based on the contracts with its clients and legal opinion obtained, by the Company, subsidiary being a broker would not incur any liability to its clients', consequent to the payment crisis at NSEL. The subsidiary would recongnise its brokerage income on receipt basis, on the amount received form NSEL on behalf of its clients.

Peer Comparision

Parameters	Bajaj Finance		Sundaram Finance		CapitalFirst	
	FY14	FY13	FY14	FY13	FY14	FY13
AUM (Rs cr)	24061	17517	15248	13574	9679	7510
NII (Rs cr)	2500	1904	2363	2169	336	250
ROA (%)	3.6	4.1	2.9	3.1	0.6	0.7
ROE (%)	19.4	24.3	18.9	21.6	5.5	5.7
EPS	144.8	135.7	50.54	49.21	6.4	7.7
Net NPA	0.28%	0.19%	1.20%	1.00%	0.01%	0.08%
PCR	67%	78%	NA	NA	82%	90%
CAR	19%		18.2%		22%	

CapFirst is comparatively smaller in size compared to other players like Bajaj Finance and Sundaram Finance. However it is more comparable to Bajaj Finance in terms of its scope of business. ROE still remain at significant discounts to peers which also influences valuations. ROE witnessed a strong expansion in FY12 influenced by the earnings spurt from launch of retail financing. But costs for business expansion and change in accounting policy brought down FY13 earnings and put the RoE expansion on hold. Adding to that, equity infusion in FY13 and FY14 also impacted the ROE numbers. ROE dropped to 5.5% in FY14.

PCR ratios of the company are relatively higher at 82% while NNPA (%) is also the lowest as seen in the table above. CAR(%) is also on the higher side which gives more scope for CapFirst to expand its growth rate in the coming years.

Conclusion:

CapFirst is a fast growing Non Banking Financing Companies providing financing to Retail and Wholesale Business. Besides SME Loans and Mortgages the company also offers Consumer Durable Loans, Two-Wheeler Loans, Loan against Property and Small Business Loans while in Wholesale Business it provides loans majorly to real estate developers. Warburg Pincus a leading global PE firm holds 72.6% in the company. As on FY14, CapFirst had an AUM of Rs 9678 cr.

In the past couple of years, CapFirst has improved its performance with major thrust on retail side of the business. It changed its focus on high risk and high ticket wholesale loans to low risk and high return retail segment. AUMs jumped from Rs 6185 cr in FY12 to more than Rs.10,000 cr in FY15. Proportion of Wholesale to Retail segment stands at 19:81. It also exited its broking business carried on through its subsidiaries viz. Capital First Securities Limited (CFSL) & Capital First Commodities Limited (CFCL) (subsidiary of CFSL) last year. While the new management led by Mr Vaidyanthan did a commendable job in scaling up the business, he also concluded the largest Indian buyout by Warburg Pincus. It now holds 71.6% in the company. This backing by the leading global PE firm provides further comfort.

Other factors in favour of CapFirst is the low NPA levels and high PCR which provides the extra buffer even in trying times. The immediate concerns are the low return ratios (ROE at 5.5% and ROA at 0.6%) which will have to improve if the company has to arrive at sustainable levels of performance. We think the management is aware of the difference in ROE and ROA of CapFirst compared to its peers. Apart from the leeway to increase lending due to comfortable CAR, any sustained steps to reduce the above difference could straightaway improve bottomline and book value boosting valuations.

The recent investment by the promoter Cloverdell Investment Ltd (an affiliate of Warburg Pincus) and an institutional investor (HDFC Standard Life Insurance Company Limited) reflects the confidence of the investors on the Company’s business model, processes, controls and governance. Company would continue to follow the business model and the pruned strategy to focus on the retail financing business to boost the MSME and consumption business in India. It has done most of the requisite investments to create the sustainable retail finance machinery with effective and prudent credit policy, operations, technology, compliance with the legal and regulatory framework, strong corporate governance and the committed, young workforce.

Indian consumer finance market could witness an 17-18% CAGR till 2020. While the market still remains underpenetrated (more than two thirds of households have no liabilities of any sort), the banks and NBFCs have developed diverse products targeted at all segments of the income pyramid, across multiple secured and unsecured loan types. Overall, we think consumer lending can be a significant growth driver for Indian financials in the coming years.

Consumer debt levels in India are significantly below (~10% of GDP) those seen in other emerging (~20% in China and ~22% in Brazil) and developed economies (more than 80% in S Korea, Australia, UK and US) , suggesting this could remain an important growth driver for the Indian banking system in the coming years.

Falling interest rates (as hinted by the latest repo rate cut should accelerate growth in demand for loans and in disbursements. The key beneficiaries from such a movement in the rates environment would be strong retail asset franchisees and wholesale funded entities. We think CapFirst could be one of such entities.

We also feel that CapFirst could get better valuations over time as it grows bigger in size (with equity issuances every 6-10 quarters) with clean asset profile and its management keeps proving itself in seizing opportunities and growing profitably.

While Bajaj Finance currently quotes at 3.4-3.5xFY16E BV and 16-17xFY16E EPS, Sundaram Finance quotes at 3.6-3.7xFY16E BV and 19.5-20xFY16E EPS. Though these two players are larger (especially Bajaj Finance) than CapFirst, the difference in their PABV could narrow going forward.

The stock at CMP trades at ~2.3x FY16E ABV and 19.5xFY16E EPS. Investors can buy at CMP and add on dips of Rs 323 -Rs 340 (1.9x – 2x FY16ABV and 16-17xFY16E EPS) with the target price of Rs 476 (2.8x FY16E ABV – ~24.0xFY16E EPS) in 2-3 quarters.

