AXIS DIRECT

29 MAR 2017 Company Update

SHRIRAM TRANSPORT FINANCE

BANKS & FINANCIAL SERVICES

HOLD

Target Price: Rs 1,040

Shift to stricter NPA regime anoverhang

We interacted with Mr. Sanjay Mundra, Senior VP at Shriram Transport Finance Ltd. (SHTF), at our Auto Conference to get an update on the business and understand the demand outlook. Mr. Mundra believes that the growth will remain uneven over the medium term, with Q4 likely to register decent growth, followed by a damp H1FY18 and a steady recovery after that (contingent on monsoon and GST).

However, the big overhang on the stock continues to be the transitionto lower GNPA recognition bucket (120 dpd by end-FY17 and 90 dpd by end-FY18). Credit costs are thus likely to remain elevated in the near term though improvement is likely given the benign CV cycle. Despite higher interest reversal, NIMto remain resilient cushioned by declining cost of funds.**MaintainHOLD.**

CMP	: Rs 1,047
Potential Upside	: -1%

MARKET DATA

No. of Shares	: 227 mn
Free Float	: 74%
Market Cap	: Rs 239 bn
52-week High / Low	: Rs 1,325 / Rs 778
Avg. Daily vol. (6mth)	: 861,045 shares
Bloomberg Code	: SHTF IB Equity
Promoters Holding	: 26%
FII / DII	: 52% / 4%

Summary of management's comments

- **Growth:** Expect 15% loan growth in FY18, 18-20% in FY19; growth to be back-ended
- **Margin:**~30% liabilities to re-price in FY18 and FY19 each, benefitting cost of funds and supporting NIM
- **Credit costs:**To remain high given transition to stricter NPA recognition; to normalize thereafter
- **GNPA:** To increase 120-150 bps for every 30-day bucket shift in GNPA recognition

Maintain HOLD with TP of Rs 1,040 (2.3x FY18E ABV; 1% downside from CMP): Though management seems optimistic on growth, we expect it to be challenging given the backdrop of rising competition from banks, NBFCs and new players (SFBs). Yieldsmay face pressure due to higher demand from low-yielding assets, however re-pricing of significant portion of liabilities will provide some cushion to NIM. Transition to 120 dpd in the current quarter and further to 90 dpd by end-FY18 may pose another challenge to asset quality and NIM (interest reversal).At CMP, SHTF trades at2.3x FY18E ABV of Rs 449.

Financial summary (Standalone)

Y/E March	FY16	FY17E	FY18E	FY19E
PAT (Rs mn)	11,782	14,645	17,690	20,673
EPS (Rs)	52	65	78	91
EPS chg (%)	(4.8)	24.3	20.8	16.9
Book value (Rs)	448	497	557	627
Adj. BV (Rs)	412	427	449	514
PE (x)	20.2	16.2	13.4	11.5
P/ABV (x)	2.5	2.5	2.3	2.0
RoE (%)	12.2	13.7	14.8	15.4
RoA (%)	1.9	2.1	2.2	2.3
Net NPA (%)	1.8	3.3	4.6	4.1

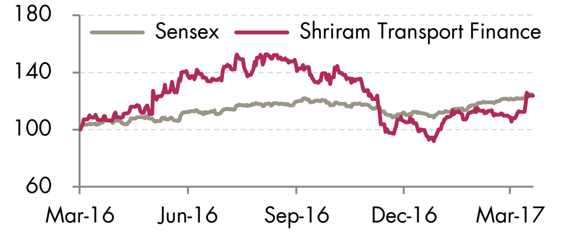
Source: Company, Axis Capital

Note: GNPAs/NNPAs/other ratios are on calculated basis and may differ from reported numbers

Key drivers(%)

	Q4'16	Q1'17	Q2'17	Q3'17
Disb. growth	39	15	3	(23)
Reported NIM	7.7	7.4	7.1	7.2
GNPA Ratio	6.2	6.4	6.6	6.6

