PINC RESEARCH

SHRIRAM TRANSPORT FINANCE COMPANY LTD.

Q4 FY 2008 update HOLD

Sector Financial I CMP Rs 320

STOCK DATA

Market Cap	Rs67.3bn.
Book Value per share	Rs87
Eq Shares O/S (F.V. Rs.10)	203mn.
Median Vol (12 mths)	61,464 (BSE+NSE)
52 Week High/Low	Rs433 / 150
Bloomberg Code	SHTF@IN
Reuters Code	SRTR.BO

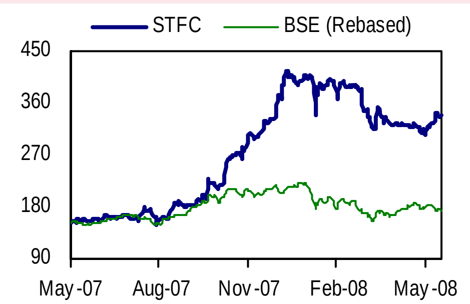
SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-07	Dec-07	Mar-08
Promoter	44.8	42.0	42.0
MFs/FI	4.5	4.8	4.2
FII/NRI/OCB	14.4	13.3	15.1
PCB	6.0	6.5	7.7
Indian Public/Others	30.3	33.3	31.1

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(0.6)	80.6	187.2
Relative	14.9	84.3	129.2

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

Shriram Transport Finance Company Ltd.(STFC) continued to witness strong growth in disbursements which led to a 76% surge in operating income to Rs7.6bn and even stronger growth in Net profit of 131% YoY to Rs1.1bn.

However, NIM declined 60bps YoY to 7.72% due to escalating cost of funds despite OPM witnessing stability at 25.88% due to rising employee cost.

- **Disbursement remains high**

Disbursements recorded a huge jump of 121% to Rs38.5bn, with over 68% being constituted by pre-owned CVs. The replacement demand for pre-owned CV's continue to remain buoyant and has led to growth in this segment.

- **NIM rises sequentially**

STFC's NIM expanded sequentially although it declined on YoY basis. Although cost of funds has been rising, the same is contained to present levels due to increasing reliance on banks/institutions for funding.

- **Net profit spurt**

Net profit exhibited a sharp rise of 131% to Rs1.1bn (against our estimate of Rs1bn) due to robust growth in fund based income led by strong asset growth. STFC continues to maintain its leadership in pre-owned CV finance with ~25% market share.

VALUATION AND RECOMMENDATION

Q4FY08 results have been in line with our estimates due to strong asset growth, income accruing from securitization and scale up that the company has been able to achieve. *However, going forward, due to surge in fuel cost and inflation which could potentially slow down GDP growth, we anticipate slowdown in disbursements and pressure on NIM. Therefore, we are downgrading our EPS estimates for FY09 and FY10 since our last quarterly update by 27% and 37% to Rs22 and Rs26 respectively.*

At the CMP of Rs320, STFC is trading at a P/E of 13.97x FY09 EPS of Rs23 and a P/BV of 2.39x. While the stock has been trading in the P/E range of 10x-22x for the last 12 months, we believe that its valuations should be at the middle of the band. Thus, assigning P/E multiple of 15x, the derived fair price works out to Rs344. Therefore we recommend 'HOLD' on the stock.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Sep-07	Dec-07	Mar-08	2006	2007	2008	2009E	2010E
Op Income	5,603	6,383	7,497	9,087	14,155	24,941	33,053	42,964
YoY Gr (%)	*77.2*	*70.2*	*77.6*	*162.8*	*55.8*	*76.2*	*32.5*	*30.0*
Op Profits	2,155	2,192	2,645	3,003	4,659.0	8,375	10,957	13,778
Op Marg. (%)	*37.8*	*33.2*	*34.6*	*33.0*	*32.2*	*33.6*	*33.1*	*32.1*
Net Profits	959	1,071	1,119	1,417	1,904	3,898	4,672	5,583
Eq. Capital	1,911	2,031	2,031	1,891	1,842	2,031	2,039	2,039

KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008E	2009E	2010E
Dil. EPS (Rs)	7.5	9.9	17.2	22.9	27.4
BV (Rs)	55.5	58.3	102.2	134.1	160.7
ROAA (%)	3.98	2.49	2.91	2.35	2.15
ROANW (%)	26.76	19.94	24.76	19.43	18.57
P/E (X)	42.72	32.26	18.64	13.97	11.69
P/BV (X)	5.77	5.49	3.13	2.39	1.99

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PERFORMANCE OVERVIEW

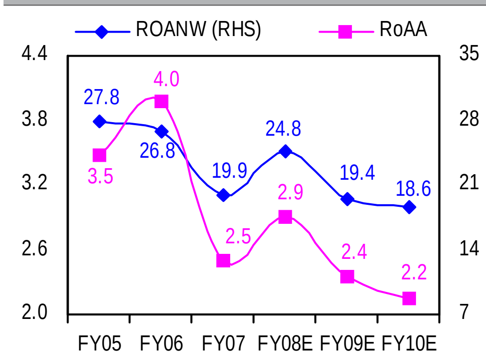
Shriram Transport Finance Company (STFC) continued to exhibit very strong disbursement across pre-owned CV segment. This resulted in the surge in operating income by 78% to Rs7.5bn. Significant increase in income from securitization (Rs514mn in Q4FY08) since last three quarters have been additionally providing impetus to the topline. The same is resulting from securitization done in Q4FY07 and fresh securitized amount of Rs11bn in Q3FY08.

Accelerated operating income driven by high disbusements in pre-owned CV finance and asset growth …

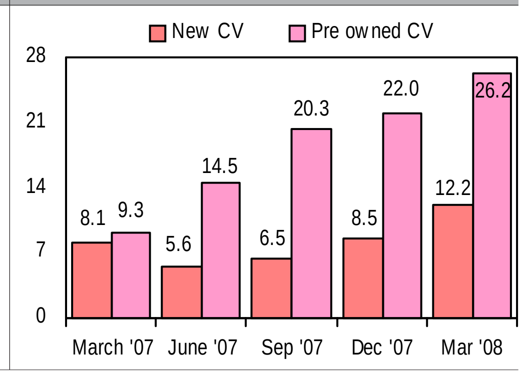
STFC has been undertaking a huge branch expansion in FY08 and added 28 branch offices in the last quarter, taking its total branch network to 430. It also added ~2,169 employees in the same period. While these resulted in employee cost increase of 19% for the quarter and 73% for FY08. However, OPM increased on YoY basis and remained stable sequentially due to high operating income.

Disbursements continued to remain strong and it rose 70% YoY to Rs30.5bn, driven by the asset finance as well as working capital finance. For the quarter, used CV finance accounted for 68% of incremental disbursements. STFC currently has a tie up with 490 private financiers who source asset for the company, and 15% of incremental disbursements have been achieved from these partnerships. Total assets under management grew 62% YoY to Rs195bn, with pre-owned CV portfolio being Rs151bn.

Return ratios of STFC



Qtrly disbursement trend



Source: PINC Research & Company data

Funding Mix of STFC

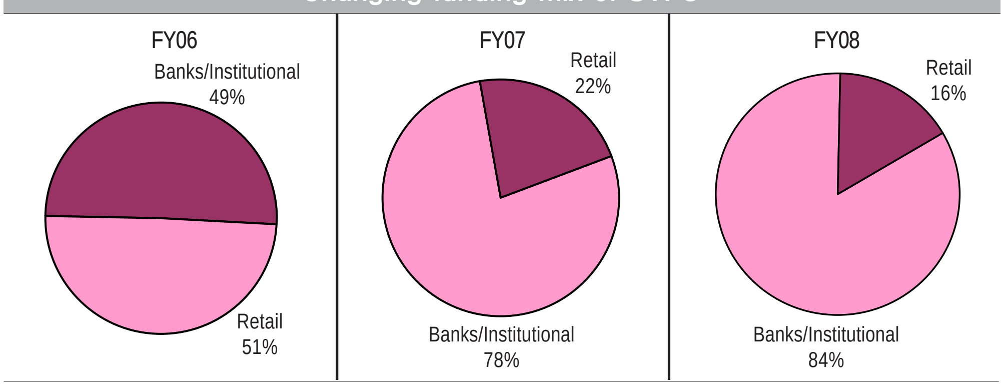
There has been a significant shift in STFCs borrowing profile during the last three years, wherein bank and institutional funding now constitute 84% of the total borrowing of Rs148bn as against 49% in FY06.

