SKP Securities Ltd

January 12, 2012

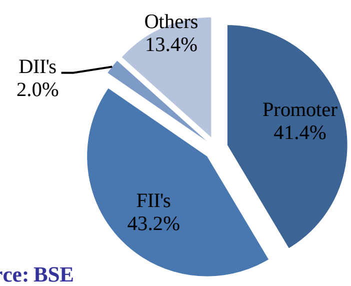
Shriram Transport Finance Co. Ltd.

Corrections overdone

CMP Rs. 514 | **Target Rs. 577** | **Initiating Coverage - Accumulate**

Key Share Data	
Face Value (Rs.)	10
Equity Capital (Rs. Mn.)	49,044
M. Cap (Rs. Mn.)	116,259
52-wk High / Low (Rs.)	832 / 416
Avg. Daily Volume (qtrly)	57,258
BSE code	511218
NSE code	SRTRANSFIN
Reuters code	SRTR
Bloomberg code	SHTF

Shareholding Pattern (as on 30th Sept, 2011)

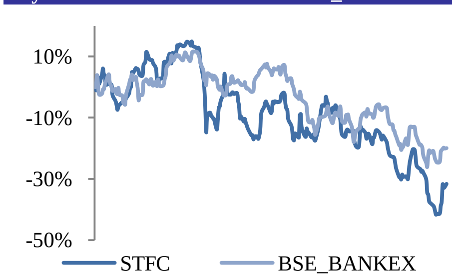


Source: BSE

Financials (Rs. Mn.)				
Particulars	FY11	FY12E	FY13E	FY14E
NII	29,582	33,536	38,100	43,337
NIMs (%)	8.1	8.1	8.2	20.7
Op. Profit	24,037	25,988	29,225	33,500
PAT	12,299	12,721	14,448	16,482
PAT Gr (%)	0.4	0.0	0.1	14.1
EPS (Rs.)	54.4	56.2	63.9	72.9
BVPS (Rs.)	216.8	265.2	320.1	392.7
ABVPS (Rs.)	213.5	259.4	312.4	383.8

Key Ratios	FY11	FY12E	FY13E	FY14E
P/E (x)	9.5	9.1	8.0	7.1
P/BV (x)	2.4	1.9	1.6	1.3
P/ABV (x)	2.4	2.0	1.6	1.4
RoAA (%)	4.2	3.6	3.6	3.7
RoAE (%)	28.1	23.3	21.8	20.7
NNPA%	0.4	0.5	0.6	0.6

I year Performance STFC v/s BSE_Bankex



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COMPANY PROFILE

Incorporated in 1979, Shriram Transport Finance Co Ltd. (STFC) is a flagship company of the Shriram group. It is the largest asset financing NBFC with assets under management (AUM) of Rs 380.8 bn (Q2FY12). The company commands a leadership position in organized financing of pre-owned trucks with strategic presence in 5-12 year old trucks and a market share of around 20-25%. It also has a 7-8% market share in the new CV financing space.

INVESTMENT RATIONALE

Slowing CV sales to lower AUM growth in FY12E

- Soaring interest rates have softened the GDP/IIP growth and put pressure on new CV sales. Considering the fact that 24% (Q2FY12) of STFCs AUM embraces new CV sales, slowing economy is likely to have repercussion on its loan growth.
- However, we do believe pre-owned CVs are less susceptible to rising interest rates but prolonged slowdown in economy is likely to hurt STFCs growth in AUM. **We expect its AUM growth to slow down to 12.5% in FY12E.**

Higher borrowing costs…

- A majority of STFC's borrowings is funded by banks, since loans to NBFCs are no longer classified as priority sector lending it has eradicated a lower source of funding for STFC and thereby increased its cost of funds. As these funds are cheaper by ~75-100 bps than otherwise.
- **We expect STFCs cost of funds to relieve in FY13E, when the liquidity scenario lightens up.**

Higher provisioning costs

- STFC wrote off loans worth Rs. 600 mn in Q2FY12 and expected to write off additional loans worth Rs. 200 mn in Q3FY12E, owing to mining ban in Karnataka. The total exposure to mining equipment vehicles is ~2% of the total portfolio.
- Moreover, adherence to the proposed RBI guideline regarding new NPA recognition norm from 180 days to 90 days is likely to add pressure to soaring NPAs. **We expect gross NPAs to rise to 2.9% in FY12E and 3.0% in FY13E.**

