Emkay Research

21 December 2006

BUY

Price	Target Price
Rs49	**Rs70**

Sensex - 13,487

Price Performance

(%)	1M	3M	6M	12M
Absolute	3.9	(8.9)	31.8	(22.2)
Rel. to Sensex	3.4	(19.1)	(12.7)	(46.7)

Source: Capitaline

Stock Details

Sector	NBFC
Reuters	SREI.BO
Bloomberg	SREI.IN
Equity Capital	Rs 1,091mn
Face Value	10
52 Week H/L	Rs 75.4/30.5
Market Cap	Rs 5.3bn$0.2bn
Daily Avg Volume (No of shares)	1.3mn
Daily Avg Turnover (US$)	1.45mn

Shareholding Pattern (%)
(30 th Sep.'06)

Promoters	20.0
FII/NRI	35.3
Institutions	1.2
GDR	0.5
FI/Banks	0.1
MF	1.6
Private Corp.	15.2
Public	26.1

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Initiating

SREI Infrastructure Finance

Play on infrastructure boom

SREI Infrastructure Finance Ltd (SREI) has carved a niche for itself in the equipment financing market for the infrastructure activities and is probably the only one-stop shop with presence in all related services in the business. Despite being an NBFC, SREI has strongly withstood competition from banks present in the sector and owns a respectable 30% market share. We believe that SREI is likely to continue to be one of the largest beneficiaries of the boom in infrastructure investment in India. At our target price of Rs70, the stock would trade at 6.5x its FY2009E EPS and 1.1x its FY2009E adjusted book value.

Serving the niche and having reach

Over the past 17 years of its existence, SREI has carved a niche for itself in the equipment leasing market by serving mostly the small and medium enterprises (SME) where the bigger players do not like to have presence due to their riskier profile. With niche positioning and a network of 43 branches/offices spread equally across India SREI has been able to grab a market share of 30% in the infrastructure related equipment financing market.

One stop shop for all requirements

SREI has turned itself into one-stop shop for all kinds of needs of its customers. SREI helps the SMEs to acquire the right kind of assets, provides finance to acquire the asset and also helps them to dispose off the asset once the need for the asset is over. It helps SREI to keep a check on customer's cash flow and conseqnently restrict the net NPAs to near zero levels despite serving the riskier SME segment.

Healthy NIMs despite constraints of an NBFC

Being an NBFC SREI does not have access to the cheap sources of funds like a bank. Despite the constraint, SREI has successfully been able to protect its NIM at 4.5%+ as presence through the whole value chain and serving SME gives better yields on assets of 12-16%.

Well placed to reap benefits of the infrastructure boom

With niche positioning, wide reach and ability to maintain margins and restrict NPAs, we believe SREI is perfectly placed to reap the benefits of the boom in the Indian infrastructure sector. We expect SREI's leasing assets book to grow at CAGR of 38.2% over FY2006-09E driven by robust spending of approximately Rs5.3-6.3 trillion on the road infrastructure, urban infrastructure and power capacity addition in 11th five year plan (FYP).

Valuations attractive relative to peers

We expect SREI's earnings per share EPS to grow at CAGR of 31% to Rs10.7 over FY2006-09E driven by a strong 38.2% CAGR in its leased asset book. At the current market price of Rs49 the stock is trading at 4.5x its FY2009E fully diluted EPS and 0.8x its FY2009E book value. At the current P/B and PER, The stock trades at significant discount of 33% on PER basis and 51% on P/ABV basis to its peers like Shriram Transport Finance Company (STFC) and Mahindra and Mahindra Financial Services (MMFS).

Exhibit A: Key financials (Rs Mn)

YE-Mar	Net income	PAT	EPS (Rs)	RoAA %	RoAE %	P/ABV (x)	P/E (x)
FY05	779	282	5.4	2.4	18.5	1.6	9.0
FY06	1,222	502	4.7	2.9	17.7	1.3	10.2
FY07E	1,838	698	6.6	2.4	16.3	1.1	9.9
FY08E	2,681	1,073	7.5	2.4	17.1	0.9	6.5
FY09E	3,659	1,548	10.7	2.7	18.0	0.8	4.5

Investment summary

SREI – a complete solution provider…

SREI is only player to provide end to end services to its clients

With past 17 years of experience in the infrastructure equipment financing business, SREI has transformed itself into a one-stop shop for all the services related to equipment financing that includes advising, financing and disposing of the financed assets.

With various tie-ups and associate companies, SREI offers a complete bouquet of services to its clients.

… having created its own niche

Serving to Niche helps getting lion's share of the market despite tough competition

Its positioning as a complete solution provider has helped SREI to create its own niche in a market where it has to compete with players of much bigger size. Despite being an NBFC, SREI has been able to withstand competition from various banks that are into this business and has got the lion's share of 30% in the infrastructure related equipment financing market.

Healthy NIM

Alternative means of financing and end-to-end services help maintain healthy margins

Being an NBFC, naturally SREI does not have recourse to the sources of low cost financing like banks have. SREI has to rely on high cost sources of funds like term loans, deposits and debentures for funding. However, with the use of alternative means of financing like securitisation (38% of the assets) and foreign currency loans (11% of the asets), SREI has been well able to maintain its margins.

As SREI serves the SME clients and provides end-to-end services it gets much better yields on assets which helps it to maintain NIM at 4.5%+.

Prudent NPA management

Envious net NPA ratio of near zero percent due to stringent provisioning norms.

While SREI has achieved tremendous growth in the asset book, revenues and net profit (CAGR of 35%, 42.4% and 63.5% respectively) over the past three years, it has not compromised on the quality of its assets. Stringent provisioning norms and a watchful eye on the financed assets are two key reasons why SREI has been able to keep its NPAs at near zero level.

We expect SREI's NPAs to remain at near zero level and the provision cover to gradually go up to 100% of the gross NPAs over the next three years.

