



Choice
Nurturing Financial Excellence

IPO REPORT

“Avoid” To
INDOSTAR CAPITAL FINANCE

Salient features of the IPO:

- Indostar Capital Finance Limited (ICFL)**, established in 2009, is a leading NBFC lending to mid-to-large sized corporates in manufacturing, services and infrastructure industries and real estate developers of residential and commercial building projects.
- The company has recently ventured into other segments such as housing finance and vehicle finance

Valuation : At the higher price band of Rs572, ICFL's share is valued at P/ABV multiple of 1.9(x) (to its post issue FY18 annualized adjusted BVPS).

Below are few key observations of the issue:

- ICFL is only a nine years old NBFC, commenced business in 2011 in order to leverage the growth opportunities in the corporate lending space. Started business with the upfront capital to the tune of Rs9 bn, ICFL is promoted by Indostar Capital. Everstone Capital, a leading private equity player is the lead investor of Indostar Capital holding 51.2% stake (pre-issue). Post issue after a OFS of Rs18.4 bn and fresh issue of Rs7 bn, promoter stake will reduce from 91.6% (pre-issue) to 59.0%.
- The company has started operations with focus on corporate segment under which it provide loans to mid-to-large sized companies in the manufacturing, services and infrastructure industries and real estate developers executing residential and commercial projects.
- The company underwrites large ticket loans for corporates instead of participating in syndicated loans which gives it flexibility to customize the terms of financing to suit specific situations.
- ICFL provides corporate loans on floating interest rates and tenor may range primarily from 3 to 5 years with an option to prepay without incurring any penalty. The company has 36 corporate customers and this accounted for 76.8% of total loan book as of as of Dec'31 2017.
- Further, ICFL has maintained a strong yield on the book in the range of 14.0%-14.6% since FY15. As per the management, ICFL continued to track 200-250 corporates studied their capital structure and ask them to take credit, besides providing valuation insight over the fund utilization.
- While corporate book increased from Rs18.3 bn in FY13 to Rs39.7 bn as of Dec'31 2017, GNPA maintained at 1.7%. Secured loan book stood at 88.8% by Dec'31 2017.
- In order to diversify loan book, the company has entered into SME lending in 2015 and share of this book has increased to 23% by Dec'31 2017 with yield ranging between 11.3%-10.4% during this period. NIM in the range of 6.5%-6.9% over the last three years was significant considering the high exposure to corporates.
- ICFL has started vehicle finance business during Nov'2017 under which in will focus more on used commercial vehicle finance in the range of 3-5 years. Further, the company has taken housing finance license under which it will focus on affordable housing space and retail housing finance. However, the company does not have retail business experience and in this highly competitive retail business, it would remain a difficult task for it to generate strong growth from this segment.
- CAR ratio at 31.6% by Dec'31 2017 shows that the balance sheet has been remained underutilized and the company is raising further Rs7 bn as a fresh issue. Post issue, FY18 annualized RoE of the business reduced to single digit to 7.7%, significantly lower than the well managed NBFCs.
- The company has conducted retail operations through 71 branches across India. ICFL shifted its focus towards retail segment, this requires large branch network and strong customer interface and thus C/I ratio is likely to increase going forward which would impact the margins.
- Corporate loan book stood at Rs39.7 bn and total client base was 36 as of Dec'31 2017. Higher than expected slippage from this book can impact the assets quality of the business going forward.
- ICFL's demanding valuation at Rs52,130.8 mn is valued at P/ABV of 1.9(x) to FY18 annualized adjusted BVPS. At this valuation, it may look cheap compared to well managed NBFCs, however, ICFL is presently a corporate lender and does not have presence in retail business. Expecting strong retail loan growth at this juncture is not logical as the segment is highly competitive and ICFL does not have experience in retail credit.

Considering all these parameters, we assign '**Avoid**' rating to the issue.

