

May 15, 2009

Banking

SRTR.BO, Rs250

Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	300
52W High -Low (Rs)	360 - 150
Market Cap (Rs bn)	53.0

Financials

March y/e	2009	2010E	2011E
Sales (Rs bn)	17.5	20.1	24.3
Net Profit (Rs bn)	6.1	6.9	7.8
EPS (Rs)	30.1	32.5	36.9
EPS gth	56.8	7.9	13.7
P/E (x)	8.3	7.7	6.8
P/B (x)	2.4	2.1	1.7
Div yield (%)	3.5	3.9	4.4

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
34.1	29.5	22.3	(21.5)

Shareholding, March 2009

	% of Pattern Portfolio	Over/(under) weight
Promoters	41.9	-
FII's	13.9	0.1 (0.0)
MFI's	1.4	0.1 (0.1)
UTI	-	- (0.1)
LIC	-	- (0.1)

Shriram Transport Finance: Stabilizing macro environment improves business outlook, upgrade to ADD

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- **STFC's management shared its growth plan with analysts**
- **Operating environment for CV operators is stabilizing; excess liquidity in the system is benefiting STFC and other NBFCs**
- **We raise estimates, upgrade to ADD with a price target of Rs300**

We believe that Shriram Transport Finance (STFC) will resume its growth traction from FY2010E as the business environment for CV operators is now stabilizing. NPL and provisions are unlikely to rise sharply (as feared earlier). Excess liquidity in the system and decline in borrowings cost provides comfort on spreads. We are raising our earnings estimates by 22-32% for FY2009E and FY2010E to factor higher loan growth, margins and lower provisions. We raise our price target to Rs300 from Rs215 earlier, upgrade to ADD from REDUCE.

Upgrade rating to ADD, 20% upside from the current levels. We are raising our target price to Rs300 from Rs215 to factor higher earnings. The increase in estimates factors higher spreads and higher loan growth. Over the last few months the business environment for CV operators (and in-turn STFC) has somewhat stabilized. Lead indicators like the freight-rate-index do not point any incremental deterioration versus 3QFY09 levels. Our channel checks indicate that freight demand has picked up from its lows, two quarters back. However, definitive conclusion of a turnaround will be premature and we will be much more sanguine if the traction maintains/ improves over next 1-2 quarters. Thus, despite raising our base-case earnings estimates, we are retaining high cost of equity (15%), somewhat higher than 13-14% assumed for most NBFCs under coverage, to factor higher risk to NPLs and loan growth. Our fair value estimate will rise to Rs350 if we assume the cost of equity to be 14%.

STFC's business model remains highly profitable. We expect STFC to deliver 20% CAGR in core PBT (PBT excl provisions) and generate medium term RoE of 25%. STFC's business has high entry barriers and hence is one of the most profitable models in the NBFC space. At our target price of Rs300, the stock will trade at 9.5X PER and 2.5X APBR FY2010E.

Raising loan growth estimates. We are raising our earnings estimates by 23% for FY2010E and 32% for FY2011E. We are now factoring disbursements growth of 21% in FY2010E and 18% in FY2011E versus decline of 5% and growth of 14%, respectively, assumed earlier. This is somewhat lower than STFC management's guidance of about 25-30% growth over the medium term and significantly below 65% annual growth in FY2007 and 2008.

Spreads will likely expand in 1HFY10E. Given the sharp decline in borrowings cost for bulk borrowers, we believe that STFC's spreads will likely expand in the 1HFY2010E, though NIMs may be somewhat lower due to higher leverage. Capital infusion on account of conversion of warrants (Rs2.16 bn) will support margins in FY2011E. The company has reported an 80 bps improvement in margins in 4QFY09 due to significant decline in borrowings cost. About 50% of its borrowings carry a variable rate and are likely to benefit from a decline in interest rates. In order to broaden its borrowings base, the company has now proposed Rs10 bn of retail NCD program.

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NPL remains the major concern. STFC's reported gross NPLs moved up to 2.1% as on March 2009 from 1.9% in December 2008 and 1.6% in March 2008. According to Fitch Ratings, STFC's static pool delinquencies on 180 days dpd basis increased to 3-3.25% in September 2008 from 2.25-2.5% in March 2008. This has likely increased further by about 0.5% to 3.5-3.75% in March 2009. We believe that static pool data is more representative ratio of the underlying business than the reported NPL ratios that get distorted by the growth in advances.

