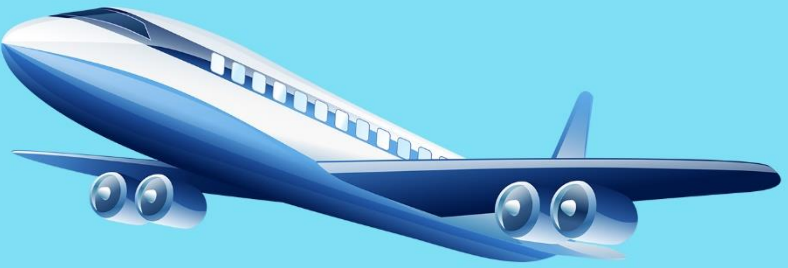


SHRIRAM TRANSPORT FINANCE COMPANY

Sole Player in the Jungle

INITIATING COVERAGE

DATE: July 12, 2018

Initiating Coverage

NALANDA RESEARCH

BUY

July 12, 2018

Shriram Transport Finance Company

Downside Scenario	Current Price	Price Target	Upside Scenario
	1206	1643	
		36% ▲	

Incorporated in 1979, Shriram Transport Finance Company (STFC) is part of Shriram conglomerate and is a market leader in pre-owned vehicle financing having a market share of 25-26%. Furthermore, the company commands a market share of 61% in pre-owned financing of heavy commercial vehicles which constitutes 47% of AUM (FY18). Company embarked its journey with an aim to finance neglected single truck operators and as of today operates through 1213 branches and 862 rural centers serving 18.6lac customers while managing an AUM of INR 953bn (FY18). We expect CV financing industry to witness robust growth driven by improved manufacturing demand, equitable monsoon forecast, higher logistic demand driven by ecommerce industry, demand of higher tonnage vehicle and better road connectivity. We estimate STFC's AUM to grow 17% CAGR FY18-20E to 1312bn. We also estimate revenue, operating profit and PAT to grow at 20%, 18% and 21% respectively over FY18-20E. We believe recent correction to be a good entry point for investors given financial impact of SVL's NCD issue (if invoked). At CMP of INR 1206, we initiate with a BUY rating giving target price of INR 1643 implying upside of 36%.

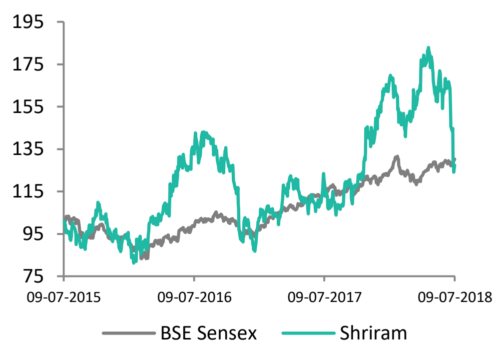
Stock Details	
Industry	BFSI
Sensex	36265
Nifty	10648
Bloomberg Code	SHTF:IN
Eq. Cap. (Rs. Crs.)	227
Face Value (Rs.)	10
52-w H/L	1668/917
Market Cap (Cr.)	27362

Valuation Data			
	FY18A	FY19E	FY20E
NIM	7.7%	7.8%	7.7%
Book value	554	626	719
P/E (x)	17.4	14.9	11.9
P/BV (x)	2.2	1.9	1.7
P/ABV (x)	5.1	5.4	4.2

Differential & Dominant presence in pre-owned CV financing

STFC's closest peers are Cholamandalam Investment & Finance Company (CIFC) and Mahindra & Mahindra Financial (MMF). STFC has total AUM exposure of INR 645bn towards CV financing (new CV: 77bn, pre-owned CV: 567bn) and branch count of 1213. CIFC and MMF has total AUM exposure of INR 168bn (new CV: 129bn, pre-owned CV: 39bn) and INR 121bn (new CV: 77bn, pre-owned CV: 44bn) respectively towards CV financing. CIFC has 873 branches and MMF has 1284 branches. STFC's 567bn v/s CIFC's 39bn & MMF's 44vn suggest differential & dominant presence in pre-owned CV financing.

STFC Vs SENSEX



Deep penetration and hold in HCV segment

STFC manages assets of INR 953bn, of which HCV constitutes 47% of total assets under management. While financing of new vehicles constitute 12% of HCV AUM, that of pre-owned vehicles constitute 88% of HCV AUM. STFC commands 23% market share in the new HCV financing space and 61% market share in pre-owned HCV financing.

Presence of deep moat

It is estimated that 80% of trucks are owned by individuals, thus for any competitor to get hold of the truck market would entail tapping these single operators, which requires considerable effort and duration. Further, STFC has cultivated its strong hold due to 39 years of persistent relationship building. Additionally, STFC's 18.6lac customers having average ticket size of INR 5.1lacs provide enormous diversification benefit. Furthermore, STFC's conscious effort of providing loans at lower than industry rate (average yield – 15.2% in FY18 v/s CIFC – 16.9%) has helped company retain customers and continue to attract new customers through word of mouth publicity. Commingled, this formulates into a deep moat for the company.

Shareholding Pattern			
	Q4FY18	Q3FY18	Q4FY17
Promoters	26.1	26.1	26.1
FIIs	49.5	49.7	47.4
DIIs	4	3.5	2.2
Retail	20.4	20.7	24.4

Robust AUM growth on back of strategic branch addition & higher disbursement per branch

STFC added 295 branches in FY18 to take its branch count to 1213. Company is further planning to add 200 branches in FY19. We expect branch addition to take place in lesser penetrated areas such as rural areas of northern India, which also typically have higher yields. We estimate higher disbursement per branch to eventually improve AUM per branch from 78.6cr in FY18 to 79.9cr & 79.4cr in FY19 & FY20. We also estimate revenues per branch to improve from 10.0cr in FY18 to 10.4cr & 10.5cr in FY19 & FY20.

18%	18%	21%
Total Operating Income Growth CAGR FY18-20	PPP Growth CAGR FY18-20	PAT Growth CAGR FY18-20

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Best in class operational efficiency

Company's cost to income ratio has hovered in the range of 22-26% while peers have reported cost to income ratio of 43% (CIFC) and 40% (MMF) respectively. This is apparently due to company's unique approach of opening rural centers as oppose to branches. Typically, rural centers have 1-2 employees on rented land with minimal infrastructure. These centers are later converted into branches depending on demand and opportunity prevailing in the area. Currently, company has 862 rural centers.

Valuation

STFC's market is expected to grow at 16% on the back of a) revival in the manufacturing sector, b) increasing demand of consumer goods on retail side, c) logistics demand from ecommerce industry and d) better road connectivity due to infrastructural push by the government. We expect STFC AUM to grow at 19% in FY19 due to strategic placement of branches. Company is expected to maintain constant NIMs despite rise in borrowing cost a) due to single operator customer base b) fixed-rate borrowing.

In terms of risk, we foresee impact of events such as a) rise in oil prices b) farmer's strike and c) overloading ban to be of ephemeral nature.

With robust market growth, stable NIMs, best in class operational efficiency and undergoing reduction in credit cost, we expect STFC to undergo re-rating. At CMP of INR 1206, stock is trading at P/BV of 1.7x on FY20E book value of 719. We assign P/BV of 2.3x and arrive at a target price of INR 1643 with an upside potential of 36%.

(INR crores)	FY15	FY16	FY17	FY18	FY19E	FY20E
Interest Income	7778	9530	9801	11003	13434	15994
Growth	*24%*	*23%*	*3%*	*12%*	*22%*	*19%*
Net Interest Income	3375	4456	4592	5595	6725	7875
Growth	*42%*	*32%*	*3%*	*22%*	*20%*	*17%*
Total Operating Income	4129	5094	5528	6746	8084	9467
Growth	*13%*	*23%*	*9%*	*22%*	*20%*	*17%*
Provisions	1278	2071	2444	3122	3607	4012
PAT	1238	1178	1257	1568	1836	2301
Growth	*-2%*	*-5%*	*7%*	*25%*	*17%*	*25%*
Book Value (INR)	407	448	498	554	626	719
P/BV (x)	2.5	2.3	2.2	2.2	1.9	1.7

Concerns pertaining to SVL and Shriram group consolidation

SVL: SVL is an investment company with investments ranging from energy companies to manufacturing companies. During 2015, SVL raised 650cr backed by STFC which is expected to mature in June, 2019. Recently, founder of Shriram group commented on fulfilling the dues via Shriram ownership trust if in case SVL defaults. Trust valuation, according to him, is pegged to be around INR 200-300 billion. Nonetheless, assuming STFC bears full financial burden and provides for 100% provisioning, financial impact of the event would result in 5% (38/share) fall in FY20E book value, which we think has already been priced by the market.

Consolidation: Shriram group had considered proposition of merger during last year so as to diversify its risk but it did not transpire. There is prevailing speculation that group is mulling on the same again. To address the concern, founder of the group clarified that any activity going forward would only be considered, if in best interest of minority shareholders.

Refer page no 22 and 23 for more information

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Investment Rationale

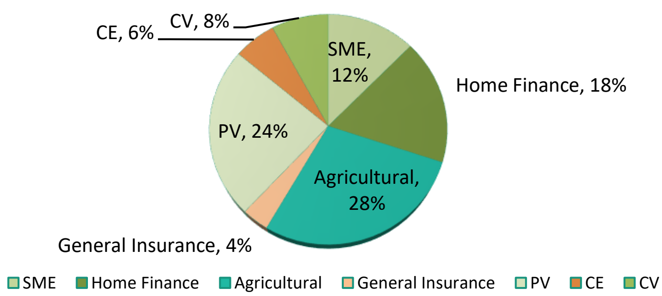
1. Differential & Dominant presence in pre-owned CV financing

Market size of CV financing

- CV financing includes financing of new vehicles and pre-owned vehicles. In FY18, approximately 8.5 lac commercial vehicles entered into the Indian market. Out of 8.5lac vehicles, 3.4 lacs were M&HCV and 5.1 lacs were LCV & buses. With a weighted average ticket size of 8.5lacs, we estimate market size of new vehicle financing at ~72,000cr.
- Pre-owned vehicle financing: It is estimated that there are 80 lacs commercial vehicles on road. This is based on the assumption that a typical commercial vehicle last for 12-15 years and changes hands 3-4 times.

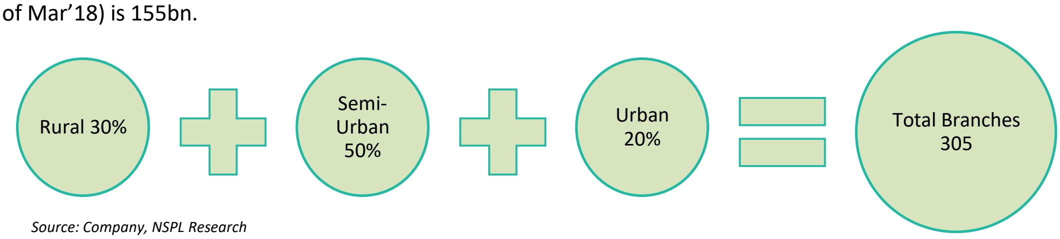
Relative placing of Shriram with respect to its peers

- Prima facie there are four major players in commercial vehicle financing space. We have categorized them on the stage of financing they cater to, i.e. first stage financier [which principally *focuses* on financing inputs/raw materials] and second stage financier [which principally *focuses* on financing machines & vehicles].
- **First stage financier** category consists of Magma Fincorp ltd. It is a Kolkata based NBFC and largely caters to retail entrepreneurs. Specifically, its AUM is bifurcated 47% towards business loan (SME, Agricultural, CE), 32% towards vehicle financing (PV, CV) and 23% towards Home finance & Insurance.



Source: Company, NSPL Research

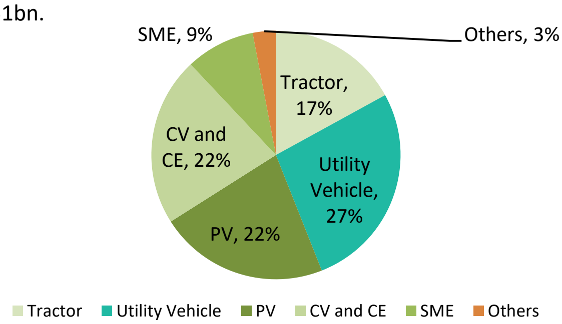
- Company operates in rural, semi-urban and urban areas, and has 305 branches as of Mar'18. Asset under management (as of Mar'18) is 155bn.



Source: Company, NSPL Research

- Company's CV financing business constitutes ~ 8% of AUM of which entirely 8% is into financing of new vehicles. AUM attributed to new CV financing is 12.4bn v/s STFC 77.4bn, whereas company is not into financing of pre-owned commercial vehicles, into which STFC has AUM exposure of 567bn. We, thereby, conclude Magma and STFC operate in different sub-sectors of CV financing space.

