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Sharekhan
Your guide to the financial jungle

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Capital First

Reco: Buy

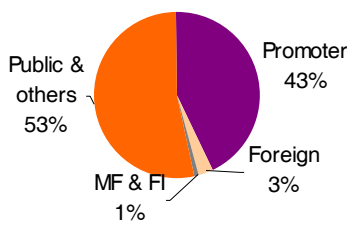
Stock Idea

Leveraging on its new-found pedigree

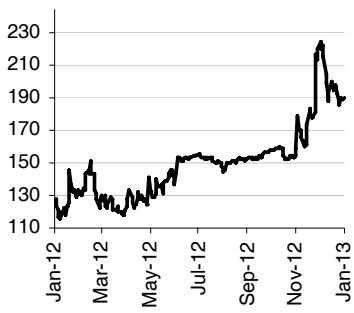
CMP: Rs190

Company details	
Price target:	Rs260
Market cap:	Rs1,245 cr
52-week high/low:	Rs235/115
NSE volume: (no. of shares)	1.8 lakh
BSE code:	532938
NSE code:	CAPF
Sharekhan code:	CAPF
Free float: (no. of shares)	3.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-13.9	20.6	24.2	55.4
Relative to Sensex	-15.0	15.7	9.8	20.4

Key points

- **A new beginning:** Capital First, the erstwhile Future Capital Holdings, has been acquired by the leading global private equity player, Warburg Pincus, from Pantaloon Retail India (in line with the Future group's strategy to exit its non-core businesses and deleverage the balance sheet of Pantaloon Retail India). As part of the transaction, Capital First's balance sheet has been cleaned up considerably with the assignment of some sticky advances (like the exposure to the Deccan Chronicle group) and the infusion of additional capital of Rs100 crore by Warburg Pincus. The accounting policies are being revised to make them more conservative and reflective of the company's actual performance.

- **Shifting gears—moving on to a higher growth trajectory:** The existing management headed by V Vaidyanathan (ex CEO and MD of ICICI Prudential Life and credited with building the consumer finance business at ICICI Bank) has a well laid-out strategy to expand in the retail and SME sectors. We see the re-energised management team in a better position to tap the vast opportunity in the high-growth retail product segments like gold loans, loan against property (LAP) and loan against shares (LAS). Moreover, the company is now well capitalised with a high capital adequacy ratio (CAR; total CAR @22.7% and tier-I CAR @18.5%) and the macro environment is likely to turn favourable as the monetary easing through policy rate cuts boosts credit demand in the retail, and small and medium enterprises (SME) segments. Consequently, the management expects to more than double its loan book to over Rs10,000 crore (Rs4,400 crore in Q2FY2013) in the next three years.

- **Robust asset quality with improving return ratios:** The management's strategy of de-risking the portfolio by expanding the secured retail book coupled with a stringent credit origination and monitoring process will help to sustain the asset quality at the prevailing healthy levels. The company's gross and net non-performing assets (NPAs) were around 0.18% and 0.04% respectively (as of September 2012), the lowest compared with the peer group. The company's provisioning policy is more stringent than the regulatory requirement and hence would not be affected by the 90-day NPA recognition norm proposed by the Reserve Bank of India (RBI). We see scope for expansion in the return ratios

Valuations

Particulars	FY2011	FY2012	FY2013E	FY2014E	FY2015E
NII (Rs cr)	87	157	254	353	495
PAT (Rs cr)	49	106	101	135	205
Growth %	*-17.1*	*115.4*	*-4.9*	*34.3*	*52.1*
EPS (Rs)	7.6	16.4	14.2	19.1	29.1
RoE (%)	6.8	13.4	10.9	12.6	17.0
RoA (%)	1.7	2.3	1.6	1.6	1.9
BV (x)	106.1	128.9	143.6	159.3	183.3
P/BV (x)	1.8	1.5	1.3	1.2	1.0
P/E (x)	25.1	11.6	13.3	9.9	6.5

(the return on equity [RoE] is expected to improve from 13.1% in FY2012 to 17% in FY2015) led by a robust growth in the earnings and the potential to improve the spreads as the company's funding cost comes down with an upgrade in its credit rating.