STFC to commence construction equipment financing. STFC has floated a company to focus on construction equipment finance. The company will require capital of about Rs1-1.5 bn. Notably, construction contractors typically finance their equipment at about 14-16%, significantly below 18-20% interest rates charged by STFC in used CV finance business. As such, we are not clear about STFC's business strategy in this segment and are currently not factoring this business in our model.

Shriram Transport Finance - Old and New estimates

March fiscal years, 2009-2011E (Rs mn)

	Old estimates			New estimates			% change		
	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E
Net interest income (a)	17,338	20,015	22,301	17,430	20,373	24,403	1	2	9
Loans (including securitised loans)	238,027	265,841	302,973	227,400	271,377	324,738	(4)	2	7
YoY(%)	22.3	11.7	14.0	16.8	19.3	19.7	-	-	-
NIM (%)	8.6	8.3	8.1	8.3	8.2	8.6	-	-	-
NPL provisions	3,071	5,091	6,171	3,058	4,211	5,850	(0)	(17)	(5)
Operating expenses	5,464	6,032	6,886	5,271	5,520	6,600	(4)	(8)	(4)
Employee	2,207	2,429	2,832	2,005	1,785	2,346	(9)	(27)	(17)
Others	3,257	3,603	4,053	3,265	3,734	4,255	0	4	5
PBT	8,803	8,892	9,245	9,206	10,747	12,057	5	21	30
Tax	2,993	3,112	3,236	3,082	3,654	4,100	3	17	27
PAT	5,810	5,780	6,009	6,124	7,093	7,958	5	23	32
PBT-provisions- extraordinary	11,874	13,983	15,416	12,264	14,959	17,907	3	7	16