- **Second stage financiers** category consists of Mahindra & Mahindra Financial (MMF), Shriram (STFC) and Cholamandalam Investment & Finance company (CIFC).
- **Mahindra and Mahindra Finance (MMF)** is one of India's leading NBFC focused in rural and semi-urban sector and is one of the largest tractor financing company in India. It largely caters to agricultural industry in India. Specifically, its AUM is bifurcated 44% towards agricultural loans (includes UV financing), 44% towards vehicle financing and 12% towards business loans. AUM (as of Mar'18) is 551bn.



Source: Company, NSPL Research

- Company majorly operates in rural and semi-urban areas, and has 1284 branches as of Mar'18.
- Company's CV financing business contributes ~22% of AUM of which 14% is financing of new CVs and 8% is financing of pre-owned CVs. AUM attributable to new CV financing is 77.2bn v/s STFC 77.4bn and AUM attributable to pre-owned CV financing is 44bn v/s STFC 567bn.

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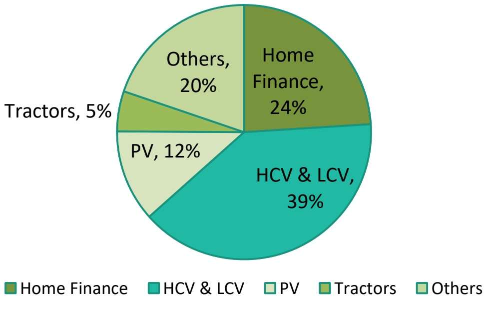
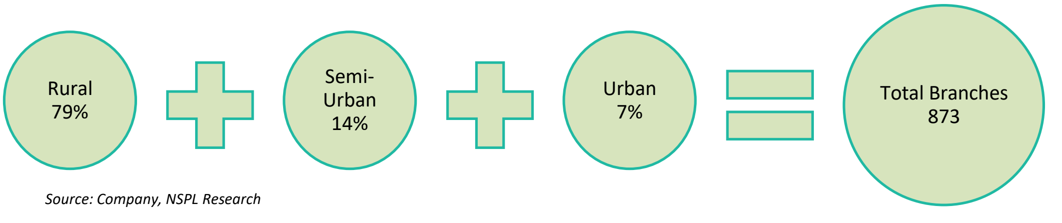
- MMF focuses on financing of newer vehicles more than of pre-owned vehicles. Company 's business model is to tie-up with vehicle manufacturers and enable financing to customers who seek to purchase these new vehicles. Whereas, STFC focuses on financing of pre-owned vehicles (especially trucks), which as per our research suggests , is in the hands of individuals and single operators (more than 80% vehicles).
- This denotes a key distinction between business model of MMF and STFC. While, MMF connects with vehicle manufacturer and disburses funding, STFC operates on a customer base (it maintains customer base) and helps them to purchase vehicles. Also, MMF looks to finance *new vehicles* with *near equal* AUM share in UV, PV and CV whereas STFC primarily focuses on financing of *pre-owned vehicles* with substantial inclination *towards HCVs*.
- Therefore, we conclude MMF and STFC principally targets two different markets. While MMF is prominent NBFC player catering to new vehicle financing, STFC is controlling significant market share in pre-owned vehicle financing space.
- As a result of different approaches of two companies, **their operational efficiency vary widely**. **MMF's cost to income ratio is 40% as against STFC's cost to income ratio of 22%. STFC operates via rural centres as oppose to branches** because of customer focused business model. Rural centre has 1-2 employees on a rented land (mostly) and minimal infrastructure. When employees achieves certain minimum clients, more employees are deployed. Once company foresee visibility in terms of revenue and growth, centre is converted into branch. This approach would not be suitable for MMF's business model.

- **Cholamandalam Investment and Finance Company (CIFC)** is part of 300bn Murugappa group. Company was established in 1978 and is one of India's leading NBFC in asset financing business. Specifically, its AUM is bifurcated 24% towards housing loans, 39% towards commercial vehicle loans, 17% towards other vehicle financing (PV, tractors) and 20% towards others (refinancing, business loan). AUM (as of Mar'18) is 429bn.



Source: Company, NSPL Research

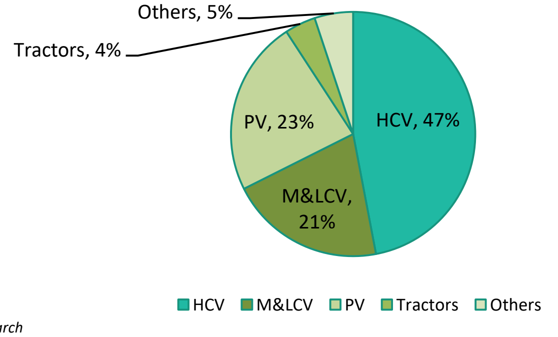
- Company operates in rural, semi-urban and urban areas, and has 873 branches as of Mar'18.



Source: Company, NSPL Research

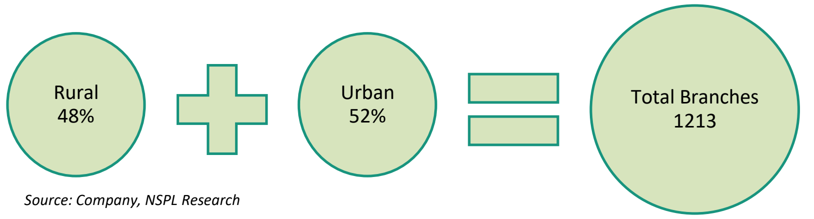
- Company's CV financing business contributes 39% of AUM, of which 30% is financing of new vehicles and 9% is financing of pre-owned vehicles. AUM attributable to new CV financing is 129bn v/s STFC 77.4bn and AUM attributable to pre-owned CV financing is 39bn v/s STFC 567bn.
- CIFC & MMF has similar business model, although, CIFC is more dominantly present in CV financing space as compare to MMF.

- **Shriram Transport Finance Company (STFC)** is part of Shriram conglomerate, established in 1979 to finance single truck operators. Largely, STFC is HCV focused company. Specifically, its AUM is bifurcated 47% towards HCV, 21% towards M&LCV, 23% towards PV, 4% towards tractors and 5% towards others (SME loans). AUM (as of Mar'18) is 953bn.



Source: Company, NSPL Research

- Company operates in rural and urban areas, and has 1213 branches as of Mar'18. Additionally, company has 862 rural centres.



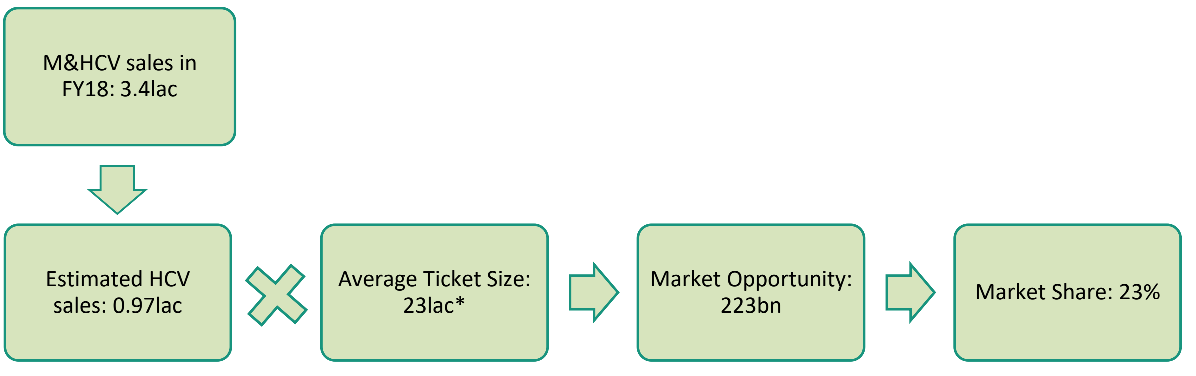
Source: Company, NSPL Research

Conclusion: Since STFC focuses on pre-owned vehicle financing and other peers focuses on new vehicle financing, STFC is a differential player and due to high AUM of INR 567bn v/s CIFC's 39bn & MMF's 44bn, STFC is also a dominant player in pre-owned CV financing space. Consequently, success of STFC's business model hinges on granular customer base (existing – 18.2lac customers) and deeper penetration in the market. For STFC to maintain its hold, it should corner higher percentage of market share to safeguard its growth story going forward.

2. Grip of STFC in its market

- As of Mar'18, Shriram has asset under management of 953bn. HCV constitutes 47% of total AUM which amounts to ~44,790cr, of which new vehicles corner 5186cr and pre-owned vehicles corner 39605cr.

Market share in new HCV financing

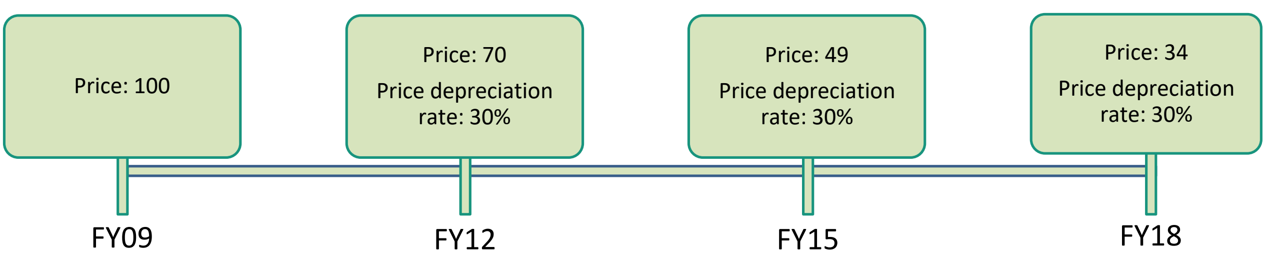


**Assuming LTV: 100% for minimum market share*
Source: NSPL Research

Market share in pre-owned HCV financing

- Typically, life span of HCV is 12 years and it changes hand every 3 years. This means that one vehicle is financed four times in its lifetime. At a stretch, last stage pre-owned vehicle financed in FY18 would have entered the market in FY09.
- Pricing of pre-owned vehicle is done based on depreciation rate which, as per norms, is 30%. As per our estimates, we have arrived at weighted average discount rate of 49% on today's market price of new vehicle.

Pricing of vehicle in subsequent years



Source: NSPL Research

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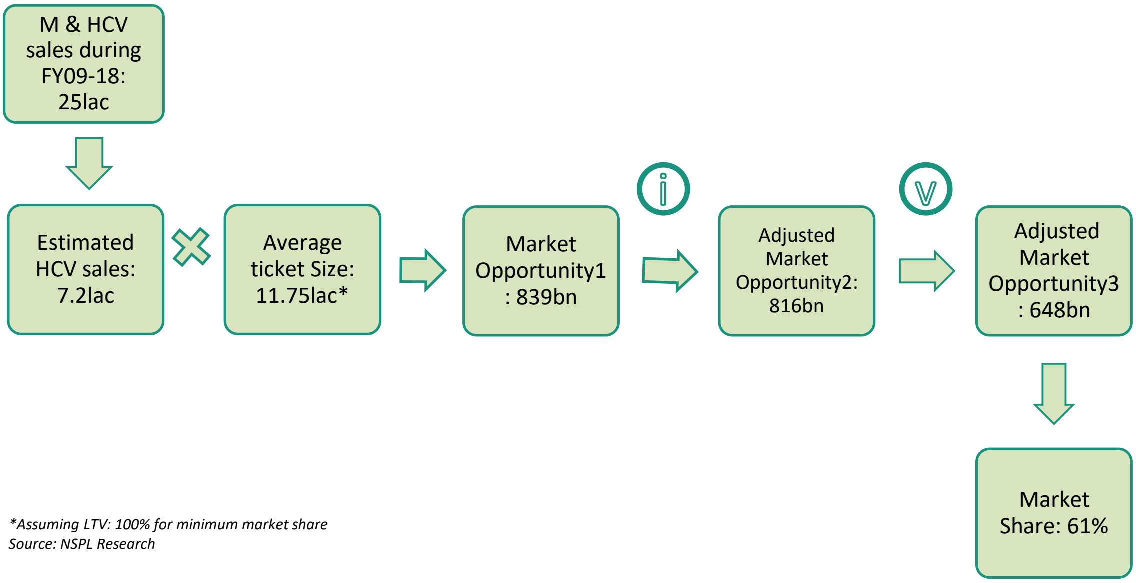
- Market opportunity1 for pre-owned vehicle is adjusted for inflation (i) and further adjusted for relevant volume (v) because vehicle financed in FY17 would not be available for financing in FY18. Thus after subsequent changes are incorporated, market share turns out to be 61%.