Great Indian infrastructure story to continue

Infrastructure boom in India to continue till FY2012

The story on the macro economic front has never been better for India than now. The industrial sector has grown at robust pace over the past three years driven by the strong show in manufacturing sector. While India is likely to complete the 10^{th} FYP (2002-07) with an average growth of 7.2% per annum in GDP, the same has left India craving for even higher growth of 9% in GDP for the 11^{th} FYP (2007-12).

However, achieving the growth of 9%+ would require tremendous investment in the infrastructure like road transport, power generation and urban infrastructure, and the Indian political system has built consensus on the infrastructure investment if not anything else.

India is likely to spend Rs5.3-6.3 trillion on the road infrastructure, urban infrastructure and power generation capacity by FY2012, i.e., over the 11th FYP.

SREI well poised to take advantage

SREI well poised to take advantage of Indian infrastructure story

We believe that SREI is well capable of taking advantage of this huge opportunity with its ability to withstand competition through its unique positioning and that too in a profitable way with its healthy NIM and watchful eye on quality of assets.

We expect SREI's asset book to grow at CAGR of 38.2% over FY2006-09E. While the equipment financing book will be primarily driven by the robust spending on the road infrastructure, the project financing asset book is likely to grow almost nine-fold over FY2006-09E driven by the investment in the road infrastructure, urban infrastructure and power generation capacity.

Comfortable capital adequacy

With strong growth in the advances book, we expect that SREI would need further equity capital infusion in FY2008. We expect SREI capital adequacy ratio to fall below the RBI stipulated level of 12% by FY2008. We have taken an equity dilution of 34.4% (37.5mn shares) in FY2008 at price of Rs70 per share, We believe that with the new capital infusion, SREI would be able to maintain comfortable CAR till FY2011.

Strong growth of 31% in earnings over FY2006-09E

Earnings to grow at CAGR of 31%

We expect SREI's net revenues (NII plus other income) to grow at CAGR of 44% to Rs3.7bn over FY2006-09E. We expect SREI's net profit to grow at CAGR of 44.8% to Rs1.6bn over the same period. We expect SREI's earnings per share to grow at slightly slower CAGR of 31% to Rs10.7 over the same period because of the equity dilution.

Return ratios to remain healthy despite equity dilution

We expect SREI return on assets to remain stable at 2.7% and the return on equity to slightly improve to 18.0% by FY2009 from 17.7% in FY2006 on back of strong growth in the asset book.

Valuations attractive compared with peers

At the current market price of Rs49, the stock trades at 4.5x its FY2009E fully diluted EPS and 0.8x its FY2009E book value. The stock trades at significant discount of 33% on PER basis and 51% on P/ABV basis to its peers like STFC and MMFS which are trading in the range of 10-12x FY2008E EPS and 2.0-2.5x FY2008E book value.

At our target price of Rs70, the stock trades at 6.5x its FY2009E fully diluted EPS and 1.1x its FY2009E adj. book value.

Comparative valuations

Company	CMP (Rs)	EPS (Rs)		PER (x)		ROE (%)		Book value (Rs)		P/BV (x)	
		FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
SREI	49.0	4.9	7.5	10.0	6.6	16.3	17.1	42.9	55.2	1.1	0.9
STFC	130.0	10.5	13.0	12.4	10.0	19.1	19.3	59.3	70.0	2.2	1.9
MMFSL	273.0	16.5	21.1	16.6	13.0	18.7	18.9	85.0	99.0	3.2	2.8
IDFC	71.1	4.1	5.1	17.3	14.0	17.4	18.5	25.6	28.8	2.8	2.5

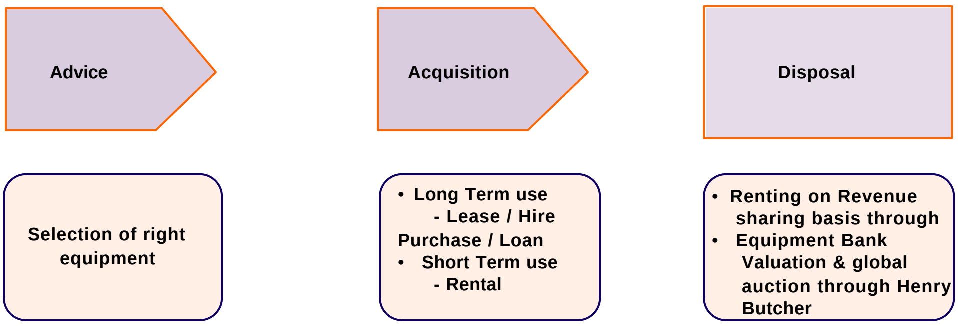
Source: Bloomberg, Emkay Research

SREI – a complete solution provider…

With past 17 years of experience in the infrastructure equipment financing business, SREI has transformed itself into one-stop shop for all the services related to equipment financing that includes

- Advice: Advising client on the right kind of equipment
- Acquire: Advise client on the right kind of financing mode like leasing, hire purchase or renting of the equipment so that client can have optimum use of the asset and strengthen his own cash flows
- Disposal: When the client wants to dispose of the assets after its use is over, SREI acquires the assets through its associate company Quipo Infrastructure Equipment (QIEL) and then gives it on rent to others. It has also tied up with Henry Butcher International, global leader in the valuations and auctioning services to advice and help the clients to dispose off the used asset at the best price.

Presence throughout the value chain

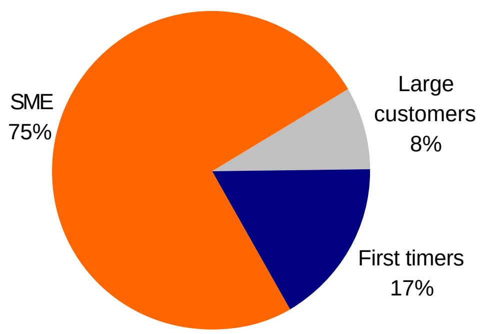


Source: Company, Emkay Research

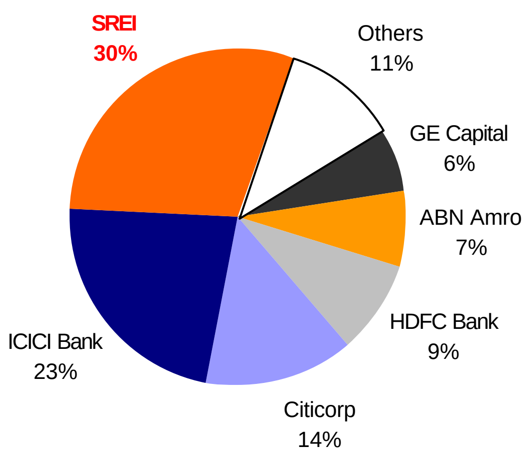
… having created its own niche

With positioning as the complete solution provider in the equipment financing business, SREI has been able to carve out a niche for itself. Of its total 6,000+ customers, nearly 75% are small and medium enterprises (SME). This has helped SREI to compete successfully and pick up the lion's share of 30% in the construction equipment financing market despite its competitors, mainly banks, having an added edge in the form of bigger size, access to cheaper funds and wider reach.