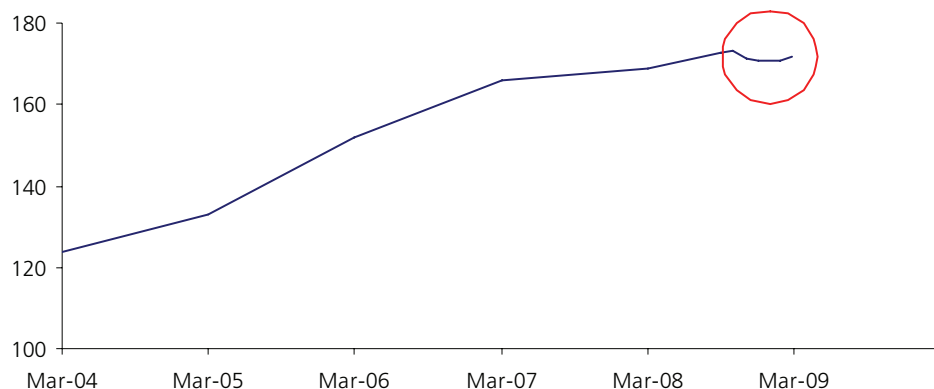
Note

(a) includes income on securitised assets

Source: Kotak Institutional Equities estimates

Freight rate index has been stabilising over the last few months

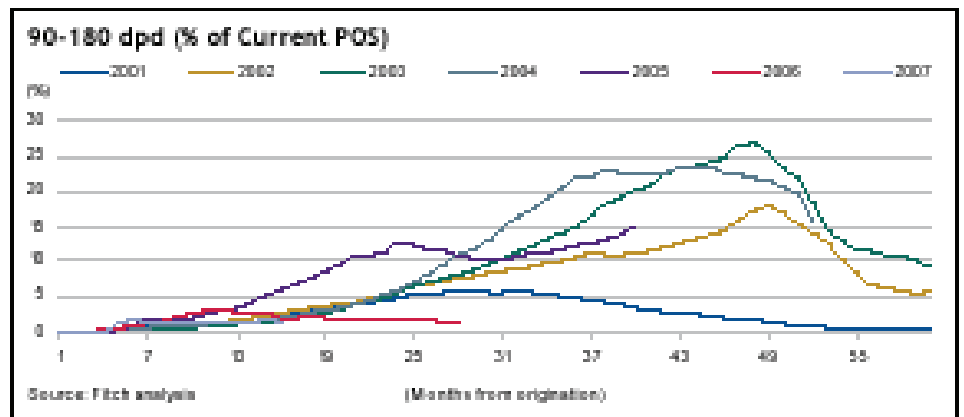
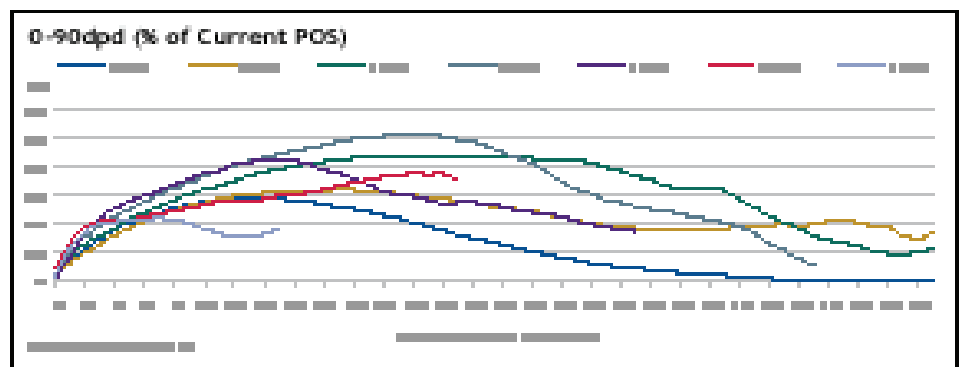
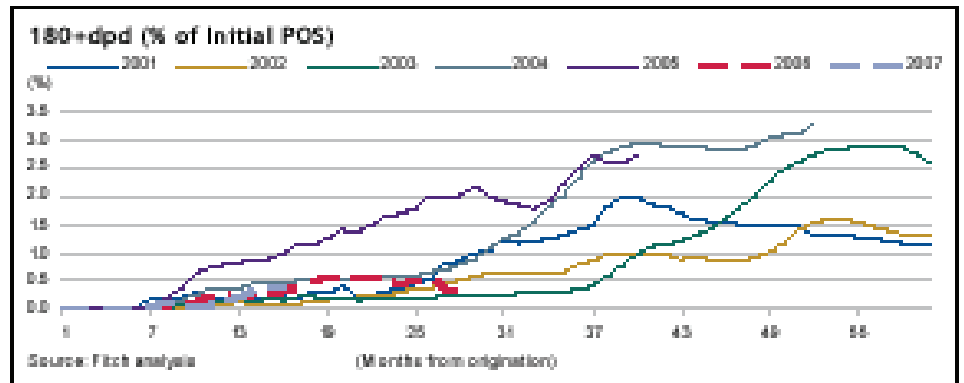
Freight rate index since March 2004



Source: Transport Corporation of India

Static pool data indicates deteriorating in the recent past

Static pool analysis as on September 2008



Source: Fitch Ratings

Shriram Transport Finance - key ratios, March fiscal year-ends, 2007-2010E (Rs mn)

	2007	2008	2009E	2010E	2011E
Growth in key parameters (%)					
Loans	54.6	80.0	18.9	18.6	20.2
Total assets	74.2	68.6	34.6	7.2	19.5
Borrowings	98.8	69.2	36.1	4.9	24.7
Net interest income	43.8	73.7	48.7	16.9	19.8
Operating expenses	20.6	54.0	46.2	4.7	19.6
Key ratios(%)					
Yield on assets	19.8	19.2	20.0	19.7	19.6
Average cost of funds	11.0	11.0	11.3	10.5	10.8
Difference	8.8	8.1	8.7	9.2	8.8
Net interest income/earning assets	8.3	8.3	8.3	8.2	8.6
Operating expenses/total income	33.9	30.1	30.1	27.0	26.9
Tax rate	34.2	35.7	33.5	34.0	34.0
Dividend payout ratio	33.1	30.5	30.0	30.0	30.0
Debt/ equity (X)	8.04	8.14	8.68	7.58	7.97
Du Pont Analysis					
(% of average assets)					
Net interest income	7.9	8.1	8.1	8.0	8.4
Loan loss provisions	2.0	1.6	1.4	1.7	2.0
Net other income	0.2	0.2	0.0	0.0	0.0
Gains on securitization	0.0	0.0	0.0	0.0	0.0
Operating expenses	2.7	2.5	2.5	2.2	2.3
(1- tax rate)	65.8	64.3	66.5	66.0	66.0
ROA	2.2	2.7	2.9	2.8	2.8
Average assets/average equity	8.9	10.0	10.4	10.0	9.5
ROE	19.8	26.9	29.6	27.8	26.1

Source: Company, Kotak Institutional equities estimates.