**Assuming LTV: 100% for minimum market share*
Source: NSPL Research

Conclusion: STFC has market share of 23% in new HCV financing and 61% market share in pre-owned vehicle financing. This suggest strong grip of STFC in its respective market.

3. Presence of Moat

- **Staggered market**: We found 80% of trucks are in the hands of individuals. They are mostly single operators. So, any competitor who plans to tap into STFC market of pre-owned vehicles would have to focus on building customer base instead of tying-up with vehicle producer.
- This would require competitors to provide loans at lower than industry rate in initial stages and account lower than industry NIMs and on top of that STFC is already disbursing loans at lower rates (had average loan yield of 15.2% while managing AUM of 953bn, whereas CIFC had average yield of 16.9% while managing AUM of 429bn during FY18). This culminates into **domino effect** which leads STFC to further enhance its grip in the vehicle financing space.
- **Diversification due to granular customer base**: STFC has 18.2lac customers on AUM of 953bn translating into AUM per customer of 5.2lac providing enormous diversification benefit for company.
- **Credible brand**: STFC has been in operations from last 39 years. This attaches credibility & reliability with brand of STFC. Additionally, in this business soft recovery mechanism plays a crucial role. There are few unorganized small private financiers who not only charge exorbitant rates but also have *cruel* recovery system in place. This gives STFC a trustworthy image in the mind of existing customer/prospective customer.

	STFC	Magma	MMF	CIFC
AUM (CV Financing) (INR bn)	645	12	121	168
AUM (Pre-owned CV)	567	0	44	39
Branches	1213	305	1284	873
NIM %	7.7	8.8	8.8	8.1
Cost to Income ratio (%)	22.1	53.2	39.7	42.6
Provision Coverage ratio (%)	71.1	27.2	58.1	43.5
ROA (%) (Total)	1.9	1.5	1.9	3
ROE (%) (Total)	13.1	10.4	11.3	20.8

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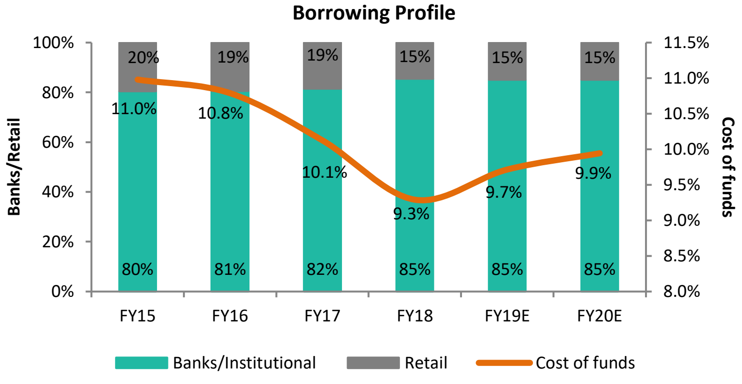
Operations

Funding source & its associated cost

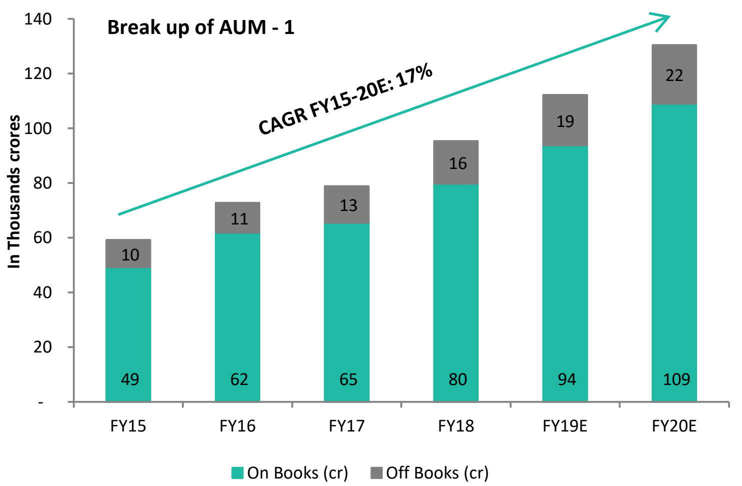


Source: Company, NSPL Research

Borrowing profile highlights source of funding and associated cost of funds. Company borrowed 15% from retail side and remaining 85% from banks & institutions. Going forward company would seek capital for funding its AUM growth and to add 200 & 240 branches in FY19 & FY20 respectively. We expect company to grow its borrowings by 18.1% & 18.3% in FY19 & FY20, considering that the existing cash balance of 3,638cr.

With regard to cost of funds, incremental cost of raising funds is expected to witness uptick given rise in interest rate regime. We have incorporated this by expanding cost of funds by 40bps from 9.3% in FY18 to 9.7% and 9.9% in FY19 and FY20.

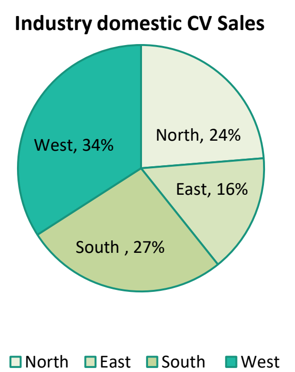
Asset under management in line to achieve double digit growth



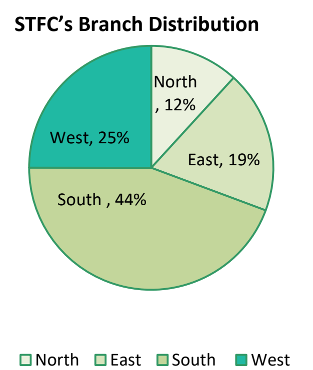
Source: Company, NSPL Research

AUM is bifurcated into On-book AUM and off-book AUM. On-book AUM constitutes 84% of total AUM, while Off-book AUM constitutes 16% of total AUM. As per management, Off-book AUM (securitization) is cheaper (cost of fund – 8-8.25%) way of raising capital. Company raises money from banks, who participate in these rounds to achieve 40% priority lending target as per RBI norms. Company typically pool HCV assets (rated AAA) and issues them as pass through certificates to banks. Company earns income as management fees, servicing fees & interest spread over Off-book AUM.

Historically, AUM grew at CAGR 17% over FY15-18. We expect similar growth till FY20. Additionally, we expect STFC being a market leader and due to its strategic branch placing to grow above industry rate at 19% in FY19 while we expect market of STFC to grow at 16% in FY19.



Source: NSPL Research



Source: Company, NSPL Research

Currently STFC has 1213 branches with above branch distribution in various regions. Interestingly, industry domestic CV sales has had very similar sales distribution as evident from above graph. West & South regions contribute 61% of total domestic CV sales and STFC has 69% of its branches in these two regions. Going forward, we expect company to increase its presence in unpenetrated regions such as northern India, and also benefit from higher yields in this region. Subsequently, we expect AUM growth of 19% in FY19, improvement in AUM per branch from 78.5cr in FY18 to 79.9cr in FY19 and improvement in revenues per branch from 10.0cr in FY18 to 10.4cr in FY19.

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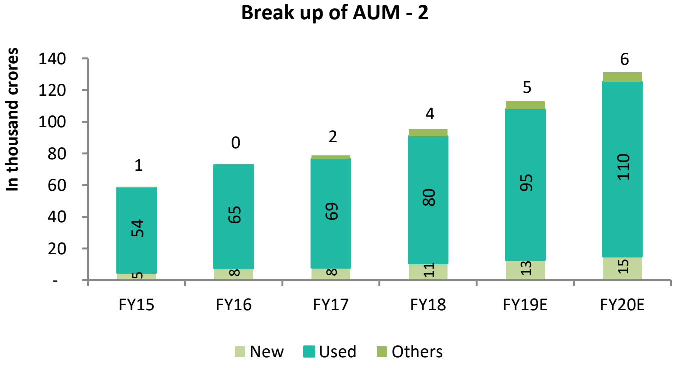
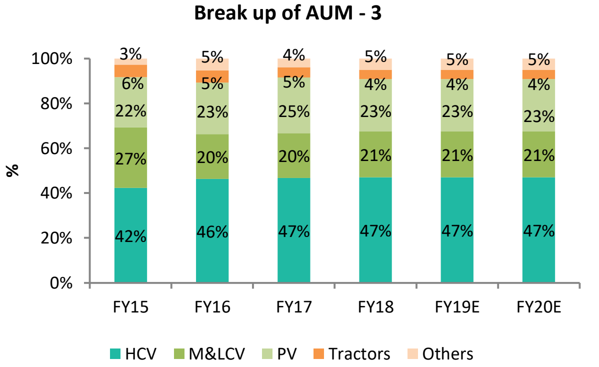
AUM distribution by vehicle-type

Company's AUM comprises 84% lending towards used vehicles, 11% lending towards new vehicles segment and 5% lending for MSME loans as of Mar'18. We expect similar trend to continue going forward.

Further, company's AUM comprises of 47% loans in HCV segment, 21% loans in M&LCV segment, 23% loans in PV segment, 4% loans in tractors & 5% loans in others (business loan). Average yield on loans ranges from 12% to 24%. Yield charged is dependent on condition of vehicle and customer profile. It is observed that HCV and PV segment has garnered higher yields.

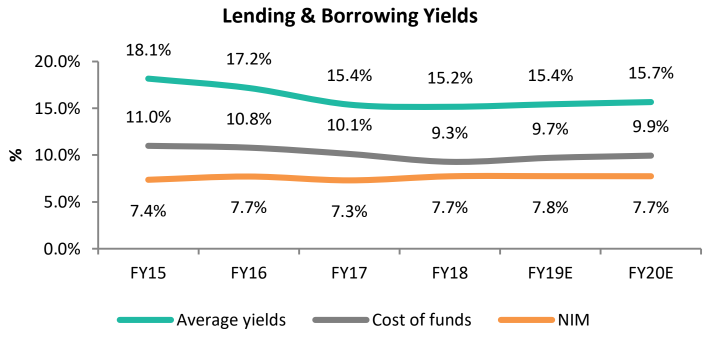


Source: Company, NSPL Research



Source: Company, NSPL Research

Constant NIM despite cost uptick

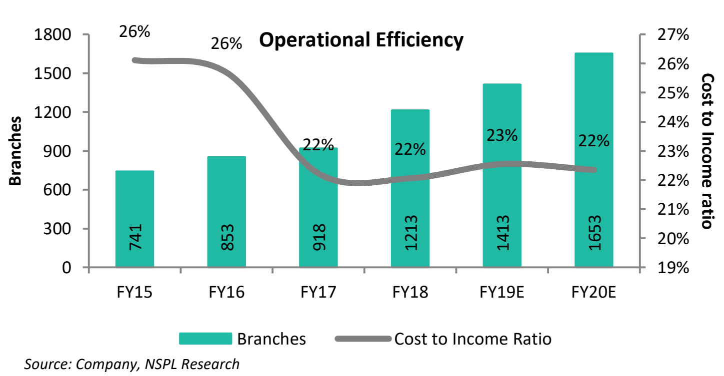


Source: Company, NSPL Research

Macro economically interest rates are on a rise. We have incorporated incremental rise in borrowings by expanding average cost of funds by 40bps. Company provide loans primarily to single vehicle operators (average ticket size 5.1lac) and can simply pass the hike. Additionally, company is focusing on higher yield segments such as HCV and PV. Therefore, we conservatively we expect NIM to remain constant due to near constant yields 15.2-15.7%. However presence in northern region and focus on HCV & PV segment are expected to outrun our assumption.

Best in class operational efficiency

Company's cost to income ratio has hovered in the range of 22-26% while peers have CI north of 35%. Company's unique approach (specific to its market) has allowed for such low margins.

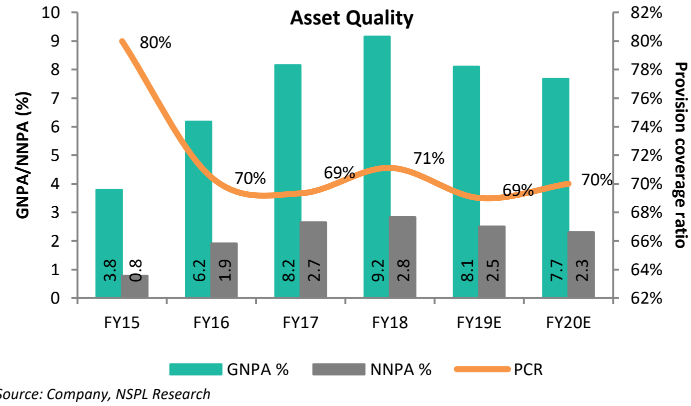


Source: Company, NSPL Research

Since company is customer focused and operates via huge customer base (18.2lacs as of Mar'18), company ventures into new areas by opening centres as oppose to branches. These centres have 1-2 employees on a rented land with minimal infrastructure. When these employees achieve certain minimum clientele, more employees are deployed. If centres gives sufficient visibility in terms of revenues & profits, these centres are then converted into branches. This approach not only saves cost but also reduces uncertainty with respect to future revenues.

