

## SREI Infrastructure Finance

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,482	SREI IN
	REUTERS CODE
S&P CNX: 3,081	SREI.BO

22 May 2006

Buy

Previous Recommendation: Buy

Rs52

		YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
Equity Shares (m)	109.0	3/06A	1,205	484	4.4	-16.1	11.6	1.4	18.0	16.9	2.3	1.4
52-Week Range	85/42	3/07E	1,593	647	5.9	33.5	8.7	1.2	15.0	14.9	1.9	1.2
1,6,12 Rel.Perf.(%)	9/-35/-71	3/08E	2,115	887	8.1	37.2	6.3	1.1	12.8	18.0	1.9	1.1
M.Cap. (Rs b)	5.6											
M.Cap. (US\$ b)	0.1											

SREI has declared excellent 4QFY06 results, with net profit rising 56% YoY resulting from a 43% increase in net interest income during the same period. Even on a sequential basis NII has increased by 21%. Increase in net interest income (YoY and sequential basis) has been the result of increased disbursements.

Disbursements increased by Rs9b in FY06 resulting in total disbursements of Rs25b, a rise of 56% from Rs16b disbursed in FY05. Total assets under management, including securitized assets increased to Rs34b (including Rs12b of securitized assets) for FY06 from Rs22b in FY05, an increase of 55%.

- ✍ Earnings continue to be robust with increased business volumes
- ✍ Disbursements and AUMs grow at a robust pace
- ✍ Asset quality remained strong
- ✍ Likely to raise capital in 2HFY07

At CMP, the stock trades at 8.7x FY07E EPS and 6.3x FY08E EPS. On a P/BV basis, the stock trades at 1.2x FY07E BV and 1.1x FY08E BV.

QUARTERLY PERFORMANCE										(RS MILLION)	
Y/E MARCH	FY05				FY06				FY05	FY06	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
Operating Income	286	311	356	342	386	447	666	769	1,296	2,268	
Other Income	0	2	0	1	0	1	1	2	3	4	
<b>Total income</b>	<b>286</b>	<b>313</b>	<b>356</b>	<b>344</b>	<b>386</b>	<b>447</b>	<b>667</b>	<b>772</b>	<b>1,298</b>	<b>2,272</b>	
Y-o-Y Growth (%)	10.3	20.6	19.7	3.8	34.7	43.1	87.4	124.6		75.0	
Interest expenses	180	167	153	58	185	191	329	362	558	1,067	
<b>Net Income</b>	<b>106</b>	<b>145</b>	<b>203</b>	<b>286</b>	<b>201</b>	<b>256</b>	<b>338</b>	<b>410</b>	<b>740</b>	<b>1,205</b>	
Operating Expenses	48	66	64	154	78	78	107	166	331	429	
<b>Operating Profit</b>	<b>59</b>	<b>80</b>	<b>139</b>	<b>132</b>	<b>123</b>	<b>178</b>	<b>231</b>	<b>244</b>	<b>409</b>	<b>776</b>	
Y-o-Y Growth (%)	38.2	19.2	118.1	26.2	109.9	123.7	66.2	85.0		89.7	
Depreciation	3	3	3	3	5	15	46	29	12	95	
<b>Profit before Tax</b>	<b>56</b>	<b>77</b>	<b>136</b>	<b>129</b>	<b>118</b>	<b>164</b>	<b>185</b>	<b>215</b>	<b>397</b>	<b>681</b>	
Tax Provisions	20	19	49	27	9	78	55	56	115	198	
<b>Net Profit</b>	<b>36</b>	<b>57</b>	<b>87</b>	<b>102</b>	<b>109</b>	<b>86</b>	<b>130</b>	<b>159</b>	<b>282</b>	<b>484</b>	
Y-o-Y Growth (%)	34.9	24.3	125.3	31.4	205.3	49.7	48.6	56.3		71.4	
Int Exp/ Int Earned (%)	62.8	53.8	43.1	16.9	47.9	42.8	49.4	47.0	43.1	47.1	
Other Income / Net Income (%)	0.0	1.0	0.0	0.5	0.0	0.3	0.2	0.6	0.4	0.3	
Cost to Income Ratio (%)	44.9	45.2	31.6	53.8	38.8	30.5	31.7	40.4	44.8	35.6	

E: MOST Estimates \* Quarterly nos and full year nos will not tally due to different way of reporting financial nos

SREI has declared excellent 4QFY06 results, with net profit rising by 56% YoY resulting from a 43% increase in net interest income during the same period. Even on a sequential basis, NII has increased by 21%. The increase in net interest income on YoY basis as well as sequential basis has resulted from increased disbursements.

