Shriram Transport Finance (SRTR.BO)

3Q12 Results: Lower Growth, Margins; But Quality Holds

- Company Update

- **3Q12 profits were flat yoy, 7% below estimates** — Shriram's 3Q12 profits were flat yoy (+1% qoq) and were below our estimates. Key earnings drags were: a) further moderation in loan growth (+16% yoy now) and b) a sharp decline in net interest margins (down 80bps qoq). However, asset quality appears to have stabilized, NPLs were largely stable, write-offs due to the Karnataka mining ban already taken and coverage levels are moving up (86% now). In sum, a modest earnings quarter, but stable balance sheet quality and longer-term business outlook.
- **P&L: Sharp decline in NIMs** — Key highlights of the quarter were: A) NIMs declined 80bps qoq to 739bps in 3Q12 (after a surprise 60bps uptick in 2Q12). NIM decline was largely attributed to lower loan yields (40bps qoq decline in loan yields), despite shifting to higher-yielding used vehicles – possible pressure on pricing power (slower loan growth, likely increase in competitive intensity). Lower interest rates should however support NIMs going ahead. B) Operating costs were managed well – cost/income ratio declined over 300bps yoy (22.4% in 3Q12). C) Credit costs moderated from 2Q12 peaks, but still remain high (2.1% annualized in 3Q12) as management increases loan loss coverage. We expect credit costs to stabilize at slightly lower levels as most of the pain (from the Karnataka mining ban) has already been taken.
- **AUM growth moderates to 16% yoy** — AUM growth moderated further to 16% yoy, disbursements were down 4% yoy – the decline largely coming from a slowdown in the new vehicle segment, even as disbursements in used vehicles were up 14% yoy. We believe AUM growth is likely to remain modest due to industry slowdown and likely increase in competitive intensity.
- **Stable longer-term outlook, but near-term uncertainty, maintain Neutral** — While Shriram's loan growth and ROE outlook have moderated slightly, they still remain healthy (15-20% sustainable growth, over 20% ROEs). Near term, however, there is uncertainty on regulatory guidelines on treatment of asset securitization, which could impact earnings going ahead. Maintain Neutral until we have further clarity.

Neutral	**2**
Price (10 Feb 12)	Rs572.00
Target price	Rs660.00
Expected share price return	15.4%
Expected dividend yield	1.2%
Expected total return	**16.6%**
Market Cap	Rs129,399M
	US$2,617M