Shriram Transport Finance - Income statement and balance sheet, March fiscal year-ends, 2006-2010E (Rs mn)

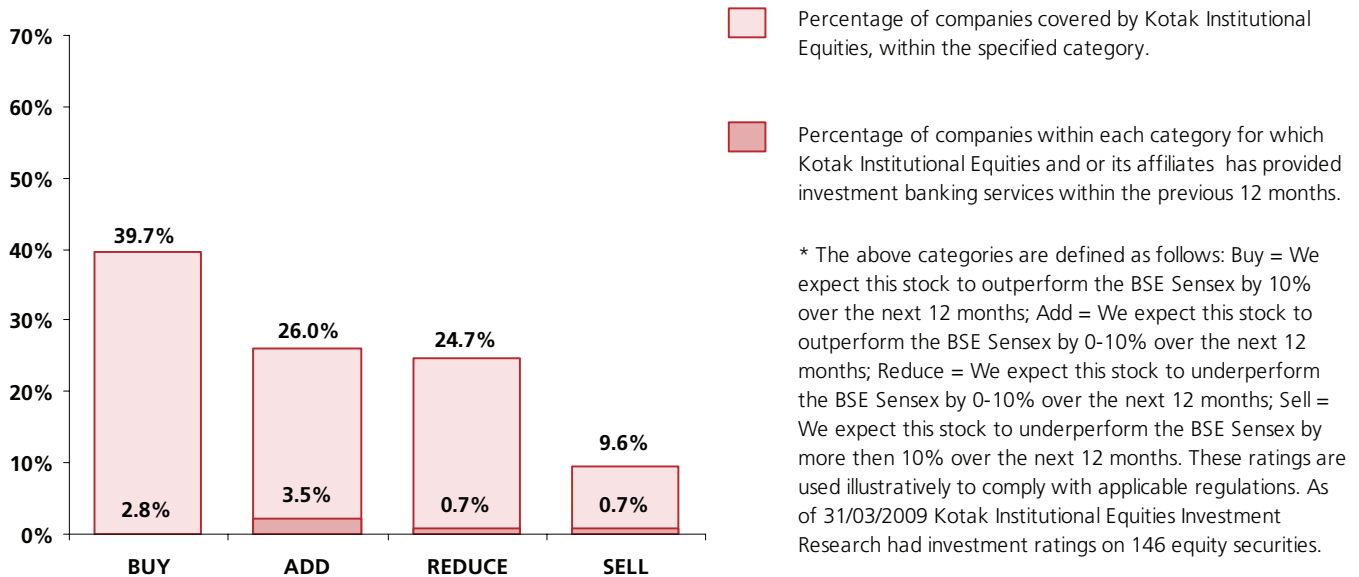
Income statement					
Total interest income	13,986	24,687	37,206	42,068	49,916
Total interest expense	7,239	12,966	19,777	21,695	25,514
Net interest income	6,747	11,721	17,430	20,373	24,403
Provisions and write/off	1,682	2,311	3,058	4,211	5,850
Net interest income (after prov.)	5,065	9,410	14,372	16,162	18,553
Other income	169	254	105	105	105
Operating expenses	2,342	3,606	5,271	5,520	6,600
Employee expenses	719	1,252	2,005	1,785	2,346
Depreciation	128	371	383	425	454
Advt and commission/brokerage	507	662	993	1,142	1,314
Sourcing and collection commission	4	6	30	30	30
Other expenses	1,030	1,309	1,853	2,131	2,451
Pretax income	2,892	6,058	9,206	10,747	12,057
Tax provisions	988	2,160	3,082	3,654	4,100
Net Profit	1,904	3,898	6,124	7,093	7,958
% growth	34	105	57	16	12
EPS (Rs)	10	19	30	34	38
% growth	23	86	57	11	12
BPS (Rs)	59	89	114	132	156
ABVPS (Rs)	54	86	108	121	148
Balance sheet					
Total Loans	83,748	150,751	179,216	212,520	255,468
Investments	80	80	80	80	80
Cash & deposits	18,120	13,742	53,650	36,101	42,821
Loans and advances	433	405	691	898	1,168
Net fixed assets	1,676	1,426	1,343	1,113	810
Other current assets	2,130	2,508	4,249	4,264	4,278
Total assets	108,353	182,684	245,966	263,680	315,033
Total Borrowings	87,384	147,864	201,194	211,064	263,176
Current liabilities	7,707	13,595	18,092	21,252	15,328
Provisions	1,530	2,703	3,514	3,514	3,514
Deffered tax liabilities	866	359	-	-	-
Total liabilities	97,488	164,520	222,800	235,830	282,018
Share capital	1,842	2,032	2,035	2,115	2,115
Reserves	9,022	16,132	21,131	25,735	30,900
Shareholders fund	10,864	18,164	23,166	27,850	33,015
Truck assets under management	120,378	194,761	227,400	271,377	324,738

Source: Company, Kotak Institutional equities estimates.

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2009

Ratings and other definitions/identifiers

Rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL: We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

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