HDFC securities RETAIL RESEARCH

Pick of the Week | 17 Jul 2017

SREI Infrastructure Finance Ltd

Industry	CMP	Recommendation	Add on Dips to band	Sequential Targets	Time Horizon
BFSI	Rs. 114	Buy at CMP and add on dips	Rs. 100-104	Rs. 131 & Rs. 146	2-3 quarters

HDFC Scrip Code	SREINFEQNR
BSE Code	523756
NSE Code	SREINFRA
Bloomberg	SREI IN
CMP as on 14 Jul 17	113.95
Eq. Capital (Rs crs)	503.09
Face Value (Rs)	10
Equity Sh. Outs (Cr)	50.31
Market Cap (Rs crs)	5732.7
Book Value (Rs)	97.94
Avg. 52 Week Vol	19,20,000
52 Week High	123.40
52 Week Low	63.05

Shareholding Pattern-% (Jun-2017)	
Promoters	60.79
Institutions	24.98
Non Institutions	14.22
Total	100.0

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SREI Infrastructure Finance Limited (SREI), a Kanoria Foundation entity, is one of India's largest holistic infrastructure institutions, delivering innovative solutions in the infrastructure space. It has been engaged in leasing and hire-purchase/hypothecation financing of heavy construction equipment and financing of infrastructure related projects. The company has been in the business for nearly three decades. With a customer base of over 77,000 and over US$ 5.5 bn of consolidated AUM, it is one of the largest player in the infrastructure segment.

Investment Rationale

- Huge investments envisaged for infrastructure – providing visibility to AUM growth
- Infra spending to spur demand for construction equipment
- Asset quality set to further improve after peaking in FY15
- Value unlocking in BRNL (short term) and Sahaj E-village (medium term)
- NIM and PAT margins have bottomed out – now they can rise from here

Concerns

- Subdued domestic environment especially in the Infrastructure space
- Continued high exposure in group Companies and strategic investments
- GST initially may result in some practical issues and impact disbursals
- Infra space dependent on regulations and economic growth – NPA can again start growing

Financial Summary

Rs in Cr	Q4FY17	Q4FY16	YoY (%)	Q3FY16	QoQ (%)	FY16	FY17	FY18E	FY19E
Total Income	608	239	*153.8*	425	*43.0*	951	2038	1685	1881
PPP	349	94	*271.6*	163	*114.0*	378	1117	697	842
Reported PAT	63	17	*273.3*	67	*-6.0*	62	243	235	275
Adj. PAT						62	-110	235	275
Reported EPS (Rs)	1.3	0.3	*273.3*	1.3	*-6.0*	1.2	4.8	4.7	5.5
P/E (x)						93.0	23.6	24.4	20.8
P/ABV (x)						1.9	1.3	1.2	1.2
RoAA (%)						0.2	0.8	0.7	0.7

(Source: Company, HDFC sec)

View and Valuation

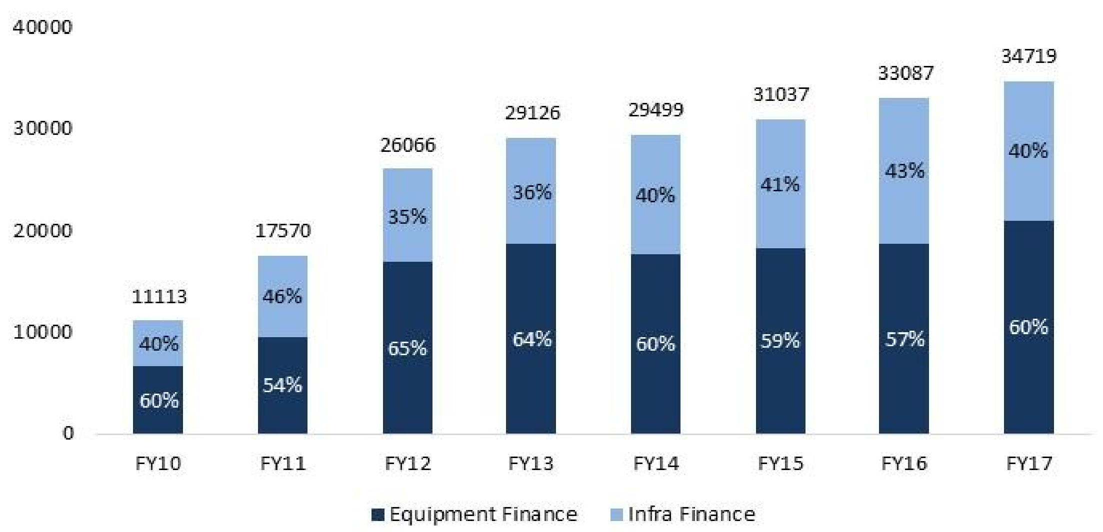
The Government's focus on improving the infrastructure of the country and clearing the backlog of infrastructure projects has given a boost to demand for infrastructure as well as construction equipment financing. After the sharp increase in NPA levels in FY14-FY15, SREI has become cautious and is lending only to safe projects. SREI has utilized the income from Viom stake sale to reduce its debt. Further the expected IPO from BRNL (Bharat Road Networks Ltd.) should result in value unlocking for SREI strengthening its balance sheet. The company has adequate capital for growth and improving asset quality with increasing lending opportunities should result in strong profitability for the company. Compared to other players in NBFC space, Infra & Equipment financing companies get lower valuation due to wholesale lending and higher impact of economic growth on their disbursals and NPAs. However we think SREI deserves to trade at higher than the current multiple of 1.17xFY19E P/ABV.