Price Performance
(RIC: SRTR.BO, BB: SHTF IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	8,731	40.70	35.1	14.1	3.4	28.5	1.1
2011A	12,299	54.45	33.8	10.5	2.7	28.4	1.1
2012E	14,140	62.51	14.8	9.1	2.1	25.8	1.2
2013E	16,590	73.35	17.3	7.8	1.7	24.3	1.3
2014E	19,714	87.16	18.8	6.6	1.4	23.4	1.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	14.1	10.5	9.1	7.8	6.6
P/E reported (x)	14.1	10.5	9.1	7.8	6.6
P/BV (x)	3.4	2.7	2.1	1.7	1.4
P/Adjusted BV diluted (x)	3.5	2.7	2.2	1.7	1.4
Dividend yield (%)	1.1	1.1	1.2	1.3	1.4
Per Share Data (Rs)					
EPS adjusted	40.70	54.45	62.51	73.35	87.16
EPS reported	40.70	54.45	62.51	73.35	87.16
BVPS	168.72	215.20	269.52	334.09	411.89
Tangible BVPS	168.72	215.20	269.52	334.09	411.89
Adjusted BVPS diluted	163.02	214.06	265.99	327.86	406.24
DPS	6.03	6.49	7.00	7.50	8.00
Profit & Loss (Rsm)					
Net interest income	21,878	30,627	35,571	42,610	50,325
Fees and commissions	305	270	433	606	848
Other operating Income	345	680	763	862	983
Total operating income	**22,528**	**31,577**	**36,766**	**44,078**	**52,155**
Total operating expenses	-5,176	-7,540	-8,668	-9,964	-11,455
Oper. profit bef. provisions	**17,352**	**24,037**	**28,099**	**34,114**	**40,700**
Bad debt provisions	-4,104	-5,556	-6,995	-9,353	-11,276
Non-operating/exceptionals	-2	8	0	0	0
Pre-tax profit	**13,246**	**18,489**	**21,104**	**24,761**	**29,424**
Tax	-4,515	-6,190	-6,964	-8,171	-9,710
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**8,731**	**12,299**	**14,140**	**16,590**	**19,714**
Adjusted earnings	8,731	12,299	14,140	16,590	19,714
Growth Rates (%)					
EPS adjusted	35.1	33.8	14.8	17.3	18.8
Oper. profit bef. prov.	41.5	38.5	16.9	21.4	19.3
Balance Sheet (Rsm)					
Total assets	**269,393**	**315,715**	**389,314**	**455,498**	**531,060**
Avg interest earning assets	246,580	261,053	311,007	379,584	449,450
Customer loans	179,650	198,656	273,549	329,818	394,680
Gross NPLs	5,113	5,286	8,356	11,200	14,802
Liab. & shar. funds	**269,393**	**315,715**	**389,314**	**455,498**	**531,060**
Total customer deposits	1,148	11,295	12,989	14,288	15,716
Reserve for loan losses	3,828	5,029	7,556	9,790	13,524
Shareholders' equity	**38,053**	**48,674**	**60,962**	**75,567**	**93,164**
Profitability/Solvency Ratios (%)					
ROE adjusted	28.5	28.4	25.8	24.3	23.4
Net interest margin	8.87	11.73	11.44	11.23	11.20
Cost/income ratio	23.0	23.9	23.6	22.6	22.0
Cash cost/average assets	2.0	2.6	2.5	2.4	2.3
NPLs/customer loans	2.8	2.7	3.1	3.4	3.8
Reserve for loan losses/NPLs	74.9	95.1	90.4	87.4	91.4
Bad debt prov./avg. cust. loans	2.3	2.9	3.0	3.1	3.1
Loans/deposit ratio	15,649.6	1,758.9	2,106.0	2,308.4	2,511.3
Tier 1 capital ratio	15.8	19.9	18.8	19.6	20.5
Total capital ratio	21.0	28.5	26.7	27.9	28.8

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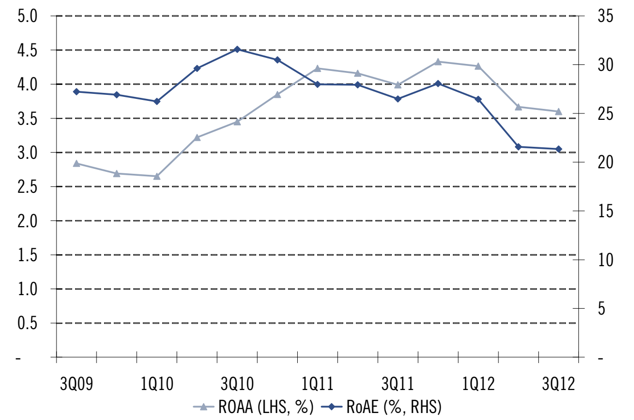
Powered by: dataCentral

Figure 1. Shriram Transport: 3Q12 Results – Key Highlights (Rupees Million, Percent)

