Shriram Finance (SHRIRAMFIN)

CMP: ₹ 1783 | Target: ₹ 2250 (26%) | Target Period: 12 months | BUY

July 21, 2023

Play on auto financing at attractive valuation

About the stock: Shriram Finance (SHF) is large financier with a strong rural presence engaged in credit solution for commercial vehicles, two wheeler, car loans, home loans, gold loans and small business.

- As of 31 March 2023, SHF has a huge presence with 2922 branches across India and employee count of 64052, customer base of ~73 lakhs
- In November 2022, Shriram group entities - Shriram Transport Finance, Shriram City Union Finance & Shriram Capital merged to form Shriram Finance resulting in one of the largest NBFCs with AUM of ₹ 185683 crore.

Investment Rationale

- **Faster growth seen in non-auto business; market dominance to benefit credit growth in CV business**: Strong demand from sub-prime borrowers, recovery in rural economy & construction activity are expected to drive CV growth. Factors attributable for continued growth in AUM – 1) large presence with more number of touch points in rural and semi urban areas, 2) high vintage and better customer understanding, 3) ability to price valuation of used vehicle, 4) improving share of faster growing non-auto AUM. Thus, we expect double digit growth in AUM at 14-15% in FY24-25E, with non-auto portfolio growth seen at faster pace.
- **Prudence in underwriting to keep asset quality stable:** Higher growth in weak cycles has led to elevated NPA formation. However, prudence in business growth as per the cycle is expected to keep asset quality steady. Further, dataset of large customer base will enable better under writing. Thus, we expect Stage 3 assets to decline from 6.1% in FY23 to 5.3% in FY25E and credit cost to remain at ~2% in FY24-25E.
- **Diversified borrowing to aid margins; efficiency and lower credit cost to drive RoE**; While cost of funds is expected to increase amid increase in MCLR by banks, diversified asset base with improving proportion of non-auto segment, potential for a rating upgrade is seen to enable sustainability of margins. Further, improvement in efficiency (~2.6-2.7%) and steady credit cost is expected to RoA at ~3%.

Rating and Target price

- SHF is well placed to benefit from healthy CV cycle with 14-15% growth in AUM and RoA improving to ~3%. Exit of large shareholders has put an end to overhang on the stock. Thus, we assign **BUY** rating on PHF, in anticipation of reduction in valuation gap with peers.
- We value PHF at ~1.7x FY25E standalone ABV and assign a ~2x multiple on FY25E ABV with a 20% holding discount. Thus we arrive at a target of **price of ₹ 2250/share**

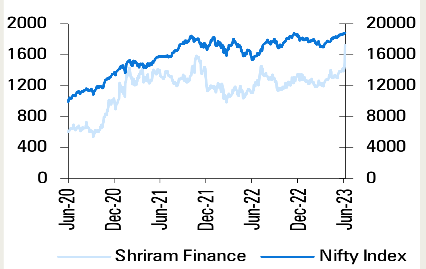
Particulars

Particulars	Amount
Market Capitalisation	₹ 66863 crore
52 week H/L	1828 / 1147
Net worth	₹ 43307 Crore
Face Value	₹ 10
DII Holding (%)	14.7
FII Holding (%)	55.4

Shareholding pattern

(in %)	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Promoter	29.3	29.4	25.3	25.5	25.5
FII	50.0	50.7	45.6	49.8	55.4
DII	15.2	14.5	11.1	11.7	14.7
Others	5.5	5.5	18.0	13.0	4.5

Price Chart



Recent Event & Key risks

- Healthy growth prospects, inexpensive valuations
- **Key Risk:** 1) Muted capex cycle 2) Increasing competitive intensity amid entry of new players

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Key Financial Summary

₹ crore	FY22	FY23	2 year CAGR (FY22-FY23)	FY24E	FY25E	2 year CAGR (FY23-25E)
NII	9,316	16,963	82%	19,653	22,442	15%
PPP	7,410	12,344	67%	14,056	16,253	15%
PAT	2,708	5,979	121%	6,764	8,000	16%
ABV (₹)	794.3	1005.0		1150.1	1323.5	
P/E	17.5	11.2		9.9	8.3	
P/ABV	2.2	1.8		1.6	1.3	
RoA	1.9	3.0		3.0	3.2	
RoE	10.4	13.8		13.8	14.3	