We feel investors could buy the stock at the CMP and add on declines to Rs. 100-104 band (~1.05x FY19E ABV for sequential targets of Rs. 131 (1.35x FY19E ABV) and Rs. 146 (1.5x FY19E ABV) in 2-3 quarters.

Company Overview

Srei Infrastructure Finance Limited (SREI), a Kanoria Foundation entity, is one of India's largest holistic infrastructure institutions, delivering innovative solutions in the infrastructure space. It has been engaged in leasing and hire-purchase/hypothecation financing of heavy construction equipment and financing of infrastructure related projects. The company has been in the business for nearly three decades. With a customer base of over 77,000 and over US$ 5.5 bn of consolidated AUM, it is one of the largest player in the infrastructure segment.

Interest earning assets (Rs Cr)



(Source: Company, HDFC sec)

Post divestment of equipment finance business into Srei Equipment Finance Ltd., Srei Infra is engaged in project financing, infrastructure project advisory, equipment financing business (equipment of more than Rs.15 crore). Srei Infra is classified as 'NBFC-IFC' by RBI and it has also received 'Public Finance Institution' status from the Ministry of Corporate Affairs, GoI. In April, 2016, Srei Infra completed stake sale in Viom Networks Ltd to ATC Asia Pacific PTE Ltd. As per such transaction, ATC Asia Pacific PTE Ltd acquired 51% shareholding in VNL from the Kanoria group (promoter of Srei Infra), Srei Infra, Tata Teleservices Ltd. (TTL) and several other minority shareholders and the overall transaction amounted to Rs.7600 crore of which Srei Infra's share was Rs.2931 crore.

SREI, has launched a digital platform, iQuippo, which is an online forum to converge buyers and sellers of construction and infrastructure equipment. Right from assisting original equipment manufacturers (OEMs) to market their products, enabling and guiding potential buyers to identify the right assets, iQuippo will have a role in financing the asset, deploying it, providing insurance, offering maintenance and operational services, making available spare parts, re-deploying the asset in multiple project sites, identifying buyers for the used assets and providing all kinds of fee-based services till the asset is finally disposed off.

Key Subsidiary

SREI Equipment Finance

SREI Equipment Finance (SEFL) was started as a 50:50 JV in 2008 between the company and BNP Paribas for equipment financing business. It has emerged as one the major equipment financiers in India. The company enjoys a Pan-India presence with offices in 89 locations. SEFL has an experienced management team having significant expertise in the financial services. It provides finance for a range of construction and mining equipment like earth moving, material handling, road construction, concrete and material processing equipment.

In Dec-2015 SREI entered into an agreement with BNP Paribas to purchase its share in the JV and post all the necessary approvals SEFL became a wholly owned subsidiary of SREI in Jun-2016. SEFL reported a networth of Rs 2473 cr and interest earning assets of Rs 20994 cr at the end of FY17.