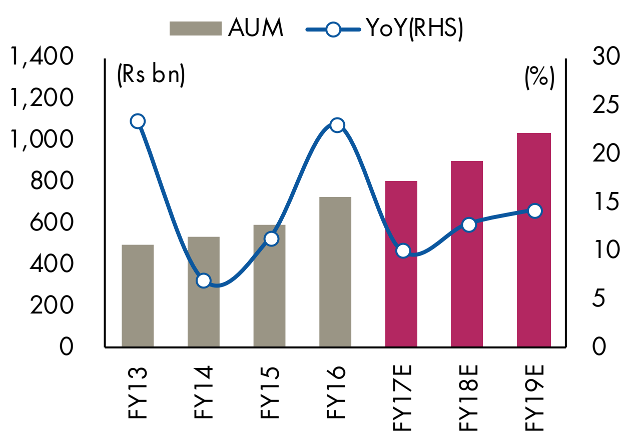
Price performance



Growth outlook

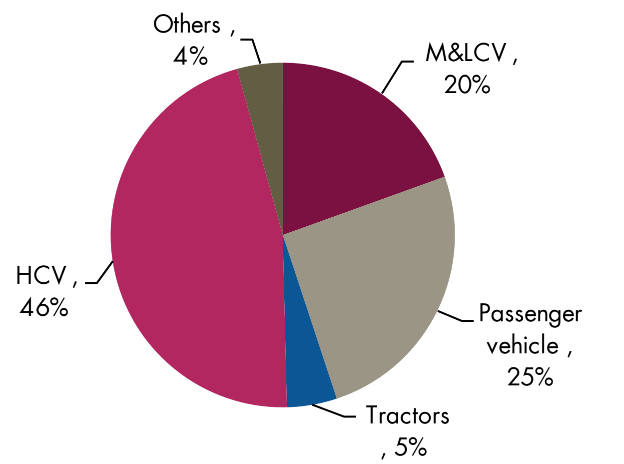
- **Comments on near, medium & long term growth outlook**
  - SHTF expects disbursements to pick up in Q4FY17 driven by replacement demand, waning effect of demonetization (complete stability by April first week) and BS-4 (auto emission norms) led pre-buying
  - Management stated that demonetization helped drive some fringe, informal financiers out of business, and is likely to be a long term tailwind for the sector
  - **Management expects 15% growth in FY18 and 18-20% growth in FY19.** Growth may be lower during H1FY18 (seasonally weak, pre-buying to exhaust demand) followed by a sharp recovery in H2FY18
  - Monsoon and GST will be key monitorables for medium term and long term growth, respectively
  - SHTF believes that industry utilization levels for fleet operators are at 20-21 days per month and, new capacity additions will likely kick in only once utilization levels are consistently above 25-26 days per month. In the meanwhile, replacement demand will drive growth
- **GST will bring in productivity gains**
  - SHTF stated that while the impact of GST on HCV and MHCV fleet operators is not clear, LCV industry will not be cornered into consolidation given the fragmented nature of operations and the need for last mile connectivity
  - While road infra is a spoil sport for last mile connectivity, GST will nonetheless bring in some productivity gains for the industry
- **Used CV market stable**
  - While prices of used CVs declined sharply during demonetization, these were more anecdotal than indicative of industry trend
  - Used CV industry is highly broker-driven and cash-intensive, and transaction volumes crashed after demonetization
  - Management believes resale values are come back to normal level due to re-monetization and younger vintage vehicles set to hit the industry after BS-4 auto emission norms

Exhibit 1: Trend in AUM growth



Source: Company, Axis Capital

Exhibit 2: Product mix of VF portfolio (Q3FY17)