	3Q12	3Q11	YoY %	2Q12	QoQ%	CIRA Comments
Interest Income	14,385	13,763	4.5	14,500	-0.8	Sharp 40bps drop in loan yields qoq, depress revenues
Interest Expense	(6,347)	(5,396)	17.6	(6,153)	3.2	Reduction in cost of funding as well - but not enough to support NIMs
Net Interest Income	8,038	8,367	-3.9	8,347	-3.7	Impact on NIMs more due to lower loan yields than cost of funding
Fee-Based Income	-	62	NM	-	NM	
Other Non-Interest Income	294	122	140.7	258	13.7	
Non Interest Income	294	184	59.8	258	13.7	
Operating Income	8,331	8,550	-2.6	8,605	-3.2	
Operating Expenses	(1,867)	(2,199)	-15.1	(1,788)	4.4	Costs well under control, slightly lower than expected
Pre-Provision Profit	6,465	6,351	1.8	6,818	-5.2	
Charges for Bad Debts	**(1,920)**	**(1,787)**	**7.4**	**(2,363)**	**-18.7**	**Credit costs remain high at 2.1% annualized, should stabilize at slightly lower levels near term**
Operating Profit	4,545	4,564	-0.4	4,454	2.0	
Pre-Tax Profit	4,545	4,564	-0.4	4,454	2.0	
Tax	(1,518)	(1,551)	-2.1	(1,460)	3.9	
Net Profit	**3,027**	**3,014**	**0.4**	**2,994**	**1.1**	**Overall 7% below estimates, largely on lower than expected NIMs and slower loan growth**
EPS	13.4	13.4	0.1	13.3	0.8	
Customer Loans	237,178	224,044	5.9	242,091	-2.0	Balance sheet growth has slowed down meaningfully, as securitization has resumed incrementally
Borrowings	228,034	211,400	7.9	218,126	4.5	
AIEA	277,432	277,432	0.0	292,603	-5.2	
AIBL	203,345	203,345	0.0	205,898	-1.2	
Total Assets	345,618	313,107	10.4	330,923	4.4	
Avg Assets	338,270	299,046	13.1	326,665	3.6	
Assets Under Management	392,596	337,797	16.2	380,764	3.1	Asset growth also slowing down, will likely remain at current levels. Management expects loan growth to remain around 15-20% medium term
Avg AUMs	435,015	375,565	15.8	407,462	6.8	
Non-Performing Loans (NPL)	6,719	5,428	23.8	6,596	1.9	Asset quality largely stable - management remains confident of maintaining asset quality
Loan Loss Reserves (LLR)	(5,788)	(4,379)	32.2	(5,609)	3.2	
Shareholders' Funds	57,891	46,690	24.0	55,520	4.3	
Book Value Per Share	256	207	23.6	243	5.2	
Key Ratios (%)	**3Q12**	**3Q11**	**Bps Δ YoY**	**2Q12**	**Bps Δ QoQ**	
ROAA (annualized)	3.6	4.0	-45	3.7	-9	
ROAE (annualized)	20.9	25.8	-490	21.6	-66	
Net Interest Margin (bps) - AUM	739	891	-152	819	-80	Key negative during the quarter - much sharper decline than expected. Lower interest rates ahead should however, support NIMs medium term.
Other Non-Interest Inc/Op Inc	3.5	2.1	138	3.0	52	
Op. Cost/ Operating Income	22.4	25.7	-331	20.8	163	Under control and well managed
Loan-to-Deposit Ratio (LDR)	104.0	106.0	-197	111.0	-698	
NPL/Loan Ratio	-	2.4	-242	2.7	-272	
LLR/NPL Ratio	86.1	80.7	549	85.0	111	Coverage levels have improved - provides comfort on future earnings

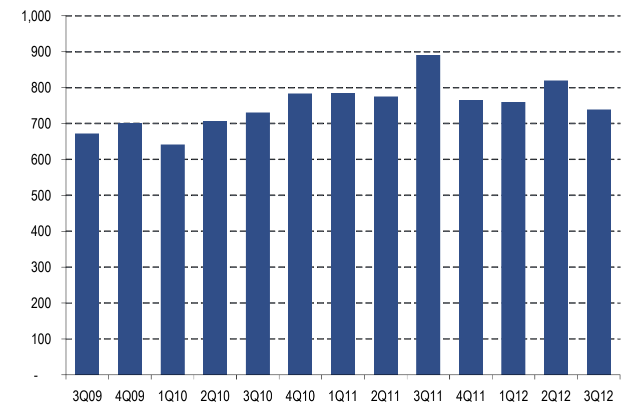
Source: Citi Investment Research and Analysis

Figure 2. Shriram – RoAA and RoAE (Percent)



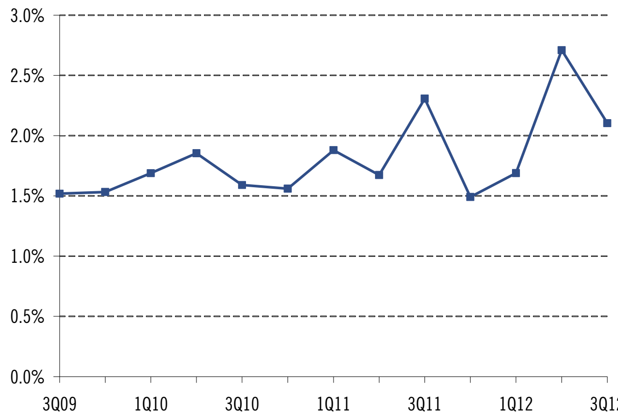
Source: Citi Investment Research and Analysis

