Shriram Transport Finance - BUY

IIFL INVESTMENT MANAGERS WEALTH MANAGEMENT

Set to flourish in a favourable cycle

Shriram Transport Finance (STFC) is entering a sweet phase of business cycle, which would be marked by steady asset growth recovery, robust growth in pre-provisioning operating profit, and significant earnings jump, thereby collectively lifting valuations towards cyclical peaks. We believe the franchise's unique and tough-to-replicate positioning helped it achieve healthy profitability despite multiple upheavals of past four years including cyclical headwinds, stringent regulation in the form of NPL and capital norms, and the burden of absorbing the loss-making equipment finance business.

In its core customer segment of owner-driver and SRTOs and vehicle vintage of 5-10 years, **STFC is a dominant organized player in used CV financing**. The company has built a highly localized business over past three decades with unmatched skills in customer acquisition and credit assessment, vehicle valuation and disposal, and customer engagement & collections. **Human capital is STFC's greatest strength with high employee loyalty and stickiness pervading all levels of the organization.**

In a scenario of hardening rates, **STFC would be amongst the few NBFCs to witness reduced borrowing cost in ensuing quarters**. Not having borrowed aggressively at the shorter end of yield curve unlike other NBFCs during the past couple of years, it should be able to maintain its desired lending spread. **Seminal reduction in cost/income ratio since FY15**, despite adverse operating conditions, **reflects pure efficiency gains**; most notable being the significant increase in clients handled per field officer. **STFC's substantial provisioning buffer will ensure smooth transition to 90dpd NPL recognition in Q4 FY18**. A steady recovery in all-round economic activity and consumption should drive improvement in vehicle utilization over FY18-20, thereby causing **credit cost to moderate meaningfully from current peak levels**.

CMP (Rs) (As on Dec 08, 2017)	1,370	SECTOR: FINANCIALS		
2-year Target (Rs)	2,020	Market cap (Rs mn)	310,900	
Upside	47.5%	Enterprise value (Rs mn)	-	

Figure 1: Financial summary

Y/e 31 Mar (Rs mn)	FY17	FY18E	FY19E	FY20E
Total operating income	55,970	66,872	77,935	89,986
yoy growth (%)	8.7	19.5	16.5	15.5
Op. profit (pre-prov.)	43,682	53,540	62,537	72,200
Net profit	12,573	18,113	24,165	29,971
yoy growth (%)	6.7	44.1	33.4	24.0
EPS (Rs)	55.4	79.8	106.5	132.1
BVPS (Rs)	425.0	449.7	544.3	650.6
P/E (x)	24.8	17.2	12.9	10.4
P/BV (x)	3.2	3.1	2.5	2.1
ROE (%)	11.7	15.1	17.6	18.8
ROA (%)	1.8	2.3	2.7	2.9
Dividend yield (%)	0.8	1.1	1.4	1.5
CAR (%)	16.9	16.8	16.9	17.1

Source: Company, IIFL Research

Whenever a business cycle turns for the better, a well-positioned player like STFC is bound to record sharp upswings in profitability and earnings. In our estimate, STFC's RoA and RoE would expand by 110 bps and 700 bps respectively over FY17-20. Profit would grow 2.4x in the same span. A steep valuation re-rating is hence highly plausible over the coming 12-15 months. The stock currently trades at a modest valuation of 2.1x P/ABV and 10.4x P/E on FY20 estimates.

Analyst: Rajiv Mehta, Sachit Damani

AUM growth to gradually accelerate

During our interaction, STFC's management expressed confidence about delivering AUM growth of average 14-15% over the next 3-4 years. The expectation is based on likely uptick in freight activity from recovery in rural consumption (post successive satisfactory monsoons), government's emphasis on infra spends and housing development, and steady pickup in manufacturing and mining activity. This positive management commentary corroborates with sanguine outlook expressed by CV OEMs and auto ancillaries catering to them.

Shifting asset ownership patterns triggers rural focus

Over the past five years, STFC has significantly enhanced its physical presence through branches and small centers in rural India, in line with the shift in used vehicle ownership patterns across the country. The prime reason for the shift is rapid urbanization of Tier 2/3 regions thus creating more income-earning opportunities. However, the location of the customer does not restrict him from catering to nearer urban and semi-urban markets.

More than 90% of the addition in branch count over the preceding five years has been through the conversion of rural centers. These are typically one-man offices to start with and covering a shorter radius. It is manned with more resources exactly in line with the growth in customer count, and eventually converted into a branch on reaching a certain scale. This way, it typically turns profitable even before its conversion into a branch.

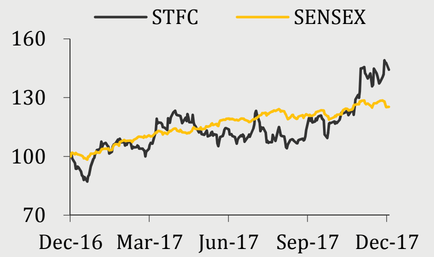
Company rating grid

Low ◄—► High

	1	2	3	4	5
Earnings Growth					■
RoA Progression					■
B/S Strength				■	
Valuation appeal				■	
Risk		■			

Sensex:	33,250
52 Week h/l (Rs)	1391/778
6m Avg t/o (Rs mn):	750
FV (Rs):	10
Div yield (%):	0.7
Bloomberg code:	SHTF IS
BSE code:	511218
NSE code:	SRTRANSFIN

Stock performance



	1M	3M	1Y
Absolute return (%)	8.0	30.5	51.2

Shareholding pattern (%)

Promoter	26.1
FII+DII	53.0
Others	20.9

No material change in competitive landscape

While the CV financing industry has witnessed many players entering into the market as well as existing players strengthening focus, the competition overlap for STFC yet remains low. In its core customer segment of owner-driven and SRTOs (<5 vehicle owners) where the business model is highly localized, competition from banks and diversified NBFCs is unlikely to rise in future too. More granular financiers such as SFBs lack the skills in old vehicles (5-10 years vintage) valuation and understanding of the customer segment economies catered by STFC. Thus, we believe STFC's current pricing power would stay resilient.

Human capital - epitome of franchise strength

STFC considers its human capital as one of its key competitive strengths. As employees climb the organization pyramid, the attrition level considerably comes down. The top management, mid management and zonal and branch managers comprise people who began their careers from the lowest ranks. The strategy of hiring locals with up to graduate level qualification and avoiding lateral hires for senior positions has worked well both in terms of cost and productivity. Notably, a significant chunk of the people quitting STFC, have generally rejoined.

NIMs to hold steady

Unlike most NBFCs, STFC has experienced a significant fall in its borrowing cost only in the past couple of quarters. Company's non-bank borrowings have a relatively longer maturity profile. It has not resorted to aggressive borrowings at the shorter-end of the yield curve to take benefit of surplus liquidity situation in the system. So, while the recent hardening of rates is likely to hurt other players, STFC would still enjoy the benefit from substitution of maturing high-cost borrowings. The management expects a 25-bps reduction in overall borrowing cost in ensuing quarters. This along with strong pricing power and improvement in vehicle utilization will enable the company in comfortably maintaining NIMs near the current level of 7.6%.

Decline in cost ratios reflect pure efficiency gains

The cost ratios of STFC has fallen substantially since the start of FY16. The cost/income ratio has fallen from 25-26% to 21-22% currently. It has been purely on the back of impressive gains in business productivity emanating from much higher level of customers being handled by the field officers. Technology has played a pivotal role in managing more clients without compromising on the engagement level. Management expects the cost/income ratio to gravitate around the current level in the coming years notwithstanding an increase in employee base and higher variable payouts in case of improved asset growth and performance. The use of technology in business operations will increase as more and more customers start using smart phones.

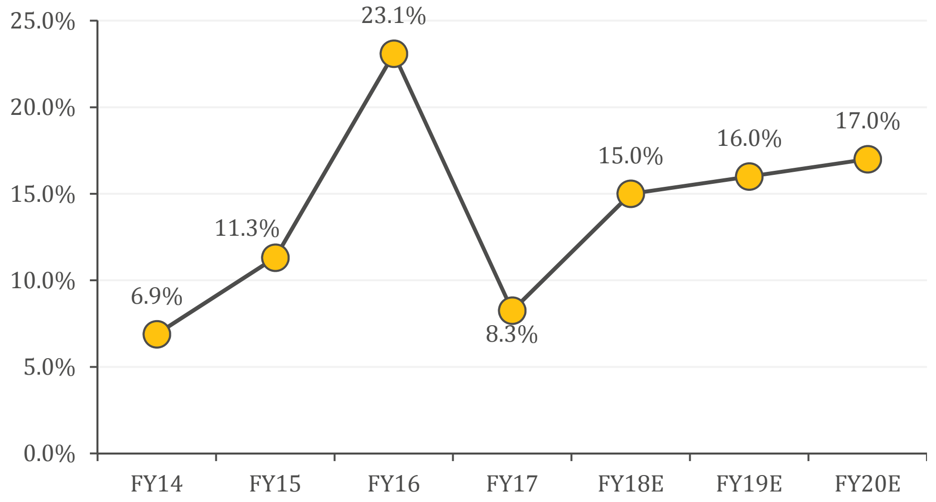
Underlying asset quality has stabilized; should improve from FY19

Q2 FY18 performance of STFC reflected that underlying credit trends are stabilizing. On the current 120dpd NPL recognition, the asset quality should improve in H2 FY18 considering the likelihood of better cash flows for the customers. This trend should continue in FY19/20 as vehicle utilization and freight rates tighten. The transition to 90dpd NPL recognition in Q4 FY18 is unlikely to be as disruptive as the previous transitions considering that company has a maintained a substantial buffer provisioning which would be most likely utilized. This can also be construed from the management's full-year credit cost guidance of 3%. The company expects credit cost to fall by 50bps in FY19 and further by 20-30bps in FY20 based on the assumption that growth and credit cycle will turn favorably.