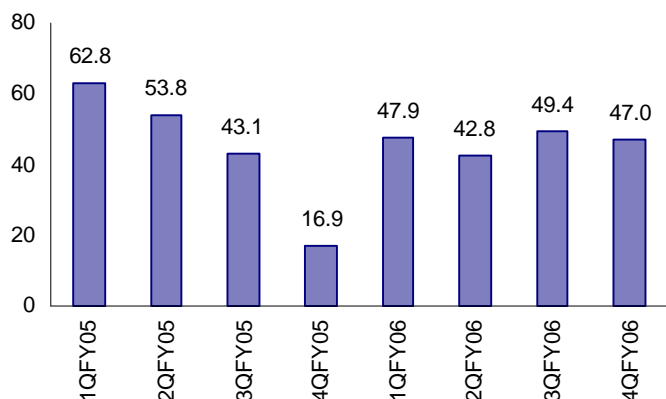
**Earnings continue to be robust with increased business volumes**

Operating income increased by 125% on a YoY basis to Rs769m in 4QFY06 underpinned by robust growth in disbursements. For FY06, operating income increased by 75% to Rs2.27b. NII increased by 43% to Rs407m in 4QFY06. For FY06, NII increased by 63% to Rs1.2b.

With increased business volume, total expenditure grew by 29% YoY to Rs429m in FY06. Operating profit grew strongly increasing by 85% to Rs244m in 4QFY06 and by 90% to Rs776m in FY06 respectively. Net profit for the quarter grew by a solid 56% YoY to Rs159m from Rs102m (for FY06 net profit grew 71% to Rs484m). Consolidated net profit was Rs503m.

SREI has been continuously reporting strong profits led by higher disbursements, higher NII and controlled costs. Between FY03-FY06, the company has reported 49% CAGR growth in its net profit. We expect the company to post 35% CAGR in net profit over FY06-FY08E, led by strong growth in NII.

QUARTERLY TREND IN INTEREST EXPENSE TO INTEREST EARNED (%)

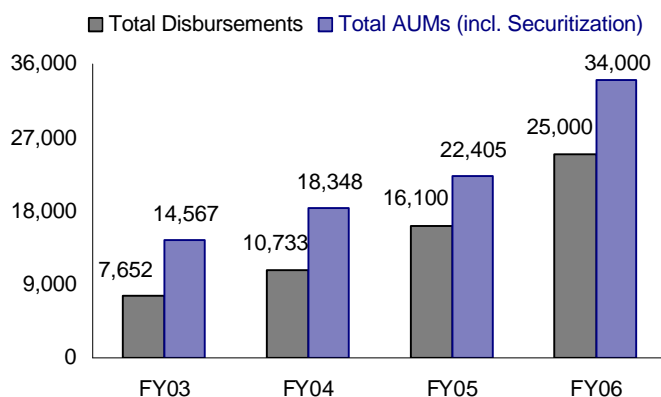


Source: Company/Motilal Oswal Securities

**Disbursements and AUMs grow at a robust pace**

Total assets under management, including securitized assets increased to Rs34b (including Rs12b of securitized assets) in FY06 from Rs22b in FY05, a 55% increase. Disbursements increased by Rs9b in FY06 resulting in total disbursements for FY06 at Rs25b, an increase of 56% YoY from Rs16b disbursed in FY05. Between FY03-FY06, disbursements have increased at a CAGR of 48%, while AUMs (including securitized assets) during the same period have increased at a CAGR of 33%. The management stated that pipeline for loans is strong and expect to maintain a similar growth in FY07.

SREI BUSINESS ON A GROWTH TRAJECTORY (RS M)

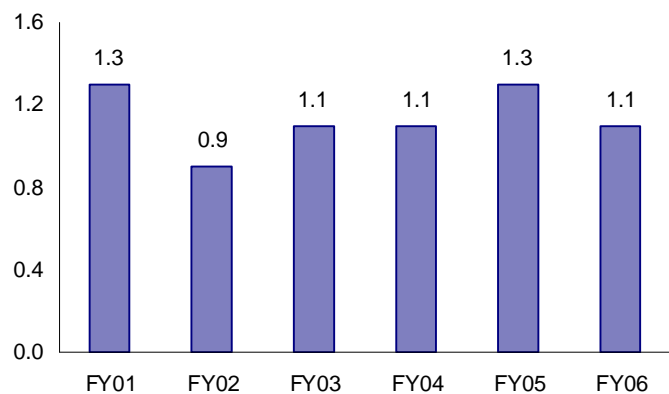


Source: Company/Motilal Oswal Securities

**Asset quality continues to be strong**

SREI has been operating in a highly specialized market and has been focusing on lending to SME-type (small and medium enterprises) customers. Despite this, it has been able to maintain healthy asset quality over the years, with zero net NPAs and gross NPAs at very low and consistent levels. Gross NPAs have been bought down by 20bp to 1.1% in FY06. We expect that with SREI’s robust appraisal system de-risking the company from probable defaults, strong collection and repossession capabilities and prudent selection of assets, enable it to maintain its asset quality at low levels.