Consolidated Profit & Loss	FY12	FY13	FY14	FY15E	FY16E
NII	161.4	249.8	336.0	495.1	663.2
% chg		54.8%	34.5%	47.3%	34.0%
Non Interest Income	186.3	86.3	86.1	128.7	168.1
% chg		-53.7%	-0.3%	49.5%	30.6%
Total Income	347.7	336.2	422.1	623.8	831.3
% chg		-3.3%	25.6%	47.8%	33.3%
PBT	151.6	51.9	59.1	159.3	217.5
% chg		-65.8%	13.8%	169.7%	36.5%
PAT	105.8	63.1	52.7	126.7	166.4
% chg		-40.4%	-16.6%	140.6%	31.4%
EPS	12.9	7.7	6.4	15.3	20.1
BV	129	136	143	154.7	172.3
ABV	129	135.9	142.3	153.6	170.1
PABV	3.0	2.9	2.8	2.6	2.3

Financials

Quarter

Particulars (Rs cr)	Q2FY15	Q2FY14	% chg	Q1FY15	% chg	H1FY15	H1FY14	% chg
Interest Income	318.0	238.1	33.6%	299.9	6.0%	618.0	458.4	34.8%
Less:Interest Exp	192.8	158.7	21.5%	189.5	1.7%	382.3	306.8	24.6%
Net Interest Income	125.2	79.4	57.7%	110.4	13.4%	235.7	151.6	55.5%
Fee Income	29.6	23.0	28.7%	33.7	-12.2%	63.3	45.1	40.4%
Total income	154.8	102.4	51.2%	144.1	7.4%	299.0	196.7	52.0%
Opex	91.3	77.7	17.5%	90.4	1.0%	181.8	151.3	20.2%
Provision	21.8	13.2	65.2%	21.3	2.3%	43.1	26.5	62.6%
PBT	41.7	11.5	262.6%	32.4	28.7%	74.1	18.9	292.1%
Tax	14.6	4.3	239.5%	11.6	25.9%	26.2	6.2	322.6%
PAT	27.1	7.2	276.4%	20.8	30.3%	47.9	12.7	277.2%

Profit & Loss

Consolidated Profit & Loss	FY12	FY13	FY14	FY15E	FY16E
Interest Income	557.4	733.3	982.9	1,277.7	1,622.7
Less : Interest Expense	396.0	483.4	646.8	782.7	959.5
NII	161.4	249.8	336.0	495.1	663.2
Fee Income	160.2	72.8	85.0	114.72	149.14
Other Income	26.1	13.5	1.1	14.0	19.0
Total Income	347.7	336.2	422.1	623.78	831.30
Opex	173.6	262.3	312.1	398.23	527.66
Provision	22.5	22.0	50.9	66.23	86.10
PBT	151.6	51.9	59.1	159.32	217.54
Exceptional Items	-	21.3	-	0	0
Tax	45.8	10.1	6.4	32.66	51.12
PAT	105.8	63.1	52.7	126.66	166.42
EPS	12.9	7.7	6.4	15.3	20.1

Balance Sheet

Consolidated Balance Sheet	FY12	FY13	FY14
Sources			
Net Worth	831.6	975.7	1,171.9
Loan Funds	4,386.3	6,230.1	8,422.0
Total	5,217.9	7,205.8	9,593.8

Application			
Goodwill	8.0	6.4	6.4
Fixed Assets	100.8	32.6	27.6
Deferred Tax Asset	6.9	10.1	17.1
Investments	22.8	1.1	347.4
Current Assets, Loans &			
Loan Book	4,670.4	5,590.2	6,944.4
Other current assets &	877.1	1,916.3	2,789.0
Less : Current Liab &	-468.1	-351.0	-538.1
Net current assets	5,079.4	7,155.5	9,195.3
Total	5,217.9	7,205.8	9,593.8

Segmental

AUM composition (Rs cr)	FY12	FY13	FY14
Retail Finance (MSME & Consumer)	3,460.4	5559.9	7883
Wholesale Credit	2,725.3	1949.6	1795.9
Total	6,185.7	7509.5	9678.9

% of Total AUM	FY12	FY13	FY14
Retail Finance (MSME & Consumer)	56%	74%	81%
Wholesale Credit	44%	26%	19%

Break up of Retail Loan Assets	FY12	FY13	FY14
Mortgage/SME Loans	3051	4623.4	6405.8
Loans against Gold Jewellery	234.3	440.8	574.6
Two Wheeler Loans	13.8	163.1	452.4
Consumer Durable Loan	44.4	182.1	359.3
Others	116.9	150.5	91.1
Total	3460.4	5559.9	7883.2

% of Retail Loan Assets	FY12	FY13	FY14
Mortgage/SME Loans	88%	83%	81%
Loans against Gold Jewellery	7%	8%	7%
Two Wheeler Loans	0%	3%	6%
Consumer Durable Loan	1%	3%	5%
Others	3%	3%	1%

Key Ratios

Particulars	FY12	FY13	FY14
Gross NPA (Rs cr)	3.6	6.1	30.78
Gross NPA %	0.08%	0.11%	0.45%
Net NPA (Rs cr)	0	0.6	5.55
Net NPA %	0.00%	0.01%	0.08%
CAR %	18.63%	23.53%	22.15%
Tier 1%	14.63%	16.26%	16.28%
NIMs	4.30%	5.10%	5.40%
Div Per Share	1.5	1.8	2.0
ROE	18.2	5.7	5.5
Cost to income ratio	49.9	78.0	73.9

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