- **Weak macros and potential sale of Pantaloon Retail's 9% stake are risks:** In addition to an unexpected deterioration in the macro-economic environment (its relatively high exposure to the real estate sector through loan against property makes it vulnerable), the potential sale of residual stake held by the Future group (which still has a 9% stake) in the open market could limit the upside in the stock in the near term.

- **A potential re-rating candidate—Buy:** Capital First currently trades at about 1.2x FY2014E book value which is a significant discount to its peers like Bajaj Finance, Mahindra Financial Services and Shriram City Union Finance. The valuation discount is largely attributed to some legacy issues (higher wholesale lending) and a lower RoE. We believe the change in the ownership, the resolution of the legacy issues, the capital infusion and the ability to aggressively grow its loan book in the retail and SME segments could result in the re-rating of its valuation multiple. We initiate coverage on the company with a Buy recommendation and price target of Rs260 (1.5x the average of FY2014E and FY2015E book values).

Company background

Capital First (erstwhile Future Capital Holdings) is a systemically important non-banking financial company, which was incorporated in 2005 by Pantaloon Retail India. The company's business is spread across consumer lending, corporate lending and wealth management services. However, in a recent transaction Warburg Pincus acquired a 40% stake in the company from the promoters and another 24.6% stake through an open offer. Warburg Pincus also infused Rs100 crore of primary capital into the company (via central counter-parties [CCPs]). Warburg Pincus as the new promoter holds a 70.28% stake in the company, which has been rebranded as Capital First.

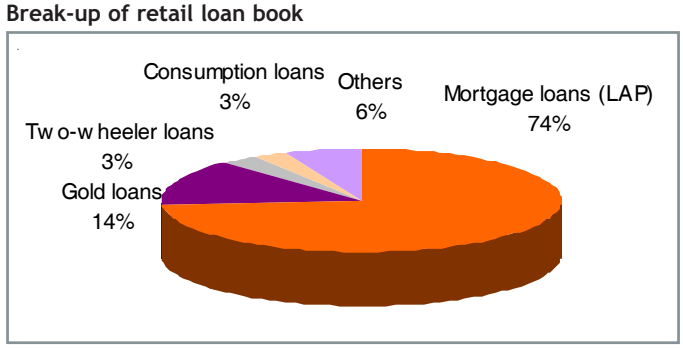
Earlier in FY2011, in a management shuffle Mr Vaidyanathan (ex CEO and MD of ICICI Prudential Life) had joined as the vice chairman and managing director of the company with an equity stake in the form of convertible warrants. The new management is focused on simplifying the organisational structure with emphasis on the lending business. Mr Vaidyanathan and his team are credited with building the secured retail, SME businesses and improving the risk management framework. As of H1FY2013, the company has loan assets of about Rs4,400 crore of which 58% is in the retail and SME segments.

Investment arguments

Making inroads into the retail and SME segments

Ever since the new management headed by Mr Vaidyanathan came on board the focus has shifted to expansion in secured retail and SME assets. Also, due to the continued sluggishness in the wholesale credit offtake compared with a steady demand for retail credit, the company has identified retail and SME segments as the next growth driver. For this it has launched several retail products such as gold loans, two-wheeler loans, mortgage loans and consumer durable loans all of which have a strong growth potential. As a result, the proportion of the retail loans to the overall portfolio has increased from 19% in FY2010 to 29% in FY2011 and 58% in Q2FY2013. The management aims to increase the proportion of retail loans to 80% of the book by FY2015. Though LAP continues to occupy a higher proportion of the loan book, but two-wheeler loans and gold financing will be the key growth drivers.