TREND IN ASSET QUALITY (%)



Source: Company/Motilal Oswal Securities

### Likely to raise capital in 2HFY07

SREI has a total CAR of 18% and Tier 1 capital of 15% at FY06. We believe that the management is comfortable with a 8x leverage and thus would raise capital as its Tier I nears 12%. We believe that given the robust pace at which the company has been growing its balance sheet year-on-year, it will probably require to enhance capital in 2HFY07.

### Valuation and view

At CMP, the stock trades at 8.7x FY07E EPS and 6.3x FY08E EPS. On a P/BV basis, the stock trades at 1.2x FY07E BV and 1.1x FY08E BV. We are not factoring in any gains arising from its subsidiaries at this juncture.

## SREI Infrastructure Finance: an investment profile

### Company description

SREI Infrastructure Finance Ltd. (SREI) is the leading private sector infrastructure equipment company with over 6,000 customers and assets under management (AUM) of Rs34b. Leveraging on its expertise in the following fields: (1) financing infrastructure equipment; (2) infrastructure projects; and (3) in-depth knowledge in sectors such as roads, power and ports. The company currently enjoys a strong foothold versus peers. It has an approximate share of 25% in its domain expertise.

### Key investment arguments

- ✍ **Beneficiary of the Indian Infrastructure growth story;** Huge untapped potential (US\$150b), likely to be unveiled over the next few years. SREI is already present in energy, roads, ports, agriculture etc., wherein demand potential is huge.
- ✍ **Stringent NPA reporting practices:** SREI follows robust risk management systems, which have resulted in low NPAs.
- ✍ **Creating value through its subsidiaries/associates:** SREI promoted **Quipo**, an equipment renting company, which is growing fast. It has also floated a venture capital fund to fund small and medium infrastructure related businesses.

### COMPARATIVE VALUATIONS

		SREI	IDFC	SHRIRAM
P/E (x)	FY07E	8.7	15.8	11.8
	FY08E	6.3	13.6	9.8
P/ABV (x)	FY07E	1.2	2.4	2.2
	FY08E	1.1	2.1	1.8
RoE (%)	FY07E	14.9	15.7	20.5
	FY08E	18.0	16.3	20.7
RoA (%)	FY07E	1.9	3.0	3.1
	FY08E	1.9	2.6	3.2

### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	20.1	19.3	31.0
Domestic Institutions	3.1	3.0	0.5
FII's/FDIs	49.1	49.3	20.6
Others	27.7	28.4	47.9

### Key investment risks

- ✍ Given the strong growth rates in its business, we believe that SREI will require capital in order to fund its growth. As per its internal guidelines, SREI intends to keep a minimum Tier I capital of 15%.

### Recent developments

- ✍ SREI has recently received shareholders' approval for issuing shares in the overseas and domestic markets.
- ✍ SREI has raised US\$50m syndicated ECB at a price band of 1.4%-1.7% over Libor.

### Valuation and view

- ✍ SREI is a niche player in the construction equipment finance and infrastructure project finance segments.
- ✍ At current market price (CMP) of Rs52, the stock trades at 1.2x FY07E BV and 8.7x FY07E EPS.

### Sector view

- ✍ A buoyant economy has been fuelling growth in the demand for credit for NBFCs.
- ✍ Volatility in interest rates would impact NII and margins of this sector.
- ✍ Benefits of significant improvement in asset quality not yet factored into earnings, valuations
- ✍ We maintain an overweight stance on the sector.

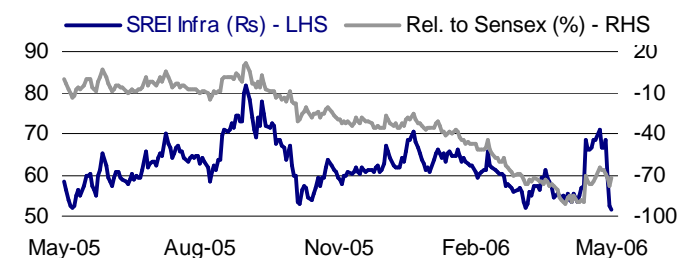
### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	5.9	-	-
FY08	8.1	-	-

### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
52	75	45.5	Buy

### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Interest Income	1,131	1,296	2,268	3,540	5,010	
Interest Expended	630	558	1,067	1,974	2,957	
<b>Net Interest Income</b>	<b>501</b>	<b>737</b>	<b>1,201</b>	<b>1,566</b>	<b>2,053</b>	
Change (%)	22.3	47.1	62.8	30.5	31.1	
Other Income	26	4	5	27	62	
<b>Net Income</b>	<b>527</b>	<b>741</b>	<b>1,205</b>	<b>1,593</b>	<b>2,115</b>	
Change (%)	26.2	40.5	62.6	32.2	32.7	
Operating Expenses	189	275	472	525	679	
<b>Operating Income</b>	<b>339</b>	<b>466</b>	<b>734</b>	<b>1,068</b>	<b>1,437</b>	
Change (%)	31.9	37.6	57.4	45.6	34.5	
Other Provisions	52	68	52	117	132	
<b>PBT</b>	<b>287</b>	<b>398</b>	<b>682</b>	<b>951</b>	<b>1,305</b>	
Tax	83	115	198	304	417	
Tax Rate (%)	28.8	28.9	29.0	32.0	32.0	
<b>PAT</b>	<b>204</b>	<b>283</b>	<b>484</b>	<b>647</b>	<b>887</b>	
Change (%)	59	38	71	34	37	
Proposed Dividend	90	91	180	185	185	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Capital	535	535	1,090	1,090	1,090	
Reserves & Surplus	912	1,105	3,014	3,476	4,177	
<b>Net Worth</b>	<b>1,447</b>	<b>1,639</b>	<b>4,105</b>	<b>4,566</b>	<b>5,268</b>	
<b>Secured Loans</b>	<b>6,014</b>	<b>7,992</b>	<b>17,982</b>	<b>26,073</b>	<b>37,806</b>	
Change (%)	5.4	32.9	125.0	45.0	45.0	
Mezzanine Capital	797	810	810	810	810	
Unsecured Loans	1,267	1,053	2,370	3,318	4,645	
Other Liabilities & Prov.	1,935	2,477	3,141	3,998	5,099	
<b>Total Liabilities</b>	<b>11,461</b>	<b>13,971</b>	<b>28,407</b>	<b>38,766</b>	<b>53,628</b>	
Cash and bank balance	485	437	1,452	1,567	2,141	
Investments	235	495	743	891	1,069	
Change (%)	-0.4	110.5	50.0	20.0	20.0	
Advances	9,682	11,895	24,980	34,972	48,960	
Change (%)	5.7	22.9	110.0	40.0	40.0	
Net Fixed Assets	168	178	134	86	32	
Deferred Tax Assets	21	14	14	2	-11	
Other Assets	870	953	1,086	1,249	1,437	
<b>Total Assets</b>	<b>11,461</b>	<b>13,971</b>	<b>28,408</b>	<b>38,766</b>	<b>53,628</b>	

ASSUMPTIONS	(%)				
Loan (borrowing) Growth	5.4	32.9	125.0	45.0	45.0
Advances Growth	5.7	22.9	110.0	40.0	40.0
Investments Growth	-0.4	110.5	50.0	20.0	20.0
Dividend	16.9	16.9	16.5	17.0	17.0

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
<b>Spreads Analysis (%)</b>						
Avg. Yield - Earning Asset	10.4	10.3	11.1	10.6	10.9	
Avg. Cost-Int. Bear. Liab.	8.3	6.2	6.9	7.7	8.1	
Interest Spread	2.1	4.1	4.2	2.9	2.8	
Net Interest Margin	4.6	5.9	5.9	4.7	4.4	
<b>Profitability Ratios (%)</b>						
RoE	14.7	18.3	16.9	14.9	18.0	
RoA	1.8	2.2	2.3	1.9	1.9	
Int. Expended/Int. Earned	55.7	43.1	47.1	55.8	59.0	
Other Inc./Net Income	5.0	0.5	0.4	1.7	2.9	
<b>Efficiency Ratios (%)</b>						
Op. Exps./Net Income	35.8	37.1	39.1	33.0	32.1	
Gross NPAs to Adv.	1.1	1.3	1.1	0.8	0.6	
Net NPAs to Adv.	0.0	0.0	0.0	0.0	0.0	
CAR	18.5	16.2	18.0	15.0	12.8	

VALUATION						
Book Value (Rs)	27.1	30.7	37.6	41.9	48.3	
Price-BV (x)	1.9	1.7	1.4	1.2	1.1	
Adjusted BV (Rs)	25.7	30.3	37.4	41.7	48.2	
Price-ABV (x)	2.0	1.7	1.4	1.2	1.1	
EPS (Rs)	3.8	5.3	4.4	5.9	8.1	
EPS Growth (%)	40.3	38.5	-16.1	33.5	37.2	
Price-Earnings (x)	13.5	9.7	11.6	8.7	6.3	
OPS (Rs)	6.3	8.7	6.7	9.8	13.2	
OPS Growth (%)	31.9	37.6	-22.8	45.6	34.5	
Price-OP (x)	8.1	5.9	7.7	5.3	3.9	

E: MOST Estimates



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

**SREI Infrastructure Finance**

- |  |    |
|--|----|
| 1. Analyst ownership of the stock            | No |
| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

MOST is not engaged in providing investment-banking services.

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.