Increasing reliability on Banks/Instituions for funding …

Mandate for Priority sector lending creates huge demand from Banks

Availability of institutional funds has become easier for STFC due to policy thrust on Priority sector lending (PSL) (Banks are to meet the mandatory 40% priority PSL criteria), there is a huge demand from banks for the same. Since the truck financing (both of new and pre-owned CVs) to small truck operators is considered a part of PSL, banks are now willing to lend funds to STFC. STFC's improved financial performance and robust business model with large customer base of 0.6mn has further enhanced trust by Banks/Institutions.

Changing funding mix of STFC



Source: PINC Research & Company data

INVESTMENT ARGUMENT

STFC is poised to rapidly build scale, driven by strong underlying growth momentum in its core business of financing pre-owned CVs and foray into new business verticals. Backed by a fast expanding pan-India footprint, we expect STFC to maintain its leadership in the pre-owned CV financing segment. The company also has a strong management team with experience in the existing business.

Strong presence in existing business, foray into new business verticles and replacement demand to create value for the company …

The balance sheet size of STFC during the last four years has expanded 15 times due to merger with *Shriram Investments* and *Shriram Overseas* and on the back of increasing disbursements. The branch expansion which has gained momentum in FY08 is to continue going forward. To augment its network, STFC set up 28 branch offices in Q4FY08, taking the total number of branch network to 430 and thereby achieved target set for FY08 in terms of network. The company plans to have 600 branches and has also set a target for AUM of Rs300bn by FY10. We estimate growth in disbursements to be ~39% and ~32% in FY09 and FY10.

The ability of the company to maintain its market share in pre-owned CV finance segment, efficient collection system and the expertise built over the years gives it a marked edge over the new entrants. As a result, STFC maintained its lead in pre-owned CV financing in the industry with a market share of 25%.

OUTLOOK

Demand for pre-owned CV's to remain high

Replacement demand is likely to remain strong due to the government pressure on truck operators to replace trucks which are >15 years of age. This demand is estimated to be ~1 mn, as these trucks would be phased out over the next 5 years. Additionally, improvement in road infrastructure and buoyant economic activity would further fan the demand for trucks.

Increasing product lines and market share in pre - owned CV segment

STFC is also entering into new product segments like tractor, passenger vehicles and recently they are also entering into construction equipment finance. This diversification along with foray into other business ventures (freight bill discounting, co-branded credit cared etc.) will reduce dependence on single business of pre-owned CV segment to some extent and maintain the growth momentum.

The company targets to expand its market share to 40% by 2010 from the existing 25%. The same would be achieved by the company's strong presence in pre owned CV segment as well as the consolidation that STFC is undertaking via partnerships with the private financiers.

Rising Delinquencies

Although disbursements would remain strong, realizations from the same would come under pressure due to dilution in the pricing power of the company. We estimate that going forward, delinquencies could be higher leading to higher *loan loss provisioning*. The same can be concluded from the scenario that earnings of small truck operators would be impacted by rise in fuel cost without commensurate increase in freight rates.

Partnership with private financiers to further enhance penetration in rural areas…

Profitability of small truck operators to witness downturn

Diesel accounts for 60% of truck operators' costs. The 10% YoY hike in diesel price combined with lack of pricing power due to slow demand will reduce truckers' profitability. This together with potential increase in overloading practices will result in a slowdown in fleet expansion and therefore, truck sales. Also, high inflation which is unlikely to come down in recent times due to the impact of fuel prices still to be factored in, could also impact the offtake in services and hence affect income levels of truck operators doubly. We estimate LLP at 1.7% and 1.8% for FY09 and FY10 respectively.