Break-up of retail loan book

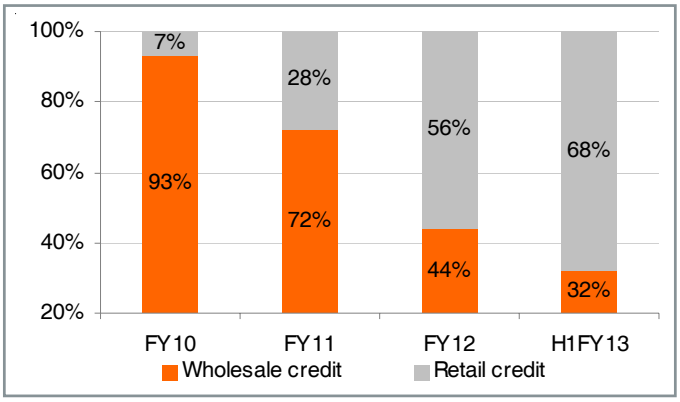


Source: Sharekhan Research, company

Business profile

Segment	Product	As a proportion of total book (%)	Yields (%)	Tenure	Avg. ticket size (Rs)
Wholesale credit	Builder finance	23.3	16-17	2-3 years	
	LAS	16.9	15	2-3 years	100-125 crore
	ICDs	2.1			
SME	LAP	41.5	14	6 years	0.8-1.0 crore
Retail	Home loans	1.2	11.5	15 years	30 lakh
	Gold loans	8.1	18	1-2 years	2-3 lakh
	Two-wheeler loans	1.7	24	1 year	~Rs30,000
	Consumer durables	1.7	24	9 months	Varies across products
	Others	3.5			

AUM break-up

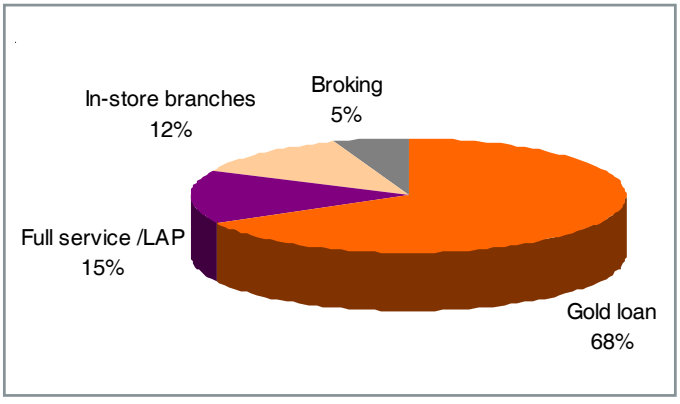


Source: Sharekhan Research, company

Experienced management and strong distribution network to support growth in retail assets

The company has a highly experienced and qualified management team headed by Mr Vaidyanathan (ex CEO and MD of ICICI Prudential Life) who has been instrumental in building the retail and SME businesses and implementing the effective risk management systems at Capital First. Mr Vaidyanathan, who is credited with launching and building the retail business at ICICI Bank, is accompanied by other experienced members which will help in effective implementation of the new strategies. We see the re-energised management team in a better position to tap the vast opportunity in the high-growth retail product segments like gold loans, LAP and LAS.

Branch distribution



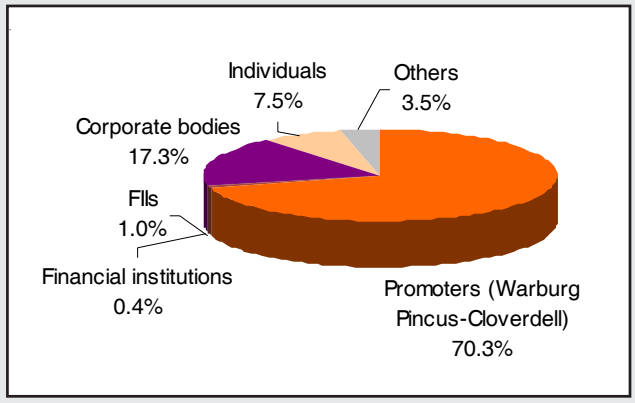
Source: Sharekhan Research, company

The company has established its business in 40 cities (mainly tier-I and tier-II cities) across India through an extensive network of 202 branches. Of the total 202 branches, 68% branches are gold loan branches, 15% are full service/LAP branches and 12% are in-store branches (based on the Future group stores). Going ahead, the management plans to focus on tier-I and tier-II cities and would fully leverage the company's skill sets to exploit the opportunities therein.