Source: Source: Company, ICICI Direct Research

ICICI Securities – Retail Equity Research

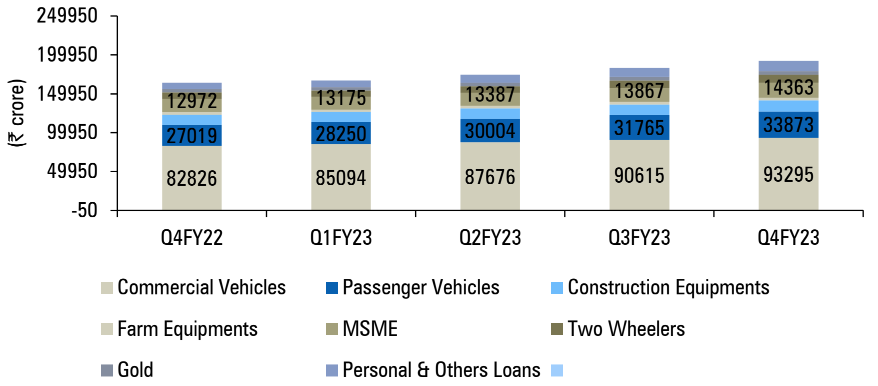
Conviction Ideas

Company Background

Shriram Finance (SHF) is large financier with a strong rural presence engaged in credit solution for commercial vehicles, two wheeler, car loans, home loans, gold loans and small business. As of 31 March 2023, SHF has a huge presence with 2922 branches across India and a employee count of 64052, customer base of ~73 lakhs and AUM of ₹ 185683 crore.

In November 2022, Shriram group entities – Shriram Transport Finance (engaged in CV financing), Shriram City Union Finance (engaged in two wheeler and small business loans) and Shriram Capital merged to form Shriram Finance resulting in one of the largest NBFCs with AUM of ₹ 185683 crore.

Exhibit 1: AUM break up of SHF (₹ crore)



Source: Company, ICICI Direct Research

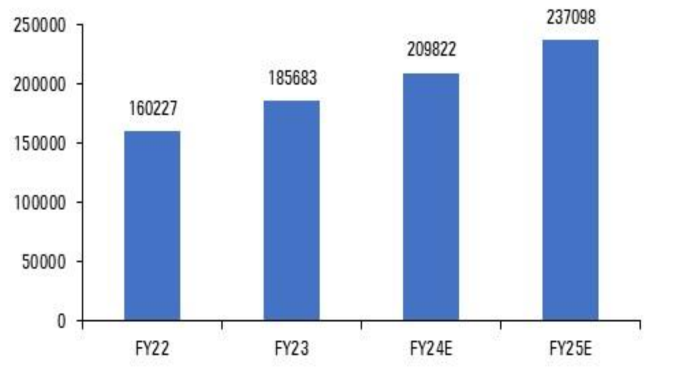
Investment Rationale

Faster growth seen in non-auto business; market dominance to benefit credit growth in CV business

Deleveraged balance of non-financial corporates and focus of government on manufacturing is seen to induce capex and thus continue to drive demand for CV. Strong demand from sub-prime borrowers, recovery in rural economy and construction activity are seen as factors attributable to drive business growth both in auto as well as non-auto segment. SHF remains a dominant player in CV financing market with a long vintage, large customer base and large network which acts as a business moat. Further, it holds substantial market share in bottom of the pyramid customers (used vehicle business, first time users and small ticket operators) with strong demand for credit.