Entering a sweet phase; valuation undemanding. BUY with 24m TP of Rs2,020

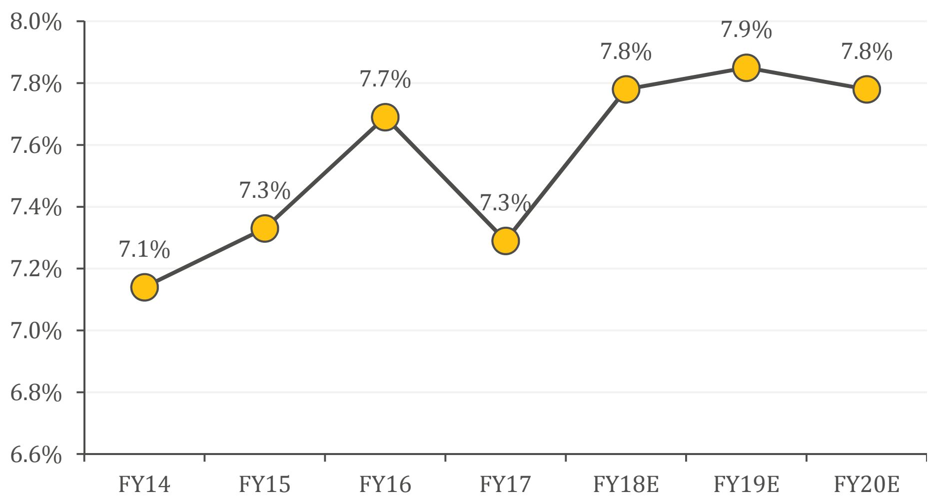
In the preceding six years (FY12-17), STFC's profit was largely static despite the balance sheet having doubled in size. Key factors that led to RoA depression were a) weak used CV demand b) tightening of NPL recognition & capital requirement norms c) merger of the troubled equipment finance business and d) persistent investment for growth. With the impact of regulatory headwinds now behind it and used CV demand looking up, the company is entering a sweet phase of the business cycle. Over FY17-20, we thus see RoA and RoE improving by substantial 110 bps and 700 bps respectively. Earnings should grow 2.4x over the said period reflecting a robust CAGR of 34% p.a. The current valuation of 2.1x P/ABV and 10.4x P/E on FY20 estimates looks attractive. We expect stock to re-rate significantly in the medium term.