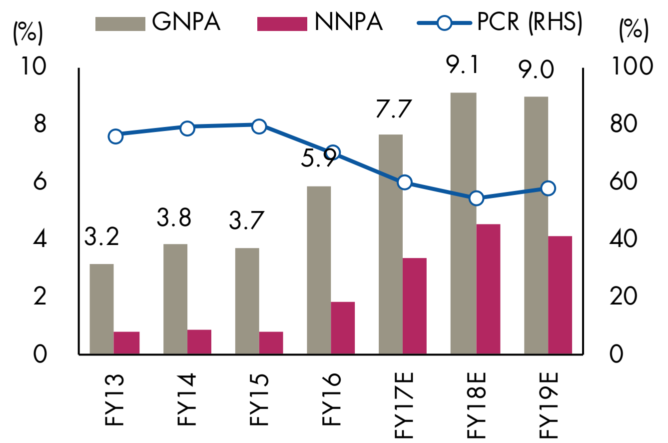


Source: Company, Axis Capital

Asset quality

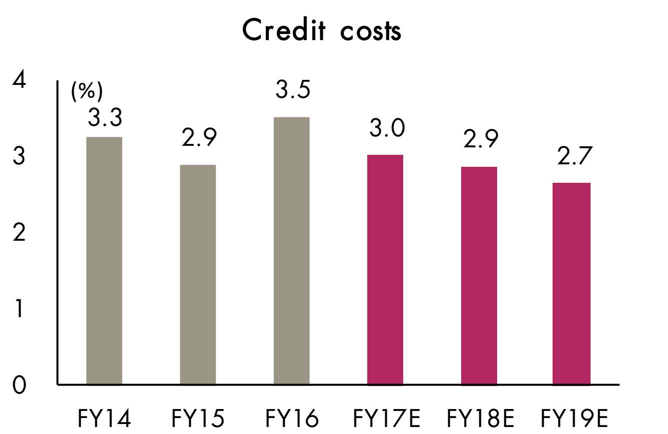
- Collections have been affected by demonetization. Not only was this due to shortage of cash, but also due to business lost (cash-economy)
- Collections however are improving MoM. Management expects disbursements to stabilize by April first week after the slowdown over Nov-Feb
- SHTF would move from 150 dpd to 120 dpd NPA recognition in Q4FY17, and further to 90 dpd in FY18
- Management expects 120-150 bps rise in GNPA for every bucket move, hence GNPAof 6.6% as of Q3FY17 could rise to ~7.7% by FY17E and further to ~9.1% in FY18E without factoring in any improvement in macro environment

Exhibit 3: Headline asset quality optically elevated with move to lower NPA recognition