Srei Infra had announced in December, 2015 that Srei Infra, BNP Paribas Leasing Group (BPLG), Srei Equipment Finance Ltd. (SEFL -50% JV between BNP and SREI INFRA), along with the promoters of SREI group have entered into a Share Purchase Agreement (SPA) wherein BPLG has agreed to acquire 2,51,54,317 equity shares of Srei Infra (representing 5% stake of Srei Infra) against BNP's existing shareholding of 2,98,30,000 equity shares in SEFL (representing 50% stake of SEFL). Post receipt of RBI approval on May 17, 2016, the transaction was completed on June 17, 2016, wherein Srei Infra has consolidated 100% shareholding in SEFL and BNP has become a shareholder in Srei Infra.

Key Milestones

Year	Milestone
1989	Srei started operations and identified infrastructure as its core business.

1992	IPO and listing on all major exchanges
1997	IFC, DEG and FMO invested in Srei as strategic equity partners
2005	One of the first Indian NBFIs to be listed on the London Stock Exchange
2008	Formed a joint venture with BNP Paribas for equipment financing business.
2009	Formed a strategic partnership with Tata Group for passive telecom infrastructure business.
2010	Synergistic integration of Srei and Quippo to create an integrated infrastructure institution.
2011	Received 'Infrastructure Finance Company' and 'Public Financial Institution' status.
2012	Received certificate of registration for mutual fund (infrastructure debt fund) from SEBI.
2014	Received certificate of authorisation from RBI to set up, own and operate White Label ATMs
2016	Sells stake in Viom to ATC, consolidates 100% shareholding in its equipment financing business.

Investment Rationale

Huge investments envisaged for infrastructure – providing visibility to AUM growth

Infrastructure sector is a key driver for the Indian economy. India has a huge unmet need for investment in infrastructure, estimated to the tune of Rs43 trillion or about $646 billion over the next five years, 70% of which will be required in the power, roads and urban infrastructure sectors. Government has planned initiatives to fast track infrastructure development with a target investment of Rs. 25 trillion (US$ 377 billion) in the sector over a period of three years. It has taken various measures like:

- Total capital and development outlay for the railways of Rs 1.31 trillion for 2017-18
- Allocated Rs. 649 billion for roads & highways
- Allocated Rs. 138.81 billion for the power sector. Rs. 33.61 billion has been earmarked for renewable energy.
- Union Budget 2017-18 has allocated Rs. 6 billion for the port sector
- UDAN scheme has been launched to improve regional air connectivity
- Accorded infrastructure status to affordable housing

The table below gives a brief view of the proposed government investment in infrastructure over the next 4-5 years. All these initiatives and targets augur well for the future of the infrastructure sector and would lead to higher demand in the infrastructure financing space.

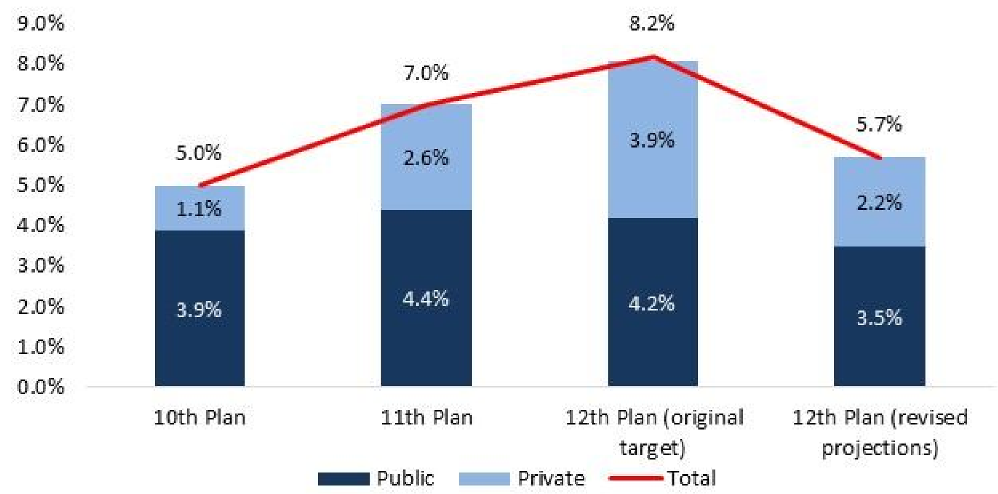
Sector	Investment (in Rs. bn)	Equipment Intensity	Opportunity (in Rs. bn)	Comments
Roads - National Highways	3900	~15%-20%	780	Investment in National Highways (FY 18 – FY 22)
Roads - State Highways	4772	~15%-20%	955	Investment in State Highways (FY 18 – FY 22)
Roads - Rural Roads	1630	~15%-20%	326	Investment in Rural Roads (FY 18 – FY 22)
Coal Mining	626	~37%	232	Coal India Limited Expected Capex (till FY2020)
Railways	6700	~3%	201	Railways Expected Capex (2016-2020)