Serving to SMEs



Market share in equipment financing market



Source: Company

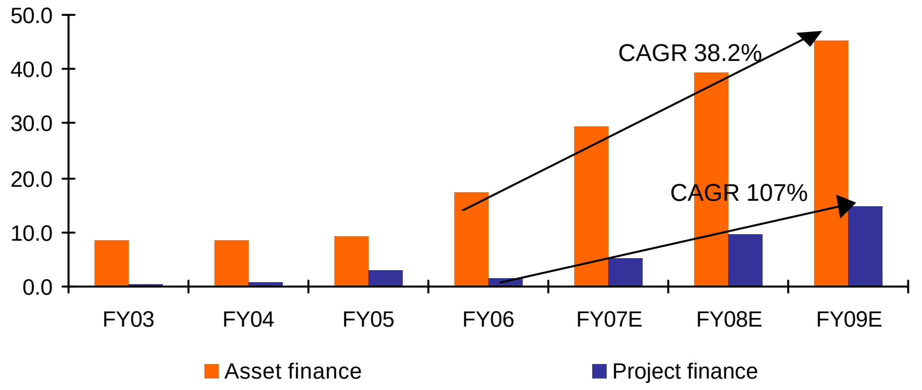
SREI well poised to take advantage of infrastructure boom

India's desire to move into next trajectory of 9% growth in the GDP in the 11th FYP(after achieving average growth of 7.2% in 10the FYP) is likely to have its natural fallout in the form of strong growth in investment in infrastructure like roads, urban infrastructure and power generation. We believe that SREI is well poised to take advantage of the boom in the infrastructure spending in India with

- Its niche positioning in the SME segment: We believe that with the order size likely to get larger in the infrastructure sector in the 11th FYP, more work will be outsourced by the larger contractors to the smaller players. As SREI has carved out its niche amongst the SME it will be direct beneficiary of this outsourcing.
- Its wide reach: SREI has got approximately 43 branches and offices equally spread out in India. With its wide reach SREI is well poised to serve the demand for the infrastructure equipment across India.

We expect SREI's financing assets portfolio to grow at CAGR of 38.2% over FY2006-09E driven by robust growth in demand for the infrastructure related equipments.

Robust growth in leased assets (Rs bn)

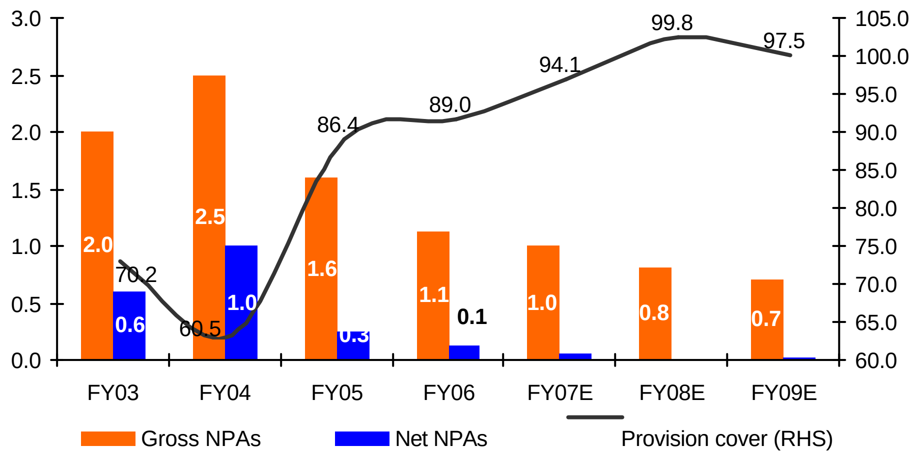


Source: Emkay Research

Prudent NPA management

Despite serving the SME segment, SREI has been able to maintain its net NPAs and near zero level with provisioning cover of up to 89%.

NPA as % of advances (as per FLI norms)



Source: Company, Emkay Research

SREI has been able to maintain the NPAs (gross as well net) at such prudent level for two reasons:

Presence through out the value chain:

- As mentioned earlier, SREI has transformed itself into a complete service provider involved in the whole value chain i.e., from advising client on the right kind of asset to its acquisition to its disposal. Being present throughout the value chain enables SREI to keep watchful eye on the client's cash flows and his creditworthiness and identify the NPA at the early stage itself and take corrective action. Using its tie up with Henry Butcher International, SREI can also dispose of the deliquent assets to realise its value.

Adherence to international standards of NPA recognition and provisioning

- SREI follows the NPA recognition and provisioning standards followed by the Foreign Lending Institutions (FLI) where the provisioning requirements are more stringent.