Recommendation	Avoid	
Price Band (per share)	Rs570-572	
Face Value	Rs10	
Shares for fresh issue	12.2 mn	
Shares for OFS	20 mn	
Fresh issue size	Rs7,000 mn	
Total Issue Size (on Higher Price Band)	Rs18,440.0 mn	
Bidding Date	May 09, 2018 - May 11, 2018	
MCAP on Higher Price Band	Rs52,130.8 mn	
Book Running Lead Manager	JM Financial Limited, Kotak Mahindra Capital Company Limited, Morgan Stanley India Company Private Limited, Motilal Oswal Investment Advisors Limited, Nomura Financial Advisory and Securities (India) Private Limited	
Registrar	Link Intime India Private Limited	
Industry	NBFCs	
Allocation detail		
Qualified Institutional Investors (QIBs)	50%	
Non Institutional Investors (NII)	15%	
Retail Individual Investors (RII)	35%	
Pre and post issue shareholding pattern		
	Pre - Issue	Post - Issue
Promoter and Promoter Group	91.6%	59.0%
Non- promoter	8.4%	41.0%
Total	100.0%	100.0%
Retail Application Money at Higher Cut-Off Price per Lot		
Number of Shares per Lot	26	
Application Money	Rs14,872	
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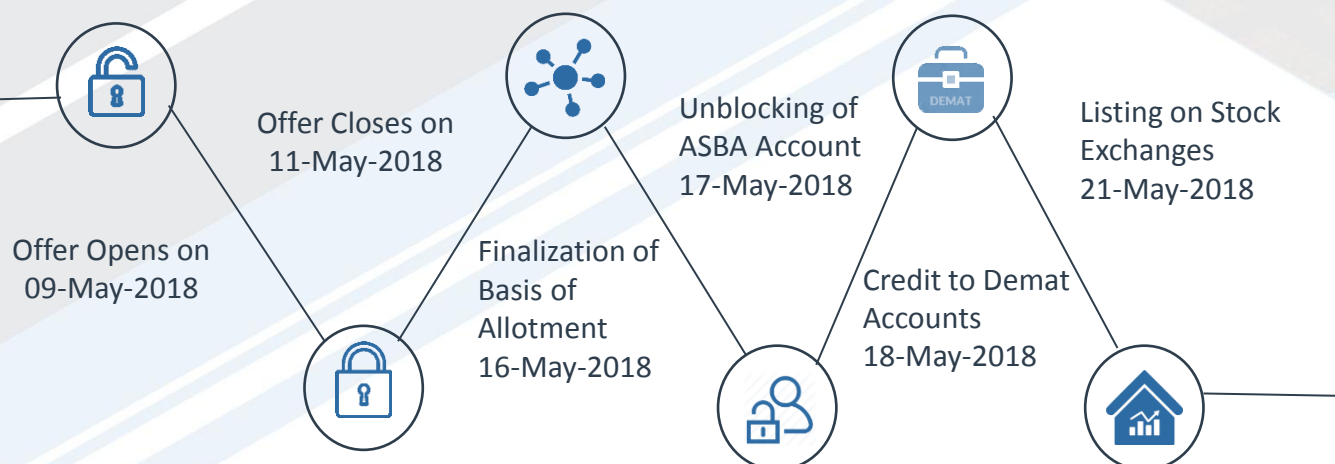
About the issue:

- ICFL is coming up with an initial public offering (IPO) with 12.2 mn shares as a fresh issue and 20 mn shares as offer for sale (OFS). Post issue promoter and promoter group's holding will reduce to 59.0% and non-promoter shareholding will increase to 41.0% from 8.4%.
- The issue will open on 9th May 2018 and close on 11th May 2018.
- Not more than 50% of the issue will be allocated to qualified institutional buyers. Further, not less than 15% of the issue will be available for non-institutional bidders and not less than 35% for retail investors.
- Total issue size is Rs18,440 mn on higher price band out of which ~62% is OFS.
- Promoter Indostar Capital is selling stake 18.5 mn shares and post issue its holding in the company will reduce to 57.7% from 90.1%
- **The company will receive Rs7,000 mn as a fresh issue . The company proposes to utilise the net proceeds from the fresh issue towards augmenting its capital base to meet future capital requirements.**

Pre and post issue shareholding pattern

	Pre - Issue	Post - Issue
Promoter and Promoter Group	91.6%	59.0%
Public	8.4%	41.0%
Total	100.0%	100.0%

Source: Choice Broking Research, Company data, RHP



Source: Choice Broking Research, Company data, RHP

Company Introduction:

Indostar Capital Finance Limited (ICFL) is a non-banking finance company (NBFC) primarily indulges in providing credit to corporates and small and medium enterprise ("SME") borrowers in India. ICFL, established in 2011, lend to mid-to-large sized corporates in manufacturing, services and infrastructure industries, real estate developers of residential and commercial building projects. The company has recently ventured into other segments such as housing finance, vehicle finance and thus the share of its corporate lending book reduced to 76.8% as of 9MFY18 as compared to 99.8% by FY15.

