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Shriram Transport Finance (STFL) NBFC

Sensex: 13,796 **CMP: Rs 130**

Bloomberg Code	SHTF IN
Reuters Code	SRTR.BO
BSE Code	511218
NSE Code	SRTRANSFIN
52-Week Range(H/L)	146 / 75
Market Cap (Rs.mn)	23,029
Shares O/S (mn)	156.26
Free Float (mn)	97.86
3m Avg. Volume	38,916
Face Value	10

Price Performance: (%)

	3m	6m	12m
Absolute	-8.92	4.16	-8.15
Relative	-3.81	0.30	-20.45

Visit Note – Shriram Transport Finance Limited

We recently met the management of Shriram Transport Finance Limited (STFL) and came back with a positive outlook.

STFL is India's largest corporate entity specializing in pre-owned commercial vehicle financing. It is classified as an "Asset Financing Company", according to RBI's recently revised classification norms for NBFCs.

Pre-owned Commercial Vehicle (CV) finance market represents a huge opportunity

STFL's CV financing activity has grown exponentially in the recent years driven by increasing CV sales, soft lending rates and more flexible loan terms. The pre-owned CV market is under penetrated and largely remains dominated by private moneylenders. STFL is arguably the only large corporate entity active in this space, with a market share of 22%.

We believe that the pre-owned trucks financing market offers a large opportunity of Rs 307 bn. With average yields of 20% in this segment, one would attribute this customer segment to be relatively more risky. However, the management opines that such high yields are more attributable to the huge existing demand for such loans, than anything else. With large banks unwilling or unable to meet this demand, either due to stringent KYC norms, or the fact that this customer segment has under-developed banking habits, the supply side for such loans is met only by STFL & a few other organized players, and private financers.

The population of pre-owned CVs in India is estimated to be ~ 4 million, of which those between 5-12 years are ~1.6 million. STFL has its major focus on this segment.

Growth Divers: Going forward, we see modernization of the trucking industry and increasing penetration of organized financiers as the key growth drivers for pre-owned CV financing market.
Strong growth in the economy and investments into core sectors lead to increased need for freight movement, and thereby increased business volumes for truck operators.

STFL has emerged as the largest organized financier in this space with an AUM of approx. Rs 80 bn. Over the past 25 years, STFL has developed strong competencies in loan origination, valuation of pre-owned trucks and collection of receivables. **In a business perceived to be risky for lending, the company has been able to manage growth and credit risk quite effectively.**

Entry Barriers to Pre-Owned CV financing

Valuation expertise required: STFL has, over the years, developed considerable expertise in the valuation of pre-owned trucks. This skill is necessary to evaluate the amount of the loan, consequent EMIs and the truck operator's ability to service the loan.

Strategically located branch network: With truck operators being on the move, it makes sense to have your branch network concentrated around freight centers, truck depots and fuel pumps, especially in rural / semi-urban locations. Close monitoring of asset and borrower is possible through this network. Banks would usually not be present at the same, particularly more aggressive private sector banks.

STFL has an extensive pan-India network of 350 branches and more than 2,000 field officers.

Robust cash collection mechanism: Due to underdeveloped banking habits of small truck operators, monthly collections are largely in the form of cash. Banks are generally not comfortable with large amounts of cash collection. STFL's field officers make monthly visits to borrowers, thus helping the company manage is cash collections efficiently.

Established customer relationships: Over the years, the company has forged strong relationships with its customers, which currently stand at half a million. These have also helped in generating leads for further prospective business, through healthy word-of-mouth.

We believe that this business model is considerably difficult to replicate. At present, STFL is enjoying its first-mover advantage in this space.

New CVs financed by STFL exist as off-balance sheet assets

Unlike the pre-owned CV finance market, the new CV finance market is highly competitive. With hardly any valuation expertise required in this market, competition has increased from the likes of new generation private sector banks.

The domestic CV industry has witnessed a CAGR of 26% in volume terms over FY02-07, driven by buoyant economic growth, replacement demand and increased government spending on road infrastructure. The management expects a CAGR of 10% over FY08-FY10 in new CV sales, which will also add to the pre-owned CV pie in subsequent years. Going forward, the market potential for financing new CVs is expected to be ~Rs 200 bn.

It is estimated that close to 90% of the new CV purchases are financed with an average LTV of 85% and average loan tenure of 4 years. Increasing competition has affected yields in this segment, which hover at ~15-16%.

Securitization has helped boost ROE

In FY07, the company securitized Rs 30 bn worth receivables. These have been largely securitized to banks that lap up these assets so as to meet their priority sector lending targets (100% of STFL's advances qualify for priority sector lending). The net spread on the securitized portfolio is ~ 4%.