SREI follows more stringent international norms

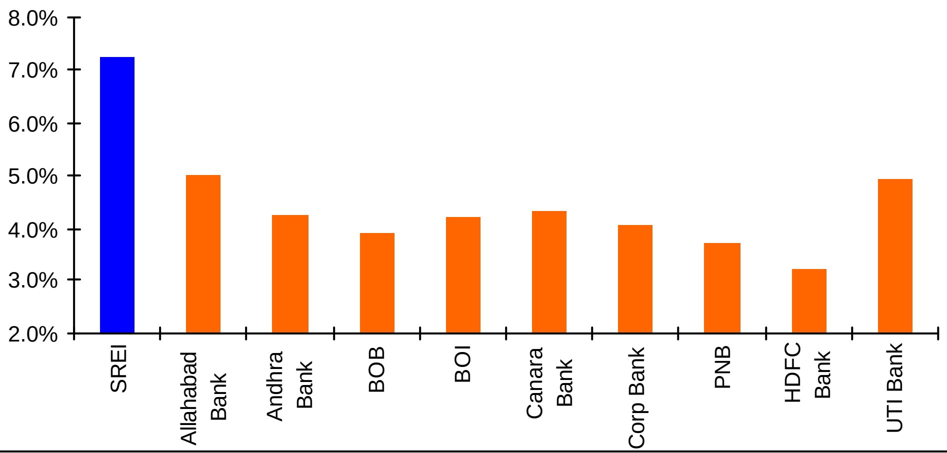
RBI norms	Provisioning (%)	FLI standards	Provisioning (%)
Up to 12 months	Nil	Up to 3 months	Nil
12-24 months	10	3-6 months	20
24-36 months	40	6-12 months	50
36-48 months	70	> 12 months	100
> 48 months	100		

Source: Company

Healthy NIM driven by alternative financing

Being an NBFC, SREI does not have access to cheaper sources of financing like the other players from banking sector.

Cost of funds (FY2006)

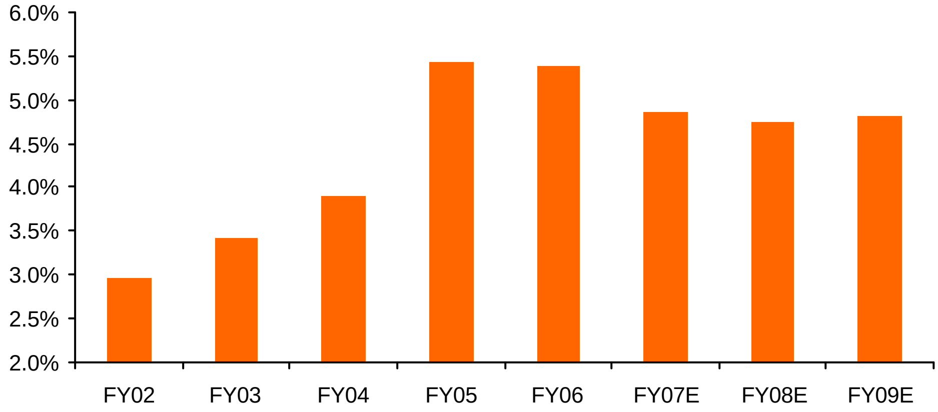


Source: Companies, Emkay Research

Despite having this constraint, SREI has been able to maintain its NIM at healthy level as

- It serves SME segment where the yield on assets is higher at 13-16%
- It provides the end-to-end solution to its customers and hence gets premium for the complete solution
- SREI effectively uses alternative modes of financing like foreign currency loans and securitisation of its assets.

Healthy NIM



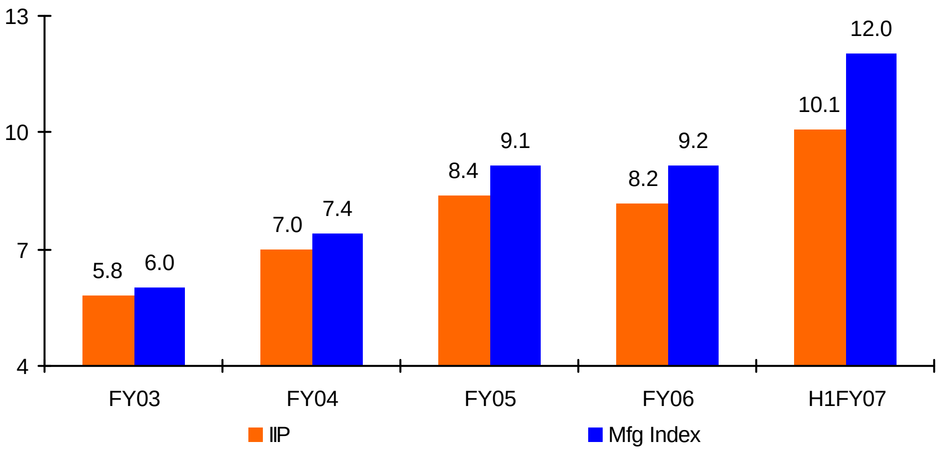
Source: Company, Emkay Research

Strong growth in the economy…

The story on the macro economic front has never been better for India than now. The industrial sector has grown at robust pace over the past three years driven by the strong show in manufacturing sector. The strong growth in the manufacturing sector has been driven by favourable changes in the Indian demographics like

- Increasing proportion of young and earning population
- Rising per capita income,
- Increased penetration and easy availability of credit

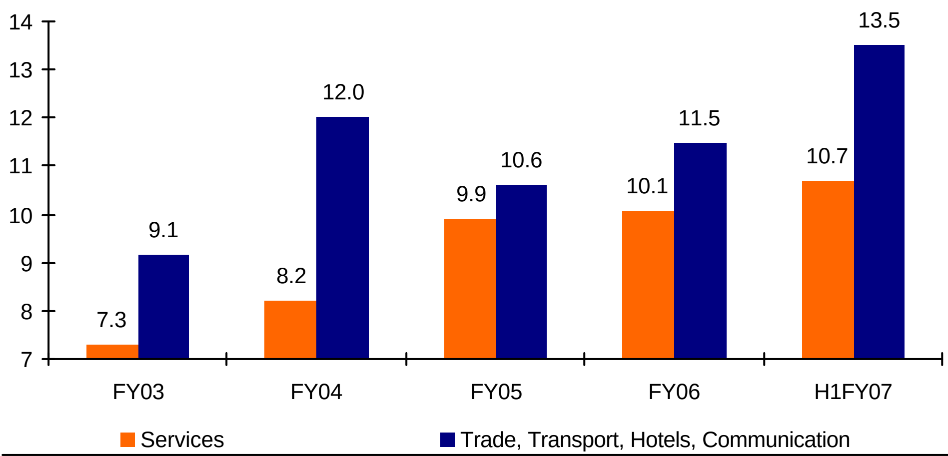
Strong growth in the industrial sector (% yoy change)



Source: CSO, Emkay Research

The buoyancy in the manufacturing sector has been equally supported by the services sector which has seen a robust growth over the same period driven primarily by hotels, transportation and communication services.