VALUATION

We initiate coverage on STFC with an Accumulate rating and a target price of Rs.577 per share yielding a potential upside of 12%. STFC trades at P/BV multiple of 1.9x and 1.6x on book value per share of Rs. 265 and Rs. 320 for FY12E and FY13E respectively. Our target price is based on a target multiple of 1.8x on FY13E ABV of Rs. 312. **Given the correction that the stock has undergone in the last 9 months, we believe that concerns regarding the margin woes and the regulatory headwinds have been factored in.**

COMPANY PROFILE

STFC is the largest asset financing NBFC with assets under management (AUM) of Rs 380.8 bn.

- Incorporated in 1979, Shriram Transport Finance Co Ltd. (STFC) is a flagship company the Shriram group. It is the largest asset financing NBFC with assets under management (AUM) of Rs 380.8 bn (Q2FY12). The company commands a leadership position in organized financing of pre-owned trucks with strategic presence in 5-12 year old trucks and a market share of around 20-25%. It also has a 7-8% market share in the new CV financing space, where it banks on its existing customer base upgrading to new trucks.

- STFC has a target audience of small road truck owners (SRTOs) who own less than 2-3 trucks. This set of potential customers are considered risky and ignored by the mainstream financers as they lack banking habits, have no credit history and depend on the assets as the sole source of income.

To mitigate any risk of credit quality and higher delinquency STFC developed a unique relationship based business model

- To mitigate any risk of credit quality and higher delinquency STFC developed a unique relationship based business model and employed local talents to have a concrete understanding and knowledge of the customer profile.

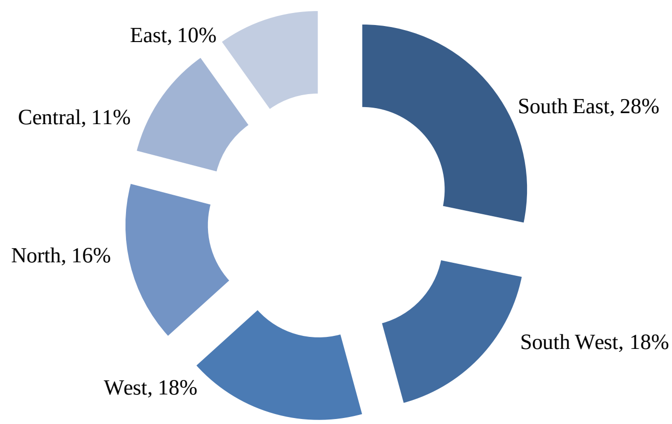
- It has a pan-India presence with a network of 496 branches (Q2FY12) and serves these customers through asset backed financing and monthly cash collection by field officers.

It has a pan-India presence with a network of 496 branches

- Over the past 33 years, it has developed strong competencies in the areas of loan origination, valuation of pre-owned trucks and collection. It has a vertically integrated business model and offers a number of products which apart from Pre-owned CV financing and New CV financing also includes other loans like accidental repair loans, tyre loans and working capital finance, etc.

- STFC has setup a wholly owned subsidiary Shriram Automall India Ltd. where it intends to provide showrooms for new commercial vehicles, a platform for sale of refurbished pre-owned commercial vehicles and will also facilitate sale of commercial vehicles repossessed by financing companies and for this purpose would set up touch-screen kiosks across the country, through which customers will be able to access real-time information on pre-owned vehicles available for sale.

Exhibit 1: Regional split of branches



Source: Company data

Exhibit 2: Senior management team

Name	Designation	Profile
Arun Duggal	Chairman	Experienced International Corporate Business Advisor on financial strategy, M&A and capital raising
R. Sridhar	Managing Director	Over two decades of experience in financial services sector, especially in commercial vehicle financing, joined Shriram Group in 1985 and is serving as the Managing Director since September 2000. Holds directorship in other Shriram Group companies
Umesh Revenkar	Deputy Managing Director	Joined as an Executive Trainee in 1987 and looks after operations of the CV finance business. Holds a degree in MBA Finance
Parag Sharma	CFO	Over 19 years experience in finance industry. Joined in 1992 and now heads the Finance function, a qualified Cost Accountant