Figure 3. Shriram – Net Interest Margins (bps)



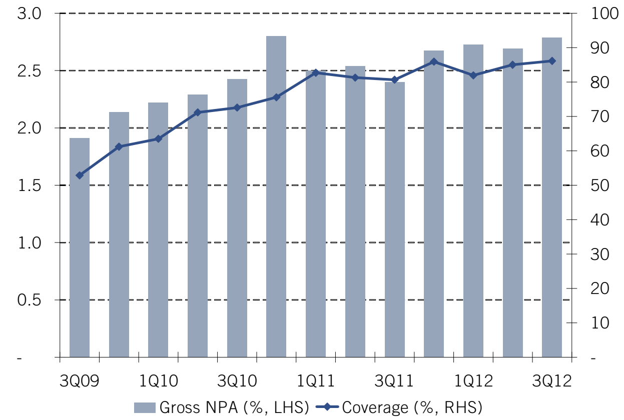
Source: Citi Investment Research and Analysis

Figure 4. Shriram – Credit Costs (% of Average AUM)



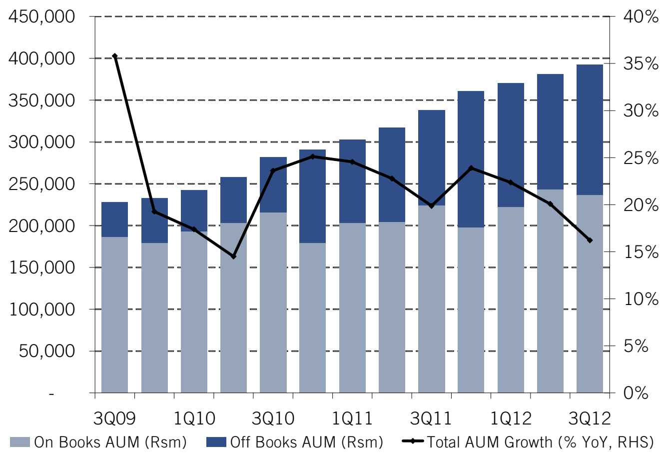
Source: Citi Investment Research and Analysis

Figure 5. Shriram – Gross NPLs and Coverage Ratio (Percent)



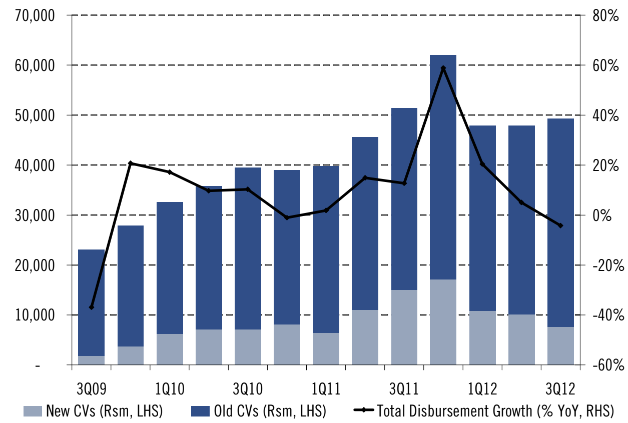
Source: Citi Investment Research and Analysis

Figure 6. Shriram – Total AUM and Growth (Rupees Million, Percent)



Source: Citi Investment Research and Analysis

Figure 7. Shriram – Total Disbursements and Growth (Rupees Million, Percent)



Source: Citi Investment Research and Analysis

Shriram Transport Finance

Company description

Shriram Transport is the largest organized player in the pre-owned commercial vehicle (CV) financing segment in India. It was started in 1979 by three entrepreneurs and focuses on financing CVs. Subsequently it diversified into financing 3-wheelers and tractors, and providing working capital, engine replacement and tire loans to truck operators. Shriram has built a strong distribution network with 494 branches, more than 16,000 employees and tie-ups with over 500 local financiers across the country, with a wide presence in South India.