Strong growth in GDP from services (% y-o-y change)



Source: CSO

Consequently, India's GDP has grown by 7% over the first four years of the 10th FYP (FY2002-07) and is likely to grow at 8% year on year (yoy) for the fifth year, taking to an average growth of 7.2% for the plan period. This has just left India craving for nothing but even more. The Planning Commission has set the target growth in GDP for the 11th FYP (FY2007-12) at 9%.

…Creates huge demand for infrastructure

The desire to move into a higher growth trajectory has had as its natural fallout an increased thrust on the infrastructure, at least something on which all the political parties have a consensus. The strong growth in the industrial sector and especially in the manufacturing sector has resulted in a strong imminent demand for infrastructure in the form of better and faster transportation, urban infrastructure and power generation capacity.

The strong demand for infrastructure is likely to result in investment to the tune of Rs2,892bn over FY2006-08E in the sector with more than 35% of it being spent on roads and urban infrastructure and 20% on the power sector.

Infrastructure spending over next two years

(Rs bn)	Infrastructure Investments				Of which construction Investment			
	FY05-FY06	As % of total	FY07-FY08E	As % of total	FY05-FY06	As % of total	FY07-FY08E	As % of total
Roads	383.0	14.4	528.0	18.3	383.0	29.2	528.0	34.8
Irrigation	423.0	15.9	482.0	16.7	254.0	19.4	289.0	19.1
Airports	38.0	1.4	50.0	1.7	16.0	1.2	21.0	1.4
Urban infrastructure	402.0	15.1	512.0	17.7	241.0	18.4	307.0	20.3
Ports	20.0	0.8	40.0	1.4	10.0	0.8	20.0	1.3
Power	771.0	28.9	572.0	19.8	241.0	18.4	183.0	12.1
Railways	302.0	11.3	280.0	9.7	127.0	9.7	118.0	7.8
Telecom	315.0	11.8	411.0	14.2	31.0	2.4	41.0	2.7
Tourism	12.0	0.5	17.0	0.6	6.0	0.5	9.0	0.6
Total	2,665.0	100.0	2,892.0	100.0	1,310.0	100.0	1,516.0	100.0

Source: CRIS INFAC, Emkay Research

Road infrastructure to take major chunk

Of the total investment of Rs2.9 trillion expected in the infrastructure sector over the next two years, major chunk is likely to go to road construction and maintenance. We expect roads to contribute 18% of the total investment in infrastructure and nearly 34% of the spending on construction out of the same.

Binge to continue through out 11th FYP

We expect the investment in the infrastructure sector to continue incessantly over the 11th FYP driven by the spending on the central government's flagship project National Highway Development Program (NHDP), massive addition in the power generation capacity and improvement in the urban infrastructure.

According to the approach paper for the 11th FYP, the National Highway Authority of India is planning to complete nearly 46,000 Kms of work during the plan which involves the total outlay of whopping Rs2.2 trillion on road infrastructure only.

Investment on roads under 11th FYP

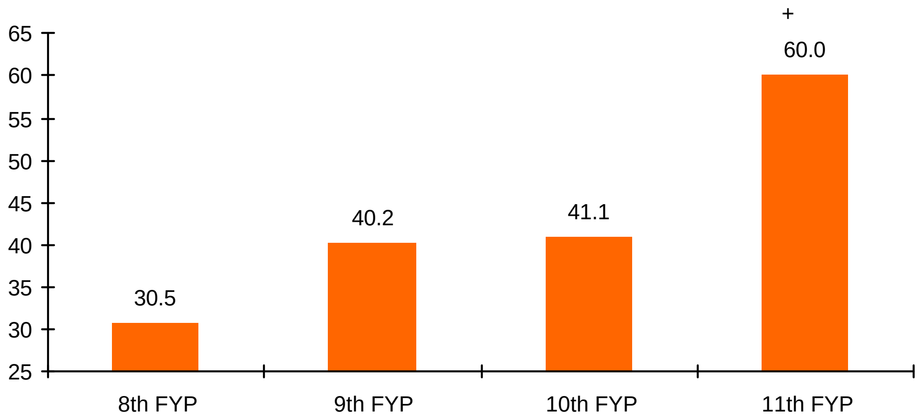
Phase/segment	Description	Length (in Kms)	Rs bn
NHDP-I	Golden Quadrilateral (GQ)	1,738	88.1
NHDP-II	East West/ North South corridors	6,736	436.2
NHDP-III	4-laning of important sections	10,000	652.0
NHDP-IV	2-laning	20,000	278.0
NHDP-V	6-laning the GQ	6,500	412.1
NHDP-VI	Expressways	1,000	166.8
NHDP-VII	Bypasses, Ring-roads etc.	To be firmed up	166.8
	Total	**45,974**	**2,200.0**

Source: Draft approach paper for 11th FYP, Emkay Research

While the road infrastructure would be the leader in the category, the power sector and urban infrastructure will be the other two sectors which will see major action during 11th FYP.

The power sector is likely to see an investment of Rs1.8-2.4trillion over 11th FYP with targeted addition of 60,000 mega watt of power capacity during the plan.

Planned capacity addition during FYP (Gega watt)



Source: Central Electricity Authority

As an extension to improve the transportation system and to handle rapid urbanization in the country, the urban infrastructure like mass rapid transit system (metro railways, flyovers and bridges) is also likely to see a massive investment. In December 2005, the government had launched Jawaharlal Nehru National Urban Renewal Mission (JNNURM) spanning over a seven year period beginning 2005-06. JNNURM envisages providing focussed attention to integrated development of infrastructural services in 63 selected cities in India.