Source: Company

INVESTMENT ARGUMENTS

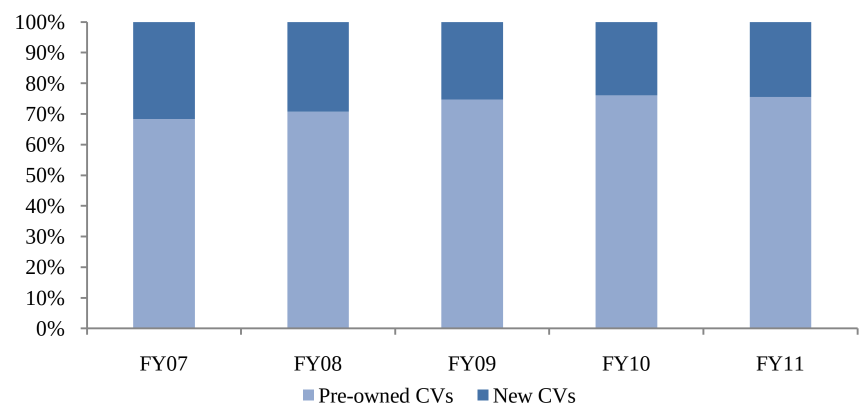
Slowing CV sales to lower AUM growth in FY12E

- The performance of India's new CV industry is directly linked to the country's macroeconomic growth, especially IIP. In contrast, the correlation of the used CV sales to the macro economy is much less, driven in part by replacement demand and by the aspiration of truck drivers to graduate to a CV owner.

- Soaring interest rates have softened the GDP/IIP growth and put pressure on new CV sales. Considering the fact that 24% (Q2FY12) of STFCs AUM embraces new CV sales, slowing economy is likely to have repercussion on its loan growth.

24% (Q2FY12) of STFCs AUM embraces new CV sales, slowing economy is likely to have repercussion on its loan growth

Exhibit 3: Bifurcation of AUM (%)



Source: Company data, SKP research

- However, we do believe pre-owned CVs are less susceptible to rising interest rates attributable to the basic characteristics of their growth drivers but prolonged slowdown in economy is most likely to hurt STFCs growth in AUM. **We expect its AUM growth to slow down to 12.5% in FY12E.**

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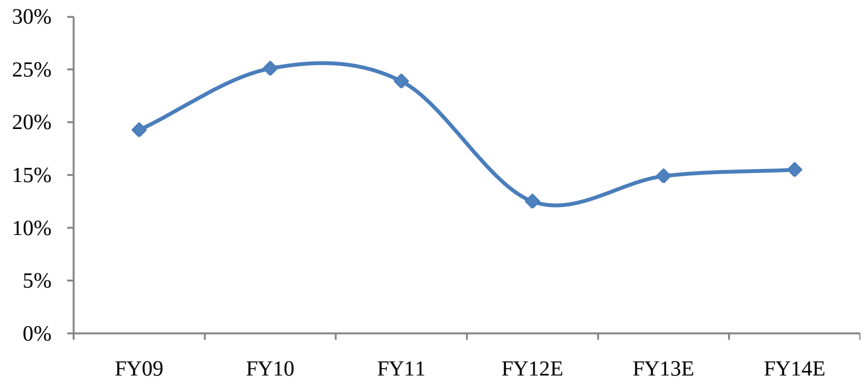
Exhibit 4: AUM growth trend



Source: Company data, SKP research

Exhibit 5: Commercial vehicles industry dynamics

	New	Pre-Owned
Year	1-5 years	>5 Years
Market size (Approximate)	370 bn	520 bn
Dominated by	Manufacturer's backed NBFC & Banks	Unorganised players
Financing focus	Manufacturer driven	Customer driven
Yields (%)	12-13	18-20
LTV	85-90%	65-70%
Operator	LTO (large truck operators)	STO (Small truck operators)
Loan tenure	3-5 years	2-4 years
Primary usage	Metros and big cities - Long hauls	Interstate and small towns
Efficiencies	Low	High
Primary growth drivers	Higher GDP / IIP growth	Increased freight rates, increasing aspirations of drivers