Figure 2: AUM growth to recover gradually



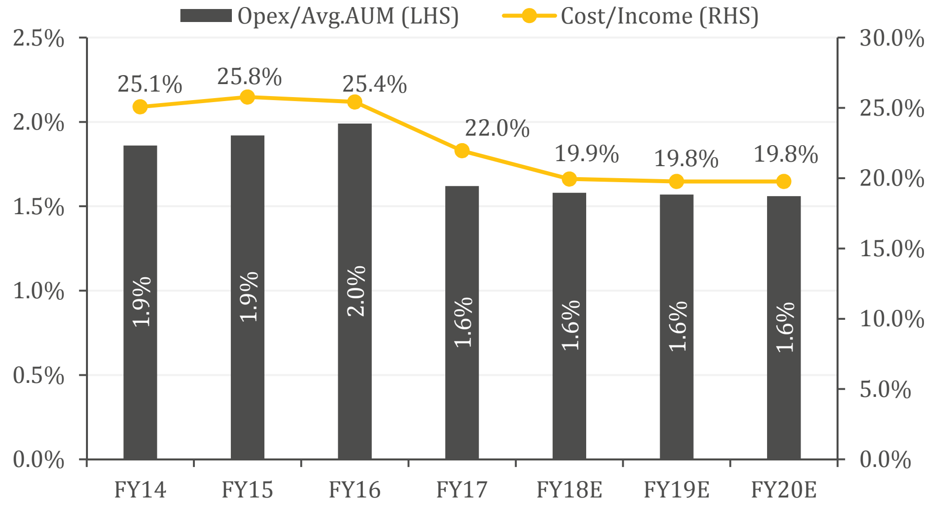
Source: Company, IIFL Research

Figure 3: NIMs to hold steady



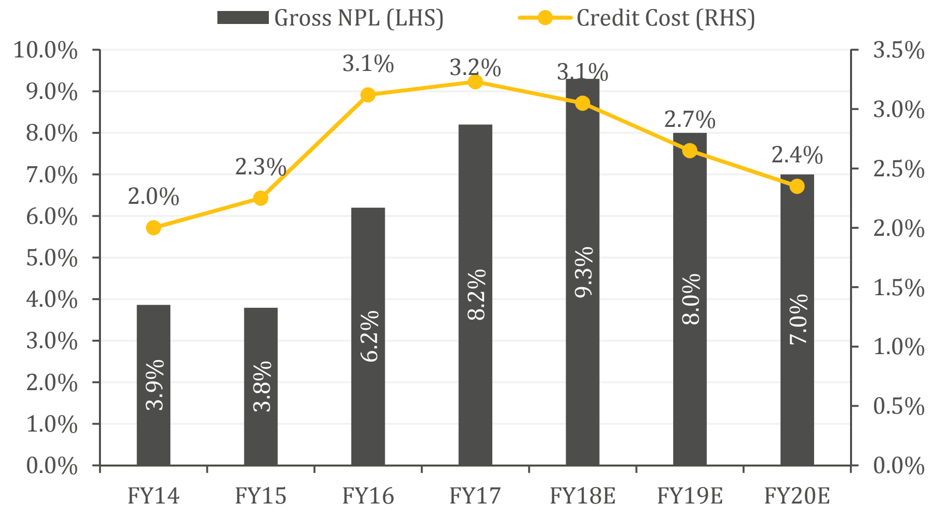
Source: Company, IIFL Research

Figure 4: Cost ratios to remain contained



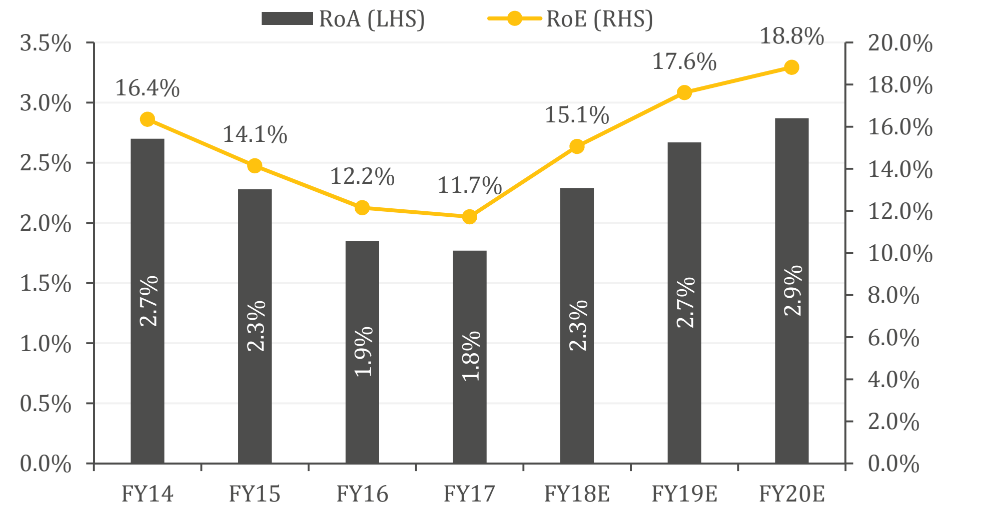
Source: Company, IIFL Research

Figure 5: Asset quality to improve over the next two years



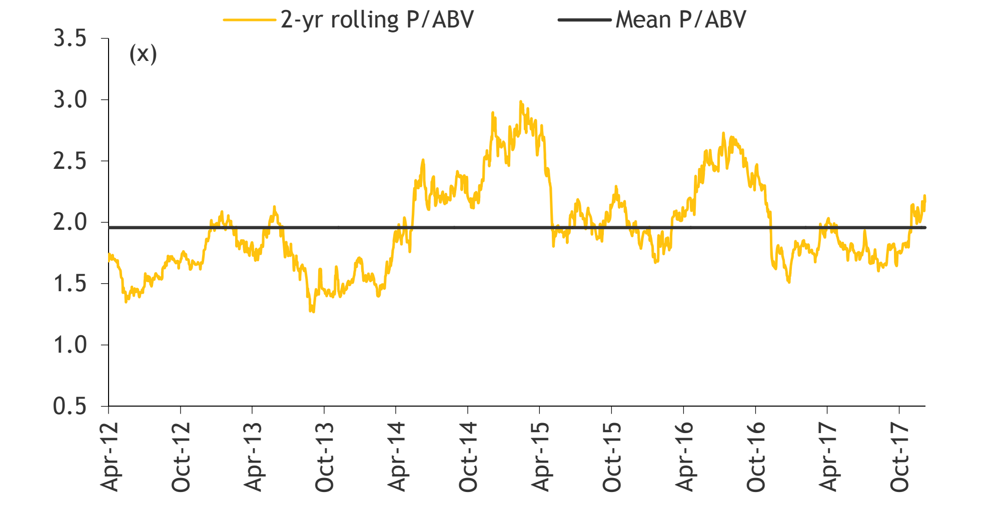
Source: Company, IIFL Research

Figure 6: Return ratios to recover significantly over FY17-20



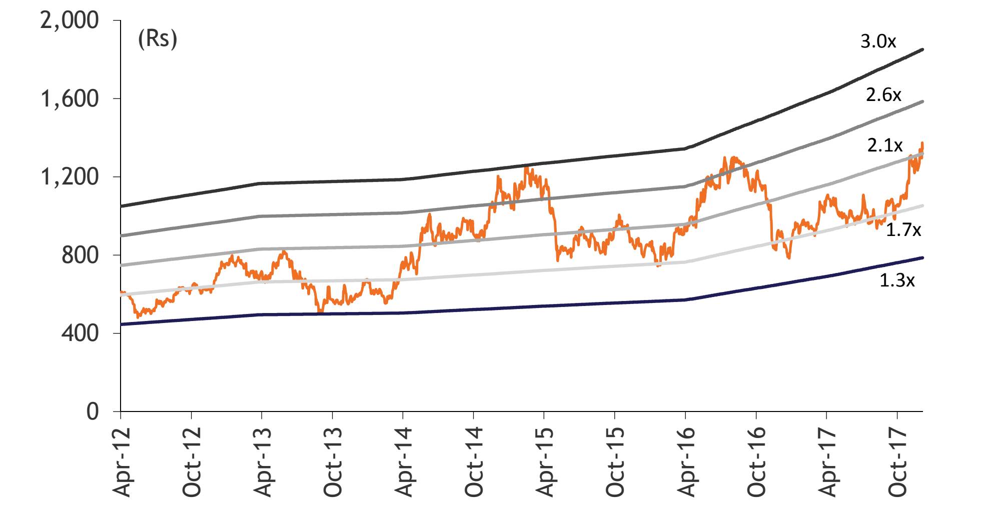
Source: Company, IIFL Research

Figure 8: Currently, valuation is near the long-term mean



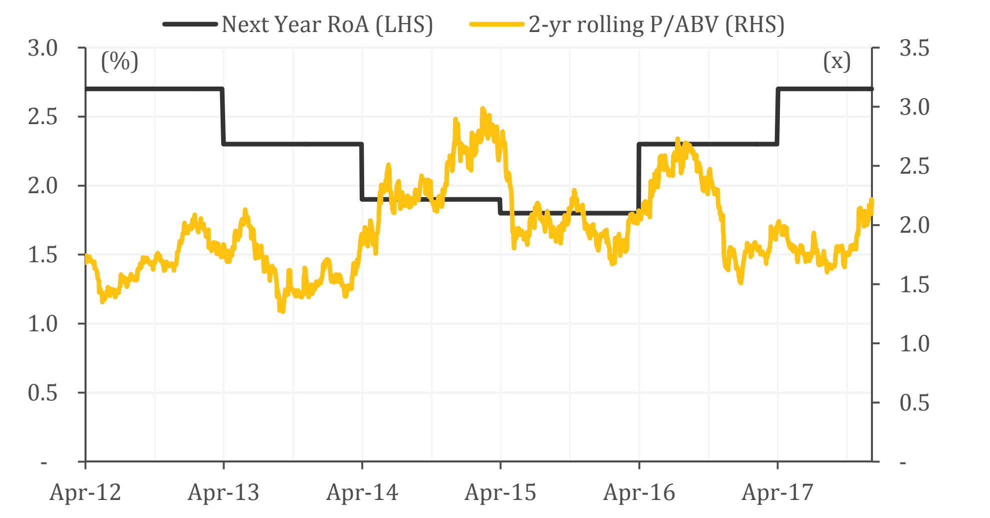
Source: Company, IIFL Research

Figure 7: 2-yr rolling P/ABV indicates room for valuation re-rating



Source: Company, IIFL Research

Figure 9: Valuation very sensitive to medium-term RoA outlook



Source: Company, IIFL Research

21 November 2017

Update | Sector: Financials - NBFC

Shriram Transport Finance

BSE SENSEX	S&P CNX
33,478	10,327

CMP: INR1,267 **TP: INR1,500 (18%)** **Buy**

Better days ahead

- **We believe that Shriram Transport Finance (SHTF) is on the cusp of a strong earnings trajectory. Company-specific drivers (reduction in credit cost, C/I ratio), along with a recovery in the CV market, should lead to 30%+ earnings growth over FY17-20.**
- **Also, we reiterate our stance that SHTF will be a big beneficiary of CoF reduction due to a large share of high-cost legacy borrowings. Thus, contrary to investor fears of a margin contraction due to rapid migration toward lower-vintage vehicle financing, margins should actually remain steady or even improve, in our view.**
- **Asset quality has been stable on an apples-to-apples basis. Over the past several quarters, the GNPL ratio has ranged from 4-4.5% on a 180-dpd basis – similar to the levels seen in FY16 before the NPL migration. However, a key point here is that the NPL provision buffer has almost doubled from INR20b in 3QFY16 (prior to NPL migration) to INR35b (ex-CE provisions) in 2QFY18. Despite the NPL migration, SHTF has stuck with a PCR policy of 70%+, which impacted its earnings, in our view.**
- **Meanwhile, an analysis of write-offs (which we believe reflects the only credit loss to the company) suggests that asset quality has been rather stable over the past 3-4 years. Write-offs, as a percentage of two-year-lag average AUM, have been steady at 2.0-2.2%, suggesting that the rise in GNPLs is merely statutory and not economic.**
- **We acknowledge that SHTF is highly levered to the economy. However, given its (a) niche, difficult-to-replicate business model, (b) virtual monopoly in old vehicle (6+ years vintage) financing and (c) 12-15%+ AUM growth and 17-18% steady-state RoE, we believe that SHTG warrants a higher multiple. Every 25bp higher margin/lower credit cost has a positive impact of 15-20bp on ROAUM, leading to a 5% upgrade in earnings. We thus expect earnings upgrades for vehicle financiers, going ahead.**

Valuation view

SHTF's return ratios are just off cyclical lows, with decadal high credit cost and NPLs. However, the elevated credit costs for the company over the past two years are just statutory and not economic – i.e. write-offs (as % of AUM) have been stable. Credit costs have been high only in order to maintain PCR and not because of high net credit losses. We believe that the worst of asset quality troubles is behind and that the company should witness improving return ratios due to lower credit costs. Additionally, we believe that margin compression fears are overplayed, with the company yet to reap benefits in its cost of funds (CoF).

We expect RoA/RoE of 3%/17% in FY19 and similar return ratios in the subsequent years. **With RoA of 3%, SHTF will be at the upper end of the RoA range of our NBFC universe.** However, its relatively slow AUM growth may limit the multiple that investors will pay for the stock, in our view. We use an RI model, with Rf of 7%, CoE of 14% and a terminal growth rate of 5%, to arrive at a target price of INR1,500 (2.1x Sep'19E BVPS). **Buy**.

Stock Info

Bloomberg	SHTF IN
Equity Shares (m)	227
52-Week Range (INR)	1,336/778
1, 6, 12 Rel. Per (%)	15/21/27
M.Cap. (INR b)	295.4
M.Cap. (USD b)	4.6
Avg Val, INRm	853.2
Free float (%)	73.9

Financials Snapshot (INR b)

Y/E March	2018E	2019E	2020E
Net Inc.	66.3	74.8	86.8
PPP	53.4	60.1	70.0
PAT	18.0	23.7	28.9
EPS (INR)	79.5	104.5	127.3
EPS Gr. (%)	43.5	31.4	21.9
Cons. EPS (INR)	80.6	106.2	127.6
BV/Sh (INR)	558	644	749
Cons. BV (INR)	561	649	754
RoA on AUM (%)	2.7	3.1	3.3
RoE (%)	15.1	17.4	18.3
Payout (%)	17.4	17.4	17.4
Valuations			
P/E (x)	15.7	11.9	9.9
P/BV (x)	2.3	2.0	1.7
Div. Yield (%)	0.9	1.2	1.5

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	26.1	26.1	26.1
DII	4.9	3.0	3.2
FII	48.1	49.5	30.3
Others	20.9	21.5	40.5

FII Includes depository receipts

Stock Performance (1-year)

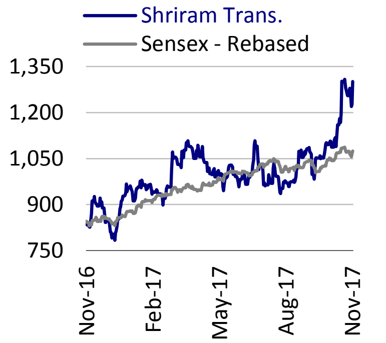


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Exhibit 1: MOSL vis-à-vis the street

Parameter	What the street is concerned about	MOSL view
Margins	Margins will compress due to migration towards lower vintage vehicle lending	We believe the unprecedented cost of funds benefit would offset any yield pressure
Asset Quality	Asset quality has worsened sharply in the past 3-4 years	Only the headline GNPL number has worsened. Trend of write-offs (as % of AUM) is stable
Net profit	PAT has been stagnant at INR12b for several years now	Over FY15-17, regulatory impact weighed in on PAT. At 180dpd and 80% PCR, PAT in FY17 would have been ~INR16b, in our view.

Source: MOSL, Company

Exhibit 2: Our thoughts on why Shriram Transport is a good investment at this juncture

What comprises a good investment	Why STF fits the bill
✓ Management has a deep understanding of the business; company has seen multiple economic cycles	❖ SHTF has been in this business for almost four decades. It was a pioneer in this segment. The customer segment that SHTF caters to is different, making it difficult for competitors to replicate the business model.
✓ Healthy growth in top and bottom line	❖ PAT was stagnant over the past few years. However, multiple factors (as explained in the note) will drive 30%+ PAT CAGR over FY17-20.
✓ The company should avoid too much risk	❖ We believe SHTF is a step behind in this segment, as over 75% of its loan book is for vehicles over five years old. There is concentration in the high-vintage loan book.
✓ Strong return ratios	❖ Before the CV downcycle in FY13, RoA/RoE was 4.0%/21%. We expect RoA/RoE to reach 3.2%/18% in FY20 (due to falling spreads on securitization/assignment, and increasing share of lower vintage loans).
✓ Asset quality should be healthy and stable	❖ While GNPL ratio of 8%+ seems high, it is reflective of the segment it caters to. However, it is important to note that asset quality has been stable, as explained later in the note. Importantly, it has 70%+ PCR on the GNPLs.
✓ Valuations should be reasonable	❖ It trades at 1.9x FY19E BVPS. Its peers trade at: MMFS – 3.2x, CIFC – 3.1x, SUF – 4.3x, Magma – 1.6x

Source: Company, MOSL

Margin contraction fears overplayed

Substantial benefit to CoF over the next two years

- **We believe that liability re-pricing (fixed rate legacy borrowing at 10%+), coupled with improving asset quality, is expected to drive margins, going forward.**
- **With improved liquidity in the market and its rating upgrade in FY16, SHTF has been able to incrementally borrow funds from the market at low rates (8.1-8.2% on NCDs and ~8.5% on bank borrowings). With the high-cost legacy book slowly coming up for refinancing, we believe SHTF's CoF is set to decline sharply. At 9.8% in FY17, CoF was higher than that for peers like MMFS (8.9%) and CIFC (9.5%).**
- **SHTF is also highly levered to the asset quality cycle. For every 100bp change in GNPA, NIM will go up by 15bp and RoAs by 10bp (3% of PAT).**

CoF for STF is much higher than similar-rated peers like CIFC and MMFS

High-cost legacy borrowings weighing on margins

Over the past several quarters, SHTF has witnessed CoF that is significantly above peers like MMFS and CIFC. While we acknowledge that the business model, customer segment and proportion of bank v/s market borrowings will lead to marginally higher CoF v/s peers, the difference appears stark.