We expect CI ratio to witness 50bps expansion due to rise in employee cost (due to 200 additional branches in FY19). However, we also expect company to realize economies of scale in FY20 and revert back to 22% level.

Asset Quality



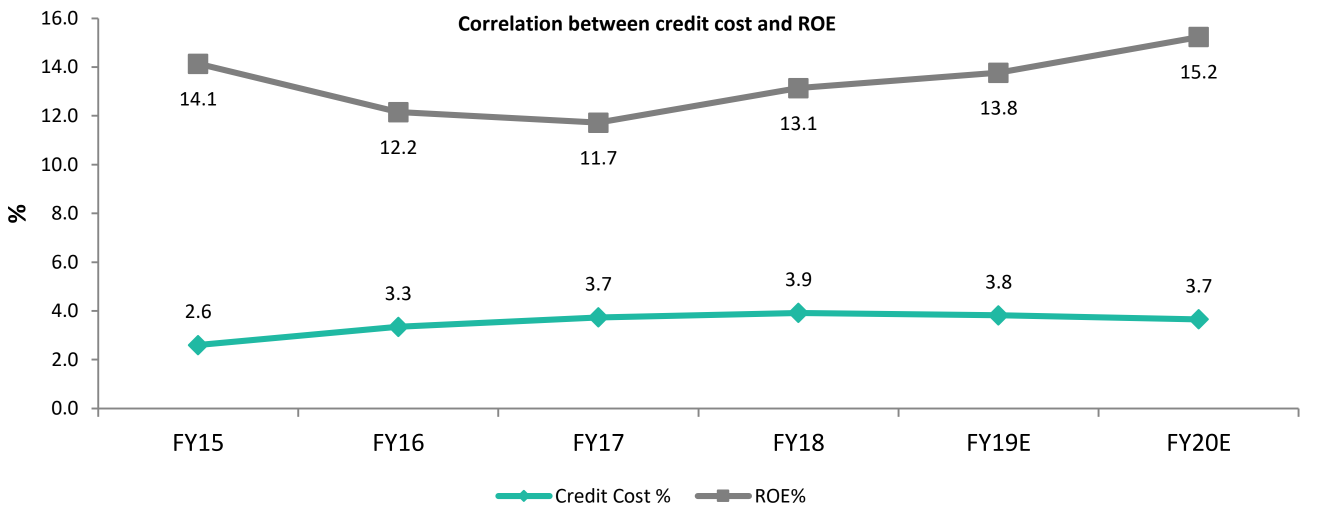
Source: Company, NSPL Research

Company followed 180 day NPA recognition in FY15 which pruned down to 150 day in FY16, 120 day in FY17 and 90 day in FY18. Also, company throughout has maintained provision coverage ratio north of 70%. These stern accounting executions resulted in expansion of credit cost from 2.6% to 3.9%.

Gross NPA & NNPA was 9.15% & 2.83% in FY18. Asset Quality of peers: MMF (GNPA – 8.5%, NNPA – 3.8%, PCR – 58%), Magma (GNPA – 7%, NNPA – 5.2%, PCR – 26%) and CIFC (GNPA – 2.9%, NNPA – 1.7%, PCR – 44%)

Asset Quality commentary:

- In Q3FY18 Gross NPA was 6,046cr, they catapulted to 7,376cr in Q4FY18. Accretive GNPA of 1330cr was due to a) slippages of 195cr and b) due to transition to 90 days norms amounting to 1135cr.
- Management has mentioned that their customer base mostly consists of small single operators who earn their daily living by transporting goods & passengers in vehicles they purchase though financing. Therefore, recovery system is expected to be robust.
- Also, company has cited that 90 day norm would remain only an accounting norm and would not be enforced on customers because its customer base largely consists of single vehicle operator and has been accustomed to 180 day norm and recovery schedule.
- Therefore, we expect GNPA & NNPA numbers to remain inflated, however, we also expect low material impact of these numbers on company's operations.
- We also expect marginal fall in slippages due to economic revival aided by good monsoon. We estimate GNPA & NNPA to reduce to 8.1% & 2.5% in FY19 and 7.7% & 2.3% in FY20 and earmark provision coverage ratio of 69% & 70% in FY19 & FY20.
- As a result, credit cost is expected to slide from 3.9% in FY18 to 3.8% & 3.7% in FY19 & FY20. Interestingly, fall in credit cost by 3% & 4% YoY in FY19 & FY20 would result in expansion of return on equity by 5% & 10% in FY19 & FY20.



Source: Company, NSPL Research

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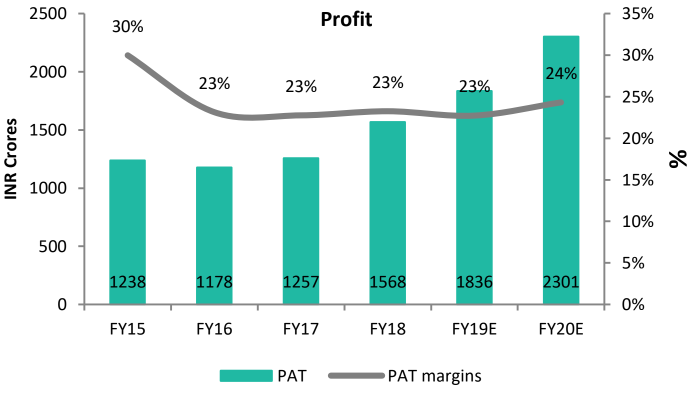
Robust bottom line growth



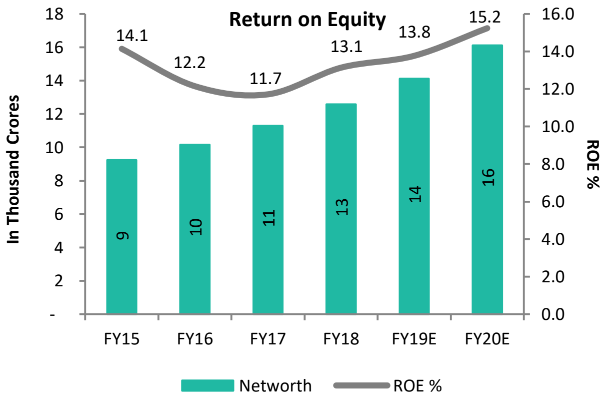
Source: Company, NSPL Research

Company reported PAT of 1568cr in FY18. PAT grew at moderate CAGR of 8.3% over FY15 to FY18 due to significant increase in credit cost. We do not expect further strictness in NPA norms. We also estimate bottom line to reflect revenue growth and improvement in credit cost going forward. We estimate bottom line to grow by 17% & 25% in FY19E & FY20E respectively.

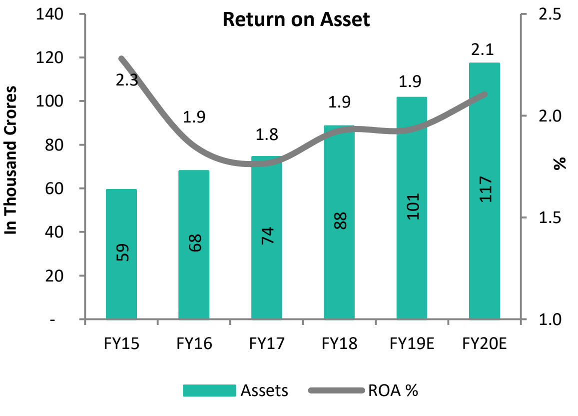
In spite of stringent implementation, company has consistently maintained margins around 23%. We expect similar trend to continue in FY19, and slight improvement to 24% in FY20 owing to reduction in cost to income ratio and credit cost.

Improvement in return ratios

	FY15	FY16	FY17	FY18	FY19E	FY20E
PAT margins	30.0%	23.1%	22.7%	23.2%	22.7%	24.3%
Asset turnover	7.6%	8.0%	7.8%	8.3%	8.5%	8.7%
Leverage	6	7	7	7	7	7
ROE	**14.1%**	**12.2%**	**11.7%**	**13.1%**	**13.8%**	**15.2%**



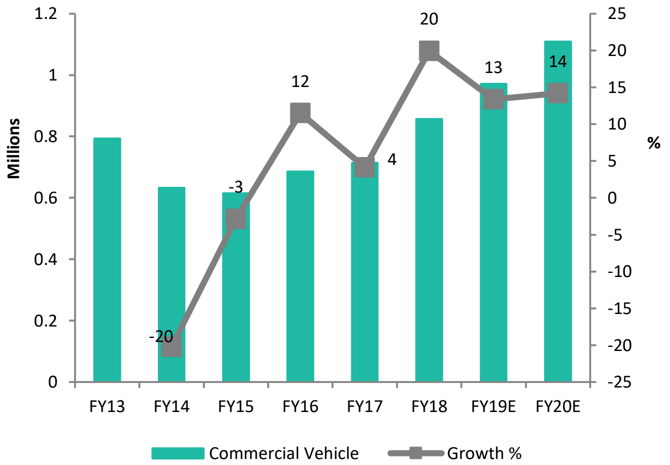
Source: Company, NSPL Research



Source: Company, NSPL Research

Industry Overview

Commercial Vehicles

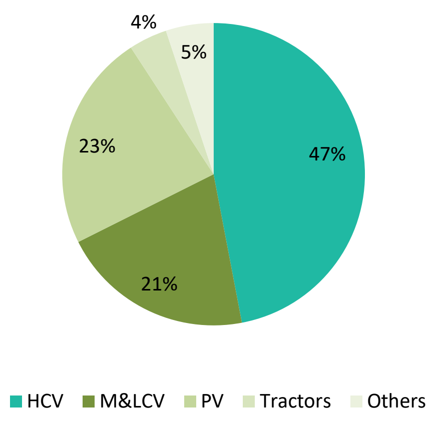


Source: NSPL Research

Commercial vehicle plays an important role in the overall economy. They transport goods and people from one location to another and exert their influence on major sectors like commodities, steel, cement & cement products, consumer goods, etc. Sales of commercial vehicle is a good indicator for measuring economic (and business) sentiment prevailing in a country. Commercial vehicles are categorized on tonnage basis as per their carrying capacity explicitly into HCV (above 16 tons), MCV (between 5 to 16 tons) and LCV (below 5 ton).

During FY14, Commercial vehicle sales were weak evident by 20% downfall from previous year. This was reflective of economic sentiment prevailing in India given deteriorating currency & widening CAD (due to surge in crude oil prices). To safeguard global investor confidence, RBI, under new Governor, introduced slew of measures. Policies like FCNR received enormous support and helped India collect $26billion in foreign inflows. This helped establish India story going forward and economy once again began flourishing. Further, formation of Narendra Modi's government at the centre boosted investor's confidence. During FY16 economic sentiment improved and cv sales reported 12% growth. During FY17 and FY18 positive momentum continued although with less intensity in FY17 (due to GST), and commercial vehicle sales reported growth of 4% and 20% respectively. We expect growth of 13% and 14% in FY19E and FY20E respectively.

STFC asset under management segment breakup:



Source: Company, NSPL Research

STFC's AUM comprises of 47% exposure towards HCV, 21%, 23%, 4% and 5% towards M&LCV, PV, tractors and others respectively. STFC AUM is also divided into 84% towards pre-owned vehicles and 11% towards new vehicles. We estimate STFC's market to grow by 16% in FY19.

High Commercial Vehicles

This segment contributes 47% in total AUM. Company facilitates businesses/operators by providing loans for purchase of vehicles. We forecast growth in this segment on following metrics a) Demand of vehicles from operators and b) Supply of vehicles in the market (including used and new vehicles).

We expect demand from operators to be driven by growth sectors such as commodity, mining, manufacturing. Our rationale is increase in production (or capacity) in these sectors would drive demand of vehicles for transportation of material.

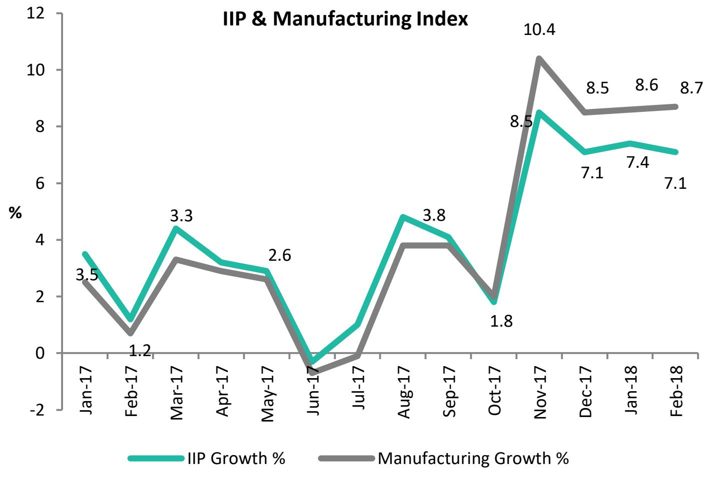
We estimate supply of vehicles by determining quantity of vehicles sold in previous years (for pre-owned vehicles) and quantity of vehicles to be sold in next year (for new vehicles).