Source: Comany data, SKP research

Higher borrowing costs…

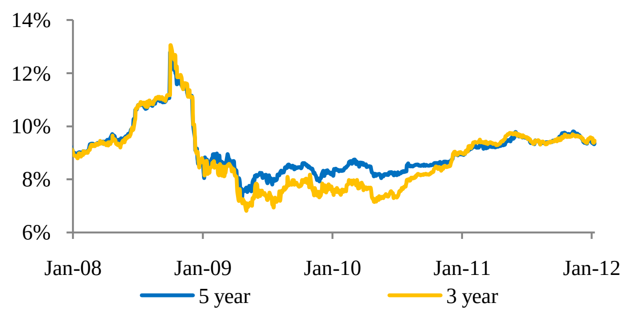
expect STFCs cost of funds to relieve in FY13E, when the liquidity scenario lightens up

- Being a wholesale funded institution the cost of funds for STFC is likely to distend with the rising interest rates. As in a rising interest rate scenario wholesale funds tend to get re-priced faster than retail funds. Although STFC does resorts to retail term deposits marginally but in the current interest rate scenario even they are competitively priced with the corporate term deposits.

- A majority of STFC's borrowings is funded by banks, since loans to NBFCs are no longer classified as priority sector lending it has eradicated a lower source of funding for STFC and thereby increased its cost of funds. As these funds are cheaper by ~75-100 bps than otherwise.

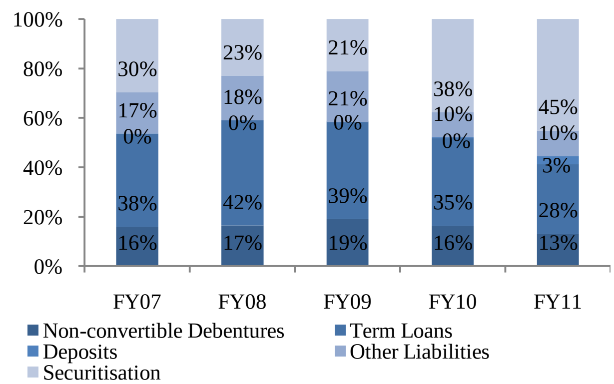
- **We expect STFCs cost of funds to relieve in FY13E, when the liquidity scenario lightens up.**

Exhibit 6: Yields on AAA bond yield



Source: Bloomberg, Company data, SKP Research

Exhibit 7: STFC's borrowing profile



Lower securitisation volumes

rationale behind securitisation is that it allows STFC to obtain funds at ~130-150 bps lower than banks funding

STFC securitised 45% of its AUM in FY11 up from 30% in FY08

- The primary rationale behind securitisation is that it allows STFC to obtain funds at ~130-150 bps lower than banks funding. Moreover, securitisation lightens the balance sheet and helps STFC in leveraging it further, thus aiding loan growth.

- STFC securitised 45% of its AUM in FY11 up from 30% in FY08. It also helps STFC to mitigate the interest risk by converting its floating liability to fixed price liability.

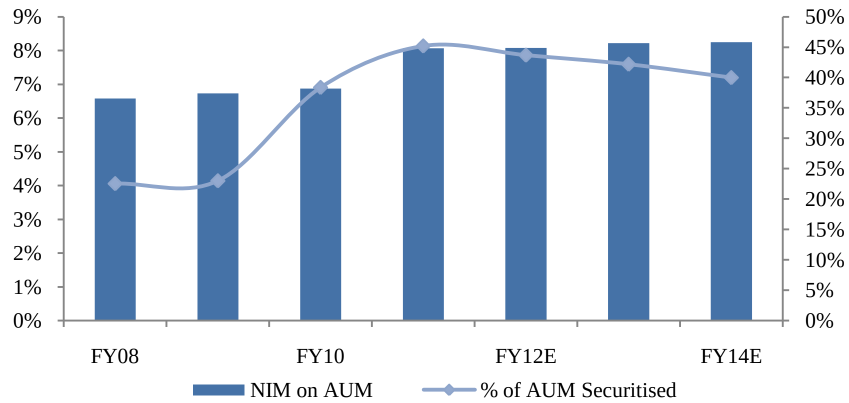
Exhibit 8: Bifurcation AUM in %

Source: Bloomberg, SKP Research

The growth momentum in securitising assets may slowdown as we expect banks to undergo stricter due diligence before accepting a priority sector loan sold down by NBFCs

- **The growth momentum in securitising assets may slowdown as we expect banks to undergo stricter due diligence before accepting a priority sector loan sold down by NBFCs and adhere to RBIs instructions. This prudence if acted upon by banks will slow down the process of selling loans.**

Exhibit 9: NIM to reduce on account of lower securitisation



Source: Company data, SKP research

Higher provisioning costs

STFC wrote off loans worth Rs. 600 mn in Q2FY12 and expected to write off additional loans worth Rs. 200 mn in Q3FY12E.