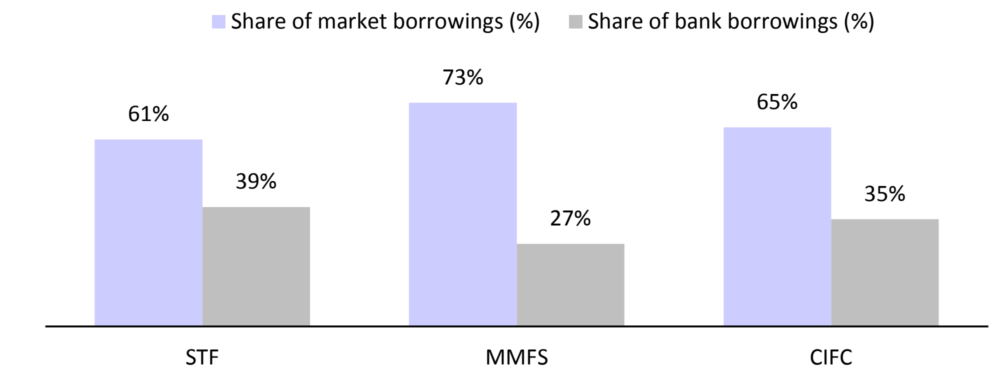
Exhibit 3: Trend in cost of borrowings of SHTF v/s peers (%)

CoF (%)	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
STF	10.42	11.84	10.45	10.40	9.96	9.78	9.44	9.40
MMFS	9.48	9.21	9.31	9.13	9.08	8.39	8.38	8.26
CIFC	9.57	9.55	9.42	9.34	9.11	8.92	8.86	8.64
V/s MMFS (bp)	*94*	*263*	*114*	*127*	*89*	*140*	*106*	*114*
V/s CIFC (bp)	*85*	*229*	*103*	*106*	*86*	*86*	*58*	*76*

Source: MOSL, Company

Marginally higher share of bank borrowings compared to peers

Exhibit 4: Liability profile is largely similar to peers (FY17)



Source: MOSL, Company; Note: Market Borrowings include public deposits

Exhibit 5: Long-term rating upgrade by CRISIL in FY16

	FY12	FY13	FY14	FY15	FY16	FY17
CRISIL rating - LT debt	AA	AA	AA	AA	AA+	AA+
CRISIL rating - ST debt	A1+	A1+	A1+	A1+	A1+	A1+

Source: MOSL, Company

A quick analysis of SHTF's liability profile from the recent annual reports suggests that the company is still bogged down by high-cost legacy NCD borrowings. Hence, while incremental cost of borrowings via NCDs is ~8%, the company still has a high share of NCDs outstanding that cost over 10%.

For example, in FY16, only 51% of the 'Privately placed redeemable NCD of INR1m each' were at a cost of <10%. In FY17, this number increased to 75%, as high-cost NCDs were refinanced at much lower rates. Note that this category of NCDs amounts to INR153b of the total outstanding NCDs of INR205b as of FY17. We expect such refinancing to continue over the medium term, which should result in healthy interest cost savings for the company. **Note that in FY17, CoF (ex-operating expenses related to raising liabilities) was 9.8%. With incremental borrowings at 8-8.5% (depending on the source), we expect ~100bp reduction in CoF over the medium term. This should help sustain margins.**

The share of NCDs in the sub-10% cost bracket increased from 51% to 75% in FY17

Exhibit 6: Privately placed NCD of INR1M each (FY17, INR m)

FY17	<10%	10-12%	>12%	Total
Over 60 months	9,321	13,672	0	22,993
48-60 months	23,960	1,300	0	25,260
36-48 months	5,750	10,250	0	16,000
24-36 months	39,750	-	0	39,750
12-24 months	23,370	3,780	0	27,150
Up to 12 months	11,613	9,700	50	21,363
Total	113,764	38,702	50	152,516
Share	75%	25%	0%	100%

Source: MOSL, Company

Exhibit 7: Privately placed NCD of INR1m each (FY16, INR m)

FY16	<10%	10-12%	>12%	Total
Over 60 months	11,646	13,672	0	25,318
48-60 months	1,900	10,250	0	12,150
36-48 months	15,800	0	0	15,800
24-36 months	4,620	3,780	0	8,400
12-24 months	3,413	9,700	50	13,163
Up to 12 months	19,650	16,581	0	36,231
Total	57,029	53,983	50	111,062
Share	51%	49%	0%	100%

Source: MOSL, Company

77% of liabilities to mature by FY20

Gradual maturity of liabilities

Given the conservative ALM, bulk of the liabilities will re-price over a period of three years. ~32% of borrowings are expected to mature in FY18 and another 45% over FY19-20.

Exhibit 8: Maturity pattern of liabilities (FY17)

Amount (INR m)	< 1 year	1-3 years	3-5 years	> 5 years
Borrowings	136,778	202,274	75,233	32,074
Deposits	37,787	41,762	12,943	-
Total	**174,565**	**244,036**	**88,176**	**32,074**
Maturity in the period	32%	45%	16%	6%

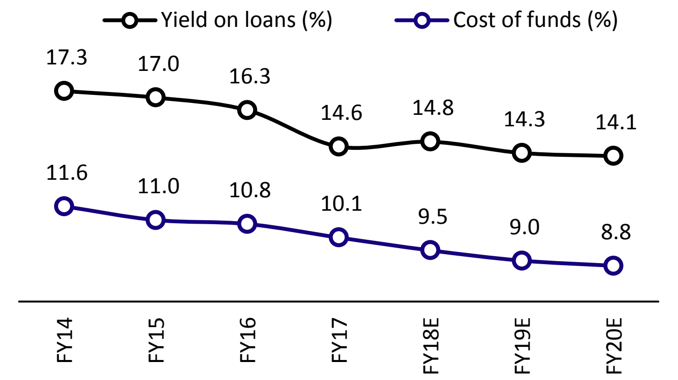
Source: MOSL, Company

~130bp impact on yields over FY15-17 due to interest reversals, in our view

Bulk of yield decline due to interest reversals

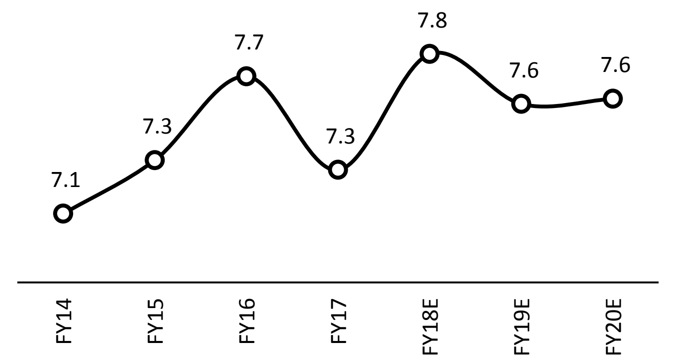
Over the past two years, SHTF has witnessed a meaningful yield compression. Yield on loans declined ~240bp from 17.0% in FY15 to 14.6% in FY17. This is on account of interest reversals due to higher NPLs, coupled with some migration toward lower-vintage vehicle financing. Our calculation suggests that the interest reversal impact on yields has been ~130bp. While there will be another hit due to this in FY18, we believe yields have by-and-large bottomed out. However, we acknowledge that our projections are conservative and factor in a yield decline in proportion to the CoF decline.

Exhibit 9: Trend in yields and CoF



Source: MOSL, Company

Exhibit 10: NIM (on AUM) to remain stable



Source: MOSL, Company

Asset quality has been stable

Sharp increase in credit costs merely statutory

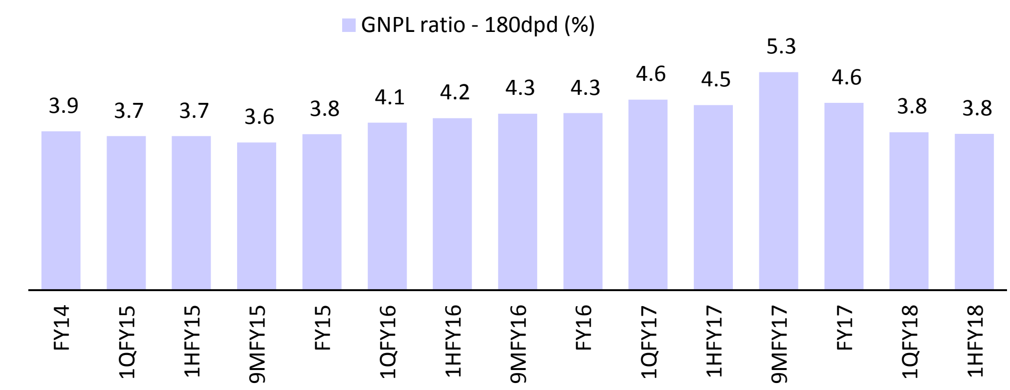
- **Over the past two years, while the headline GNPL ratio has gone up due to NPL migration from 180dpd to 120dpd and consolidation of the CE financing subsidiary, asset quality has remained stable on an apples-to-apples basis. On an 180dpd basis, the GNPL ratio currently is sub-4%, similar to the levels in FY16 prior to migration.**
- **More importantly, we prefer to look at write-offs as those are the eventual losses in any financing business. Write-offs, as a percentage of AUM (two-year-lag basis), have remained stable at 2.0-2.2% over the past four years, allaying fears that asset quality has worsened sharply over the past four years.**
- **With a provision buffer of INR35b (ex-CE book) v/s INR20b in 3QFY16 prior to migration, SHTF has a much stronger balance sheet now.**

GNPL ratio, on 180dpd basis, is in line with trend at 3.8%

Asset quality stable

If one were to exclude the CE financing book from the erstwhile subsidiary, the GNPL ratio has been stable on an 180dpd basis over the past several quarters. The CE financing book has GNPL of INR5.86b, and the company has made provisions of INR5.75b. Given below is the asset quality trend on an apples-to-apples basis.

Exhibit 11: Asset quality has been stable

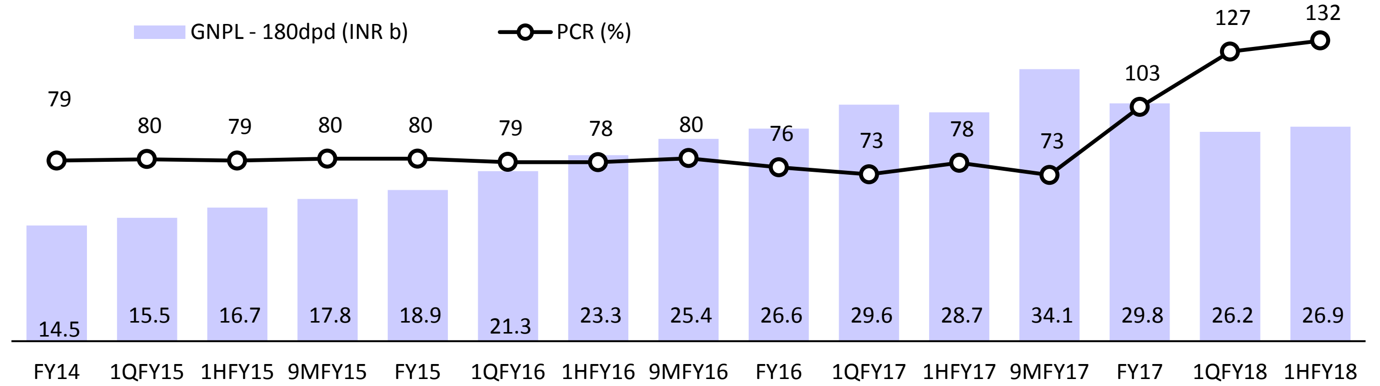


Source: MOSL, Company; Note: 9MFY17 number is MOSL estimate and is an outlier due to demonetization

Balance sheet much stronger today than a few quarters ago

Over the past six quarters, while underlying asset quality has been stable (as depicted above), the company has continued to add to its provision buffer. As a result, its PCR on an 180dpd basis has gone up sharply over the past few quarters. Given below is the PCR trend, excluding the CE financing book and assuming GNPLs on an 180dpd recognition basis. We note that PCR has increased sharply from 80% in 3QFY16 (prior to NPL transition) to 132% currently. This has been driven primarily in the past three quarters, when GNPLs on an absolute basis have declined, while the company has continued to build on its provision buffer.