Demand from operators

We expect demand from a) Wholesale side and b) retail side. Wholesale side primarily includes demand from manufacturing and mining sector. Our rationale is as companies foresee opportunity (due to improvement in business sentiment), they operate at higher utilization levels and install more capacities. This increases transportation of goods and thereby improves demand of high commercial vehicle.

Retail side primarily includes demand of goods & services from individuals. This depends on consumption sentiment and is function of spending done by individual. Our rationale is as economy revives, bottom line of businesses improve. This results in higher dividends for shareholders and improvement in personal disposable income of employees. Similarly, we also expect disposable income of rural sector to improve on back of normal monsoon forecast. This would increase spending in the economy and more products would be transported from factory to retail side. This would improve demand of high commercial vehicles.

Wholesale Demand



Source: NSPL Research

During last 18 months, India has witnessed events such demonetization and GST. Demonetization led to lack of availability of disposable cash and therefore businesses reacted by reducing their utilization levels. Impact of demonetization can be observed in IIP & manufacturing index numbers during Jan-17 to June-17. Government announced goods and service tax on 1st July 2017. In the initial months of GST, there was uncertainty regarding impact of new system on various products which resulted in businesses selling their inventory at discounts. Impact of which can be observed during July-17 to Oct-17. From Nov-17, doubts cleared for few products and businesses started manufacturing.

Recently, economy has witnessed four consecutive periods of 8.5%+ manufacturing growth and 7%+ of IIP growth attributable to a) revival in business sentiment and b) low base. We expect short term growth rate to be influenced by following factors:

a) Elections of central government (India)
b) US-China trade war

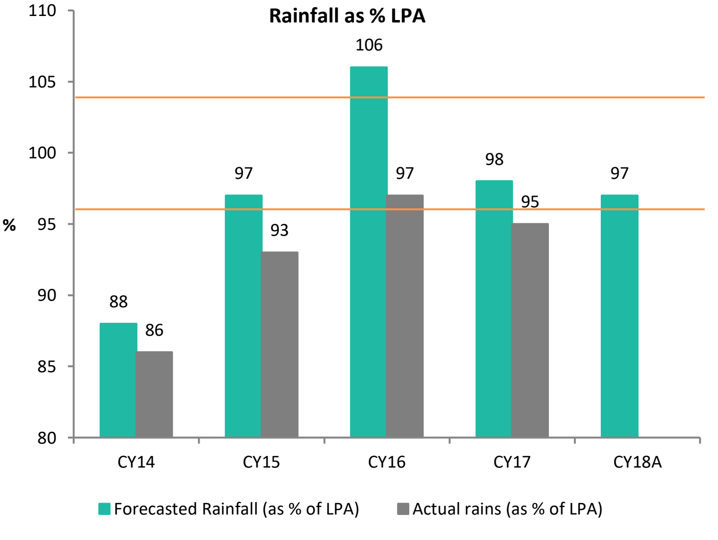
We expect long term growth rate to continue the positive momentum unfettered. India's GDP is expected to grow at 7.4% & 7.8% in FY19 & FY20 (as per IMF).

As business sentiment improves, businesses would augment capacities. This would require transportation of inventory to factory site and transportation of output from factory site. This would enhance demand of high commercial vehicles in economy.

Also, resumption of mining ban in few areas and infrastructural push by government (through Bharatmala, Sagarmala and Affordable housing) is expected to further improve demand of high commercial vehicle.

Retail Demand

Retail demand is consumer based demand of goods & products and is therefore spending driven. 70% of Indian population reside in villages and thus we expect retail demand to be largely driven by a) monsoon (adequate and equitable) and b) agricultural activity. We gauge impact of monsoon by normalcy of rainfall and distribution of rainfall and measure agricultural activity by number of tractors sold during period of time.



Source: IMD, NSPL Research

Monsoon is measured in terms of LPA (Long Period Average). LPA indicates average of rainfall received over 50-year period from 1951 to 2001. Typically, India receives ~116 cm of rainfall every year. A normal monsoon suggests amount of rainfall is in the range of 96% to 104% of LPA.

During CY14: India experienced less than normal rainfall which led to drought in many years and fall in agricultural economy of country and subsequently tractor sales during FY15 reported 21% downfall. During CY15 & CY16: India experienced normal monsoon, although agricultural output remained subdued due to uneven distribution of rainfall. Tractor sales during FY16 & FY17 reported mild 4% & 2% growth. During CY17: country experienced less than normal monsoon but agricultural output zoomed because of better distribution of rainfall and consequently tractor sales during FY18 catapulted 20%.

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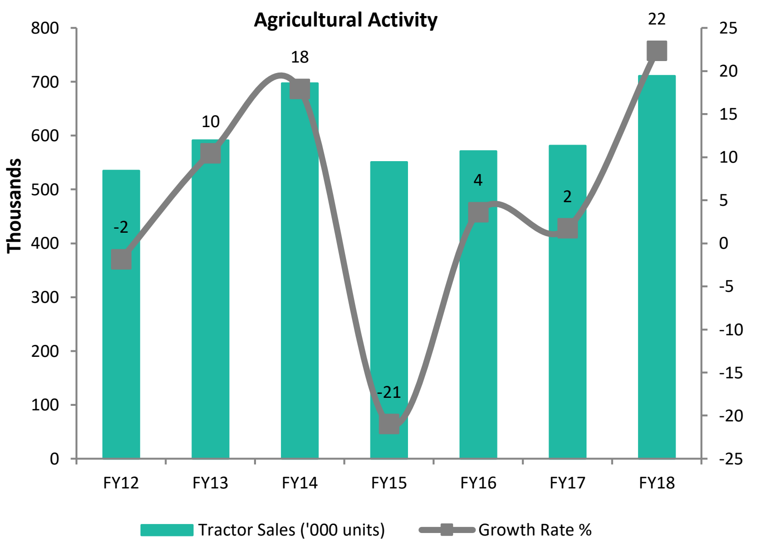


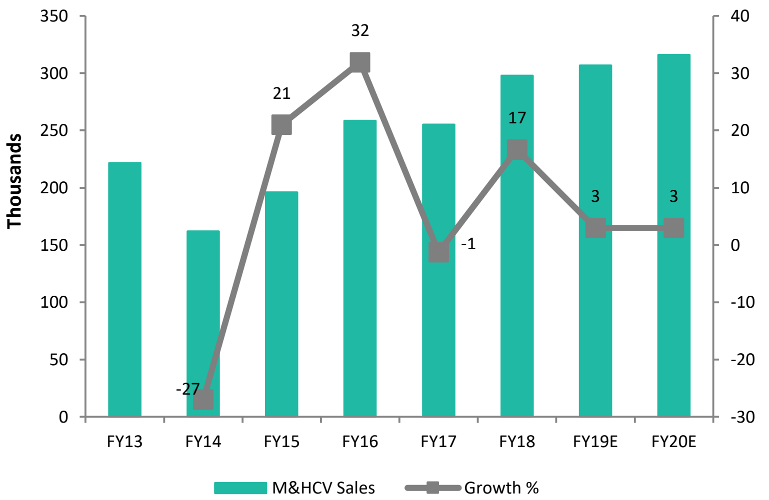
Source: NSPL Research

As per IMD forecast, normal monsoon is expected during CY18 and most importantly rainfall is expected to be equitable.

Overall, agricultural economy was weak during last three years. This resulted in low farmer income and even lower personal disposal income. With normal monsoon forecast disposal income is going to rise and result in higher spending. This would improve demand of consumer goods, which further would improve demand of commercial vehicle in economy.

Demand conclusion: enormous demand is present from wholesale and retail side. We are bullish on manufacturing sector due to expansion plans announced by many companies for installation of new capacities. We also expect retail demand to grow at a robust rate because of higher disposal income in urban and rural side.

Supply of M&HCV Vehicles



Source: NSPL Research

Typically, a vehicle is financed three to four times in lifespan of 12 years. Considering refinancing schedule of 3 years, we estimate supply of vehicles to grow by 27%.

During FY16 sales grew by 32% due to extension of reduction in excise duty for manufacturers and partial resumption of mining in Karnataka. During FY13 sales grew by 14% and during FY10 sales grew by 38%.

In coming years we expect market to be flooded by vehicles which we believe would provide sufficient vehicles at disposal of single operators to conduct their businesses. We expect supply of vehicles to increase by 27% in FY19.

Supply conclusion: Supply of vehicle is suffice. We expect strong growth in pre-owned vehicles and new vehicles (due to rise in demand of manufacturing & retail good).

Overall, we expect HCV segment to grow by 27%. Since, HCV contributes 47% of total AUM, we estimate HCV segment to contribute 13% growth in AUM.

Demand	Supply
a) Favorable Wholesale demand **b) Favorable Retail demand**	**a) Robust supply of vehicle**
Growth contribution of HCV in total AUM growth: 12%	

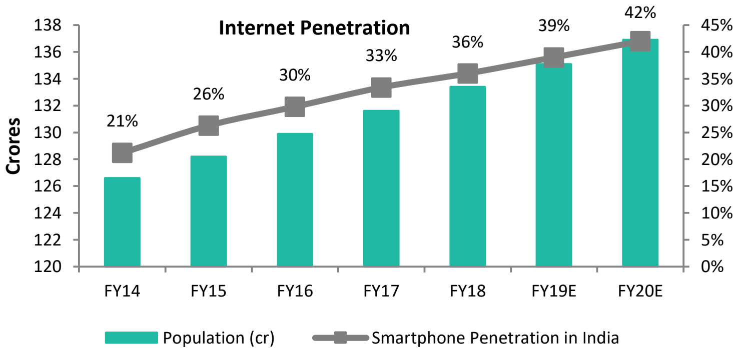
Light Commercial Vehicles

This segment contributes 21% towards AUM. LCVs act as facilitators in any economy. Light commercial vehicles largely consists of mini trucks and pick-up trucks. With regard to function, if M&HCV transfer bulk of goods to a storage house LCV take these goods in small portions via hub and spoke model and complete the transaction.

LCV industry witnessed slowdown during FY14-FY16 due to imposition of stringent lending norms such as low LTV ratio (due to high default rates in LCV segment). Although the cycle resurrected and begun upward march reporting growth rates of 8% and 32% in FY17 and FY18.

We expect growth drivers in this segment to emerge from budding ecommerce industry in India, which is eventually depended on a) internet penetration and b) adoption of online platform by consumer. We measure internet penetration by reach of smartphone in India assuming both are positively correlated. Adoption is measured by increase in volume purchased per individual via online platform. We measure supply by grasping availability of vehicles on road (new and pre-owned).

Demand Drivers



Source: NSPL Research

India is a consumer driven economy. Factor such as population growth and behavioral changes in consumer has potential to significantly propel demand of e-commerce industry in India. Indian population grew from 126cr in FY14 to 132cr in FY18. Simultaneously, smartphone penetration has increased from 21% to 36%. Commingled, internet adoption has increased by 79% from FY14 to FY18 and has reported 15.6% CAGR during the same period. This suggest internet penetration has grown nearly twice the GDP growth rate in India, representing aggressive capture of consumer market share. It is also estimated that penetration is going to further improve to 39% & 42% by FY19E & FY20E.

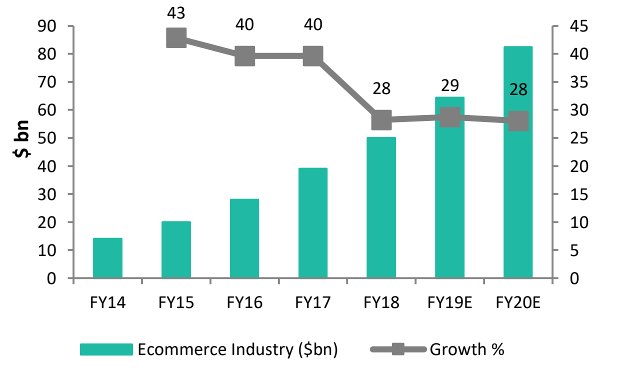
E-Commerce Industry

Ecommerce industry in India grew at an impressive 40%+ CAGR (in $ terms) during FY15-FY17 and 28% in FY18. Phases of demonetization also firmed foundation of cashless economy. Resultant, more companies are shifting towards online route sensing the opportunity. Crucial factor of ecommerce industry is to enable businesses to reach to prospective customers in any part of the country without significant branch capex. Since more companies & customers are accepting online route we expect domino effect to favour growth of ecommerce industry. It is estimated that ecommerce industry is going to report growth of 29% & 28% in FY19E & FY20E on the back of strong population penetration. This represents enormous opportunity for logistic companies and financiers of these companies.