Corporate lending: Corporate lending business primarily consists of (i) lending to mid-to-large sized corporates in manufacturing, services and infrastructure industries and real estate developers of residential and commercial building projects against tangible collateral as well as security in other forms, such as charge on operating cash flows. Corporate lending generally in the form of structured finance, promoter financing and assets financing. Customers of corporate finance business belong to diverse industries including financial services, infrastructure, iron and steel, and poultry.

Real estate financing include structured debt for take out of early stage equity investors, mezzanine financing and construction finance. Loan products in corporate lending business generally have floating interest rates and tenor may range primarily from three to five years with an option to prepay without incurring any penalty. The company generally do not provide funding for greenfield projects.

(in ₹ million)						
Total Credit Exposure	As of December 31, 2017	As of March 31, 2017	As of March 31, 2016	As of March 31, 2015	As of March 31, 2014	As of March 31, 2013
Corporate lending	39,693.97	45,857.93	40,418.73	34,218.24	26,328.97	18,329.32
SME lending	11,733.97	6,500.74	2,232.14	74.08	-	-
Housing finance	145.95	-	-	-	-	-
Vehicle Finance	143.01	-	-	-	-	-
Total	51,716.91	52,358.67	42,650.87	34,292.32	26,328.97	18,329.32

Source: Choice Broking Research, Company data, RHP

SME lending: SME lending business was commenced in 2015 primarily involves extending secured loans for business purposes to small and medium size enterprises, including businessmen, traders, manufacturers and self-employed professionals. Credit is extended against self-occupied residential and commercial property, reducing the risk of loan. SME lending business accounted for 0.2%, 5.2%, 12.4% and 22.7% of total credit exposure for FY15, FY16 and FY17 and by Q3FY18, respectively (this book stood at Rs11,733.9 million as on 9MFY18).

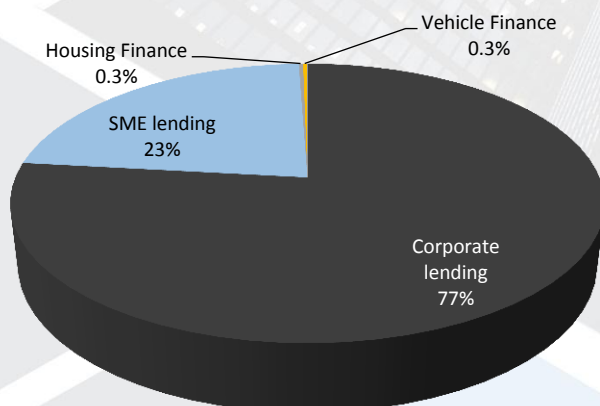
The company only target customers having turnover of approximately Rs100.0 mn and provides loans for purposes such as expansion of businesses, working capital and purchase of equipment. Loan tenors for SME lending loans are typically up to 15 years and are generally collateralized against completed and largely self-occupied residential and commercial property. LTV of SME book stood at 65% as on Dec'31 2017. Under this segment, the company provides vanilla loans, gross turnover loans, loans for purchases of commercial property and banking profile based loans.

Company Introduction:

Vehicle Finance: Vehicle finance business primarily involves providing financing for purchases of used or new commercial vehicles, passenger vehicles and two-wheelers. This is the new business which started in Nov'2017 and as of 9MFY18, vehicle finance credit exposure amounted to Rs143.0 mn. customers are predominantly transport operators, small businesses and self-employed and salaried individuals, who generally contribute between 10.0% and 30.0% of the purchase price of the asset financed, with the balance lent by the company. For LCVs, customers are typically medium and small fleet operators. For HCVs, customers are typically transport operators and small businesses.