With the income from securitization not dependant on the bank's owned or borrowed capital, it has helped improve the company's ROE. By FY10, STFL expects securitized assets to comprise 40% of its projected AUM of Rs 250 bn, which is expected to further boost ROAE.

New partnerships - fee income opportunity as well as business driver

STFL aims to evolve into a one stop shop for meeting the diverse credit requirements of truck operators. It has planned new partnerships to further drive its business growth and income earning potential.

Franchisees to help increase STFL's customer base

To increase its market share in the pre-owned CV finance market, STFL plans to set up a franchisee network, using private moneylenders as its franchisees. The company will use this network to tap new clientele, which have traditionally used private financers to meet their financing requirements.

An example of such a set up would be the franchisee being able to finance Rs 100 million of pre-owned CV loans, with his equity contribution being only 10%, i.e. Rs 10 million. Profit / loss would be equally shared by both STFL and the franchisee.

Ashok Leyland – Freight Exchange & Freight Bill Discounting

STFL has tied up with Ashok Leyland to set up hubs so that there is efficient exchange of freight between truck operators between common routes. The company plans to invest in 40% equity of this venture. The upside for STFL would be increased business coming in the form of freight bill discounting from this avenue.

Reconditioning of pre-owned trucks

STFL is in talks with a "reputable third-party" to enter the business of reconditioning used trucks and financing their sales through this route. This venture is still in its infancy.

Truck Rentals

The company is also looking at leasing out trucks as a means of boosting its income growth.

Probable future acquisition plans and entry into new business segments

- STFL has firmed up plans to foray into three - wheeler and tractor financing. It is scouting for a potential acquisition target for the same.

- STFL also has plans to enter the housing finance market in rural / semi-urban markets. It will tie up with an international company for developing a suitable mortgage product for the same.

Valuation

STFL has developed strong competencies in pre-owned truck financing. The company has managed healthy asset quality in a seemingly difficult line of business. The management has targeted Rs 250bn as AUM by FY10, of which Rs 150bn would be on its balance sheet.

We expect pre-owned CV finance market to exhibit strong incremental growth on the back of improving infrastructure and regulatory norms. Being a dominant player in this segment, STFL should be able to leverage on its capability and increase its market share to ~35% by FY10.

We expect STFL's loan book to grow at ~29% CAGR over FY06-FY10, which would lead to a 35% CAGR in its net interest income over the same period. Net interest margin is expected to decline going forward (from ~9% currently) with increasing cost of funds and the company's aggressive growth plans. We expect net profit to grow at CAGR of 42% over FY06-FY10. Increased fee based income from new initiatives would improve RoE to ~24% in FY10 from 21% currently.

At the CMP of Rs 130, the stock trades at a price to book multiple of 1.9xFY08E and 1.4xFY09E and looks attractive.

Valuation

Y/E March (Rs. mn.)	FY05	FY06	FY07E	FY08E	FY09E
Net Interest Income	1,293	4,060	6,496	8,161	10,063
Total Income	1,830	4,881	6,947	9,261	11,413
Net Income	470	1,320	1,986	2,767	3,553
EPS (Rs.)	6.7	8.8	12.7	15.0	19.3
ABV	30.0	53.4	66.9	73.1	85.2
RoA (%)	2.9	3.4	2.6	2.8	2.9
RoE (%)	32.4	27.1	22.0	23.9	25.1
P/E	19.3	14.7	10.2	8.6	6.7
P/ABV	4.3	2.4	1.9	1.8	1.5

Income Statement

Rs million	FY05	FY06	FY07E	FY08E	FY09E
Interest Income	2,921	8,211	13,282	17,151	21,050
Interest Expense	1,628	4,151	6,786	8,990	10,987
Net Interest Income	**1,293**	**4,060**	**6,496**	**8,161**	**10,063**
Other Income	537	821	450*	1,100	1,350
Total Income	**1,830**	**4,881**	**6,947**	**9,261**	**11,413**
Employee Expenses	140	467	602	745	885
Other Expenses	690	1,475	1,789	2,310	2,812
Total Expenditure	**830**	**1,942**	**2,391**	**3,055**	**3,697**
Operating Profit	**1,000**	**2,939**	**4,556**	**6,206**	**7,716**
Provisions	222	832	1,500	1,950	2,250
PBT	**778**	**2,107**	**3,056**	**4,256**	**5,466**
Taxes	308	787	1,069	1,490	1,913
PAT	**470**	**1,320**	**1,986**	**2,767**	**3,553**

* Fall in other income due to revised accounting policy for securitization income