Source: Company, Axis Capital

Exhibit 4: Credit cost to remain elevated in near term

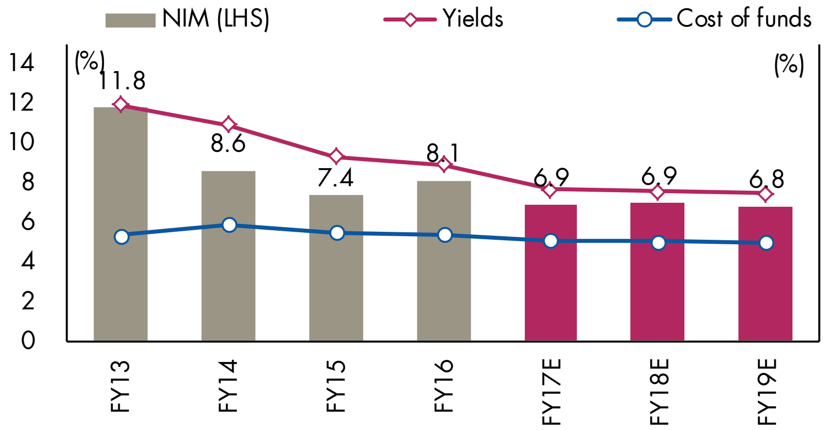


Source: Company, Axis Capital

Significant chunk of liabilities to reprice ahead

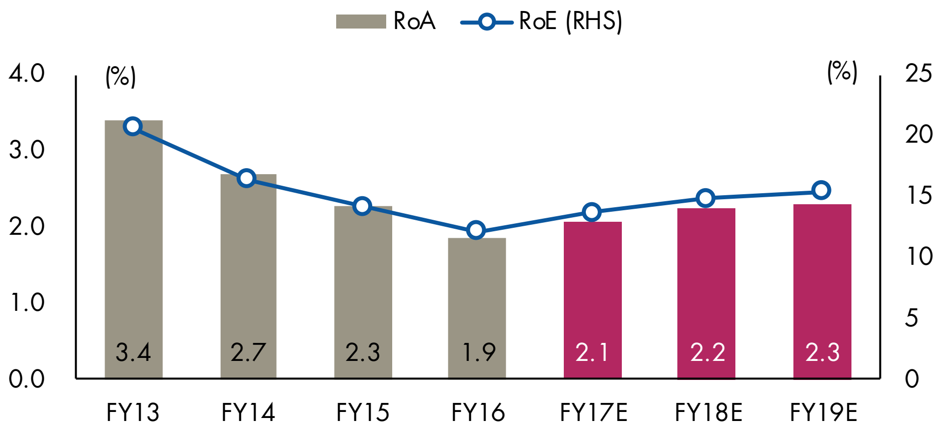
- Shift in loan mix away from high-margin used CV loans would weigh on yields, but would be compensated by fall in cost of funds
- 30% of liabilities will get repriced lower in FY18 and FY19 each, reducing cost of funds

Exhibit 5: NIM to remain stable over FY17-19E after coming off significantly from highs of ~12% last seen in FY13



Source: Company, Axis Capital

Exhibit 6: Expect return ratios to remain stable despite migration to lower dpd NPA recognition



Source: Company, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs bn)

Y/E March	FY16	FY17E	FY18E	FY19E
Interest earned	99	99	110	123
Interest expended	(51)	(53)	(58)	(65)
Net interest income	**48**	**47**	**52**	**58**
Non interest income	3	10	11	12
Net income	**52**	**57**	**63**	**70**
Operating expenses	**(13)**	**(13)**	**(13)**	**(14)**
Staff expenses	(6)	(6)	(6)	(6)
Other operating expenses	(8)	(7)	(7)	(8)
Operating profit	**38**	**44**	**50**	**55**
Provisions & contingencies	(21)	(22)	(23)	(24)
Pre-tax profit	**18**	**22**	**27**	**31**
Tax expense	(6)	(8)	(9)	(11)
Profit after tax	**12**	**15**	**18**	**21**
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	12	15	18	21

Balance sheet (Rs bn)

Y/E March	FY16	FY17E	FY18E	FY19E
Total assets	**680**	**740**	**835**	**959**
Cash & Balances with RBI	39	20	23	27
Investments	14	12	11	12
Advances	619	681	771	886
Fixed assets	1	1	1	1
Other assets	7	26	29	33
Total liabilities	**680**	**740**	**835**	**959**
Equity capital	2	2	2	2
Preference capital	-	-	-	-
Reserves & surplus	99	111	124	140
Networth	102	113	126	142
Borrowings	498	544	609	699
Deposits	-	-	-	-
Other liabilities & prov.	80	84	99	117

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17E	FY18E	FY19E
Per share data				
FDEPS (Rs.)	52	65	78	91
BV (Rs.)	448	497	557	627
Adj. BV (Rs.)	412	427	449	514
DPS (Rs.)	12	15	18	21
Dividend payout (%)	23	23	23	23
Yields & Margins (%)				
Yield on advances	17.8	15.3	15.1	14.8
Cost of deposit	-	-	-	-
Net interest margin	8.1	6.9	6.9	6.8
Asset quality (%)				
Gross NPAs	5.9	7.7	9.1	9.0
Net NPAs	1.8	3.3	4.6	4.1
Credit cost	3.5	3.0	2.9	2.7
Provisioning coverage	70.4	60.1	54.7	58.1
Capital (%)				
Tier-I	14.7	12.7	11.2	10.2
CAR	17.6	14.7	13.0	11.8
Efficiency (%)				
ROA	1.9	2.1	2.2	2.3
ROE	12.2	13.7	14.8	15.4
Cost to income	26	23	21	21
CASA	-	-	-	-
Effective tax rate	34	34	34	34
Growth (%)				
Net interest income	34	(4)	11	12
Fee income	-	-	-	-
Operating expenses	20	(5)	3	9
Profit after tax	(5)	24	21	17
Advances	26	10	13	15
Deposits	-	-	-	-
Total assets	15	9	13	15

Source: Company, Axis Capital

Note: NPAs in above table are calculated as a percentage of on-book loans

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HOLD	Between 10% and -10%
SELL	Less than -10%

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