Housing finance: Housing finance business comprises two business lines, namely (i) affordable housing finance, which commenced operations in September 2017, and (ii) retail housing finance, which commenced operations in March 2018. Housing finance business line primarily involves loans to the salaried and self-employed customers for housing purposes where the property cost is typically up to Rs5 mn. The company primarily extends loans to salaried and self-employed customers for the purchase of residential properties. As of 9MFY18, housing finance credit exposure amounted to Rs145.9 mn. Loans are generally required to be repaid in equated monthly installments ("EMI") over an agreed period and tenure of retail housing loans can be up to 30 years and may vary according to the purpose of the loan, the customer's age and the customer segment.

Breakout of advance portfolio



Source: Choice Broking Research, Company data, RHP

The company has maintained a strong assets quality considering its corporate lending book. As of FY15, FY16 and FY17 and 9MFY18, ICFL's Gross NPAs accounted for 0.6%, 0.2%, 1.4% and 1.7% of gross advances, while company's net NPAs accounted for 0.5%, 0.2%, 1.2% and 1.3% of ICFL's net advances, respectively.

Key financials					
Particulars (Rs mn)	FY14	FY15	FY16	FY17	9MFY18
Net Interest Income (NII)	1,675.7	2,074.3	2,747.5	3,317.3	2,858.0
Growth (%)		23.8%	32.5%	20.7%	
Net profit	1,121.3	1,490.4	1,916.4	2,108.0	1,640.8
Growth (%)		32.9%	28.6%	10.0%	
Loan Book	25,863.7	33,920.6	42,839.0	51,606.3	51,716.9
Net interest margin (NIM)	6.6%	6.0%	6.5%	6.8%	6.9%
Restated EPS (Diluted)	12.3	16.4	21.0	23.1	
Adjusted BVPS		139.1	168.3	202.0	
RoA (%)	3.5%	3.7%	4.1%	3.8%	2.7%
RoE (%)	9.9%	12.3%	13.6%	12.2%	7.7%
GNPA (%)	0.8%	0.6%	0.2%	1.4%	1.7%
NNPA (%)	0.7%	0.5%	0.2%	1.2%	1.3%
CAR (%)		32.6%	34.2%	33.8%	31.6%

Source: Choice Broking Research, Company data, RHP



Competitive Strengths:

- Highly motivated, professional and experienced management team
- Well-established corporate and strong SME lending businesses
- High asset quality achieved through robust credit assessment and risk management framework
- Proven track record of delivering results
- Well diversified funding profile
- Ownership by institutional investors ensuring international corporate governance standards

Business Strategy:

- Four pillars strategy focused on secured lending
- Expand geographical footprint and sourcing platform for products across India
- Increase use of technology and data analytics to support business growth and improve efficiency
- Continue to create brand awareness to become the preferred NBFC for borrowers



Risk and Concerns:

- Increasing competition in vehicle finance and housing finance
- Business sensitive to economic scenario
- Lower future growth would lead to underutilization of fund and lower RoE
- Higher than expected slippage from corporate book

Peer Comparison and Valuation:

Particulats (Rs)	CMP	6M R(%)	12M R(%)	Mar. Cap. (Rs mn)	P/ABV (x)	P/E (x)	Loan Book (Rs bn)	PAT Rs mn
Indostar Capital Finance	572	-	-	52,130.8	1.9	23.8	51.7	2,188
Cholamandalam Investment & Finance Company Ltd.	1,712	37.8%	57.3%	267,709.9	6.0	27.5	372.0	9,741
L&T Finance Holdings Ltd.	174	-12.7%	29.5%	304,477.9	3.8	22.2	745.0	13,699
Magma Fincorp Ltd.	175	-1.6%	50.2%	41,487.3	3.1	92.4	117.0	449
Shriram Transport Finance	1,556	19.5%	54.3%	352,981.2	3.4	22.5	796.7	15,680
Axis Bank Ltd.	523.45	-1.3%	3.6%	1,343,460.6	2.9	487.3	4,396.0	2,757
ICICI Bank Ltd.	277	-12.5%	10.5%	1,779,910.3	2.3	22.9	5,053.9	77,800
Average	771	8.0%	23.8%	854040.7	3.3	140.4	2,468.4	23,121.5