Due to the impact of the same as well as high base effect built in FY08, net profit growth will stabilise at ~20% for the next 2 years. We expect RoA to decline in FY09 to 2.35% and then decline to ~2.15% in FY10. RoE would hover ~20%.

Slowdown in disbursements, higher LLP and pressure on NIM would bring down the pace of growth in Net profit…

Income accretion from securitization has provided additional benefits to the company. We have estimated deceleration in net profit growth from 104% in FY08 to 20% in FY10 due to declining NIM. Without further equity dilution for the next 2 years, we arrive at a sustainable RoE of 20.07%. We have estimated balance sheet size growth of 35% and 27% to Rs228bn and Rs290bn respectively.

Considering slowdown in disbursements and pressure on NIM going forward, we are downgrading our EPS estimates for FY09 and FY10 since our last quarterly update by 27% and 37% to Rs23 and Rs27 respectively.

Sensitivity Analysis

We have estimated balance sheet size of Rs228bn and NIM at 7% as at the end of FY09. The same for FY10 is estimated at Rs290bn and 6.8% respectively. Assuming average yield at 15% on the total disbursement of Rs211bn and Rs280bn, securitization income of Rs1.8bn and Rs2bn, we arrived at net profit estimate of Rs4.67bn and Rs5.58bn for FY09 and FY10 respectively. However, if balance sheet grows higher than our estimates on the back of spurt in disbursements and NIM is maintained at higher levels, net profit could be higher and thereby re-rating of the stock could be possible.

Sensitivity on Net Profit (Rs Bn)

	Balance Sheet Size (Rs Bn)				
	FY09		FY10		
NIM (%)	**230**	**250**	**270**	**290**	**310**
7.3	5.13	5.97	5.74	6.52	7.04
7.0	**4.67**	5.48	5.26	5.93	6.44
6.8	4.41	5.14	4.90	**5.58**	6.02
6.5	4.00	4.70	4.38	4.99	5.42

VALUATIONS

The stock is trading at P/E and P/BV of 14.97x and 2.68x FY09 earnings …

At the CMP of Rs330, STFC is trading at a P/E of 13.97x FY09 EPS of Rs23 and a P/BV of 2.39x. While the stock has been trading in the P/E range of 10x-22x for the last 12 months, we believe that its valuations should be at the middle of the band considering its strong franchise and high growth. Thus, assigning P/E multiple of 15x, the derived fair price works out to Rs344.

We value the stock at a FY09 adjusted book value multiple of 2.57 and implies a sustainable RoE of 19% with a cost of equity at 13.85% and terminal growth at 10% under Gordon's model. This arrives at FY09 target price of Rs330. This implies that currently the stock is fairly priced and therefore we recommend 'HOLD' on the stock. However, we would revisit the same if the company achieves greater than expected growth in disbursements. Positive upside might also come if the company retains pricing power that it enjoys currently which will enable it to maintain NIM at the current level.

CONCERNS

1. Economic slowdown impacting the freight movements in the country will adversely affect the company since it will lead to defaults from the truck operators due to absence of income stream thereby adding to the non performing assets of the company.
2. Liquidity crunch in the banking system will have impact on the company since the demand for PSL would come down.
3. Any negative policy action by the regulators towards NBFCs is also impending risk for STFC.

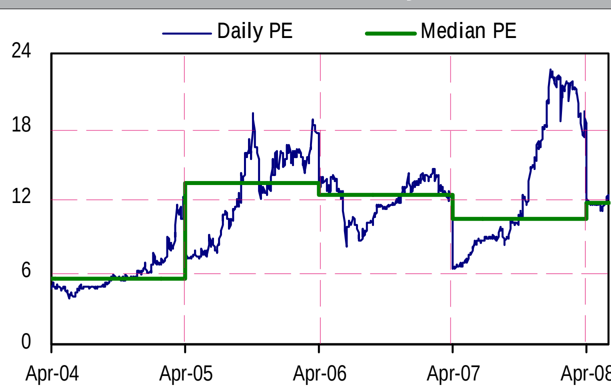
Company description

Shriram Transport Finance Company Ltd. (STFC) is a market leader in pre-owned commercial vehicles financing. It is a Chennai-based company, which was formed in 1979 by three entrepreneurs, Mr R Thyagrajan, Mr A V S Raja and Mr T Jayaraman. Over the past few years, it has carved out a niche for itself by increasing its focus on institutional funding rather than high cost retail funding.