Power	8500-9000	~1%	85-90	Expected Investments Over FY17-FY21
Ports	325-375	~16%	52-60	Expected Investments upto FY2021

(Source: Company Presentation, HDFC Sec)

While India has consistently experienced yoy GDP growth in the range of 6-8% over the last few years, infrastructure spending has witnessed a slowdown due to various macro factors. Consequently the targets for the 12th five year plan were tapered down from original estimates.

Slowdown in infrastructure spending in 12th Plan (% of GDP)



(Source: Company Presentation, HDFC sec)

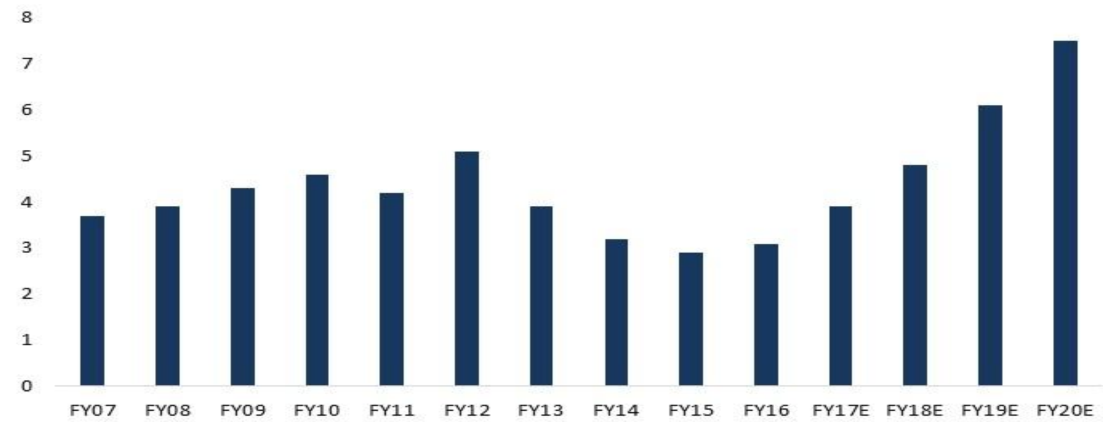
Infra spending to spur demand for construction equipment

The expected investment in infrastructure would give a boost to demand for construction equipment. As per a report titled 'Revival of Indian Construction Equipment Industry' by Indian Construction Equipment Manufacturers' Association, the equipment industry in India is expected to more than double from the 2015-16 levels of around 57,000 equipment to 1,20,000 equipment by 2019-20, registering an average yearly growth of more than 20 per cent.

The Indian construction equipment market which was witnessing a steady decline since 2012 due to the economic slowdown has turned around and is expected to post strong growth over the next 2-3 years driven mainly by the increasing investment in building infrastructure.

In the construction and mining machinery financing market, SREI holds a 30% market share. It has expanded product offerings in the leasing and financing business to non-CME including health care and technology equipment, rural equipment, Port and electric power equipment and warehouse equipment.

Sales value of construction equipment (US$ bn)