Particulats (Rs)	RoE (%)	RoA (%)	NNPA (%)	NIM (%)	C/I (%)	Loan Gr. (%) FY14-FY18 (avg.)	CAR (%)	Loan Book (Rs bn)
Indostar Capital Finance	7.7%	3.6%	1.3%	6.9%	27.6%	25.0%	31.6%	51.7
Cholamandalam Investment & Finance Company Ltd.	20.6%	3.0%	1.8%	9.1%	41.4%	17.5%	18.4%	372.0
L&T Finance Holdings Ltd.	13.1%	1.6%	2.6%	4.9%	30.0%	18.2%	>15%	745.0
Magma Fincorp Ltd.	9.6%	1.6%	5.2%	8.0%	49.3%	40.0%	20.3%	117.0
Shriram Transport Finance	13.1%	2.2%	2.7%	7.6%	21.3%	21.1%	16.9%	796.7
Axis Bank Ltd.	0.5%	0.0%	3.8%	3.1%	47.3%	17.5%	16.6%	4,396.0
ICICI Bank Ltd.	10.3%	1.3%	4.7%	3.3%	35.8%	12.9%	17.7%	5,053.9
Average	9.8%	2.0%	2.9%	5.6%	38.0%	18.2%	21.1%	2,468.4

Since ICFL is a corporate lender, it is not logical to drive valuation insight from this peer comparison

Source: Choice Broking Research, Company data, RHP

Below are few key observations of the issue:

- The company underwrites large ticket loans for corporates instead of participating in syndicated loans which gives it flexibility to customize the terms of financing to suit specific situations.
- ICFL provides corporate loans on floating interest rates and tenor may range primarily from 3 to 5 years with an option to prepay without incurring any penalty. The company has 36 corporate customers and this accounted for 76.8% of total loan book as of as of Dec'31 2017.
- While corporate book increased from Rs18.3 bn in FY13 to Rs39.7 bn as of Dec'31 2017, GNPA maintained at 1.7%. Secured loan book stood at 88.8% by Dec'31 2017.
- In order to diversify loan book, the company has entered into SME lending in 2015 and share of this book has increased to 23% by Dec'31 2017 with yield ranging between 11.3%-10.4% during this period. NIM in the range of 6.5%-6.9% over the last three years was signification considering the high exposure to corporates.
- ICFL has started vehicle finance business during Nov'2017 under which it will focus more on used commercial vehicle finance in the range of 3-5 years. Further, the company has taken housing finance license under which it will focus on affordable housing space and retail housing finance. However, the company does not have retail business experience and in this highly competitive retail business, it would remain a difficult task for it to generate strong growth from this segment.
- CAR ratio at 31.6% by Dec'31 2017 shows that the balance sheet has been remained under utilized and the company is raising further Rs7 bn as a fresh issue. Post issue, FY18 annualized RoE of the business reduced to single digit to 7.7%, significantly lower than the well managed NBFCs.
- The company has conducted retail operations through 71 branches across India. ICFL shifted its focus towards retail segment, this requires large branch network and strong customer interface and thus C/I ratio is likely to increase going forward which would impact the margins.
- Corporate loan book stood at Rs39.7 bn and total client base was 36 as of Dec'31 2017. Higher than expected slippage from this book can impact the assets quality of the business going forward.
- ICFL's demanding valuation at Rs52,130.8 mn is valued at P/ABV of 1.9(x) to FY18 annualized adjusted BVPS. At this valuation, it may look cheap compared to well managed NBFCs, however, ICFS is presently a corporate lender and does not have presence in retail business. Expecting strong retail loan growth now is not logical as the segment is highly competitive and ICFS does not have experience in retail credit.

Considering all these parameters, we assign '**Avoid**' rating to the issue.