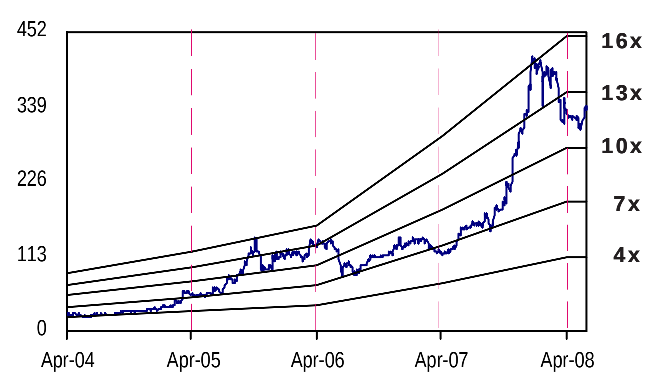
Financial Results for the quarter & year ended 31 March 2008

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/08	31/03/07	Gr %	31/03/08	31/03/07	Gr %
Operating income	**7,497**	**4,221**	**77.6**	**24,939**	**14,116**	**76.7**
Other Income	148	50	194.4	9	40	(78.5)
Total Income	**7,645**	**4,272**	**79.0**	**24,948**	**14,155**	**76.2**
Interest expended	3,934	2,392	64.4	12,966	7,383	75.6
Operating expense	1,066	614	73.7	2,742	2,117	23.8
Total Expenditure	**5,000**	**3,006**	**66.3**	**15,708**	**9,500**	**63.7**
Operating profit	**2,645**	**1,266**	**109.0**	**9,240**	**4,655**	**102.8**
Provisions & Contingencies	667	534	24.9	2,317	1,665	39.2
Depreciation	206	40	416.0	872	98	789.9
PBT	**1,773**	**692**	**156.2**	**6,050**	**2,892**	**109.2**
Tax	654	208	214.1	2,160	988	118.6
Net Profit	**1,119**	**484**	**131.3**	**3,890**	**1,904**	**104.4**
Equity capital (FV Rs 10)	2,031	1,842		2,031	1,842	
EPS for the period(Rs)	**5.5**	**2.6**		**19.2**	**10.3**	
OPM (%)	**34.6**	**29.6**		**37.0**	**32.2**	
NPM (%)	14.6	11.3		15.6	13.4	
NIM (%)	**7.72**	**7.88**		**7.77**	**8.47**	

Median PE v/s Daily PE



PE Band



Year Ended March (Figures in Rs mn)

Income Statement	2005	2006	2007	2008	2009E	2010E
Operating Income	**3,433**	**8,984**	**13,963**	**24,933**	**33,000**	**42,911**
Other Income	25	102	192	9	53	53
Total Income	**3,458**	**9,087**	**14,155**	**24,941**	**33,053**	**42,964**
Interest Expanded	1,628	4,151	7,239	12,966	17,257	22,890
Operating expenses	777	1,831	2,258	3,600	4,840	6,297
Depreciation	49	102	101	-	-	-
Operating Profit	**1,003**	**3,003**	**4,557**	**8,375**	**10,957**	**13,778**
Provisions	225	841	1,665	2,317	3,879	5,319
PBT	**779**	**2,162**	**2,892**	**6,058**	**7,078**	**8,459**
Tax	285	745	988	2,160	2,407	2,876
Net Profits	**493**	**1,417**	**1,904**	**3,898**	**4,672**	**5,583**
Fully diluted Eq. sh. O/s (mn no)	149.6	150.6	184.2	227.1	203.9	203.9
Book Value (Rs)	25	55	58	102	134	161
Basic EPS (Rs)	**5.4**	**9.4**	**10.3**	**19.2**	**22.9**	**27.4**