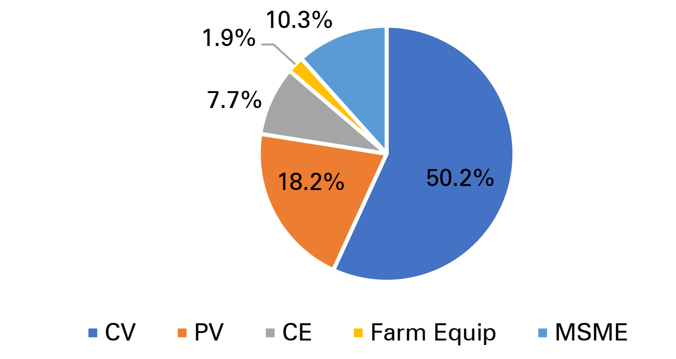
Under penetration in used CV market with ~55-50% of finance from informal financing sources (money lenders, private financiers) charging higher interest rates provide potential for gradual increase in market share by formal players wherein SHF holds domain position. Factors attributable for continued growth in AUM – 1) large presence with more number of touch points in rural and semi urban areas, 2) high vintage and better customer understanding, 3) ability to price valuation of used vehicle, 4) improving share of faster growing non-auto AUM

Exhibit 2: Loan growth at 13-15% in FY24-25E (₹ crore)



Source: Company, ICICI Direct Research

Exhibit 3: CV remain major contributor at ~50%



Source: Company, ICICI Direct Research

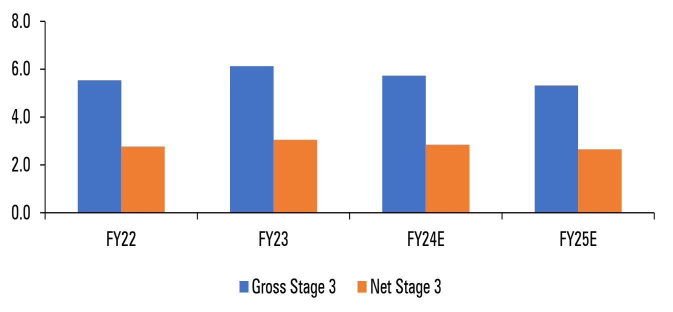
We expect double digit growth in AUM at 14-15% in FY24-25E given dominance of CV business (~50% of AUM) with gradual gain in market share. However, non-auto book is expected to grow at a faster pace thereby supporting overall growth momentum.

Prudence in underwriting to keep asset quality stable

Historically, SHF has undertaken robust credit growth even during weak cycles which has later reslted in elevated NPA formation. However, improving prudence could be seen in the slowdown during Covid which has kept asset quality steady with minor blips. Now normalization in economic activities, SHF has plans to pedal higher business growth which is expected to keep asset quality steady.

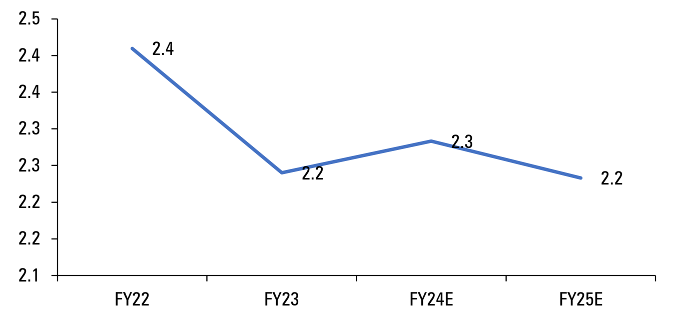
A huge customer base and historical data of customer behaviour during various cycles is expected to instrumental to keep asset quality steady. Further, ability to correctly price value of used vehicle remains a key factor to avoid excessive disbursement which could lead to slippages. Thus, we expect Stage 3 assets to decline from 6.1% in FY23 to 5.3% in FY25E and credit cost to remain at ~2% in FY24-25E.