The total exposure to mining equipment vehicles is ~2% of the total portfolio.

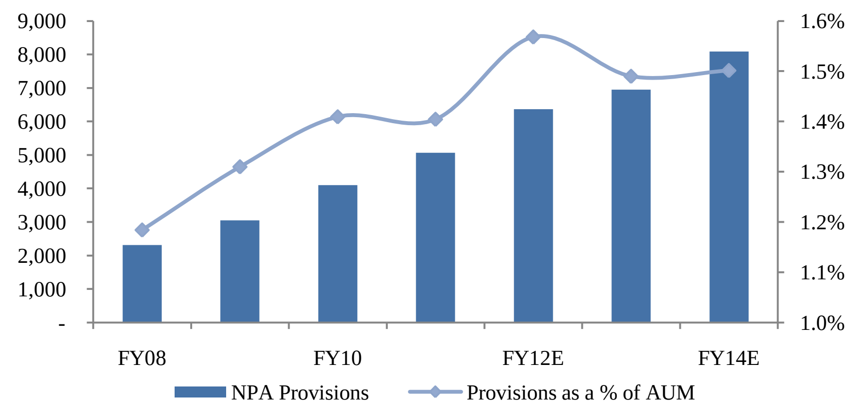
NPA recognition norm from 180 days to 90 days is also likely to add pressure to soaring NPAs

- STFCs provisioning costs are likely to rise substantially in FY12E owing to Supreme Courts interim ban on mining in the key iron-ore rich Bellary-Hospet region in Karnataka amid concerns of de-forestation and environment degradation.
- The ban on mining affected the livelihood of thousands of truck owners employed in moving iron ore. Since they were out of employment, STFC took possession of the trucks and has been trying to sell them off.
- However, if the trucks are to be sold for different uses, they would have to be appropriately retrofitted, which costs money. The market price of these trucks is sometimes lower than the value of the loans. Hence, STFC needs to write off this loss.
- STFC wrote off loans worth Rs. 600 mn in Q2FY12 and expected to write off additional loans worth Rs. 200 mn in Q3FY12E.
- The total exposure to mining equipment vehicles is ~2% of the total portfolio.
- Moreover, adherence to the proposed RBI guideline regarding the change in the NPA recognition norm from 180 days to 90 days is also likely to add pressure to soaring NPAs.

gross NPAs to rise to 2.9% in FY12E and 3.0% in FY13E owing to issues related to the mining ban, tougher NPA recognition norms and slowing economy

- **We expect gross NPAs to rise to 2.9% in FY12E and 3.0% in FY13E owing to issues related to the mining ban, tougher NPA recognition norms and slowing economy.**

Exhibit 10: Provisioning cost to increase



Source: Company data, SKP research

KEY CONCERNS

- Macro headwinds, rising policy rates, lower credit off take and liquidity scare may put further pressure on cost of funds and hamper our valuation estimates.

initiate coverage on STFC with an Accumulate rating and a target price of Rs.577 per share yielding a potential upside of 12%

VALUATIONS

- **We initiate coverage on STFC with an Accumulate rating and a target price of Rs.577 per share yielding a potential upside of 12%.** We valued STFC using Two Stage Gordon Growth model (Rf: 8.5%; Beta: 0.7; CoE: 12.5%).

- **STFC currently trades at P/BV multiple of 1.9x and 1.6x on book value per share of Rs. 265 and Rs. 320 for FY12E and FY13E respectively. Our target price is based on a target multiple of 1.8x on FY13E ABV of Rs. 312.**

correction that the stock has undergone in the last 9 months, we believe that concerns regarding the margin woes and the regulatory headwinds have been factored in.

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believe a PBV multiple of 1.8x is justifiable for STFC given 3.6% ROAA and 21.8% ROAE for FY13E.

