

June 01, 2007

BUY

Price	Target Price
Rs72	Rs110
Sensex	14,544

Price Performance

(%)	1M	3M	6M	12M
Absolute	30	36	46	43
Rel. to Sensex	24	21	37	2

Stock Details

Sector	Financial Services
Reuters	SREI.BO
Bloomberg	SREI@IN
Equity Capital (Rs mn)	1090
Face Value	Rs10
52 Week H/L	72/31
Market Cap	Rs7.8bn/USD192mn
Daily Avg Volume (No of shares)	410,926
Daily Avg Turnover (US\$)	0.6

Shareholding Pattern (%)

(31st Mar.'07)	
Promoters	20.1
FII	43.7
Institutions	1.5
Private Corp.	13.0
Public	21.8

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SREI Infrastructure FinanceSector
Update**Value unleashed**

French financial services giant BNP Paribas's leasing group (BPLG) has taken 50% stake in SREI Infrastructure Finance's (SREI) equipment financing business for Rs7.8bn. Of the total consideration of Rs7.8bn, Rs3.75bn will be paid to SREI as a consideration of transferring the equipment financing business to the 50:50 JV.

The deal puts valuation of SREI's equipment financing business (100%) at Rs15.5bn, which is 2x, its current market capitalisation. Add to that the value of its subsidiaries like private equity (AUM of \$185mn, valued at Rs1.3bn), value of existing project financing business (Rs4.8bn at 1x FY07 book value) and value of the 16% stake in Quippo (Rs640mn at 1x book value), the total value of SREI comes to Rs11.6bn.

We expect significant synergies from the deal for SREI as with BPLG holding its back; it could result in significant savings in cost of funds. On its current asset base of Rs45bn, a 25bps reduction in cost of funds can add Rs120mn to the net profit. Also BPLG, being one of the largest leasing companies in Europe brings in its huge expertise in the business.

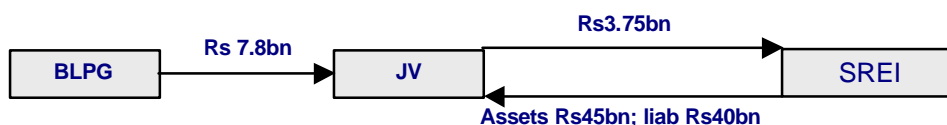
Even if one were to give 40% discount to the valuation given by BNP Paribas to the equipment financing business, SREI's valuation works out to Rs11.6bn or Rs110 per share.

We have always contended that SREI's valuations at 0.7x FY09E ABV are at significant discount to its peers and need re-rating looking at the niche positioning, high market share and less risky model in the equipment financing business. The above-mentioned deal exactly signifies that. We are revising our price target on the stock to Rs110.

BNP Paribas takes 50% stake in SREI's asset financing business

BPLG has picked up 50% stake in SREI's equipment financing business for a total consideration of Rs7.8bn. Under the deal, BPLG will contribute Rs7.8bn to the net worth of the joint venture company. Of Rs7.8bn, Rs3.8bn will be paid to SREI for transferring the equipment financing business to the JV. SREI will transfer Rs45bn worth of assets and all of its liabilities to the JV. SREI will also make additional contribution of Rs250mn to the joint venture taking the total net worth of the JV to Rs8.0bn.

BPLG is subsidiary of French financial services giant, BNP Paribas. BPLG currently manages about €14bn of leasing assets and has presence in about 11 countries in the world.

Deal structure**Proforma Balance sheet of the Joint venture**

Liabilities	Rs bn	Assets	Rs bn
Net worth			
SREI	0.25	Assets	44.00
BPLG	7.75	Cash	4.00
Total	8.00		
Liabilities	40.00		
Total	48.00	Total	48.00

Source: Company, Emkay Research

The structure of SREI post JV

Businesses to be retained in existing SREI	Businesses to be transferred
Project financing	Equipment financing
Private equity	Insurance broking
Merchant/investment banking	50% to be held by SREI and 50% by BPLG
ZAO SREI Leasing (Russian venture)/Quipo	