Exhibit 4: Gradual improvement in asset quality



Source: Company, ICICI Direct Research

Exhibit 5: Credit cost seen at ~2-2.2% in FY24-25E



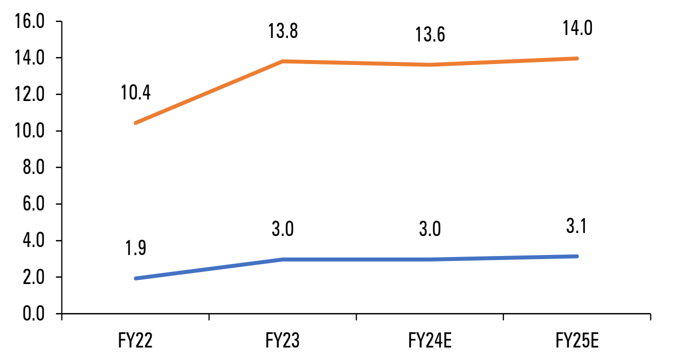
Source: Company, ICICI Direct Research

Diversified borrowing to aid margins; efficiency and lower credit cost to drive RoE

While cost of funds is expected to increase amid increase in MCLR by banks, diversified asset base with improving proportion of non-auto segment, potential for a rating upgrade is seen to enable sustainability of margins.

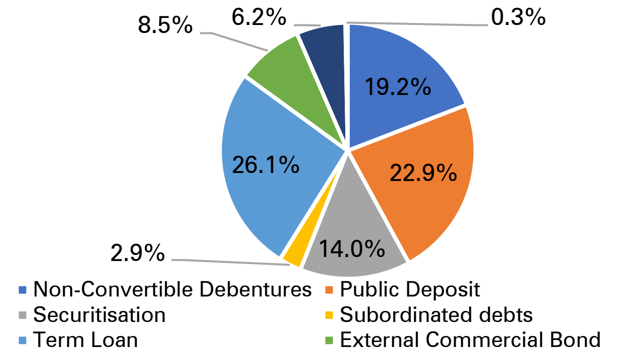
SHF has remain competitive in operational parameters including AUM per branch, business efficiency like Cost to Income ratio when compared to peers. Going ahead, we expect efficiency to remain steady at ~2.6-2.7% of AUM (despite investment in distribution of non-auto products). Thus, uptick in business growth coupled with steady efficiency and credit cost is seen to keep RoA at ~3%. Relatively lower leverage remains one of the factors which could act as catalyst in driving return ratios higher, though we have not factored in our estimates.

Exhibit 6: RoA seen at 3-3.1% in FY24-25E



Source: Company, ICICI Direct Research

Exhibit 7: Borrowing profile (FY23)



Source: Company, ICICI Direct Research

Valuation and outlook

Shriram Finance is well placed and poised to benefit out of improving rural demand and uptick in construction activity. Portfolio of erstwhile Shriram City Union Finance (two wheeler and small business finance) is expected to grow at a faster pace. However, given dominant position in auto financing sector, which forms a substantial proportion of AUM, we expect credit growth in double digit at 14-15% (which is lower compared to peers which are adding new products).

Exit of large shareholders (~15% of equity) has put an end to the overhang on the stock. Relatively cheap valuation amid anticipated slower growth compared to peers makes the stock an attractive investment opportunity. The stock currently trades at ~1.3x FY25E ABV. We remain positive on the stock and value the stock at ~1.7x FY25E ABV and assign ~2x multiple on FY25E ABV with a 20% holding discount. Thus, we arrive at a target of ₹ 2250 per share and assign a **BUY** rating on the stock.

Exhibit 8: SOTP valuation

	BVPS	Multiple	Valuation	Value per share
Standalone business	1,323.5	1.7	81,989	2,190
Shriram Housing	51.0	2	3,326	75
Discount				15
Target				2,250

Source: Company, ICICI Direct Research

Exhibit 9: Peer comparison

Sector / Company	CMP	M Cap	EPS (₹)				P/E (x)				P/BV (x)				RoA%				RoE (%)			
	(₹)	(₹ Cr)	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E
Shriram Finance	1783	62557	101.7	159.7	180.6	213.7	17.5	11.2	8.3	8.3	1.9	1.5	1.4	1.2	1.9	3.0	3.0	3.2	10.4	13.8	13.8	14.3
Cholamandalam Invt	1156	16319	26.2	32.4	39.5	49.0	44.1	35.7	23.6	23.6	8.1	6.7	5.5	4.5	2.7	2.7	2.5	2.5	20.2	20.5	20.6	20.8
MMFS	323	37584	8.0	16.5	17.8	22.0	40.4	19.6	14.7	14.7	2.5	2.3	2.2	2.0	1.3	2.4	2.1	2.3	6.5	12.5	12.4	14.2