Exhibit 12: Analyzing provision coverage on 180dpd basis



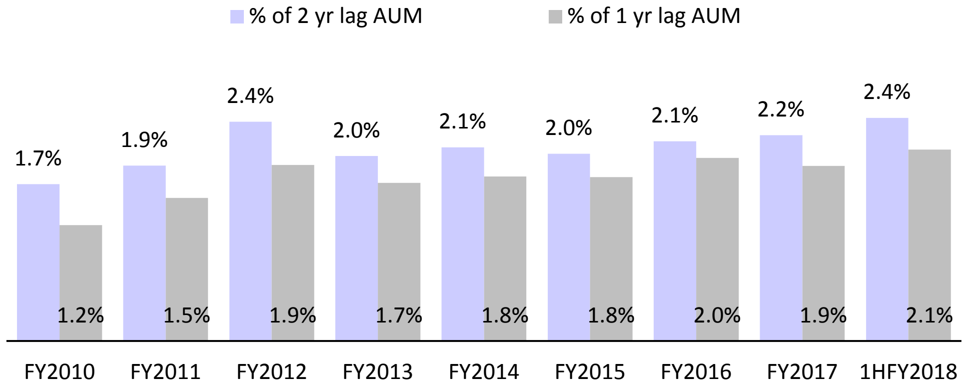
Source: MOSL, Company

Write-offs as % of AUM have been stable

Analyzing write-offs – the actual loss

Our view on the credit cost increase for SHTF over the past two years is that it was merely statutory and not economic. We mean that this was only on account of the RBI requirement of NPL migration and not because there were underlying asset quality issues. Hence, we analyze the trend of write-offs. We believe that write-offs are the only actual loss to any financing business. We have analyzed write-offs as a percentage of AUM on a two-year-lag basis. The reason for this is that we assume that the time difference between disbursing a loan, it becoming an NPL and then finally writing it off is ~2 years. This analysis reveals that write-offs, as a percentage of AUM, have remained stable and in line with the long-term averages over the past four years.

Exhibit 13: Trend in write-offs



Source: MOSL, Company

Growth – A key monitorable

Growth still driven by used CV segment

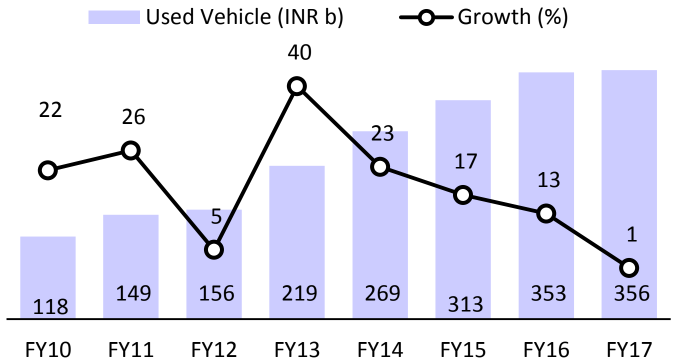
- **Contrary to general opinion, the share of disbursements toward new vehicles has declined sharply over the past four years. Prior to FY13, new vehicles disbursements accounted for 15-25% of overall disbursements, but it averaged only 9% over FY13-17.**
- **Over FY15-17, used vehicle disbursement growth slowed down sharply from 17% to 1% YoY. However, if not for the impact of demonetization, growth would have been 10-15%, in our view.**
- **Given the good start to FY18 and a favorable base, we expect overall disbursement growth of 24% YoY in FY18, and 15% in FY19 and FY20.**

Disbursement growth in used CV financing would have bottomed out at 10-15% if not for demonetization, in our view

Disbursement growth to pick up

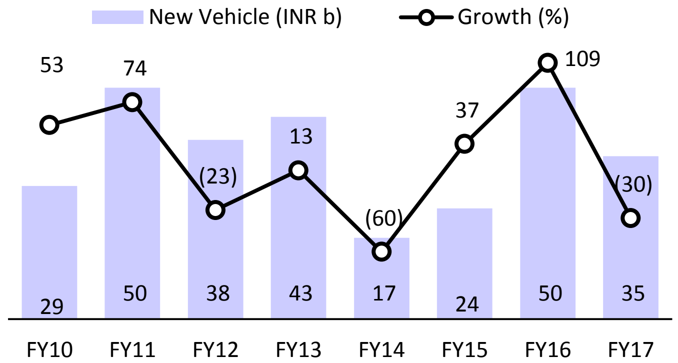
Used vehicle financing is still the driver of growth for SHTF. The share of disbursements toward new vehicles has declined sharply over the past four years. Prior to FY13, new vehicles disbursements constituted 15-25% of overall disbursements, while it averaged only 9% over FY13-17. Also, over FY15-17, used vehicle disbursement growth slowed down sharply from 17% YoY to 1% YoY. However, if not for the impact of demonetization, growth would have been 10-15%, in our view.

Exhibit 14: Used vehicle disbursements would have bottomed out in FY17 if not for demonetization



Source: MOSL, Company

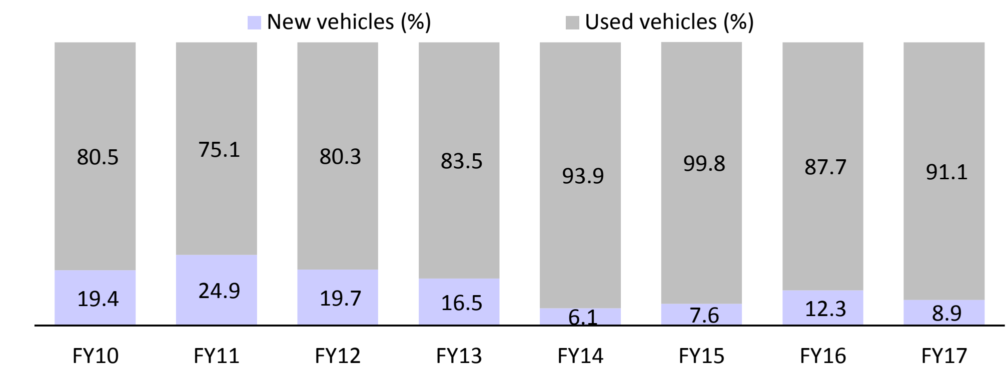
Exhibit 15: New vehicle disbursement growth mirrors M&HCV industry sales growth



Source: MOSL, Company

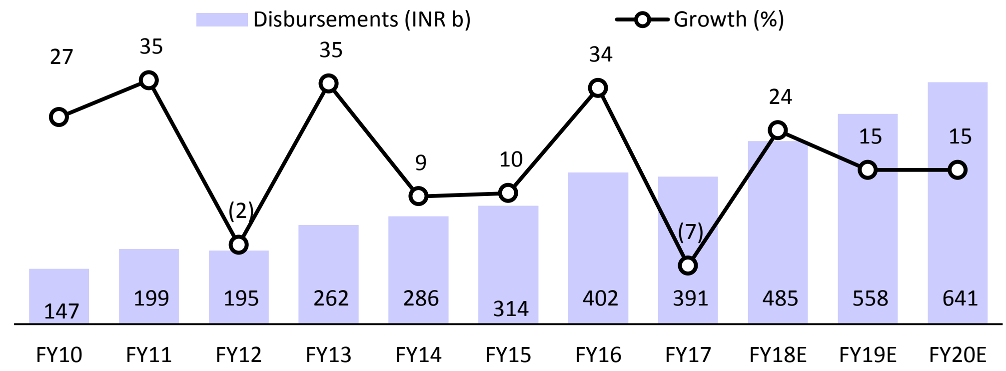
Share of new CV disbursements has declined from 25% in FY11 to 9% in FY17

Exhibit 16: Share of new vehicle disbursements have actually declined in past five years



Source: MOSL, Company

Exhibit 17: Overall disbursements should bounce back in FY18 and normalize post that



Source: MOSL, Company

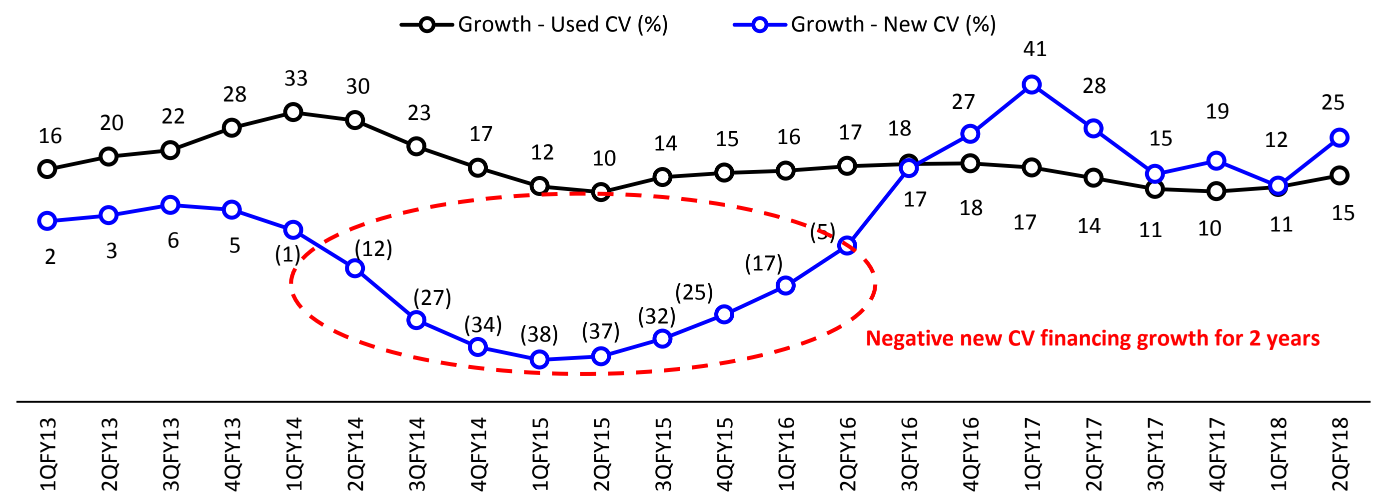
Drag on AUM growth in FY13-15 was due to new CV financing

AUM growth could see some recovery

A key thing to note for SHTF is that disbursement, and thus, AUM growth comes with a lag compared to industry CV sales. After being strong up to 1HFY14, growth started slowing down for the company. The key reason, as could be inferred from disbursement data above, was that the new vehicle book was de-growing (more than halved from INR95b in FY13 to INR47b in FY15). Consequently, the share of new CV financing in total AUM declined from 19% to 8% over the same period. While things stabilized in FY16, the following year (FY17) was slow for used CV financing, as primary market sales volumes were soft in FY12 and FY13. We believe that there will still be some softness over the next 12 months in used CV volumes. However, there is some respite in terms of pricing. Over the past five years, CV prices (net of discounts) have increased ~20%. This will have a second-order impact on used CV prices, in our view.