Deal with Warburg Pincus

- On September 28, 2012, Warburg Pincus acquired a 40% stake in the erstwhile Company Future Capital Holdings from the Future group.
- Warburg Pincus also infused Rs100 crore of primary capital into the company (via CCPS) of which 50% has been already converted into equity and the rest may be converted too within 18 months.
- Warburg Pincus acquired another 24.6% stake in the erstwhile Company Future Capital Holdings from the public.
- Warburg Pincus as the new promoter now holds 70.3% of the entire equity share holding of the company, which has been renamed Capital First.

Equity shareholding pattern (as on Dec 21, 2012)

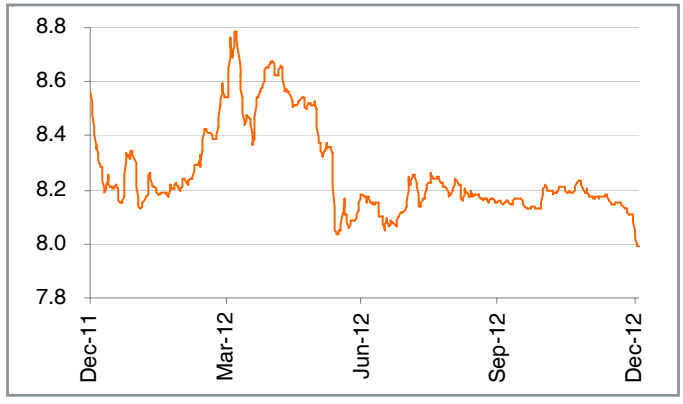


Source: Sharekhan Research, company

Margins likely to remain stable

The company is likely to maintain its net interest margin (NIM) of 4.9-5.0% due to a presence in the high-yielding segments (eg two-wheeler, gold and SME loans). Further, most of the borrowings are for the long term and matched with asset maturity. Though the interest rates have come off since the beginning of the fiscal, but any further softness in the interest rates contributed by the likely easing of the RBI's monetary policy will cushion the NIM.

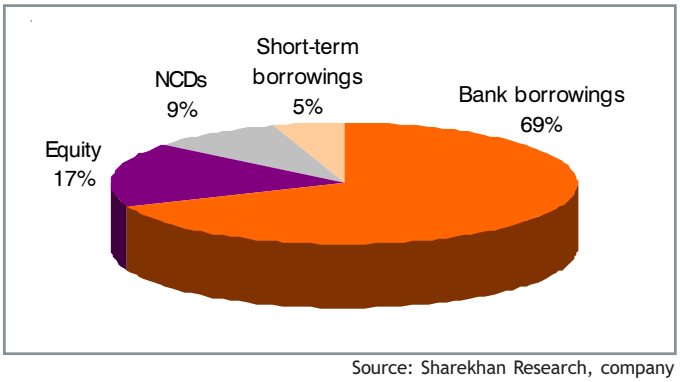
Movement of rates (10 year G-Sec yield in %)



Source: Bloomberg

The company accesses around 70% of the borrowings from banks followed by non-convertible debenture (NCDs; 9%) and short-term instruments (5%). However, over 90% of the borrowings are long-term in nature which is matched with the tenure of the assets. Recently, the company's rating was upgraded by CARE to "AA" which will enable the company to raise resources at competitive rates. Going ahead, the management plans to diversify the borrowing mix by raising resources through subordinate bonds, NCDs etc.