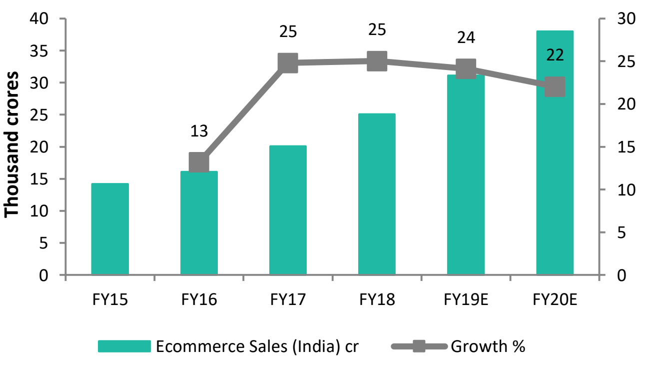
Sustainable E-commerce story: population grew 1.4% during FY18 and smartphone penetration improved 300bps to 36%, this denotes consumer rise of 9% during FY18. However, during this period ecommerce revenues grew by 25%. We attribute this robust growth to improvement in volume per customer, since, online companies are shelling out hefty discounts to capture market share. Consequently we estimate 16% rise due to incremental volume per customer. Higher volumes per customer denotes adoption of online platform and that customer is getting accustomed to online route. This affirms sustainability of ecommerce industry in India. This would lead to rise in logistics demand and further improve LCV demand in the economy.

Other factors: We expect government's Bharatmala and Sagarmala project to further improve demand of LCV in the economy.

Demand conclusion: We expect robust growth on back of enhanced logistics demand from ecommerce industry and government projects.



Source: NSPL Research



Source: NSPL Research

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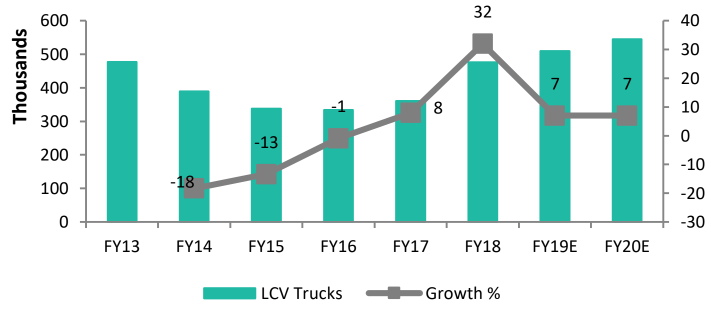
Supply



Source: NSPL Research

Sales reported strong 8% & 32% growth during FY17 & FY18 respectively. We expect sales to grow at 7% each in FY19E & FY20E on the back of improved logistic demand.
We consequently expect supply of LCV trucks to grow by 7% in FY19.

Supply conclusion: LCV supply is going to grow at 7% during FY18.

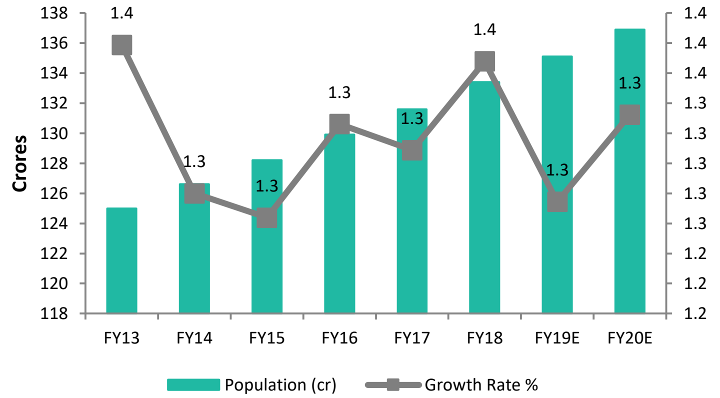
Conclusion: We conservatively expect LCV industry to grow by 7%. Since LCV contributes 21% of AUM, we estimate LCV industry to contribute 1.5% growth.

Demand	Supply
a. Ecommerce industry **b. Government projects**	**a. Moderate LCV supply**
Growth contribution of LCV in total AUM growth: 1%	

Passenger Vehicles

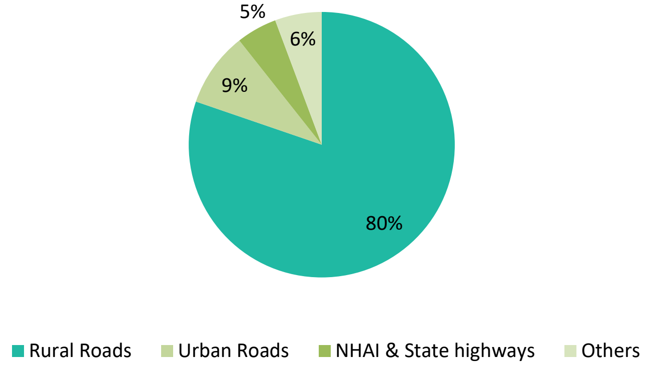
This segment contributes 23% towards AUM. Passenger vehicles are required to transport passengers from destination A to B. Passenger vehicles include private owned vehicles (cars) and public transport vehicles (tempo, buses, etc). We expect demand in this segment to be driven by population growth (meaning more people require transportation), higher disposable income and better road network in India (presenting better routes and easy connectivity between places). Since, more than 70% of Indian population reside in villages where road infrastructure is not adequate, enhanced road network is expected to surge demand of passenger vehicles in India due to higher disposable income.

Demand Drivers



Source: NSPL Research

Source: Company, NSPL Research



Source: Morth, NSPL Research

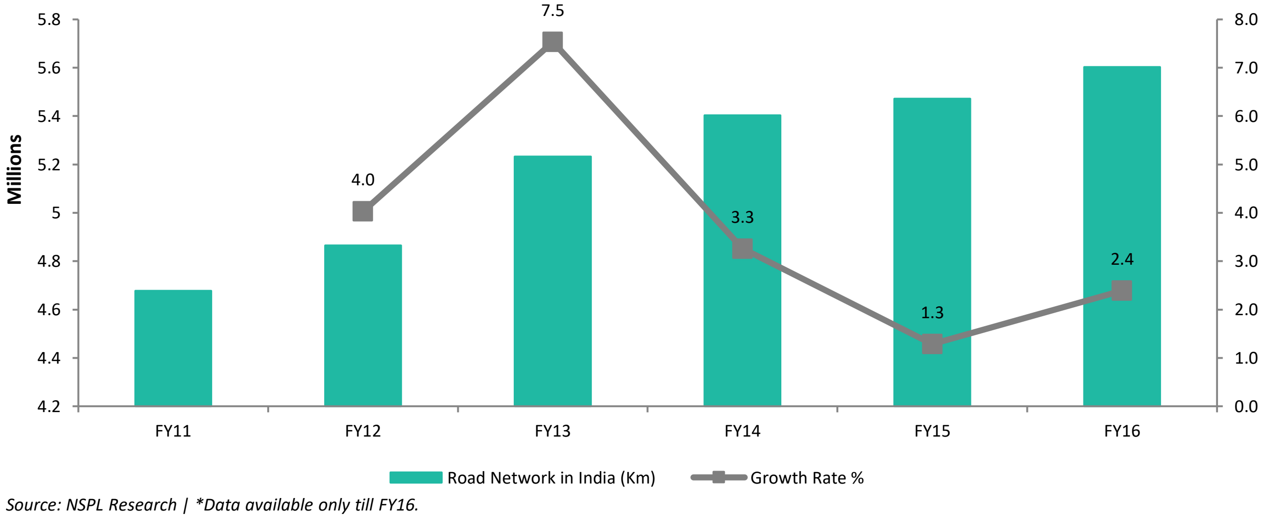
Population & its Growth

We believe population in any economy is analogous to equity on a balance sheet of any company. High population, although reduces per capita figures (similar to high equity reducing return on equity) but simultaneously provides buffer and future opportunity for growth. We expect increasing population coupled with higher disposable income is going to drive demand of passenger vehicle. We expect robust lifestyle improvement in rural areas due to normal monsoon and agricultural output, and also improvement in urban lifestyle on back of improved business sentiment and bottom line. Average age of population in India is 29 years. With flourishing lifestyle, we expect demand to come in two forms a) cab aggregators such as Ola & Uber and b) desire to own car.

Road Networks in India

Roads are called vehicles of last mile connectivity in any country. Improvement in road network opens up new avenues for connectivity within cities & also gives boost to tourism industry. Government's infrastructural push with initiatives like Bharatmala project (which aims to lay 34,800km road) and Sagarmala (which aims to improve sea side logistic), we expect road network to grow at a hardy pace. Over the years, road network has grown at an average rate of 2.5% each year. We expect 3% going forward.

Demand Conclusion: Population growth coupled with higher disposable income and enhanced road network augurs well for passenger vehicle industry.



*Source: NSPL Research | *Data available only till FY16.*

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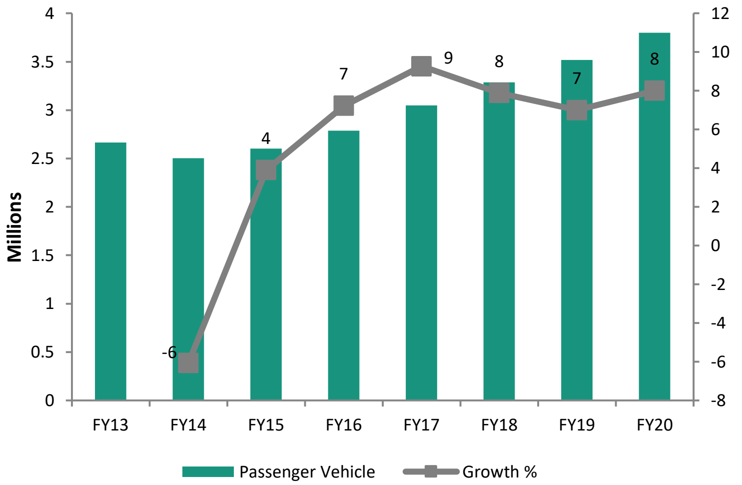
Supply



Source: NSPL Research

Passenger vehicles have grown at an average rate of 7% from last four fiscals. Furthermore supported by growing demand, we conservatively expect growth to be on similar lines for next couple of years.

During FY14, sales witnessed 6% slide, however FY15 onwards industry sales firmly recovered and consistently reported growth north of 7%. We believe continuation of trend due to capacity addition announced by major players. For example, Tata Motors have announced its desire to increase its market share in passenger vehicle from 6.5% to 10%. Furthermore, TM reported volume growth of 22% by selling more than 2 lakh passenger vehicle in FY18 and reported notable 34% volume growth in April month (2019).
Supply conclusion: we conservatively expect total passenger vehicle to grow by 7% in FY19.

Conclusion: we expect vehicle count to increase by 7%, passenger vehicle contributes 23% of AUM, thus we estimate this segment to contribute 1.6% in growth.

Demand	Supply
a) Increasing population and desire of improved lifestyle. **b) Enhanced road networks**	**a) We expect 7% growth in FY19**
Growth contribution of HCV in total AUM growth: 2%	

Infrastructure Push by Government

Roads

Government has approved plan to build 83,677km highways by March 2022 at cost ~ 7lac crore. Bharatmala project is part of the plan and involves development of 34,800km of National highways at 5.35lac crore cost. Government looks to achieve following targets:

a) Increase corridor count from 6 to 50
b) Expects 70-80% of freight traffic to move along national highways from 40% at present
c) Connect 550 districts by 4+ lane highways from 300 districts at present

Conclusion: Improvement in road network would increase demand of HCV, M&LCV vehicles.

Ports

Government is planning to build/enhance port infrastructure through Sagarmala project. Project is expected to cost ~8lac crores. During the 20 year tenor from 2015 to 2035, government would undertake 562 projects to augment port capacity and develop multi-modal logistic parks to reduce logistic cost. Government looks to achieve following objectives:

a) Increase capacity of ports from 2000 mt to 3500 mt by 2025 (phase I target)
b) Reduce logistic cost by 35,000 to 40,000 crores per annum

Conclusion: Higher logistics demand would increase demand of commercial vehicles.

Affordable housing

Government is planning to cater to affordable housing through implementation of "Housing for All" by 2022. Target is to construct 5 crore houses by 2022. During the budget 2018-19, following points were highlighted:

a) Allocation to affordable housing increased by 120% from Rs 29,500 cr in FY18 to Rs 64,500 cr in FY19.
b) Rural area: more than 1 cr houses to be built over next two years
c) Urban area: 37 lac houses sanctioned.