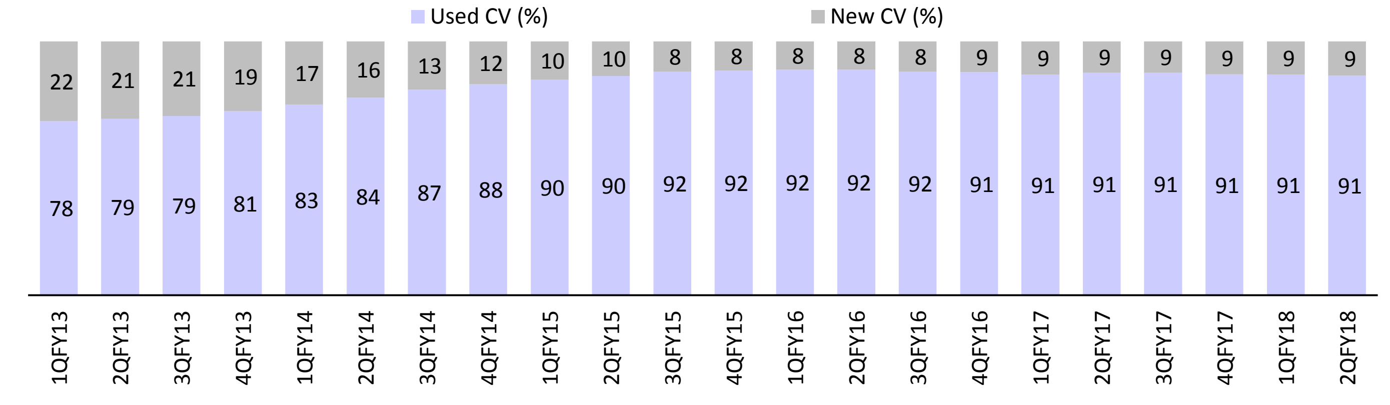
Note: All charts below have been adjusted for CE Finance subsidiary consolidation, in order to compare on an apples-to-apples basis. Note that in the past 20+ quarters, used CV financing AUM growth has never been less than 10%.

Exhibit 18: Overall AUM growth dragged down by new CV financing growth



Source: MOSL, Company

Exhibit 19: As a result, share of used CV financing increased meaningfully over FY12-15

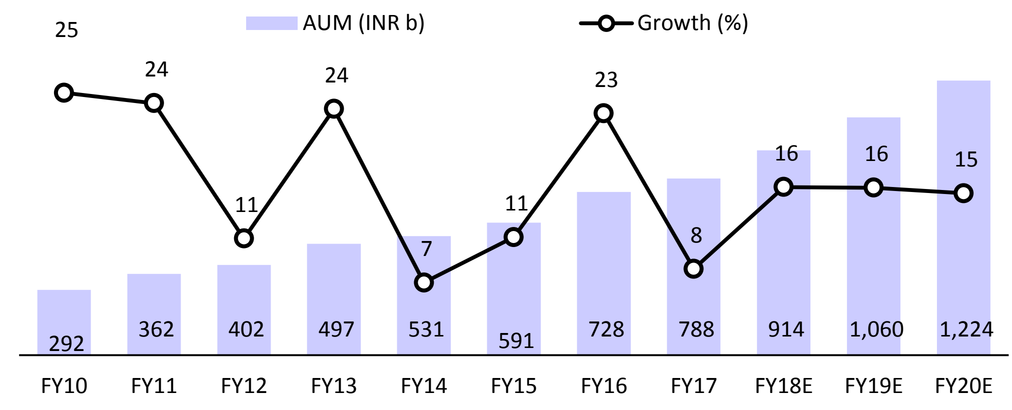


Source: MOSL, Company

Over the past 12 months, SHTF opened 136 branches, of which 110 are in rural areas

Over the past 12 months, SHTF has invested significantly in expanding its rural branch network. Of the 136 branches opened over this period, 110 were in rural areas. Consequently, the share of AUM from rural areas increased from 25% in 1HFY17 to 29% in 1HFY18. We believe that given the pick-up in disbursements (over a favorable base), coupled with the support of increasing CV prices, SHTF would be able to deliver 15-16% AUM CAGR over FY17-20E. In 1HFY18, the rural economy-related AUM grew 36% YoY.

Exhibit 20: AUM growth trend (%)



Source: MOSL, Company

Analyzing various bull cases

Understanding sensitivity of PAT to margins and credit costs

Bull Case - 1

- ☑ **We expect margin to improve to 7.7% by FY20 (v/s 7.5% in the base case).**
- ☑ **We expect credit cost to moderate to 2% by FY20 (v/s 2.25% in the base case; FY05-15 average of 1.6%).**
- ☑ This results in PAT CAGR of 36% (v/s 32% in base case) over FY17-20, with PAT approaching INR32b v/s INR28b in the base case.
- ☑ **RoA/RoE in FY20 would be 3.6%/20% (v/s 3.3%/18% in the base case).**

Bull Case - 2

- ☑ **We expect margin to improve to 7.8% by FY20 (v/s 7.5% in the base case).**
- ☑ **We expect credit cost to moderate to 1.7% by FY20 (v/s 2.25% in the base case; FY05-15 average of 1.6%).**
- ☑ This results in PAT CAGR of 41% (v/s 32% in the base case) over FY17-20, with PAT approaching INR35b v/s INR28b in the base case.
- ☑ **RoA/RoE in FY20 would be 3.9%/22% (v/s 3.3%/18% in the base case)**

Exhibit 21: Scenario Analysis: Bull Case -1

Bull Case - 1	FY18E	FY19E	FY20E
NII	**66.3**	**74.8**	**88.2**
Opex	14.0	16.1	18.4
Provisions	25.9	24.2	23.4
PBT	27.5	35.9	48.0
PAT	**18.0**	**23.7**	**31.7**
NIM (%)	7.8	7.6	7.7
Credit cost (%)	3.0	2.4	2.0
RoA (%)	**2.7**	**3.1**	**3.6**
RoE (%)	**15.1**	**17.4**	**19.9**
EPS	80.6	106.2	140.0
BV	**561.1**	**648.9**	**764.4**

Source: Company, MOSL

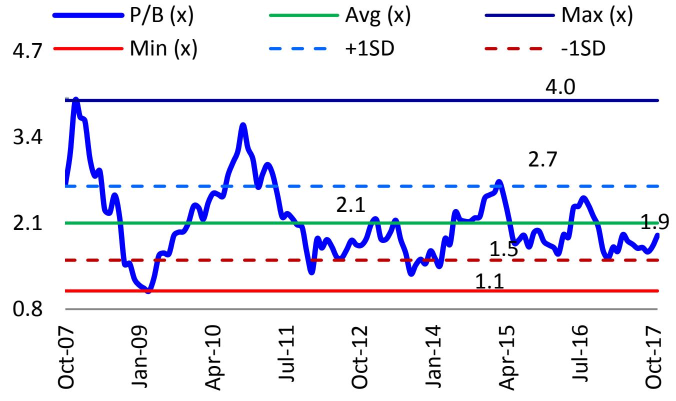
Exhibit 22: Scenario Analysis: Bull Case - 2

Bull Case - 2	FY18E	FY19E	FY20E
NII	**66.3**	**76.0**	**89.6**
Opex	69.5	55.5	39.5
Provisions	25.9	22.2	20.0
PBT	27.5	39.1	52.9
PAT	**18.0**	**25.8**	**34.9**
NIM (%)	7.8	7.7	7.8
Cost to assets (%)	3.0	2.2	1.7
RoA (%)	**2.7**	**3.4**	**3.9**
RoE (%)	**15.1**	**18.8**	**21.5**
EPS	80.6	115.5	154.1
BV	**561.1**	**656.6**	**783.6**