Borrowing mix



Source: Sharekhan Research, company

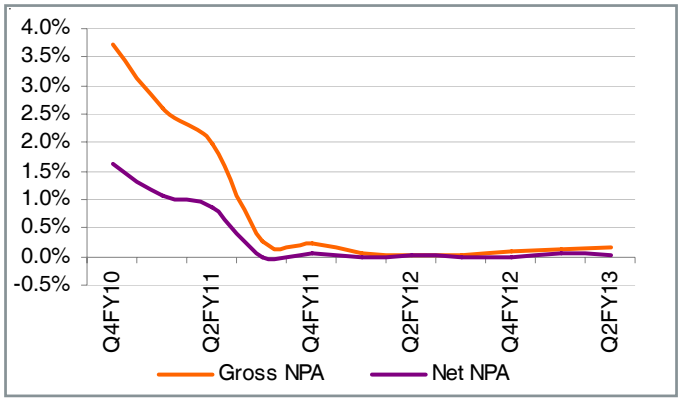
Fee income streams trending well

Currently, 85% of the company's income is fund based while 15% is fee based and the proportion is likely to be maintained. Capital First provides a range of service-based offerings like wealth management services, broking services, property services and distribution of financial products (eg insurance) which completely meet the needs of a customer. The company operates its wealth management service via ten full service branches across India and has a team of 70 private wealth managers. It advises over 2,000 high net worth individuals. Capital First has also started loan syndication as a fee-based product for its corporate customers.

Robust asset quality sustainable

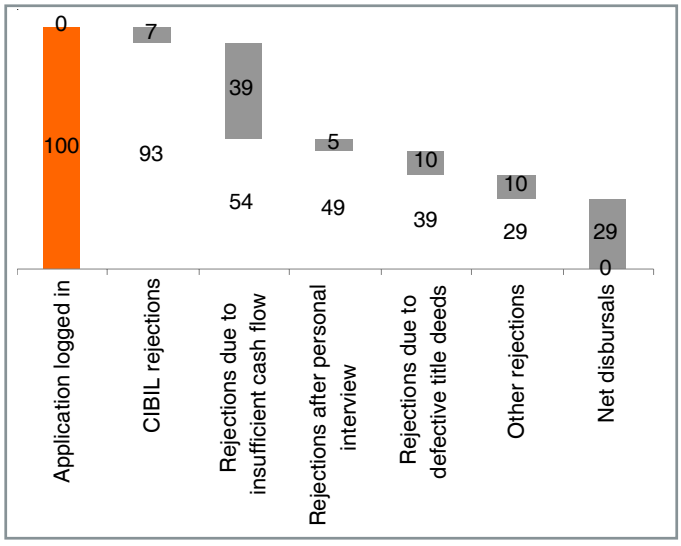
The company's asset quality remains healthy as its gross and net NPAs were merely 0.18% and 0.04% respectively in Q2FY2013. The company has derisked its balance sheet (by assigning the sticky loans and increasing the proportion of the retail loans) and developed stringent credit appraisal and risk mechanisms for different products which will contain the slippages. The application/approval ratio is 29% which indicates a stringent credit appraisal process. In addition, the company follows a unique structure whereby the functions of different department are separated from each other which aid in monitoring the portfolios.

Asset quality trend



Source: Sharekhan Research, company

Application/Rejection ratio in %



Source: Sharekhan Research, company

Cost/Income ratio to trend down post-investment phase

In order to implement the retail expansion strategy the company invested in acquiring the required skill sets for different products and expansion of the branch infrastructure. The number of employees increased to 1,272 in FY2012 from 400 in FY2011 while the number of branches increased to 202 in Q2FY2012 from 90 branches in FY2011. This contributed to a sharp rise in the expenses leading to a surge in the cost/income ratio to about 50%, which is higher than that of its peers. Since the company is in the process of building business in segments like two-wheeler and gold loans, its cost/income ratio may remain high for the next four to six quarters. However, the management has an ambitious plan to improve the cost/income ratio to about 35% by FY2015 which will boost the return ratios.

Shift to conservative accounting practice—positive for long term

In Q2FY2013, the company changed its accounting policy and made it more conservative. Earlier the company was following a policy of booking some of the incomes upfront (fee and securitisation incomes) which are now being amortised over the average tenure of loans. This could result in a drop in the profit for a couple of quarters till the impact gets neutralised. This measure will reduce the bulkiness and improve the volatility in the Profit and Loss Account and hence will be positive in the long term.