Balance Sheet	2005	2006	2007	2008E	2009E	2010E
Equity Share Capital	907	1,506	1,842	2,031	2,039	2,039
Optianally convertible warrants	10	199	77	240	-	-
Suspense account	-	186	-	-	-	-
Reserves & Surplus	1,317	6,462	8,822	18,477	25,307	30,727
Net worth	**2,235**	**8,353**	**10,741**	**20,748**	**27,346**	**32,766**
Total Loans(secured & unsecured)	14,819	43,964	87,384	147,729	200,561	257,290
Deferred Tax liability	535	1,337	866	359	359	359
Employee stock option o/s	-	35	123	-	-	-
Capital Employed	**17,589**	**53,689**	**99,115**	**168,836**	**228,266**	**290,415**
Fixed Assets	489	1,568	1,276	1,427	1,676	2,076
Net current assets	17,054	52,025	95,193	153,158	218,358	281,085
Investments	41	92	2,246	13,852	7,832	6,852
CWIP	-	-	399	399	399	400
Misc exp.	4	4	1	-	1	2
Total Assets	**17,589**	**53,689**	**99,115**	**168,836**	**228,266**	**290,415**

Year Ended March (Figures in Rs mn)

ROE Analysis	2005	2006	2007	2008E	2009E	2010E
% of average assets						
Operating Income	19.52	16.73	14.09	14.77	14.46	14.78
Interest & Finance Charges	9.26	7.73	7.30	7.68	7.56	7.88
Net Interest Income	**10.27**	**9.00**	**6.78**	**7.09**	**6.90**	**6.89**
Other Income	0.14	0.19	0.19	0.01	0.02	0.02
Operating Income	**10.41**	**9.19**	**6.98**	**7.09**	**6.92**	**6.91**
Staff Cost	0.70	0.79	0.67	0.74	0.83	0.88
Overheads and Depreciation	3.72	2.63	1.60	1.39	1.29	1.28
Operating Costs	**4.42**	**3.41**	**2.28**	**2.13**	**2.12**	**2.17**
Pre-provision operating profit	**5.99**	**5.78**	**4.70**	**4.96**	**4.80**	**4.74**
Loan Loss provisions	1.28	1.57	1.68	1.37	1.70	1.83
Profit Before Taxes	**4.43**	**4.03**	**2.92**	**3.59**	**3.10**	**2.91**
Taxes	1.62	1.39	1.00	1.28	1.05	0.99
RoAA	**3.47**	**3.98**	**2.49**	**2.91**	**2.35**	**2.15**
Avg. Assets/Avg. net worth	8.02	6.73	8.00	8.51	8.26	8.63
RoE	**27.80**	**26.76**	**19.94**	**24.76**	**19.43**	**18.57**

Key Ratios	2005	2006	2007	2008E	2009E	2010E
OPM (%)	29.0	33.0	32.2	33.6	33.1	32.1
NPM(%)	14.3	15.6	13.5	15.6	14.1	13.0
RoAA(%)	3.47	3.98	2.49	2.91	2.35	2.15
RoANW(%)	27.8	26.8	19.9	24.8	19.4	18.6
NIM (Calculated)	11.3	8.8	8.0	7.1	7.0	6.8
NIM (Reported)	10.1	8.5	8.8	7.8	-	-
Book Value(Rs)	24.6	55.5	58.3	102.2	134.1	160.7
Total Income/Total Assets (x)	0.20	0.17	0.14	0.15	0.14	0.15
PBT/Avg Assets(%)	5.5	6.1	3.8	4.5	3.6	3.3
Cost - Income Ratio (%)	22.5	20.2	15.9	14.4	14.6	14.7
P/E (x)	59.5	42.7	32.3	18.6	14.0	11.7
P/BV (x)	12.99	5.77	5.49	3.13	2.39	1.99

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