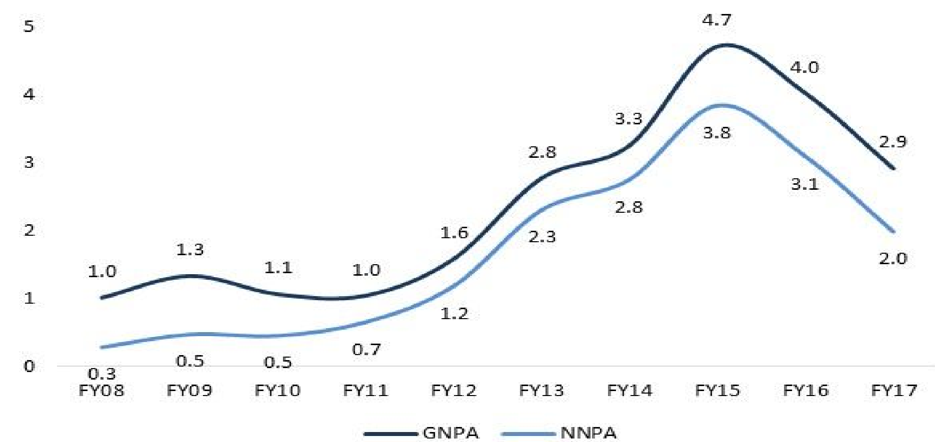


(Source: Company Presentation, HDFC sec)

Asset quality set to further improve after peaking in FY15

Asset quality of SREI deteriorated during FY11-FY15 with GNPAs increasing from 1% to 4.7%. Both the segments witnessed deterioration with GNPA of the equipment finance business rising from 2.8% to 4.8% in FY14 followed by the infrastructure finance business from 2.4% to 4.6% in FY15 due to the slowdown in the economy and a ban on mining activity. Overall NPAs peaked in FY15 and asset quality has started to improve with the recovery in economic activity. GNPA/NNPA have improved from 4.7%/3.8% in FY15 to 2.9/2% in FY17 and expected to improve further.

Sharp improvement in NPA levels



(Source: Company, HDFC sec)

The recently introduced Insolvency & Bankruptcy Code (IBC) will surely enable the much awaited resolution for the over-leveraged corporates and the bank burdened with bad loans. The timeframe for addressing issues under IBC is practical and, as and when implemented, will effectively help in resuscitating the stressed companies. As IBC has become fully operational, it will enable change in management of many stressed infrastructure assets. Infrastructure Finance Companies (IFCs) like SREI, which have specialized skill sets in managing infrastructure assets, will be well equipped to take charge of such assets and revive them.

Value unlocking possible in BRNL and Sahaj E-village

SREI holds 30.43% stake in Bharat Road Networks Ltd, a road BOT company in India, focused on development, implementation, operation and maintenance of roads/highways projects. It is involved in the development, operation and maintenance of national and state highways in several states in India with projects in states of Uttar Pradesh, Kerala, Haryana, Madhya Pradesh, Maharashtra and Odisha through partnerships with experienced EPC players in the local space where the project is located. BRNL has a project portfolio consisting of six (6) BOT Projects, of which two (2) are Projects operational under Final COD, three (3) are Projects operational under Provisional COD and one (1) is a Project under Construction. BRNL has filed DRHP with SEBI and is looking to issue 2.93 cr shares to raise ~Rs 1200 cr according to market estimates. This is likely to enhance the value of SREI's holding in the company.

To enable IT enabled financial inclusion, SREI launched Sahaj E-village in 2007 and opened IT equipped service centres (for e-governance, e-commerce and e-learning) across the rural country. Sahaj is a long–gestation rural distribution & e–governance initiative and SREI has opened 60,000 service centres throughout India in villages with populations below 10,000. Due to the accumulated losses, its net worth has eroded as at 31st March, 2017. However, it has taken a number of steps as part of a revamped business plan viz. substantial cost rationalization, business expansion in new geographies and introduction of newer services etc., and its performance is expected to improve significantly over the coming years. SREI holds 49.47% stake in the company whose value may be unlocked going forward.

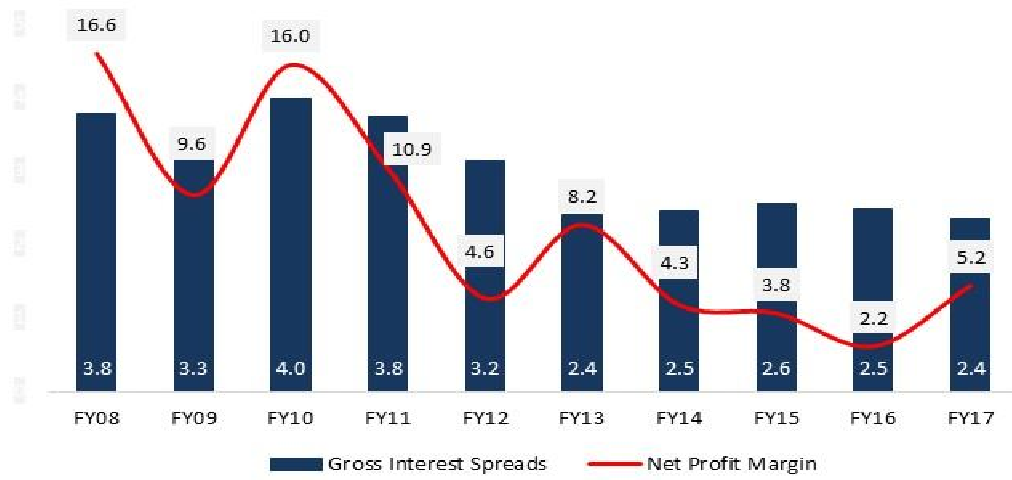
Large write off taken in FY17 may not be repeated