Valuation and outlook

We see scope for expansion in the return ratios (the RoE is expected to improve from 13.1% in FY2012 to about 17% in FY2015) led by a robust growth in the earnings (at a compounded annual growth rate of 26% over FY2012-14) and the potential to improve the spreads as its funding cost drops with an upgrade in its credit rating.

Capital First currently trades at about 1.2x FY2014E book value which is a significant discount to its peers like Bajaj Finance, Mahindra Financial Services and Shriram City Union Finance. The valuation discount is largely attributed to some legacy issues (higher wholesale lending) and a lower RoE. We believe the change in the ownership, the resolution of the legacy issues, the capital infusion and the ability to aggressively grow its loan book in the retail and SME segments could result in the re-rating of its valuation multiple. We initiate coverage on the company with a Buy recommendation and price target of Rs260 (1.5x the average of FY2014E and FY2015E book values).

Comparative analysis

Particulars	RoE (%)			RoA (%)			P/BV (x)		
	FY13E	FY14E	FY15E	FY13E	FY14E	FY15E	FY13E	FY14E	FY15E
Bajaj Finance	23.0	22.1	21.6	3.6	3.4	3.3	2.7	2.2	1.8
Mahindra Finance	22.8	22.3	23.2	3.8	3.7	3.6	3.2	2.7	2.5
Shri Ram City Union Finance	22.9	23.0	22.5	3.1	2.9	3.1	3.1	2.5	2.1
Capital First	11.1	12.8	17.0	1.6	1.7	1.9	1.3	1.2	1.0

Source: Sharekhan Research, *Bloomberg consensus

Financials

Profit & Loss statement Rs cr

Particulars	FY11	FY12	FY13E	FY14E	FY15E
Net interest income	**87**	**157**	**254**	**353**	**495**
Non interst income	135	190	191	224	268
Net total income	**221**	**346**	**445**	**577**	**764**
Operating expenses	103	172	257	319	382
Operating profits	119	174	188	259	382
Provision	35	23	46	64	87
PBT	84	152	142	194	295
Taxes	35	46	41	59	89
PAT	**49**	**106**	**101**	**135**	**205**

Balance sheet Rs cr

Particulars	FY11	FY12	FY13E	FY14E	FY15E
Liabilities					
Share capital	65	64	71	71	71
Reserves and surplus	682	767	944	1,055	1,225
Networth	747	832	1,015	1,126	1,296
Borrowings	2,624	4,386	5,487	7,623	10,370
Current liabilities and provisons	269	467	523	602	692
Total liabilities	**3,640**	**5,685**	**7,025**	**9,351**	**12,357**
Net block	83	101	116	130	145
Investments	260	264	267	270	272
Loans and advances	2,857	4,447	5,776	8,024	10,915
Current assets	425	859	859	920	1,017
Deffered tax assets	6	7	7	7	7
Other assets	9	8	-	-	-
Total assets	**3,640**	**5,685**	**7,025**	**9,351**	**12,357**

Key ratios

Particulars	FY11	FY12	FY13E	FY14E	FY15E
Per share data (Rs)					
EPS	7.6	16.4	14.2	19.1	29.1
BV	106.1	128.9	143.6	159.3	183.3
ABV	105.1	127.7	143.8	159.6	183.3
DPS	1.5	1.5	2.1	2.9	4.4
Spreads (%)					
Yield on funds	12.3	15.2	15.3	14.8	14.8
Cost of funds	9.5	11.3	10.6	10.2	10.0
Net interest margins	4.0	4.3	5.0	5.1	5.2
Operating ratios (%)					
Interest expended/ interest earned	67.4	71.8	67.4	65.5	64.5
Cost to income	46.5	49.7	57.7	55.2	50.0
Non interest income/ total income	60.7	54.8	42.9	38.9	35.1
Return ratios (%)					
RoAE	6.8	13.4	10.9	12.6	17.0
RoAA	1.7	2.3	1.6	1.6	1.9
Assets/equity (x)	4.9	6.8	6.9	8.3	9.5
Dividned yield	0.8	0.8	1.1	1.5	2.3
Growth ratios (%)					
Net interest income	39.5	80.1	62.4	38.7	40.5
PPP	74.6	46.9	8.1	37.3	47.8
PAT	-17.1	115.4	-4.9	34.3	52.1
Advances	90.9	55.6	29.9	38.9	36.0
Borrowings	123.2	67.2	25.1	38.9	36.0
Valuation ratios (x)					
P/E	25.1	11.6	13.3	9.9	6.5
P/BV	1.8	1.5	1.3	1.2	1.0
P/ABV	1.8	1.5	1.3	1.2	1.0