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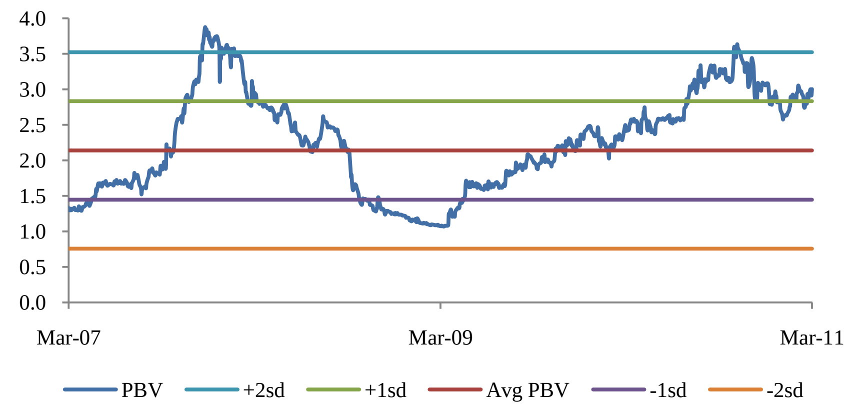
Exhibit 11: One year forward PBV



Source: Bloomberg, SKP Research

FINANCIALS

(All data in Rs. mn unless specified, Y/e March)

Income Statement	FY11	FY12E	FY13E	FY14E
Net Interest Income	**29,582**	**33,536**	**38,100**	**43,337**
Non Interest Income	1,995	1,310	1,477	1,555
Net Total Income	31,577	34,847	39,577	44,892
Non Interest Expenses	7,540	8,859	10,352	11,392
Other Provisions	5,548	7,002	7,661	8,900
Pre-tax Income	18,489	18,986	21,564	24,600
Tax Provisions	6,190	6,265	7,116	8,118
Post-tax Income	**12,299**	**12,721**	**14,448**	**16,482**

Balance Sheet	FY11	FY12E	FY13E	FY14E
Net worth	49,044	59,979	72,398	86,566
Loan funds	198,817	249,194	270,554	292,198
Current liabilities & provisions	68,223	75,046	79,548	84,321
Total Liabilities	**267,040**	**324,240**	**350,102**	**376,519**
Investments	36,507	44,855	48,700	52,596
Current assets, loans & advances	78,631	83,134	87,018	83,782
-Cash and Bank balances	36,251	27,732	26,917	18,920
-Loans & advances	41,800	54,823	59,522	64,284
Fixed Assets (net)	384	413	453	506
Commercial vehicle loans	198,656	254,280	284,793	324,664
Other assets	1,906	1,537	1,537	1,537
Total Assets	**316,084**	**384,219**	**422,500**	**463,085**

Ratios	FY11	FY12E	FY13E	FY14E
NIM (%)	8.1	8.1	8.2	8.2
Other Inc. / Net Total Inc. (%)	6.3	3.8	3.7	3.5
Efficiency ratio (%)	23.9	25.4	26.2	25.4
Gross NPA (%)	2.6	2.9	3.0	3.0
Net NPA (%)	0.4	0.5	0.6	0.6
ROAA (%)	4.2	3.6	3.6	3.7
ROAE (%)	28.1	23.3	21.8	20.7
CAR (%)	25.0	24.0	25.1	26.3
Tier I (%)	16.7	17.3	19.0	20.8
P / BV (x)	2.4	1.9	1.6	1.3
P / ABV (x)	2.4	2.0	1.6	1.4
P / E (x)	9.5	9.1	8.0	7.1
BVPS (Rs.)	216.8	265.2	320.1	382.7
ABVPS (Rs.)	213.5	259.4	312.4	373.8

Du Pont Analysis	FY11	FY12E	FY13E	FY14E
Net Interest Income	10.1	9.6	9.4	9.8
Non Interest Income	0.7	0.4	0.4	0.4
Net Total Income	10.8	10.0	9.8	10.1
Non Interest Expenses	(2.6)	(2.5)	(2.6)	(2.6)
Other Provisions	(1.9)	(2.0)	(1.9)	(2.0)
Tax Provisions	(2.1)	(1.8)	(1.8)	(1.8)
ROAA	**4.2**	**3.6**	**3.6**	**3.7**
Leverage (x)	6.7	6.4	6.1	5.6
ROAE	**28.1**	**23.3**	**21.8**	**20.7**

The above analysis and data are based on last available prices and not official closing rates. SKP Research is also available on Bloomberg, Thomson First Call & Investext Myiris, Moneycontrol, Ticker plant and ISI Securities

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SKP Securities Ltd

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