SREI has been going slow in infrastructure lending and gradually cleaning its loan book by writing off highly stressed assets. In FY17 SREI has written off bad debts worth Rs 510 cr as compared to just Rs 3 cr in FY16. Such large write offs are unlikely to be repeated in the coming years. Any recovery from these assets will also add to the profits going forward.

NIM and PAT margins have bottomed out – now they can only rise from here.

SREI has become cautious in infrastructure segment and lending only to safe projects. Disbursements in the construction equipment segment have also increased with the pickup in infrastructure building activity. Total advances of SREI increased by 32% in FY17. After the large write off taken in FY17 the balance sheet has become healthier and we believe margins are likely to increase going forward.

Trend in Gross Interest spreads and PAT margins

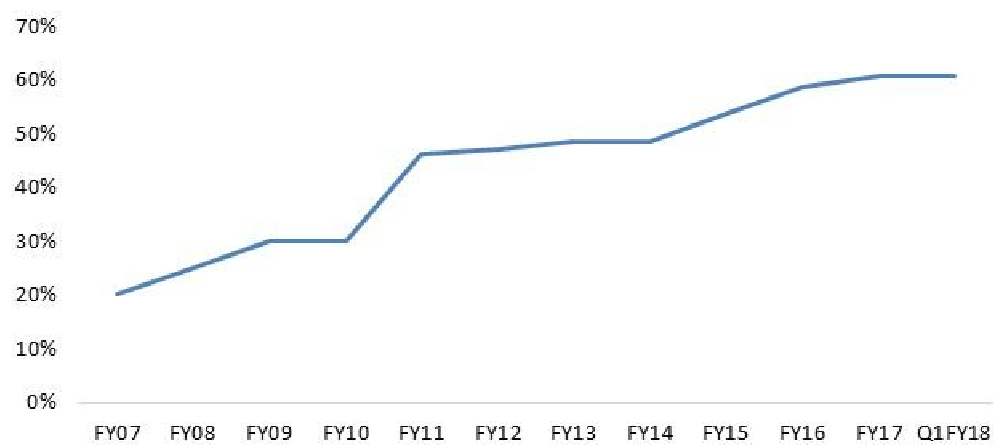


(Source: Company, HDFC sec)

Creeping acquisition by promoters

The promoters have been increasing their stake in the company through market acquisitions post 2011. Over the last 5 years the promoter holding has increased from 47.1% to 60.8%. Increase in promoter stake indicates that they are confident of strong performance by the company going ahead.

Increasing promoter share



(Source: Capitaline, HDFC sec)

Adequate capital adequacy ratio

SREI has maintained adequate capital adequacy ratio and with the stress reducing and profitability improving we believe it will not require to raise capital for the next couple of years. At the end of FY17 SREI had CAR of 18.9% against regulatory requirement of 15% and Tier I capital of 13.8%.

Concerns

Subdued domestic environment especially in the Infrastructure space which has resulted in stressed asset quality of the company

The slowdown in economy over the last few years had resulted in lower spending on infrastructure. Consequently a significant number of borrowers turned into NPA. Although the environment has improved in recent times, we cannot rule out further stress in the asset quality of the company.

Continued high exposure in group Companies and strategic investments

SREI has exposure to group companies majority of which are in the infrastructure space and are yet to be divested/diluted to yield commensurate returns.

GST initially may result in some practical issues

The new tax reform will pose several challenges for the infrastructure sector such as treating of works contracts as service contracts, the imposition of new tax rates on ongoing projects, and change in the costs of construction materials. However, the advent of GST is also expected to boost the infrastructure sector with the elimination of ´tax on tax' and the introduction of input tax credit (ITC).