Investment strategy

We rate Shriram as Neutral with a target price of Rs660. It has a unique business model, long track record of operating profitably in a segment considered difficult by banks, healthy asset quality, and an experienced and stable management team. However, there are near term growth and earnings challenges from: a) Expected slowdown in the Indian CV sales cycle and its linkage to the strong industrial production cycle; b) Tighter (draft) regulatory norms for NPL recognition and provisioning, which could lead to near term earnings impact; and c) Expected increase in NPLs due to slowdown in capex cycle, leading to slower economic activity near term. Fundamentally, however, Shriram’s return profile is should remain robust with expected ROEs of 23-26% over FY12-14E. However, the stock appears close to fair value at 2.0x 1yr Fwd P/BV and we see limited upside to the stock price from current levels.

Valuation

We value Shriram at Rs660 based on our EVA model, which captures the long-term value of the business and is our standard valuation measure for CIRA India Banking coverage. Our EVA model assumes: a) a risk-free rate of 8% (in line with secondary market yields); b) longer-term loan loss provisions of 300bps given its higher asset risk profile; c) loan spreads of 730bps due to its higher-yielding asset profile; and d) long-term fee income growth of 12%. As a reference, we benchmark our fair value off 2.2x 1Yr Fwd P/BV (Sep'12), at the lower end our target multiples for private-sector banks (2.0-3.5x), based on this, the stock would be valued at Rs664. We believe Shriram can trade at higher multiples during strong economic growth and asset quality cycles, though it will be challenging in the current environment.

Risks

We believe key upside risks for the stock are: a) Continued easy liquidity / low interest rate environment; b) Better-than-expected loan growth; and c) Possibility of a new banking license. Key downside risks that could cause the stock to trade below our target include: a) Asset quality - good so far, but slower economic activity, rapid pace of loan growth suggests credit costs can rise; b) Wholesale funding - can hurt in a tight-liquidity scenario; c) Execution of the planned fee income initiatives; d) Regulatory changes in the NBFC and transportation sectors.

Appendix A-1

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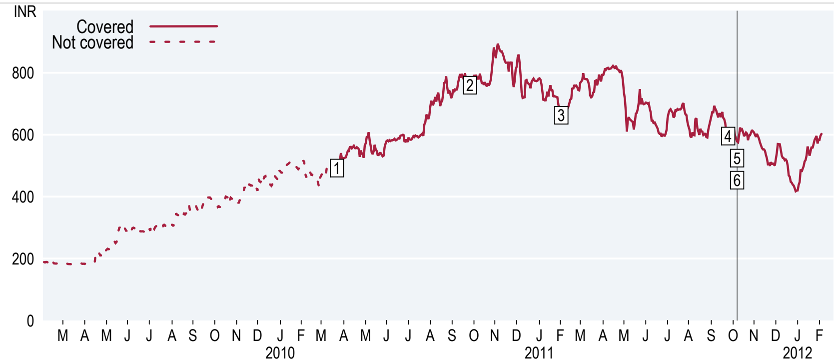
IMPORTANT DISCLOSURES

Shriram Transport Finance (SRTR.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since March 23 2010



	Date	Rating	Target Price	Closing Price
1	23-Mar-10	*1M	*615.00	493.20
2	27-Sep-10	*2M	*830.00	769.05
3	2-Feb-11	2M	*750.00	662.90
4	26-Sep-11	2M	*660.00	599.65
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*2	660.00	578.15

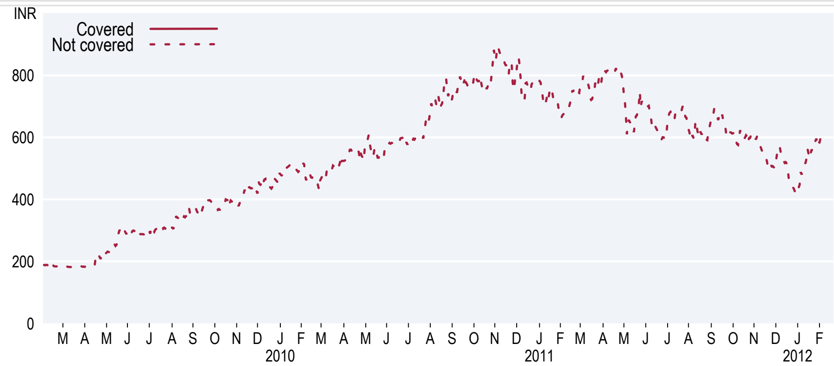
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Shriram Transport Finance (SRTR.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since March 23 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%

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Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings,** which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were:Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were:Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

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