Source: Company, Emkay Research

Proforma Balance sheet of SREI post JV

Liabilities	Rs bn	Assets	Rs bn
Net worth	5.00	Investments	1.50
Liabilities	5.30	Project financing	5.30
		Cash	3.50
Total	5.00	Total	5.00

Source: Company, Emkay Research

Immense benefits for SREI

We see two benefits for SREI out of this deal, viz.,

1. The Indian infrastructure story is a known fact to everyone on the street. The huge imminent infrastructure investment of \$300bn+ has put SREI in a sweet spot with 30%+ market share in the infrastructure related equipment financing market. With the above mentioned deal, SREI gets much required funding without having to dilute equity in the parent company
2. Supposing the deal had not happened and SREI goes for an equity dilution for funding the future growth, it will unnecessarily dilute the existing shareholders' stake in the other businesses of SREI thereby depriving them of the immense value being created in this business. For example, private equity business which is now manages assets worth \$185mn (68% growth over last year), Quipo Infrastructure Investments in which the company has 16% stake and which has Rs3bn of assets under management.

Valuations not expensive for BPLG if one looks at benefits

At 28.2x FY07E EPS and 2.0x book value, the valuations might look expensive and one would wonder why BPLG has paid so high for the business. However, there are lots of synergies that BPLG can derive from this JV and we believe that taking them into account, BPLG may not have paid too far for the stake.

1. BPLG straight forward gets access to 40% market share in the infrastructure related equipment financing market in India it also gives BPLG an access to nearly 40+ branches and offices of SREI.
2. If BPLG was to enter the Indian infrastructure financing market on its own, it would take it years to establish itself. Players like Citigroup, GE Capital and ICICI Bank still share very small portion of the market compared with 30%+ share held by SREI which itself speaks about entry barriers in this business
3. With BPLG being a partner in JV, we believe there can be significant savings in cost of funds for the joint venture. Even a 25bps reduction in cost of funds can add Rs120mn to the bottomline of the JV on an asset base of Rs45bn. This itself means incremental growth of 21% in the FY07E net profit.

Valuations of the deal

Particulars	Rs bn
Valuation of the asset financing business (50% stake taken for Rs7.8bn)	15.5
Standalone PAT of SREI of FY07E	0.6
PER (x)	28.2
P/BV (x)	2.0

Source: Company, Emkay Research

We see SREI's value at atleast Rs110 per share

The deal puts valuation of SREI's equipment financing business (100%) at Rs15.5bn which is 2x its current market capitalisation. Even if one were to give 40% discount to the valuation given by BPLG to the equipment financing business (given the fact that BPLG is a strategic investor), SREI's valuation works out to Rs11.6bn or Rs110 per share if one adds the value of subsidiaries and other businesses.

Particulars	Rs mn	Comments
Value of 50% stake in Joint venture	4,650	@40% discount to valuations given by BPLG
Value of the retained balance sheet excluding the subsidiary value#	4,750	@ 1x book value
Value of private equity	1,332	11x management fees of 1.5%
Value of Quipo	640	@1x book value
Total	11,622	
Per share	107	

#Excluding the investments in JV and private equity

We have always contended that SREI's valuations at 0.7x FY09E ABV are at significant discount to its peers and need re-rating looking at the niche positioning, high market share and less risky model in the equipment financing business. The above-mentioned deal exactly signifies that. We are revising our price target on the stock to Rs110.

At our target price, the valuations might look stretched at 44.0x FY07E EPS and 2.2x FY07E ABV. Nevertheless, the key points to be noted here are that

- The current balance sheets of SREI as well as SREI are underleveraged. With Rs8bn of net worth in the JV, the assets under equipment financing can be doubled and that in the retained business can be grown 9x on the existing equity, and,
- The standalone SREI would have investments and cash worth Rs5bn which keep the earnings as well as ROE subdued.

At our target price of Rs110, the stock would trade at 11.7x our FY09E# EPS and 1.8x FY09E# ABV.

The numbers of FY09E are provisional, we will review them once we revise our numbers on finalization of the deal

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