Source: Company, MOSL

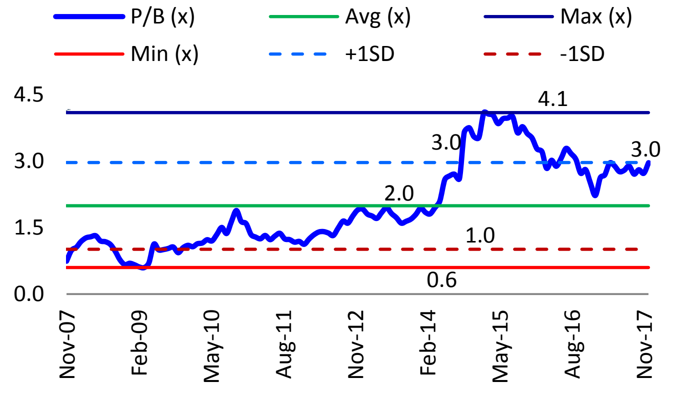
Story in charts

Exhibit 23: SHTF P/B



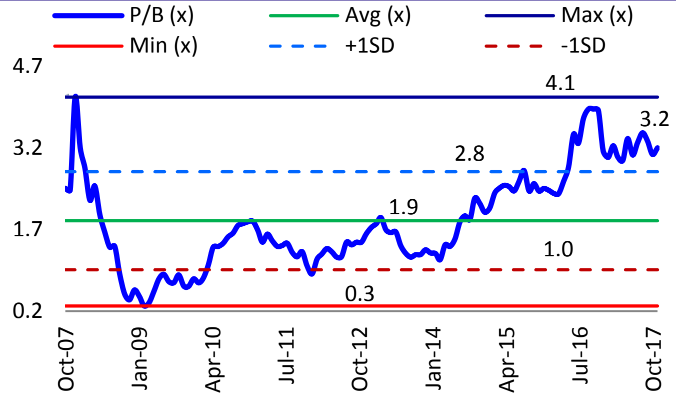
Source: MOSL, Company

Exhibit 24: SUF P/B



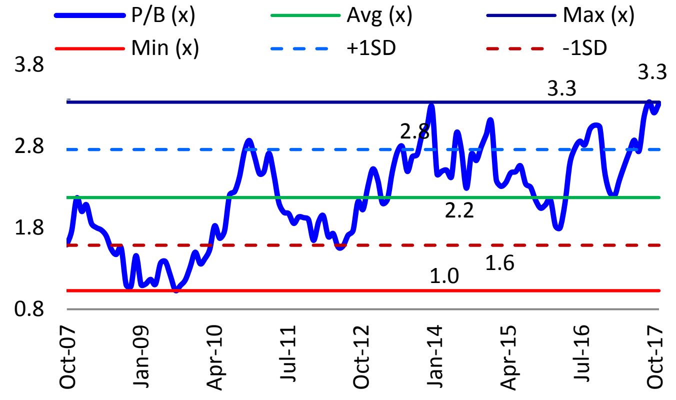
Source: MOSL, Company

Exhibit 25: CIFC P/B



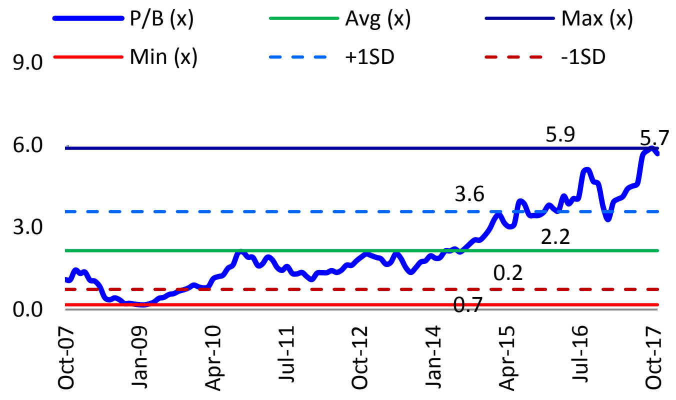
Source: MOSL, Company

Exhibit 26: MMFS P/B



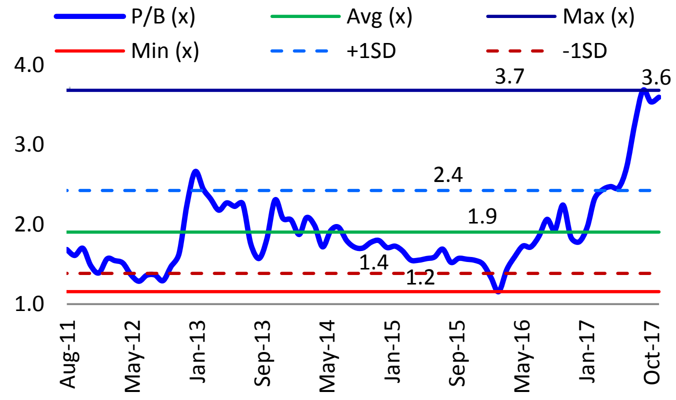
Source: MOSL, Company

Exhibit 27: BAF P/B



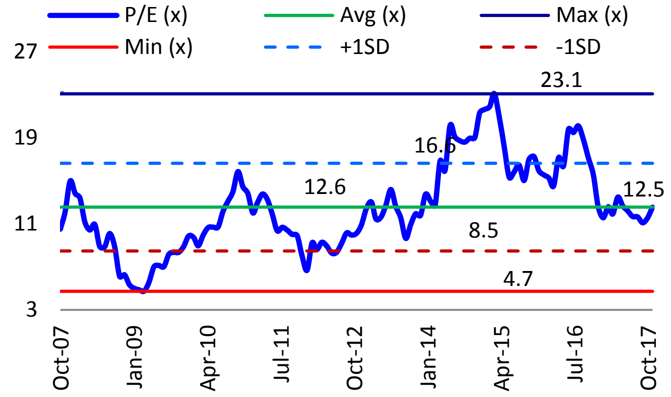
Source: MOSL, Company

Exhibit 28: LTFH P/B



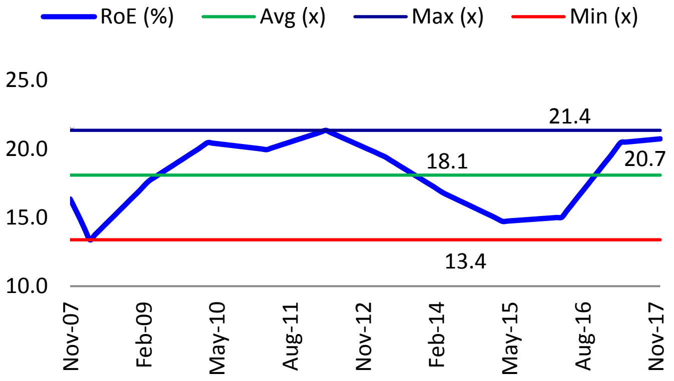
Source: MOSL, Company

Exhibit 29: SHTF P/E



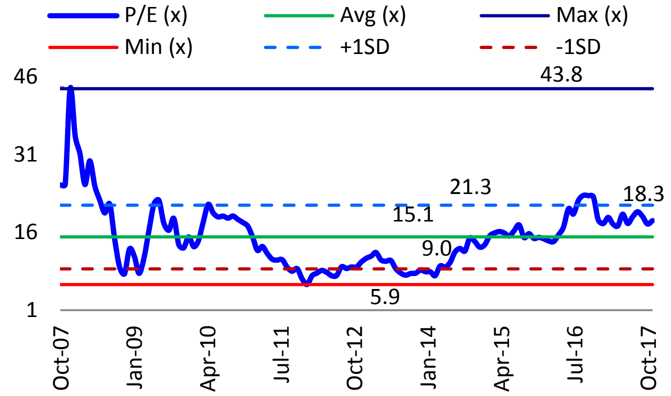
Source: MOSL, Company

Exhibit 30: SUF P/E



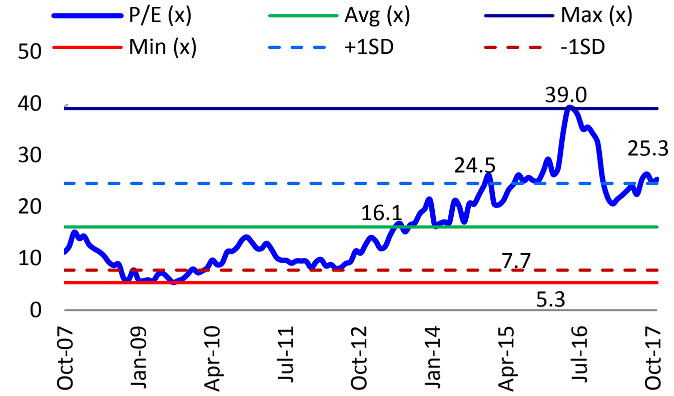
Source: MOSL, Company

Exhibit 31: CIFC P/E



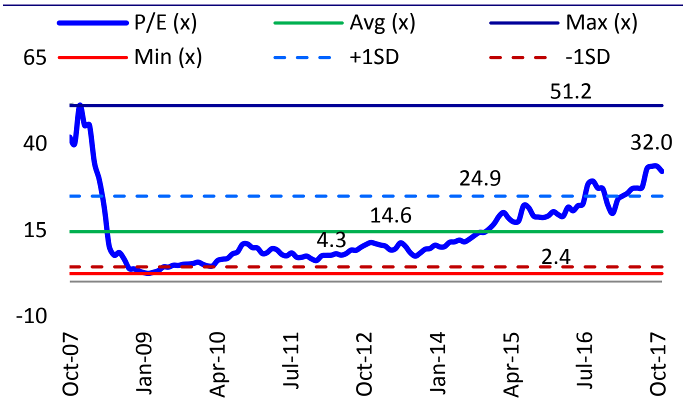
Source: MOSL, Company

Exhibit 32: MMFS P/E



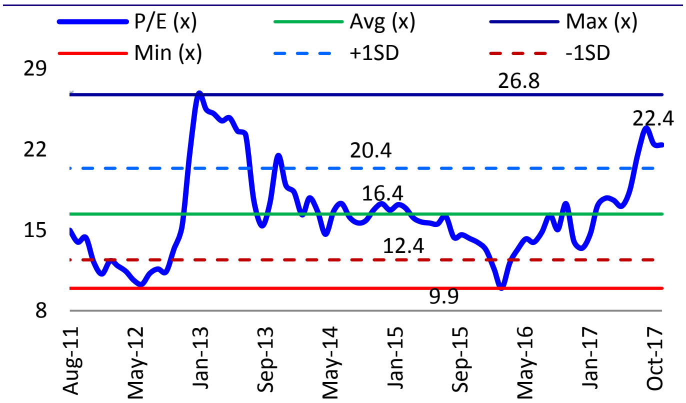
Source: MOSL, Company

Exhibit 33: BAF P/E



Source: MOSL, Company

Exhibit 34: LTFH P/E



Source: MOSL, Company

Financials: Valuation metrics

	Rating	CMP	Mcap	EPS (INR)		P/E (x)		P/BV (x)		RoA (%)		RoE (%)	
		(INR)	(USDb)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
ICICIBC*	Buy	320	31.4	13.6	17.0	17.0	12.7	1.79	1.55	1.07	1.20	8.8	10.5
HDFCB	Buy	1,846	72.5	68.7	84.7	26.9	21.8	4.84	4.10	1.86	1.92	18.8	20.4
AXSB	Buy	547	20.1	18.4	30.8	29.7	17.8	2.04	1.83	0.71	1.07	7.3	10.8
KMB*	Buy	1,029	29.3	32.1	41.6	32.1	24.8	4.43	3.78	1.77	1.95	14.8	16.5
YES	Buy	312	11.0	17.8	23.3	17.5	13.4	2.84	2.41	1.70	1.82	17.3	19.5
IIB	Buy	1,646	15.2	60.9	78.6	27.0	20.9	4.26	3.63	1.82	1.89	16.9	19.0
IDFC Bk	Neutral	55	2.9	2.8	3.2	19.7	17.0	1.21	1.15	0.74	0.71	6.3	6.9
FB	Buy	112	3.0	5.5	6.6	20.2	16.8	1.77	1.62	0.81	0.86	9.6	10.0
DCBB	Neutral	180	0.9	8.5	10.5	21.1	17.2	2.14	1.92	0.98	1.00	11.5	11.8
JKBK	Buy	75	0.6	4.1	8.7	18.2	8.7	0.72	0.67	0.27	0.51	4.0	8.0
SIB	Buy	31	0.7	1.9	3.8	16.9	8.4	1.16	1.05	0.42	0.75	6.7	12.6
Equitas	Buy	145	0.8	1.7	5.7	83.9	25.3	2.15	2.00	0.59	1.57	2.6	8.2
RBL	Buy	511	3.0	16.4	23.0	31.3	22.2	3.22	2.87	1.22	1.32	12.4	13.7
Private Aggregate													
SBIN (cons)*	Buy	331	44.3	14.6	26.8	20.5	11.0	1.31	1.19	0.36	0.60	7.0	11.4
PNB	Buy	186	6.1	8.5	13.5	21.8	13.8	1.00	0.94	0.25	0.36	4.7	7.1
BOI	Neutral	202	3.3	3.2	9.2	63.4	21.9	0.95	0.93	0.06	0.16	1.5	4.3
BOB	Buy	181	6.6	17.9	22.6	10.1	8.0	1.08	0.99	0.37	0.52	6.4	9.4
CBK	Neutral	392	3.3	16.1	30.3	24.3	12.9	0.81	0.77	0.16	0.26	3.4	6.1
UNBK	Neutral	168	1.8	-13.5	6.0	-12.4	28.2	0.59	0.58	-0.21	0.08	-4.7	2.1
OBC	Neutral	128	0.7	17.1	21.4	7.5	6.0	0.33	0.32	0.22	0.26	4.6	5.4
INBK	Buy	410	3.1	36.7	44.0	11.2	9.3	1.24	1.13	0.76	0.82	11.6	12.7
Public Aggregate													
Banks Aggregate													
HDFC*	Buy	1,692	41.0	41.4	47.2	23.5	18.2	4.27	3.01	1.85	1.85	19.3	18.6
LICHF	Neutral	601	4.7	41.0	46.5	14.7	12.9	2.38	2.08	1.42	1.42	17.4	17.2
IHFL	Buy	1,177	7.8	83.6	105.1	14.1	11.2	3.67	3.23	3.16	3.09	27.6	30.7
PNBHF	Buy	1,386	3.5	52.5	66.5	26.4	20.8	3.74	3.27	1.66	1.51	15.0	16.7
GRHF	Neutral	503	2.8	9.9	12.0	50.9	41.7	15.18	12.45	2.40	2.40	32.8	32.8
REPCO	Buy	617	0.6	36.0	41.9	17.2	14.7	2.84	2.38	2.31	2.30	18.0	17.6
DEWH	Buy	622	3.1	37.6	46.0	16.5	13.5	2.21	1.94	1.23	1.28	14.1	15.3
Housing Finance													
SHTF	Buy	1,267	4.4	80.6	106.2	15.7	11.9	2.26	1.95	2.66	3.10	15.06	17.39
MMFS	Buy	437	3.8	14.2	19.1	30.9	22.9	3.55	3.25	1.75	2.01	11.9	14.8
BAF	Buy	1,806	16.0	45.7	63.7	39.5	28.3	6.34	5.32	3.45	3.55	20.2	20.4
CIFC	Buy	1,294	3.1	59.2	70.4	21.9	18.4	3.95	3.32	3.03	3.09	19.6	19.6
SCUF	Buy	2,055	2.1	115.6	145.3	17.8	14.2	2.40	2.11	3.25	3.61	14.3	15.9
LTFH	Buy	179	5.3	6.9	10.4	25.8	17.2	3.54	3.01	1.60	2.06	14.9	18.9
MUTH	Neutral	452	2.8	42.6	42.0	10.6	10.8	2.31	1.99	5.41	4.96	23.8	19.9
CAFL	Buy	707	1.1	32.8	43.7	21.6	16.2	2.68	2.33	1.73	1.84	13.2	15.4
SKSM	Under Review	974	2.1	30.3	47.2	32.2	20.6	4.46	3.59	3.24	3.43	15.3	19.3
Asset Finance													

UR=Under Review*Multiples adj. for value of key ventures/Investments; For ICICI Bank and HDFC Ltd BV is adjusted for investments in subsidiaries

Financials and valuations

Income Statement (INR m)

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Financing Income	45,028	62,664	77,779	95,300	98,013	108,553	118,805	135,784
Financing charges	28,439	38,982	44,029	50,744	52,094	53,016	56,625	63,205
Net Financing income	**16,588**	**23,683**	**33,750**	**44,556**	**45,919**	**55,537**	**62,180**	**72,579**