For the first time in five years, in 2016 the construction equipment industry grew after the much-required push from the government in terms of budget allocation and resuming stalled projects especially in the road sector. This has pushed capacity utilisation to 50-70 per cent from around 40 per cent in 2010-11. However, in December last year, the industry was hit by demonetisation, though for a brief period. Then in April-May this year, sales were hit badly due to the confusion about the court order on the ban on BS III automobiles. Now under GST, while the input tax is 28 per cent, output is taxed at 12 per cent, and hence the balance needs to be borne by the industry. Due to this anticipated price hike, the current surge of infrastructure-related activities would be adversely affected. However the effect of this will be overcome in a few weeks and business could return to usual thereafter.

Infra space dependent on regulations and economic growth – NPA can again start growing

Infrastructure spending is highly dependent on regulations in terms of tendering, land acquisition, clearance from various agencies, etc. as well as the economic growth of the country. Change in regulations or slowdown in the economic growth could once again lead to worsening asset quality of the lenders in this space.

Q4FY17 Result Review

Operating income increased by 39.5% yoy to Rs 1103 cr driven by 100% consolidation of equipment finance business. Disbursements in equipment finance were up 9% to Rs 3538 cr while in the infra finance space it increased by 36% yoy to Rs 1964 cr. Interest expenses were up 21.3% yoy to Rs 703 cr. Other income increased from Rs 28 cr to Rs 207 cr as the company booked Rs 191 cr of non-compete fees received from Viom in the quarter. PAT increased from Rs 17 cr to Rs 63 cr yoy. Asset quality improved sequentially in equipment finance business with GNPA/NNPA contracting from 2.6%/1.8% to 2.4%/1.7% qoq respectively while in infra finance it was stable at 3.2%/2.0%.

(Rs Cr)	Q4FY17	Q4FY16	YoY (%)	Q3FY17	QoQ (%)	FY17	FY16	YoY (%)
Operating Income	1103	791	*39.5*	1110	*-0.7*	4275	3180	*34.4*
Interest Expenses	703	579	*21.3*	710	*-1.0*	2628	2311	*13.7*
Net Income	400	212	***89.1***	401	***-0.2***	1647	869	***89.5***
Other income	207	28	*647.7*	24	*760.9*	406	82	*394.7*
Total Income	608	239	***153.8***	425	***43.0***	2053	951	***115.9***
Operating Expenses	258	145	*77.7*	262	*-1.3*	921	573	*60.8*
Pre Prov. Profit	349	94	*271.6*	163	*114.0*	1132	378	*199.2*
Prov. & Cont.	250	69	*262.8*	65	*287.9*	772	272	*183.3*
PBT	99	25	*296.2*	99	*0.2*	360	106	*239.9*
Tax	36	8	*344.2*	31	*13.6*	117	44	*164.2*
PAT	63	17	***273.3***	67	***-6.0***	243	62	***294.5***
EPS (Rs)	1.3	0.3	*273.3*	1.3	*-6.0*	4.8	1.2	*294.5*

(Source: Company, HDFC sec)

View and Valuation

The Government's focus on improving the infrastructure of the country and clearing the backlog of infrastructure projects has given a boost to demand for infrastructure as well as construction equipment financing. After the sharp increase in NPA levels in FY14-FY15, SREI has become cautious and is lending only to safe projects. SREI has utilized the income from Viom stake sale to reduce its debt. Further the expected IPO from BRNL (Bharat Road Networks Ltd.) should result in value unlocking for SREI strengthening its balance sheet. The company has adequate capital for growth and improving asset quality with increasing lending opportunities should result in strong profitability for the company. Compared to other players in NBFC space, Infra & Equipment financing companies get lower valuation due to wholesale lending and higher impact of economic growth on their disbursals and NPAs. However we think SREI deserves to trade at higher than the current multiple of 1.17xFY19E P/ABV.