Source: Company, Bloomberg, ICICI Direct Research

Key risks and concerns

Muted capex cycle

Prolonged muted capex cycle could impact CV volumes and thus demand for auto financiers. Lower freight load or lower utilization of fleet could create pressure on credit demand as well as ability to repay loans thereby impacting asset quality. Currently, demand is lower on export related business which can accentuate if traction in domestic demand faces a slower growth

Macro natural events or lag in freight rates could add stress

External macro events including El Nino could impact agriculture output and thus impact demand for logistics and thus business growth for auto financiers. In addition, any lag in freight rates, amid rising running cost (led by higher interest rates, fuel and repair cost) could derail profitability of logistics players and thus impact credit demand

Increasing competitive intensity

Entry and grabbing of decent market share remains a challenge in CV financing business given higher vintage of existing players, large penetration and challenges in under writing of CV, especially used CV. However, increasing competitive intensity owing to entry of new players including small finance banks and captive NBFCs could be ruled out and can impact business growth for existing players

Financial Summary

Exhibit 10: Profit & Loss statement (₹ crore)

(Year-end March)	FY22	FY23	FY24E	FY25E
Interest Earned	19,180.6	29,639.6	33,744.4	38,115.2
Interest Expended	9,864.6	12,676.5	14,091.6	15,672.9
Net Interest Income	9,316.0	16,963.1	19,652.8	22,442.3
growth (%)		82.1%	15.9%	14.2%
Non Interest Income	81.0	155.4	170.9	188.0
Net Income	9,397.1	17,118.5	19,823.8	22,630.3
Opex	1,987.0	4,774.5	5,767.3	6,377.3
Operating Profit	7,410.1	12,344.0	14,056.5	16,253.0
Provisions	3,860.9	4,159.2	4,790.8	5,294.5
PBT	3,549.2	8,184.8	9,265.7	10,958.5
Taxes	841.3	2,205.6	2,501.7	2,958.8
Net Profit	2,707.9	5,979.2	6,763.9	7,999.7
growth (%)		120.8%	13.1%	18.3%
EPS (₹)	101.7	159.7	180.6	213.7

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios

(Year-end March)	FY22	FY23	FY24E	FY25E
Valuation				
No. of Equity Shares (Crores	27.1	37.4	37.4	37.4
EPS (₹)	101.7	159.7	180.6	213.7
BV (₹)	958.6	1156.6	1310.2	1491.8
ABV (₹)	794.3	1005.0	1150.1	1323.5
P/E	17.5	11.2	9.9	8.3
P/BV	1.9	1.5	1.4	1.2
P/ABV	2.2	1.8	1.6	1.3
NII/AUM	5.8	9.1	9.4	9.5
Cost to AUM	1.2	2.6	2.7	2.7
Gross Stage 3	5.5	6.1	5.7	5.3
Net Stage 3	2.8	3.1	2.9	2.7
RoE	10.4	13.8	13.8	14.3
RoA	1.9	3.0	3.0	3.2

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet Statement (₹ crore)

(Year-end March)	FY22	FY23	FY24E	FY25E
Sources of Funds				
Capital	271	374	374	374
Reserves and Surplus	25662	42932	48682	55481
Networth	25932	43307	49056	55856
Borrowings	114497	157906	178415	197975
Other Liabilities & Provisions	1677	2451	3505	5088
Total	142106	203664	230976	258918
Application of Funds				
Cash & Bal	16355	15817	17664	19442
Advances	116665	171985	197799	224461
Investment	6809	8565	7978	6918
Other assets	2277	7297	7535	8097
Total	142106	203664	230976	258918

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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