Change (%)	36.1	42.8	42.5	32.0	3.1	20.9	12.0	16.7
Income from securitization	18,057	12,796	7,379	6,171	9,293	10,743	12,591	14,197
Net Income (Incl Secur)	**34,645**	**36,479**	**41,129**	**50,727**	**55,212**	**66,280**	**74,771**	**86,775**
Change (%)	7.4	5.3	12.7	23.3	8.8	20.0	12.8	16.1
Other Income	1,885	1,655	707	762	758	1,137	1,365	1,638
Net Income	**36,530**	**38,134**	**41,836**	**51,489**	**55,970**	**67,418**	**76,136**	**88,413**
Change (%)	8.9	4.4	9.7	23.1	8.7	20.5	12.9	16.1
Employee Cost	3,848	4,089	4,296	5,891	5,482	6,634	7,629	8,773
Brokerage & Commission	948	1,227	609	587	479	575	633	696
Other Operating Exp.	3,065	4,245	5,878	6,611	6,326	6,800	7,791	8,926
Operating Profit	**28,670**	**28,573**	**31,054**	**38,400**	**43,682**	**53,409**	**60,084**	**70,019**
Change (%)	8.5	-0.3	8.7	23.7	13.8	22.3	12.5	16.5
Total Provisions	**8,508**	**10,293**	**12,630**	**20,586**	**24,443**	**25,869**	**24,164**	**26,241**
% to operating income	29.7	36.0	40.7	53.6	56.0	48.4	40.2	37.5
PBT	**20,162**	**18,280**	**18,424**	**17,814**	**19,239**	**27,540**	**35,920**	**43,778**
Tax	6,556	5,638	6,046	6,032	6,666	9,501	12,213	14,884
Tax Rate (%)	32.5	30.8	32.8	33.9	34.6	34.5	34.0	34.0
PAT	**13,606**	**12,642**	**12,378**	**11,782**	**12,573**	**18,038**	**23,707**	**28,893**
Change (%)	8.2	-7.1	-2.1	-4.8	6.7	43.5	31.4	21.9
Proposed Dividend	1,590	1,588	1,815	2,269	2,269	2,706	3,556	4,334

Balance Sheet

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Capital	2,269	2,269	2,269	2,269	2,269	2,269	2,269	2,269
Reserves & Surplus	69,679	80,463	90,111	99,272	110,753	124,264	143,811	167,634
Net Worth	**71,947**	**82,732**	**92,380**	**101,541**	**113,022**	**126,533**	**146,080**	**169,903**
Borrowings	**310,025**	**359,200**	**442,800**	**497,907**	**531,101**	**585,024**	**673,313**	**771,373**
Change (%)	34.1	15.9	23.3	12.4	6.7	10.2	15.1	14.6
Other Liabilities	22	22	0	0	0	0	0	0
Total Liabilities	**381,995**	**441,955**	**535,180**	**599,448**	**644,123**	**711,557**	**819,393**	**941,276**
Investments	35,689	27,253	33,272	13,562	15,494	17,818	20,490	23,564
Change (%)	-10.0	-23.6	22.1	-59.2	14.2	15.0	15.0	15.0
Loans	**311,227**	**364,878**	**492,271**	**637,701**	**678,402**	**754,746**	**872,341**	**1,006,775**
Change (%)	41.1	17.2	34.9	29.5	6.4	11.3	15.6	15.4
Net Fixed Assets	601	1,007	1,007	1,011	838	1,181	1,291	1,377
Net Current Assets	34,478	48,818	8,629	-52,825	-50,610	-62,187	-74,729	-90,440
Total Assets	**381,995**	**441,955**	**535,180**	**599,448**	**644,123**	**711,557**	**819,393**	**941,276**

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
Spreads Analysis (%)									
Avg. Yield - on Financing portfolio	16.5	16.3	17.3	17.0	16.3	14.6	14.8	14.3	14.1
Avg Cost of funds	11.4	10.5	11.6	11.0	10.8	10.1	9.5	9.0	8.8
Int Spread on Financing portfolio	5.2	5.8	5.6	6.0	5.6	4.4	5.3	5.3	5.4
NIM (incl Securitisation)	8.4	7.7	7.1	7.3	7.7	7.3	7.8	7.6	7.6
NIM (Excl Securitisation)	5.9	6.2	7.0	7.9	7.9	7.0	7.8	7.6	7.7
Profitability Ratios (%)									
RoE	23.1	20.6	16.3	14.1	12.2	11.7	15.1	17.4	18.3
RoA	4.7	4.0	3.1	2.5	2.1	2.0	2.7	3.1	3.3
ROA (On AUM)	2.8	2.6	2.2	2.0	1.8	1.7	2.2	2.5	2.7
Int. Expended/Int.Earned	66.8	63.2	62.2	56.6	53.2	53.2	48.8	47.7	46.5
Other Inc./Net Income	63.7	54.6	37.9	19.3	13.5	18.0	17.6	18.3	17.9
Efficiency Ratios (%)									
Op. Exps./Net Income	21.2	21.5	25.1	25.8	25.4	22.0	20.8	21.1	20.8
Empl. Cost/Op. Exps.	52.0	49.0	42.8	39.8	45.0	44.6	47.4	47.5	47.7
Asset-Liability Profile (%)									
Loans/Borrowings Ratio	95.4	100.4	101.6	111.2	128.1	127.7	129.0	129.6	130.5
Net NPAs to Adv.	0.5	0.8	0.8	0.8	1.9	2.7	3.3	3.0	2.9
Leverage	4.9	5.3	5.3	5.8	5.9	5.7	5.6	5.6	5.5
Average leverage (on BS)	4.9	5.1	5.3	5.6	5.9	5.8	5.7	5.6	5.6
Average leverage (On AUM)	8.1	7.9	7.6	7.1	6.9	6.9	6.9	6.9	6.9

Valuations

	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
BVPS (INR)	266.5	323.4	375.1	408.4	449.6	494.4	561.1	648.9	754.1
Price-BV (x)						**2.6**	**2.3**	**2.0**	**1.7**
EPS (INR)	57.8	64.5	59.9	45.3	53.3	55.6	80.6	106.2	127.6
EPS Growth (%)	9.9	11.6	-7.2	-24.3	17.6	4.3	44.9	31.8	20.2
Price-Earnings (x)						**23.1**	**15.9**	**12.1**	**10.1**
Dividend	6.5	7.0	7.0	8.0	10.0	10.0	11.9	15.7	19.1
Dividend Yield (%)						**0.8**	**0.9**	**1.2**	**1.5**

E: MOSL Estimates

NOTES

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