Under JNNURM, various states will be provided grant by the central government as a percentage of the total cost of projects. For the 11th FYP, the central government is likely to provide Rs500billion as a grant for JNNRUM. A back of the envelope calculation based on the estimated grant suggests that the total investment in the urban infrastructure could range anywhere between Rs0.8-1.4trillion.

Total estimated investment in infrastructure

Sector	Spending (Rs bn)
Road	2,200
Power	2,400-2,700
Urban Infrastructure	750-1,400
Total	**5,350-6,300**

Source: Draft approach paper for 11th FYP, Emkay Research

Infrastructure boom will also drive project finance business

The booming infrastructure activities have lined up dual opportunities for SREI. It will also help SREI to build up its infrastructure/project financing business. The robust growth in the infrastructure/project financing business would be driven by massive investments in three key industries. While the road infrastructure would be leader in the category, power sector and urban infrastructure will be the other two sectors which will see major action during 11th FYP.

Driven by the investment in these three sectors, we expect SREI's infrastructure/project financing asset book to grow almost nine fold over FY2006-09E.

Fee income from subsidiaries

SREI has harnessed the synergies of its domain expertise in infrastructure sector and huge customer base to grow fee income from its subsidiaries. Through its subsidiaries, SREI caters to the variety of needs of its SME clients, ranging from insurance to merchant banking to equity needs which enables SREI to broadbase its product basket and add more value to the customer.

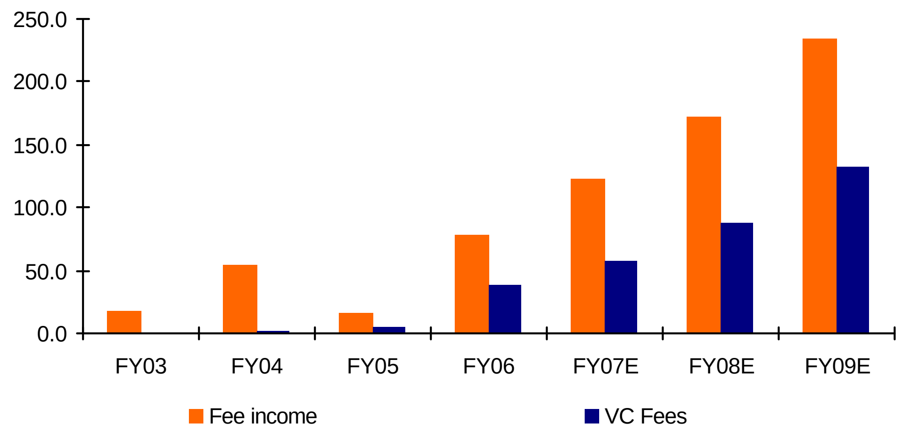
To leverage on its expertise in the infrastructure financing SREI has launched SREI Venture Capital Ltd (100% subsidiary), The company is currently managing Rs4.6billion worth of assets under four venture capital funds with plans of gradually scaling it up to Rs10.0billion. SREI charges management fees on these funds and is entitled to carry up to 20% of the profits earned by the fund on the exit.

Name of the fund	Full potential Size	Current Corpus	Fee	Target Sector
MASIF	$22mn (Rs1bn)	$10.56mn (Rs0.5bn)	2.0%	Road, Power, Port & Urban Infrastructure Projects
IGCF	$220mn (Rs10bn)	$83.14mn (Rs3.7bn)	1.0%	Globally competitive Indian Cos.
Prithvi	$110mn (Rs5bn)	$6.7mn (Rs0.3bn)	2.0%	Infrastructure & Realty Sectors
IPDF	$2.2mn (Rs100mn)	$1.1mn (Rs50mn)	2.0%	Infrastructure Sectors
Total	$354mn (Rs16.1bn)	$101mn (Rs4.55bn)		

Source: Company

In another extension of its expertise, SREI has also taken up the merchant banking business, wherein it helps the companies involved in the infrastructure sector to raise funds. While the merchant banking division is still in nascent stage we believe it will be a steady contributor to SREI's fee income looking at the fact that with increased activities in the infrastructure sector, many of the companies in the sector are in queue to raise funds.

Fee income to grow at robust pace (Rs mn)



Source: Emkay Research

Earnings to grow at CAGR of 31%

We expect SREI's net revenues and net profit to grow at CAGR of 44% and 44.8% respectively over FY2006-09E driven by a strong CAGR of 38.2% in financing assets over the same period, stable NIM and strong growth in fee income. We also expect the return on average assets to remain stable at 2.7%over FY2006-09E and the return on equity to improve slightly from 17.7% to 18.0% over FY2006-09E driven by strong growth in the leasing asset book.

Strong RoE driven by robust growth in asset book

As % of avg earnings assets	FY2006	FY2007E	FY2008E	FY2009E
NIM	6.4	5.8	5.6	5.9
Other income	0.7	0.6	0.5	0.5
Opex	2.6	2.4	2.1	2.1
Provisions	0.4	0.3	0.3	0.2
Tax	1.1	1.2	1.2	1.4
Profit after tax	3.0	2.5	2.5	2.7
Leverage (x)	5.94	6.59	6.94	6.61
RoE	17.7	16.3	17.1	18.0

Source: Emkay Research

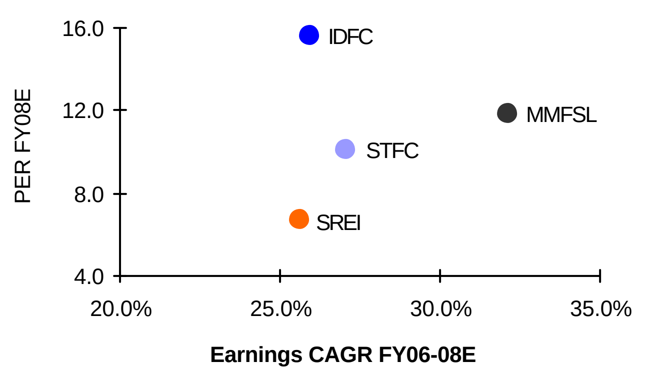
Capital adequacy comfortable

SREI's Tier I capital adequacy ratio (CAR) at the end of FY2006 was at 17.6% with overall CAR at 19.8%. SREI is likely to go with additional equity capital issue of Rs2.6bn (37.5mn shares) which will sufficiently fund its robust pace of growth for at least next three years i.e., FY2011. We expect SREI to end FY2009 with an expected Tier I CAR of 11.4%.