Conclusion: Improvement in construction sector would increase demand of M&HCVs.

Others

a) Smart City scheme: 99 cities to be build with state-of-the-art amenities. We expect requirement of building materials, infrastructural setup to increase demand of commercial vehicles.
b) UDAN project by AAI: plans to expand airport capacity by more than five times to handle 100 cr passenger trips a year from current 20 cr passenger trip.

Industry Growth & Contribution

Segments of STFC	% contribution in AUM	Industry Growth rate	Adjusted segment contribution
HCV	47%	26%	12%
LCV	21%	7%	1%
PV	23%	7%	2%
Tractors	4%	4%	0%
Others	5%	0%	0%
Total			**16%**

Thus, we expect industry to contribute 16% growth in AUM.

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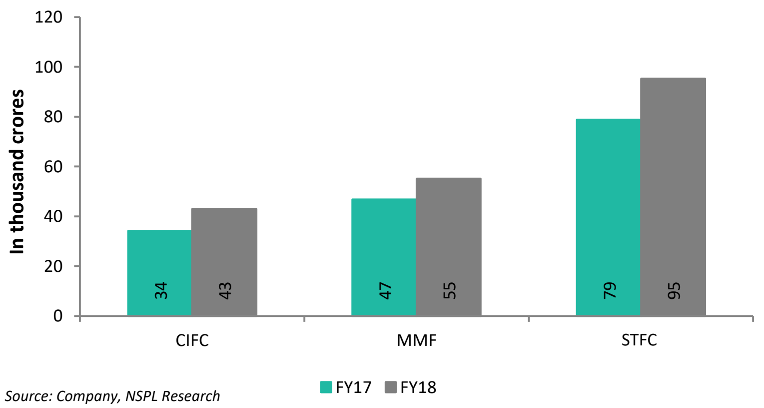
Financial analysis with peers

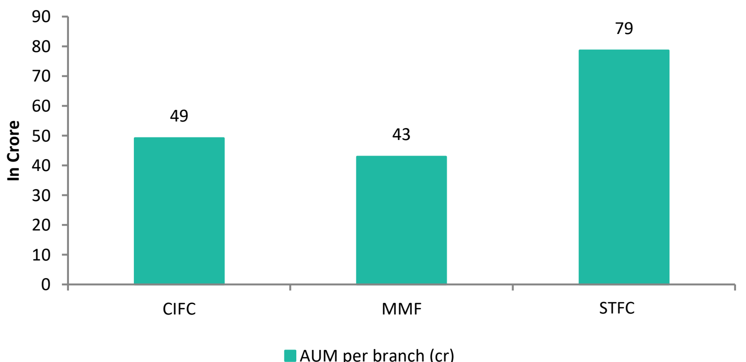
We analyze STFC alongside its two closest peers: Cholamandalam Investment & Finance Company (CIFC) and Mahindra & Mahindra Finance (MMF). CIFC is part of renowned Murugappa group whereas MMF is part of a well-established Mahindra group. CIFC is engaged in business of vehicle financing (comprises 73% of its AUM), housing loans (comprises 24% of its AUM) and others (MSME loans),while MMF is engaged in business of vehicle financing (comprises 88% of its AUM) and others(SME).

Asset under Management



Source: Company, NSPL Research

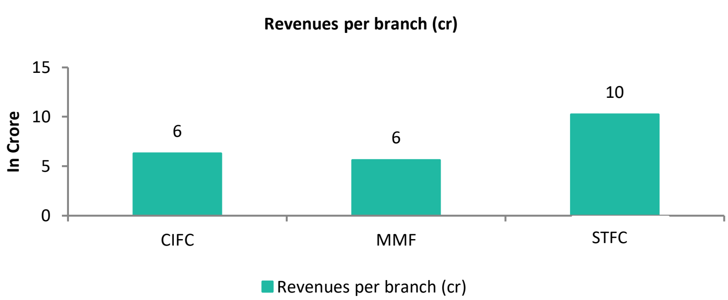
During FY18, CIFC registered AUM growth of 25% to 429bn, MMF registered AUM growth of 18% to 551bn and STFC registered AUM growth of 21% to 953bn. CIFC recorded impressive growth on the back of strong presence in southern region and its focus on entrepreneurs. While, STFC catapulted by deepening its penetration in rural areas, and simultaneously increasing its coverage by opening 295 additional branches during the year. In terms of size, STFC's AUM is more than combined AUM of CIFC and MMF.



Source: Company, NSPL Research

As of date, CIFC, MMF and STFC has 873, 1284 and 1213 branches. MMF has equitable distribution of its branches in four regions, whereas STFC has 69% of its branches concentrated in southern and western region, in line with 61% of domestic CV sales accounting from these regions.
Additionally, STFC has higher AUM per branch due to deeper penetration and presence of 39years. While CIFC began vehicle financing in 1990, MMF began 2 decades back with a focus on tractor financing & gradually allocated some portion towards CV financing. Also, tractor sales are relatively more cyclical than CV sales.

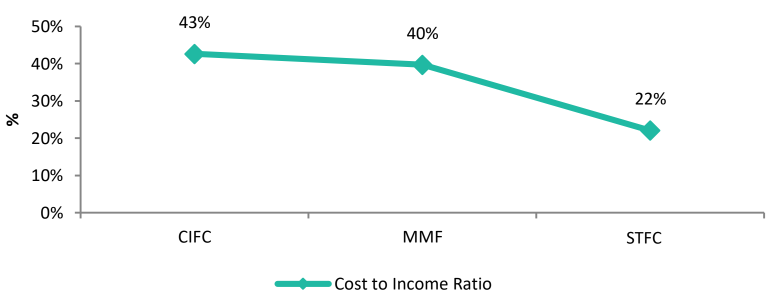
Revenues



Source: Company, NSPL Research

STFC's plan of adding another 200 branches in FY19 augurs well for the company given empirical revenue evidence because of deeper penetration.

Operational Metrics



Source: Company, NSPL Research

STFC portfolio is heavily inclined towards HCV, which entails huge customer base. This directs company to opt rural centers as oppose to branch. This has allowed company to maintain lowest cost to income ratio of 22%. While, peers have reported cost to income ratio of 43% (CIFC) and 40% (MMF).

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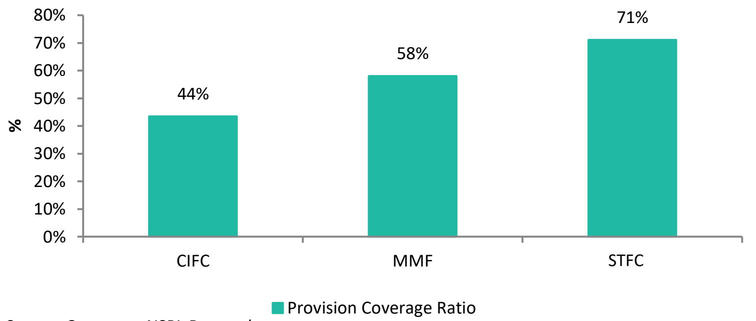
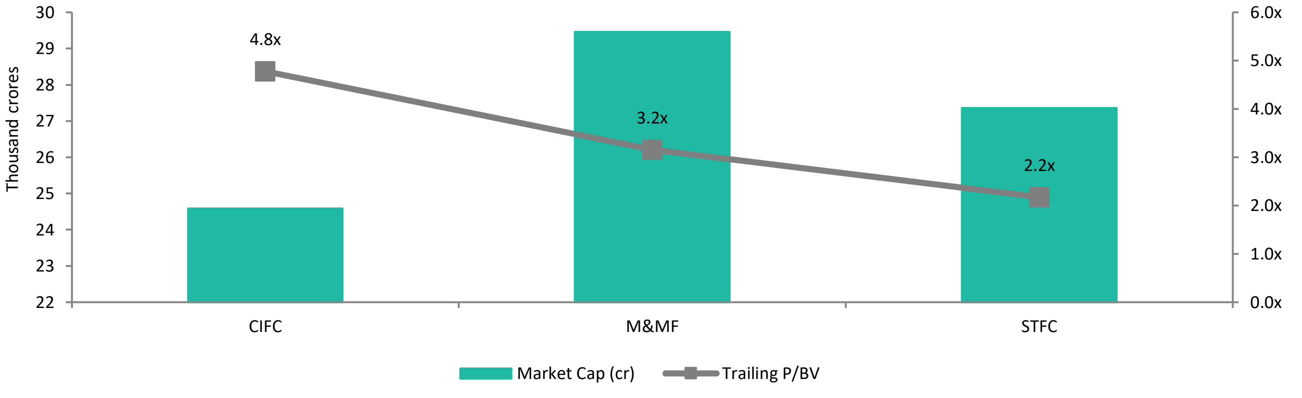
Asset Quality



Source: Company, NSPL Research

Company has regularly accounted high provision coverage ratio in the industry. In previous years, when NPA recognition followed 150 day norm, company used to account highest provisioning ratio of 80% and post shifting to 90 days, company has maintained the trend by accounting PCR of 71%. We believe high provisioning coverage ratio helps in reducing tax outflow (tax rate – 33%), while keeping divergence in check.

Valuations



Source: Company, NSPL Research

Peer Comparison

	CIFC	M&MF	STFC
CMP (INR)	1573	477	1206
Market Cap (cr)	24586	29464	27362
ROA %	3.00%	1.90%	1.94%
ROE %	20.78%	11.30%	13.06%
Book Value (INR)	329	151	554
Trailing P/BV	4.8x	3.2x	2.2x

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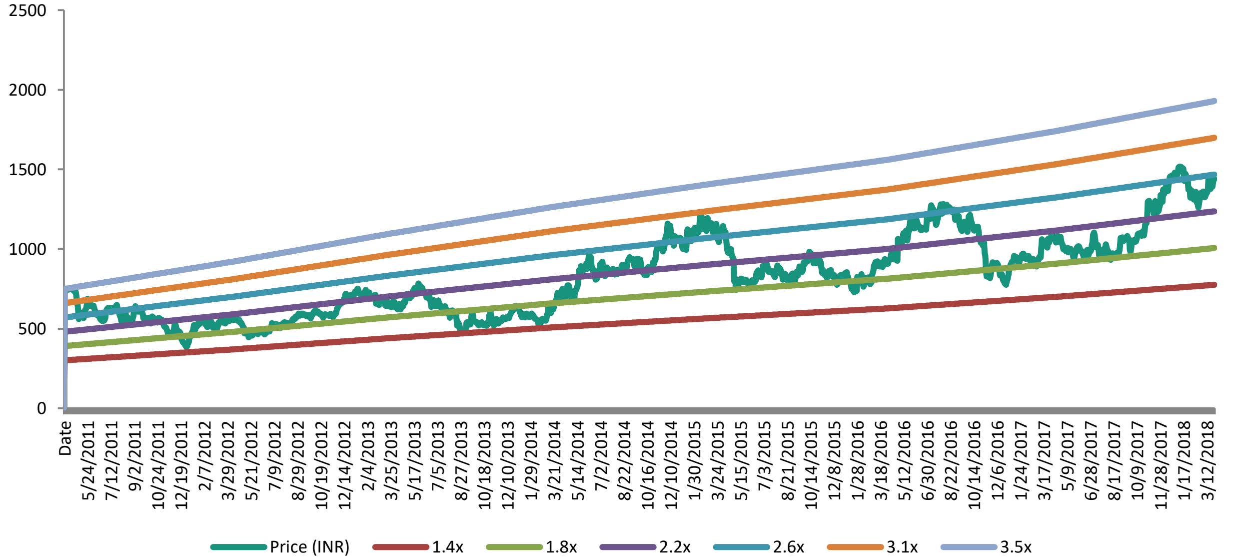
Valuations

Incorporated in 1979, STFC began with an aim to finance vehicles for neglected single truck operators. As of date, it has opened 1213 branches and 862 rural centers which serves 18.6lac customers by managing AUM of INR 953bn. STFC has emerged as a market leader in pre-owned vehicle segment with market share of 25-26%.

We expect STFC's market to grow at 16% on the back of robust 26% growth in HCV segment, 7% growth in LCV segment and 7% growth in PV segment. We expect HCV to record robust growth on back of upbeat manufacturing and retail side demand. We expect business sentiment to witness boost on the back of improved manufacturing data, while equitable rainfall coupled with agricultural demand is expected to boost retail demand. We expect thrust in LCV segment to be driven by ecommerce industry, and boost in passenger vehicle demand due to growing population with a desire of better lifestyle and enhanced road network.