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Income Statement

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E
Interest Income	2794	2914	3511	4270	4841
Interest Expenses	2274	2311	2628	3133	3590
Net Interest Income	**520**	**604**	**883**	**1137**	**1251**
Non interest income	566	348	1155	548	630
Operating Income	**1086**	**951**	**2038**	**1685**	**1881**
Operating Expenses	588	573	921	988	1039
PPP	498	378	1117	697	842
Prov & Cont	310	272	772	346	431
Profit Before Tax	188	106	344	351	411
Tax	67	44	117	116	136
PAT	**121**	**62**	**243**	**235**	**275**
Extraordinary gains (net of tax)	0	0	-353	0	0
Adj. PAT	**121**	**62**	**-110**	**235**	**275**

Balance Sheet

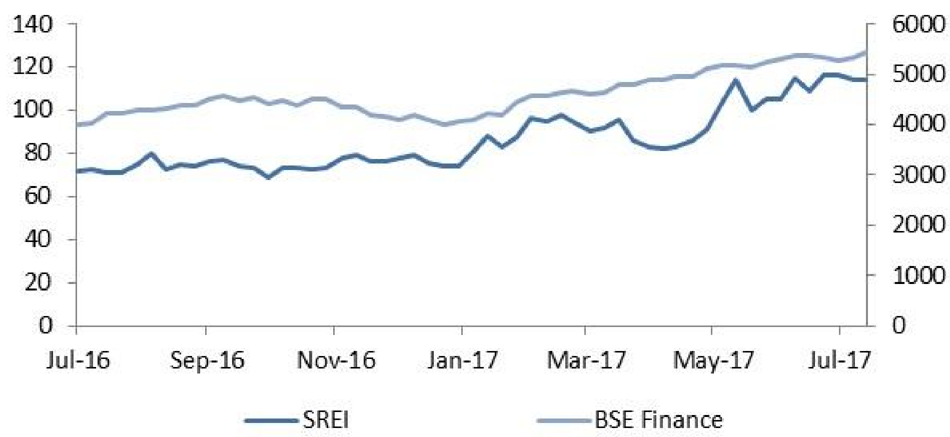
(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E
Share Capital	503	503	503	503	503
Reserves & Surplus	3081	3122	4416	4620	4865
Shareholder funds	**3585**	**3625**	**4919**	**5124**	**5369**
Minority Interest	13	1	1	1	1
Borrowings	20326	20673	26204	30762	35105
Other Liab & Prov.	971	1239	2268	2495	2721
SOURCES OF FUNDS	**24894**	**25538**	**33392**	**38380**	**43195**
Fixed Assets	1859	1740	3293	3457	3630
Investment	2250	2170	1282	1549	1696
Cash & Bank Balance	575	664	932	1023	1060
Advances	18940	20220	26713	30988	35326
Other Assets	1270	744	1172	1363	1484
TOTAL ASSETS	**24894**	**25538**	**33392**	**38380**	**43195**

Ratio Analysis (based on reported numbers)

Particulars	FY15	FY16	FY17	FY18E	FY19E
Return Ratios					
Calc. Yield on adv	17.9%	14.9%	15.0%	14.8%	14.6%
Calc. Cost of borr	11.3%	11.3%	11.2%	11.0%	10.9%
Calc. NIM	3.3%	3.1%	3.8%	3.9%	3.8%
RoAE	3.4%	1.7%	5.7%	4.7%	5.2%
RoAA	0.5%	0.2%	0.8%	0.7%	0.7%
Asset Quality Ratios					
GNPA on advances	4.1%	4.0%	2.1%	2.0%	2.1%
NNPA on advances	3.4%	3.2%	1.4%	1.4%	1.4%
Growth Ratios					
Advances	53.3%	6.8%	32.1%	16.0%	14.0%
Borrowings	2.8%	1.7%	26.8%	17.4%	14.1%
NII	38.7%	16.1%	46.3%	28.8%	10.1%
PPP	23.9%	-24.0%	195.1%	-37.6%	20.8%
PAT	-12.1%	-49.1%	294.5%	-3.2%	17.1%
Valuation Ratios					
EPS	2.4	1.2	4.8	4.7	5.5
P/E	47.3	93.0	23.6	24.4	20.8
Adj. BVPS	58.4	59.4	90.6	93.5	97.1
P/ABV	1.6	1.6	1.2	1.1	1.1
Dividend per share	0.5	0.5	0.5	0.5	0.5
Dividend Yield (%)	0.4	0.4	0.4	0.4	0.4
Other Ratios					
Cost-Income	54.1	60.2	45.2	58.6	55.3

One year Forward PABV

One year Price chart



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