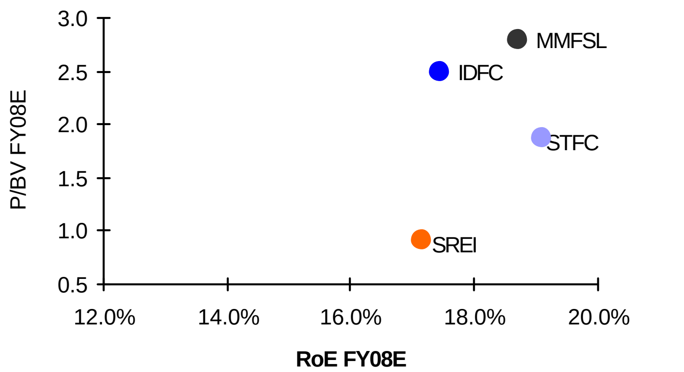
Valuations

We believe that SREI's valuations at 4.5x FY2009E diluted EPS and 0.8x FY2009E book value are quite attractive looking at 31% CAGR in earnings over FY2006-09E and average RoE of 17% over FY2006-09E. We expect the RoE to remain stable at 18% even after FY2009 due to no equity dilution atleast till FY2011.The valuations are also attractive compared with its peers like STFC and MMFSL which are trading in the range of 10.0-12.0x FY2008E diluted EPS and 1.9-2.5x FY2008E book value per share.

Comparative valuations - PER



Comparative valuations - P/BV



Source: Bloomberg, Emkay Research

Company	CMP (Rs)	EPS (Rs)		PER (x)		ROE (%)		Book value (Rs)		P/BV (x)	
		FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
SREI	49.0	4.9	7.5	10.0	6.6	16.3	17.1	42.9	55.2	1.1	0.9
STFC	130.0	10.5	13.0	12.4	10.0	19.1	19.3	59.3	70.0	2.2	1.9
MMFSL	273.0	16.5	21.1	16.6	13.0	18.7	18.9	85.0	99.0	3.2	2.8
IDFC	71.1	4.1	5.1	17.3	14.0	17.4	18.5	25.6	28.8	2.8	2.5

Source: Bloomberg, Emkay Research

Risks and concerns

Strong competition from banks

The Indian banks have not been able to take advantage of the boom in the infrastructure industry because of long term gestation period and non-existence of financial institutions that can provide take-out financing facility after certain years of loan tenure. However, with recent moves by the Reserve Bank of India to curb the flow of money into other loan portfolios like loans to capital markets, personal loans and other retail loans, there may be some diversion of funds to infrastructure lending. However, SREI has an additional edge over the banks with its end-to-end solution model which the banks can not provide and also as a dynamic and vibrant take-out financing mechanism will be required for smooth asset-liability management by banks.

Higher cost of funding

Being an NBFC, SREI's cost of funds has always been higher than that of banks. In the rising interest rate scenario, SREI may face pressure on its margins if its not able to revise its lending rates. We believe that with alternative methods of raising resources like ECB and securitization of assets, SREI will be able to face the margin pressures.

Warrant conversion in FY06 – issues on corporate governance far from being true

In August 2005 SREI's promoters and other people acting in concert converted some (21.06 mn) detachable warrants into equity shares. Serious issues were raised on the corporate governance as the conversion was done at a steep discount of 40% over the then prevailing market price. However, the company has been regularly disclosing the terms of conversion in its annual reports since the date of the issue of the warrants (in June 2000). The warrants were to be exercised at 40% discount to the average of high and low prices for the 26 weeks preceding the date of conversion. Based on these terms the conversion price worked out to Rs33 per share.

Company background

Essentially a Non-Banking Financial Company (NBFC), SREI was promoted in 1989. SREI's journey that started from Kolkata now has a pan-India presence with a network of 43 offices. The company has also ventured overseas and has set up offices in Russia.

Riding on the ongoing infrastructure boom in India, SREI' consolidated net revenues have grown at a CAGR of 32% over FY2002-06E and its consolidated net profit has grown at CAGR of 39.5%. It is also one of those companies that can boast of having paid dividends to its shareholders throughout its life.

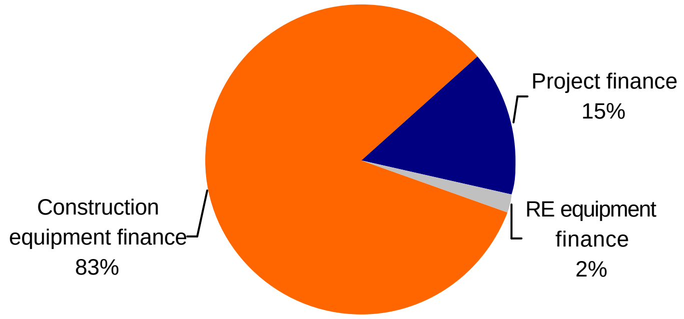
With its niche positioning and wide reach SREI has been able to grab a respectable market share in the construction related equipment business, that too while competing with various banks which have much wider reach and easy access to cheaper funds.

SREI's growth prospects and its robust business model have attracted renowned multilateral and bilateral institutions like IFC-Washington, KfW & DEG-Germany, FMO-Netherlands and BIO-Belgium and a host of European and American banks and financial institutions who have become stakeholders in the company.

SREI has three principal lines of business in financing:

- **Infrastructure equipment financing:** SREI finances construction equipments which include heavy earthmoving equipment and plant and machinery like excavators, cranes, heavy dumpers, compressors, surface miners, loaders, motor graders, road equipment, mechanical and sensor pavers among others. The lease period for these equipments is usually three years.
- **Project financing:** SREI is also actively involved in the direct financing of the projects in the road sector, independent power projects and captive power project and port terminals
- **Renewable energy equipment financing:** SREI is one of the first Indian companies to finance renewable energy systems. SREI finances equipments used in the renewable energy projects mostly relating to solar energy.