Company has 18.6 lacs customers having an average ticket size of 5.1lac and market share of 23% in new HCV and 61% in pre-owned HCV segment. Company's brand is going to propel growth while diversified & granular loan book is going to reduce concentration risk. We estimate STFC's AUM to grow at 17% CAGR FY18-20E to 1312bn and revenue, operating profit and PAT to grow at 20%, 18% and 21% respectively over FY18-20E. Additionally, with best in class operational efficiency and decline in credit cost, we estimate STFC to improve ROA from 1.9% in FY18 to 1.9%/2.1% in FY19/FY20 and improve ROE from 13.1% in FY18 to 13.8%/15.2% in FY19/FY20.

At CMP of INR 1206, STFC is trading at FY20 P/BV of 1.7x. We expect re-rating to 2.3x and arrive at a target price of INR 1643, implying an upside of 36%.



Source: Company, NSPL Research

Company Background

Shriram Transport Finance (STFC) is a market leader in the used CV financing space and is part of the "Shriram" conglomerate that has noteworthy presence in varied financial services. STFC began its journey in 1979 with an aim to finance neglected small truck owners. As of date, STFC employs 23,819 people and 15,049 field-officers across 1213 branches and 862 rural centers serving 1.86mn customers by managing an AUM of INR 95306 crore.

1979
- STFC was established

1984
- Initial Public Offering

1990
- Investment from Telco& Ashok Leyland

1999
- Tied up with Citicorp for CV financing under Portfolio Management Services (PMS)
- The 1st securitization transaction by STFC

2002-04
- Preferential Allotment to Citicorp Finance (India) in 2002
- Preferential Allotment to Axis Bank and Reliance Capital in 2004

2005-06
- Merger of Shriram Investment Ltd. and Shriram Overseas Finance Ltd. with STFC; PAT crosses Rs. 1,000 mn (2006)
- Investment from ChrysCapital (2005) and TPG (2006)

2009
- Successfully placed Rs. 10 bn of NCD with domestic investors
- Purchased hypothecation loan outstanding of commercial vehicles and construction equipment of GE Capital Services India and GE Capital Financial Services (GE) aggregating to approximately Rs. 11 bn

2010
- Securitised Rs. 87.6 bn during FY 2010.
- Successfully raised Rs. 5.8 bn through QIP with domestic & international investors.
- Initiated financing of construction equipment

2011
- Introduced Shriram Automalls – a dedicated platform for trading of preowned trucks at a fair value

2013
- AUM crosses Rs. 500 billion

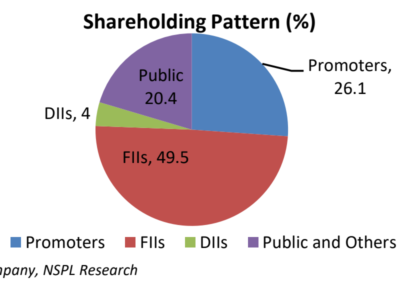
2015-16
- Fitch upgraded long term issuer ratings to 'IND AA+' from 'IND AA'
- CRISIL upgraded long-term debt instruments and bank facilities, and FD to 'CRISIL AA+/FAAA/Stable' from 'CRISIL AA/FAA+/Positive'
- Merger of Shriram Equipment Finance Co. Ltd with STFC

2017
- Successfully raised Rs. 13.5 Bn through issuance of 'Masala Bonds' – Senior Secured Rupee Denominated Bonds' listed on Singapore Stock Exchange

Source: Company

Fund Holdings

Name of fund	No. of Shares	% holding in STFC
SBI Mutual Fund	3,964,168	1.75%
Canara Robeco Mutual Fund	639,000	0.28%
HDFC Mutual Fund	645,600	0.28%
Birla Sun Life Mutual Fund	527,400	0.23%
Reliance Mutual Fund	455,150	0.20%



Source: Company, NSPL Research

Risks and Concerns

- Impact of events such as overloading ban: Such events enforce operators to shift to higher tonnage vehicles which disproportionally increases demand of new vehicles in the market. While STFC is market leader in pre-owned segment, it might have to face stiff competition in new vehicle segment which has prominent players like MMF, CIFC. However, we believe these are short term hiccups, because, in the long-run this would increase vehicle count and market size of STFC.
- Slow Market growth: Overall market might witness slower growth due to macro events like hike in crude prices and trade wars.
- More stringent norms would impact bottom line: As evident in Q4FY18, GNPA rose by 1330cr, of which 1135cr was due to transition to 90day NPA regime. We believe further stringency would impact bottom-line and Pat margins. Although, we do not expect any material impact in operations of company.
- Merger: Shriram group had considered proposition of merger during last year so as to diversify its risk but it did not transpire. There is prevailing speculation that group is mulling on the same again. To address the concern, founder of the group clarified that any activity going forward would only be considered if in best interest of minority shareholders.

Management Meet

- We met with the management of STFC, and were sufficiently enthused about its growth story and future outlook.
- Industry CV Sales have picked up due to economic revival and is expected to remain upbeat for next 3 years.
- Overloading ban in northern region might cause short-term impact, although in the long run it is only going to increase vehicle count and would have neutral (or even positive) impact.
- Robust demand seen in LCV (grew by 24.6% YoY) segment driven by ecommerce industry and PV (grew by 12.7% YoY) segment driven by improvement in lifestyle and higher disposable income.
- Company is mulling (but not adamant) on raising equity.
- Company has guided AUM growth of 18% for FY19. Company also plans to open 200 branches during FY19.
- Banks (especially PSUs) have turned reluctant in lending due to prevailing liquidity issues.
- Company foresee rise in cost of funds due to incremental rise in interest rates. However, it can pass the rates to customers and continue to maintain its net interest margin.
- Company would continue to raise some capital via securitization as it is a cheaper way of raising money (cost of funds – 8-8.25%). Pooled assets are mostly AAA rated HCV loans.
- On Asset Quality front, company has suggested rising NPA is due to accounting & regulatory norms, otherwise no material (or alarming) concern in operations. Company has also guided to reduce its credit cost to 2.5% & 2.1% by FY19 & FY20 from current levels of 3.8%.

Clarification regarding SVL Ltd

SVL Ltd is part of Shriram group. Company invests in various business ranging from manufacturing to energy. Thereby, earns income through dividends or interest. Company posted revenues of 53crs and loss of 315cr in FY18. Company had debt of ~1400cr as of Mar'18 and interest coverage of 0.32. Many investments of company such as Leitwind Shriram manufacturing had gone bad in recent past. Company has following bonds outstanding as of Mar'18:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	
				August 2017	March 2017	September 2015	July 2015
1	NCD	Long - Term	650.00	[ICRA]AA (SO) (Stable)	[ICRA]A A (SO) (Stable)	[ICRA]AA (SO) (Stable)	[ICRA]AA (SO) (Stable)^
2	NCD	Long - term	112.50	[ICRA]D	[ICRA]B+ (Negative)	[ICRA]BBB (Stable)	-
3	Term Loans	Long - term	110.50	[ICRA]D	[ICRA]B+ (Negative)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
4	Unallocated Limits	Long - term	50.50	[ICRA]D	[ICRA]B+ (Negative)	-	-

In previous years, since company was incurring losses, company raised money through NCDs worth 650cr in June2015 by getting support of Shriram transport finance. Coupon interest rate on issuance was 11.25% and maturity was due on 28th June 2019.
As of date: SVL's financial condition looks dire and is expected to default and therefore burden seems to be coming on Shriram transport. However, SVL had given loan of 543cr to one of its subsidiary, which company expects to be good and recoverable. This might take some burden off Shriram. Otherwise also, Shriram holds cash of 3638cr as of Mar'18 and burden might slightly reduce disbursement growth but would not distort operations (as market is assuming). Thereby, correction offers a good entry point for investors. We await clarity on Ind-AS impact and therefore, have not updated our estimates but expects INR 38/share impact on FY20E book value if guarantee is invoked in June'19.

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Financials

Profit & Loss (INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E
Interest Income	7,778	9,530	9,801	11,003	13,434	15,994
Securitization Income	770	687	953	1,165	1,379	1,616
Total Revenues	**8,551**	**10,226**	**10,761**	**12,180**	**14,821**	**17,618**
Interest Expense	4403	5074	5209	5409	6709	8119
Securitization Expense	19	58	24	25	28	32
Net Interest Income	**3,375**	**4,456**	**4,592**	**5,595**	**6,725**	**7,875**
Growth %	42%	32%	3%	22%	20%	17%
Net Securitization Income	**751**	**629**	**929**	**1,140**	**1,351**	**1,584**
Growth %	-41%	-16%	48%	23%	19%	17%
Other fee based income	3	10	7	12	8	8
Total Operating Income	**4,129**	**5,094**	**5,528**	**6,746**	**8,084**	**9,467**
Growth %	13%	23%	9%	22%	20%	17%
Operating Expenses	1,078	1,309	1,229	1,489	1,823	2,116
Pre-Provisioning Profit	**3,050**	**3,786**	**4,299**	**5,258**	**6,261**	**7,351**
Growth %	13%	24%	14%	22%	19%	17%
Provisions	1,278	2,071	2,444	3,122	3,607	4,012
PBT	**1,842**	**1,781**	**1,924**	**2,372**	**2,777**	**3,481**
Tax	605	603	667	804	941	1,179
PAT	**1,238**	**1,178**	**1,257**	**1,568**	**1,836**	**2,301**
Growth %	-2%	-5%	7%	25%	17%	25%
PAT as % of TOI	30%	23%	23%	23%	23%	24%

Balance Sheet (INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	227	227	227	227	227	227
Reserves & Surplus	9,011	9,927	11,075	12,345	13,881	15,882
Net Worth	**9,238**	**10,154**	**11,302**	**12,572**	**14,108**	**16,109**
Borrowings	44,276	49,791	53,110	63,320	74,789	88,507
Total Liabilities	**59,327**	**67,963**	**74,410**	**88,470**	**101,476**	**117,194**
Cash & Investments	6,936	2,468	4,493	3,638	1,839	2,269
Advances	50,764	63,770	67,840	82,740	97,535	112,810
Fixed Asset	101	101	84	120	129	142
Other Assets	1,627	1,725	2,077	2,093	2,102	2,115
Total Assets	**59,327**	**67,963**	**74,410**	**88,470**	**101,476**	**117,194**

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RATIOS	FY15	FY16	FY17	FY18	FY19E	FY20E
Operating ratios (%)						
Yield on On-book	18.1%	17.2%	15.4%	15.2%	15.4%	15.7%
Yield on Off-book	5.8%	6.6%	7.9%	8.1%	8.1%	8.1%
Cost of funds	11.0%	10.8%	10.1%	9.3%	9.7%	9.9%
Net Interest Margins	7.4%	7.7%	7.3%	7.7%	7.8%	7.7%
Cost to Income	26.1%	25.7%	22.2%	22.1%	22.6%	22.4%
Tax rate	32.8%	33.9%	34.6%	33.9%	33.9%	33.9%
Balance sheet ratios (%)						
AUM growth	11.3%	23.1%	8.2%	21.0%	18.6%	16.2%
Borrowing growth	23.3%	12.4%	6.7%	19.2%	18.1%	18.3%
Gross NPA	3.8%	6.2%	8.2%	9.2%	8.1%	7.7%
Net NPA	0.8%	1.9%	2.7%	2.8%	2.5%	2.3%
Provision Coverage	80.0%	70.4%	69.3%	71.1%	69.0%	70.0%
Return Ratios (%)						
ROAA	2.3%	1.9%	1.8%	1.9%	1.9%	2.1%
ROE	14.1%	12.2%	11.7%	13.1%	13.8%	15.1%
Valuation metrics						
EPS (INR)	54.6	51.9	55.4	69.1	80.9	101.4
Book Value (INR)	407.2	447.5	498.2	554.1	626.3	719.0
Adjusted Book Value (INR)	407.2	332.7	269.5	238.7	223.2	288.8
P/E (x)	18.7	20.2	19.7	17.4	14.9	11.9
P/BV (x)	2.5	2.3	2.2	2.2	1.9	1.7

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Details of Disciplinary History of NSPL	No disciplinary action is / was running / initiated against NSPL
Research analyst or NSPL or its relatives'/associates' financial interest in the subject company and nature of such financial interest	No (except to the extent of shares held by Research analyst or NSPL or its relatives'/associates')
Whether Research analyst or NSPL or its relatives'/associates' is holding the securities of the subject company	NO
Research analyst or NSPL or its relatives'/associates' actual/beneficial ownership of 1% or more in securities of the subject company, at the end of the month immediately preceding the date of publication of the document	NO
Research analyst or NSPL or its relatives'/associates' any other material conflict of interest at the time of publication of the document	NO
Has research analyst or NSPL or its associates received any compensation from the subject company in the past 12 months	NO
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Has research analyst or NSPL or its associates received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past 12 months	NO
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Has research analyst or NSPL engaged in market making activity for the subject company	NO
Other disclosures	NO

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