Financial Statements (Consolidated, Rs mn)

Profit & Loss A/c					
Particulars (Rs mn)	FY14	FY15	FY16	FY17	9MFY18
Interest Income:	3,594.5	4,653.6	5,640.1	6,435.8	5,148.5
Interest expenses	1,918.9	2,579.3	2,892.6	3,118.5	2,290.5
Net Interest Income (NII)	1,675.7	2,074.3	2,747.5	3,317.3	2,858.0
Other Income	374.5	627.0	800.3	763.4	711.0
Total Income	2,050.2	2,701.3	3,547.9	4,080.7	3,569.0
Staff cost	251.9	280.6	394.5	481.9	565.2
Other Operating expenses	92.3	129.9	187.5	245.1	418.5
Pre-Prov. Operating Profit	1,706.0	2,290.8	2,965.9	3,353.7	2,585.2
Provisions and write offs	13.54	30.37	33.82	123.28	86.15
Operating Profit before Tax	1,692.5	2,260.5	2,932.0	3,230.4	2,499.0
Tax	571.1	770.1	1,015.7	1,122.5	858.2
Net profit	1,121.3	1,490.4	1,916.4	2,108.0	1,640.8
Extraordinary items	0.0	0.0	0.0	0.0	0.0
Adjusted PAT	1,121.3	1,490.4	1,916.4	2,108.0	1,640.8

Balance Sheet					
Particulars (Rs mn)	FY14	FY15	FY16	FY17	9MFY18
Share capital	683.2	683.7	733.5	783.6	786.8
Reserves & Surplus	10,673.3	12,168.7	14,684.5	18,243.9	19,981.6
Net Worth	11,356.5	12,852.4	15,418.0	19,027.5	20,768.3
Borrowings	13,584.1	19,577.6	22,582.8	26,971.6	28,538.6
Other liabilities & Provisions	6,667.4	7,486.5	8,932.2	8,888.5	11,143.9
Total Liabilities	31,608.0	39,916.5	46,933.0	54,887.7	60,450.8
Advances	25,863.7	33,920.6	42,839.0	51,606.3	51,716.9
Investments	608.4	546.0	0.0	1,869.7	7,115.8
Fixed Assets	10.86	8.71	37.52	88.01	258.8
Cash and bank balance	4,681.8	4,856.5	3,596.1	651.3	754.3
Other Assets	443.2	584.7	460.4	672.4	604.9
Total Assets	31,608.0	39,916.5	46,933.0	54,887.7	60,450.8

Financial ratios					
Particulars (Rs mn)	FY14	FY15	FY16	FY17	9MFY18
Profitability ratios (%)					
Net interest margin (NIM)	6.6%	6.0%	6.5%	6.8%	6.9%
Yield on corporate book	14.6%	14.3%	14.6%	14.1%	14.0%
Interest Spread	2.5%	2.5%	3.3%	3.5%	4.2%
RoA (%)	3.5%	3.7%	4.1%	3.8%	2.7%
RoE (%)	9.9%	12.3%	13.6%	12.2%	7.7%
Operating ratios (%)					
Cost of borrowings		11.9%	11.1%	10.3%	9.1%
Cost to income	16.8%	15.2%	16.4%	17.8%	27.6%
Non interest income / Total income	18.3%	23.2%	22.6%	18.7%	19.9%
Capital adequacy		32.6%	34.2%	33.8%	31.6%
Asset Quality ratios (%)					
GNPA (%)	0.8%	0.6%	0.2%	1.4%	1.7%
NNPA (%)	0.7%	0.5%	0.2%	1.2%	1.3%
Per Share Data (Rs)					Post issue
Restated EPS (Diluted)	12.3	16.4	21.0	23.1	
Restated BVPS	124.6	141.0	169.2	208.8	312.1
Adjusted BVPS	122.7	139.1	168.3	202.0	304.3
Valuation ratios (x)					
P/E (x)	37.3	28.1	21.8	19.8	Post issue
P/BV (x)	3.7	3.3	2.7	2.2	1.8
P/ABV (x)	3.7	3.3	2.7	2.3	1.9
Growth Ratios (%)					
Advances		31.2%	26.3%	20.5%	
Net interest income		23.8%	32.5%	20.7%	
Interest income		29.5%	21.2%	14.1%	
PAT		32.9%	28.6%	10.0%	

Source: Choice Broking Research, Company data, RHP



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