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Automobiles

Sector Update

In reverse gear

Volumes decline post-festive season

The domestic automobile (auto) companies are facing demand challenges after the end of the festive season in November. In December 2012, except for Mahindra and Mahindra (M&M; the automotive segment) and Hero MotoCorp (Hero), most of the auto companies reported a volume decline . On a year-till-date (YTD) basis, there has been a drop in the sales of most auto companies except for Maruti Suzuki (Maruti) and M&M.

MHCVs and two-wheelers most affected

While the slowdown is broad-based, the medium and heavy commercial vehicle (MHCV) and two-wheeler segments have been affected the most. MHCV sales have witnessed pressure with a double-digit decline in volumes on a YTD basis. Two-wheeler sales have continued to moderate with the YTD growth slipping to low single digits.

FY2013 to end on a weak note, expect recovery in FY2014

Auto volumes are unlikely to recover in Q4FY2013, given the weak sentiment. Auto sales are likely to remain subdued in FY2013. We expect a gradual recovery in FY2014 on the back of an improved economic outlook, improved policy action and softening of the interest rates.

M&M: auto sales moderate, tractor sales disappoint

- M&M's auto sales moderated to mid single digits, growing by 6% year on year (YoY) to 45,297 units.
- Utility vehicle (UV) sales maintained a strong momentum growing at 17.7% YoY.
- Sales of light commercial vehicles (LCVs; Gio + Maxximo) moderated significantly and remained flat YoY.
- Three-wheeler sales declined by 9% YoY.
- Sales of heavy commercial vehicle (HCV) Navistar declined significantly on the back of the weakness in the MHCV industry.
- Exports grew by 4.2% to 2,990 units.
- The domestic tractor sales disappointed with a 10.5% year-on-year (Y-o-Y) decline even on a low base of December 2011. Tractor exports declined by 10.4% to 1,047 units.

M&M: December 2012 sales performance

Particulars	Dec -12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
UV + Verito	22761	19341	-7.5	17.7	203447	156547	30.0
Three-wheeler Alfa	5209	5744	-24.1	-9.3	50065	51114	-2.1
GIO + Maxximo	13706	13757	-4.5	-0.4	127403	110730	15.1
Total vehicles M&M	41676	38842	-9.1	7.3	380915	318391	19.6
CV (Navistar)	631	1049	-32.2	-39.8	8535	9506	-10.2
Total auto—domestic	**42307**	**39891**	**-9.5**	**6.1**	**389450**	**327897**	**18.8**
Exports M&M	2990	2870	115.4	4.2	24692	20543	20.2
Total auto	**45297**	**42761**	**-5.9**	**5.9**	**414142**	**348440**	**18.9**
Tractors-domestic	13712	15315	-30.6	-10.5	165699	173519	-4.5
Tractors-exports	1047	1169	45.6	-10.4	8519	9850	-13.5
Total tractors	**14759**	**16484**	**-27.9**	**-10.5**	**174218**	**183369**	**-5.0**

Tata Motors: sales decline across segments except LCV

- Tata Motors' overall sales declined by 20% YoY to 65,582 units. The sales declined across segments except the LCV segment.
- Its MHCV sales remained under pressure with a 46% Y-o-Y decline. The LCV sales, however, bucked the trend with a strong 28% Y-o-Y growth.
- Passenger car sales disappointed with a 51% Y-o-Y decline. This is the fourth consecutive month of declining sales.
- Its export sales declined by 31% YoY to 3,882 units.