SREI business mix



Source: Company

Our key assumptions are as follows: (%)

Particulars	FY2006	FY2007E	FY2008E	FY2009E
Growth in disbursals	334.9	65.0	45.0	30.0
yield on financial assets	13.6	13.6	13.6	13.6
yield on operating assets	17.4	17.4	17.4	17.4
yield on average assets	12.0	13.0	13.2	13.2
Interest on floating rate loans	8.0	10.0	10.5	11.0
Interest on domestic term loans	5.2	9.0	9.5	10.0
Interest on foreign term loans	3.5	5.0	5.0	5.5
Interest on working capital loans	7.6	8.6	9.1	9.6
Interest on public deposits	9.2	10.2	10.7	11.2

Consolidated Income Statement (Rs.Mn)

(Year Ending Mar 31)	FY05	FY06	FY07E	FY08E	FY09E
Net interest income	722.2	1,107.2	1,677.2	2,471.1	3,387.0
Other income	57.0	115.2	161.2	210.3	272.4
Net income	779.2	1,222.4	1,838.4	2,681.4	3,659.4
Staff cost	114.0	173.5	303.6	455.4	637.6
Other expenses	187.8	256.3	352.6	449.0	537.3
Depreciation	13.6	18.4	32.6	37.1	41.6
Profit before provisions	463.8	774.2	1,149.6	1,739.9	2,442.9
Provisions	68.4	75.1	96.3	121.4	109.2
Profit before tax	395.4	699.1	1,053.3	1,618.5	2,333.7
Tax	112.9	196.2	354.5	544.8	785.5
Profit after tax	282.5	502.9	698.7	1,073.7	1,548.2
Add: Profit from associates	5.7	9.4	24.1	24.3	24.4
Less: Minority interest	0.0	-4.1	3.2	3.2	3.2
Profit attributable to SREI	288.2	516.4	719.7	1,094.8	1,569.4

Source: Emkay research

Consolidated Balance Sheet (Rs.Mn)

(Year Ending Mar 31)	FY05	FY06	FY07E	FY08E	FY09E
TOTAL LIABILITIES					
Equity share capital	534.5	1,090.9	1,090.9	1,465.9	1,465.9
Reserves and surplus	1,129.0	3,070.5	3,584.9	6,628.9	7,855.6
Total net worth	1,663.5	4,161.4	4,675.8	8,094.8	9,321.5
Secured loans	7,541.8	13,322.2	27,138.6	35,628.6	45,703.6
Unsecured loans	1,503.4	2,866.5	3,866.5	6,166.5	6,166.5
Total borrowed funds	9,045.2	16,188.7	31,005.1	41,795.1	51,870.1
Mezzanine capital	810.1	796.5	796.5	796.5	796.5
Current liabilities	552.1	939.6	1,250.3	1,621.4	1,970.2
Minority interest	26.9	22.4	25.6	28.8	32.0
Deferred tax	475.2	638.0	638.0	638.0	638.0
Total liabilities	12,573.0	22,746.6	38,391.4	52,974.5	64,628.3
TOTAL ASSETS					
Net block	191.7	213.0	230.4	243.3	251.8
Investments	484.0	996.7	996.7	996.7	996.7
Operating leases	0.0	2,035.9	3,311.3	4,642.0	5,838.4
Financial leases	9,187.8	15,259.0	25,809.8	34,509.2	39,838.8
Current assets	2,695.1	4,181.9	8,031.1	12,631.4	17,752.1
Misc. expenses (not w/o)	14.4	60.1	48.9	37.7	26.5
Total assets	12,573.0	22,746.6	38,391.4	52,974.5	64,628.3

Source: Emkay research

Consolidated Ratios (%)

(Year Ending Mar 31)	FY05	FY06	FY07E	FY08E	FY09E
yield on financial assets	12.6	13.6	13.6	13.6	13.6
yield on operating assets	NA	17.4	17.4	17.4	17.4
yield on average assets	10.7	12.0	13.0	13.2	13.2
cost of borrowing	6.2	8.5	10.0	10.2	10.3
cost of funds	5.3	6.6	8.1	8.4	8.4
NIM	5.4	5.4	4.9	4.7	4.8
Cost to net income	40.5	36.7	37.5	35.1	33.2
Cost to total assets	2.5	2.0	1.8	1.8	1.9
Gross NPA	1.8	1.1	1.0	0.8	0.7
Net NPA	0.3	0.1	0.3	0.1	0.1
Tier I CAR	0.0	17.6	10.9	13.2	12.8

Source: Emkay research

Consolidated Valuation table

(Year Ending Mar 31)	FY05	FY06	FY07E	FY08E	FY09E
EPS (Rs)	5.4	4.7	6.6	7.5	10.7
PER (x)	9.0	10.2	7.3	6.5	4.5
FDEPS (Rs)	5.4	4.7	4.9	7.5	10.7
FDPER (x)	9.0	10.2	9.9	6.5	4.5
Book value (Rs)	31.1	38.1	42.9	55.2	63.6
P/BV (x)	1.6	1.3	1.1	0.9	0.8
Adj book value (Rs)	30.5	37.9	41.9	54.7	63.3
P/ABV (x)	1.6	1.3	1.2	0.9	0.8
P/PPP (X)	5.6	6.8	4.6	4.1	2.9
Dividend yield (%)	3.1	3.4	3.4	3.7	4.2
RoAA (%)	2.4	2.9	2.4	2.4	2.7
RoAE (%)	18.5	17.7	16.3	17.1	18.0

Source: Emkay research

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Emkay Rating Distribution

Ratings	Definition
BUY	Expected total return (%) of stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) of stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
REDUCE	Expected total return (%) of stock price appreciation and dividend yield) of below 10% within the next 12-18 months.
SELL	The stock is believed to under perform the broad market indices or its related universe within the next 12-18 months.
NEUTRAL	Analyst has no investment opinion on the stock under review.