Tata Motors: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
M&HCV domestic	9866	18247	3.9	-45.9	109178	147367	-25.9
LCV domestic	37649	29500	8.1	27.6	281192	227101	23.8
Cars domestic	14185	28916	-21.3	-50.9	183977	206899	-11.1
Exports	3882	5615	-6.4	-30.9	39403	45213	-12.9
Total	**65582**	**82278**	**-1.4**	**-20.3**	**613750**	**626580**	**-2.0**

Ashok Leyland: MHCV sales decline, LCV sales moderate

- Ashok Leyland's MHCV sales declined by 33% YoY to 5,230 units. This is the second consecutive month of more than a 30% decline in the company's MHCV sales.
- The sales of LCV Dost grew by 73% YoY. However, on a month-on-month (M-o-M) basis the sales declined by 28%.
- The overall sales declined by 19% YoY to 7,299 units.

Ashok Leyland: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
MHCV sales	5230	7853	16.6	-33.4	56092	63525	-11.7
Dost	2069	1195	-28.2	73.1	23898	2796	754.7
Total sales	**7299**	**9048**	**-1.0**	**-19.3**	**79990**	**66321**	**20.6**

Eicher Motors: sales decline on weakness in MHCV industry

- The company's domestic sales declined by 20% YoY to 3,598 units. The weakness in the MHCV industry is affecting the demand for its products.
- Its export sales declined by 19.5% YoY to 434 units.

Eicher Motors: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	CY12	CY11	YoY (%)
Domestic	3598	4512	5.3	-20.3	45761	45229	1.2
Exports	434	539	195.2	-19.5	2501	3108	-19.5
Total sales	**4032**	**5051**	**13.1**	**-20.2**	**48262**	**48337**	**-0.2**

Hero MotoCorp: sales rebound after a fall in November

- Hero's sales rebounded after a fall in November 2012. The sales remained flat at 5,41,615 units.
- On a YTD basis, the sales declined by 2.5% YoY.

Hero MotoCorp: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
Two-wheelers	541615	540276	7.8	0.2	4548232	4663178	-2.5

Bajaj Auto: sales grow on a low base

- Bajaj Auto's motorcycle sales grew by 13% YoY on a low base of the corresponding period of the last year. The company is witnessing a strong demand for its new products, Discover ST and Pulsar NS.
- Its three-wheeler sales increased for the third consecutive month with an 8.6% growth on the back of the opening of new permits.
- Its export sales recovered with a growth of 5.3% YoY to 1,26,016 units

Bajaj Auto: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
Motorcycles	298350	263699	-8.7	13.1	2897410	2937157	-1.4
Three-wheelers	45596	41991	0.1	8.6	358510	395236	-9.3
Total two- and three- wheelers	**343946**	**305690**	**-7.6**	**12.5**	**3255920**	**3332393**	**-2.3**
Exports of above	126016	119708	1.5	5.3	1182152	1232410	-4.1

TVS Motor: two-wheelers remain under pressure, three-wheelers register strong growth

- TVS Motor Company's two-wheeler sales declined by 9.6% YoY to 151,735 units.
- Its scooter and moped sales faced pressure with a decline of 32% and 8% respectively. Its motorcycle sales registered a mid single-digit growth on the back of the newly launched Phoenix.
- Its three-wheeler sales grew strongly by 77.8% YoY to 4,486 units.

TVS Motor: December 2012 sales performance

Particulars	Dec-12	Dec-11	MoM (%)	YoY (%)	YTD FY13	YTD FY12	YoY (%)
Motorcycles	60210	56662	-8.1	6.3	562625	648717	-13.3
Mopeds	61127	66439	-4.2	-8.0	582320	577738	0.8
Scooters	30398	44804	-18.9	-32.2	343816	411538	-16.5
Total two-wheelers	**151735**	**167905**	**-9.0**	**-9.6**	**1488761**	**1637993**	**-9.1**
Three-wheelers	4486	2523	-11.2	77.8	34894	32047	8.9
Overall sales	**156221**	**170428**	**-9.1**	**-8.3**	**1523655**	**1670040**	**-8.8**

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