



Shriram Transport Finance

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,571	SHTF IN
S&P CNX: 4,297	REUTERS CODE
	SRTR.BO

1 June 2007

Buy

Previous Recommendation: Buy

Rs156

Equity Shares (m)	184.2
52-Week Range	166/75
1,6,12 Rel.Perf.(%)	21/13/-14
M.Cap. (Rs b)	28.7
M.Cap. (US\$ b)	0.7

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)
3/07A	6,916	1,904	10.3	22.0	15.1	2.6	15.4	20.1	2.2	2.7
3/08E	9,402	2,591	13.5	30.4	11.6	2.3	14.1	21.5	2.0	2.3
3/09E	11,869	3,404	17.7	31.4	8.8	1.9	13.3	23.4	2.1	1.9

Shriram Transport Finance (STF), reported strong growth in disbursements at 62% for FY07 (4QFY07 disbursements at 20% YoY). However, spreads declined as the proportion of new truck finance increases in the overall portfolio. Overall PAT growth at 31% YoY in 4QFY07 and 35% in FY07 was lower than expected, as it increased provisioning following prudent accounting practices. Outlook on growth continues to be robust with spreads likely to remain stable over the next few years.

- ✍ Strong growth in disbursements and loan book in FY07
- ✍ Spreads decline due to higher composition of new trucks
- ✍ Aggressive provisioning leads to lower profitability
- ✍ Increasing NPLs – needs to be watched closely
- ✍ Outlook on loan growth continues to remain positive

STF is a play on high yield retail assets. With a huge market for used truck financing yet unexplored, we believe the company should continue to see robust growth. While spreads are likely to remain stable despite growth in loan book, we expect higher operating costs and provisions. Shriram currently trades at 1.9x FY08E BV. We value the current business at 2.5x FY09E BV (RoA of >2%, RoEs of 23.4%). Reiterate **Buy** with a revised target price of Rs207.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Operating Income	1,857	2,320	2,165	2,567	2,796	3,349	3,749	4,221	9,032	13,964
Other Income	26	19	24	37	12	21	8	50	103	192
Total income	1,883	2,339	2,189	2,604	2,808	3,369	3,757	4,272	9,134	14,155
Y-o-Y Growth (%)	22.9	19.8	26.0	27.6	49.1	44.0	71.6	64.1	25.8	55.0
Interest expenses	931	941	969	1,175	1,350	1,644	1,842	2,392	4,104	7,239
Net Income	952	1,399	1,220	1,429	1,458	1,725	1,915	1,879	5,030	6,916
Operating Expenses	467	778	685	839	806	1,006	1,014	1,147	2,783	3,916
Operating Profit	485	620	535	590	651	719	901	732	2,247	3,000
Y-o-Y Growth (%)	29.4	24.3	23.0	6.9	34.4	15.9	68.4	24.0	20.7	33.5
Depreciation	30	27	26	18	27	25	27	40	98	107
Profit before Tax	455	594	510	572	625	694	874	692	2,149	2,892
Tax Provisions	156	200	174	203	219	229	299	208	741	988
Net Profit	299	394	336	369	405	465	575	484	1,408	1,904
Y-o-Y Growth (%)	35.3	47.5	26.9	13.4	35.4	18.1	71.1	31.2	30.6	35.2
Int Exp/ Int Earned (%)	50.1	40.5	44.8	45.8	48.3	49.1	49.1	56.7	45.4	51.8
Other Income / Net Income (%)	2.7	1.4	2.0	2.6	0.8	1.2	0.4	2.7	2.0	2.8
Cost to Income Ratio (%)	49.1	55.6	56.1	58.7	55.3	58.3	53.0	61.1	55.3	56.6

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

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Strong growth in disbursements and loan book

Shriram maintained strong growth in disbursements in FY07, even as disbursements were slow in 4QFY07, owing to a decline in used truck disbursements. Overall disbursements increased by 62% in FY07, with used truck disbursements increasing by 44% and new truck disbursements by 107%. Shriram has securitised Rs30b of portfolio in FY07 (mostly new trucks). As this qualifies for the priority sector, there is strong demand from banks mainly during 4Q.

LOAN DISBURSEMENTS (RS M)

	H1	3Q	4Q	FY07
Disbursements	30,763	17,926	17,394	66,083
New CVs	11,074	5,585	8,126	24,785
Pre-owned CVs	19,689	12,341	9,268	41,298
<i>Growth (%) YoY</i>	95	73	19	62
New CVs	149	116	64	107
Pre-owned CVs	74	59	-4	44

Source: Company/ Motilal Oswal Securities

Loan growth has remained strong for Shriram during FY07. Total AUM has increased by 62% in FY07 to Rs120b. Loans (on balance sheet) increased by 58% to Rs84b. This strong growth in AUMs in FY07, should result in strong earnings over the next year as much of this AUM was created during 2HFY07.

TREND IN AUMS (RS M)

	SEP-06	DEC-06	MAR-07
AUMs	90,807	101,427	120,469
On-books	70,173	80,964	83,833
Off-books	20,634	20,463	36,637

Source: Company/ Motilal Oswal Securities

Lower spreads - higher composition of new trucks

As the proportion of new trucks increased in the company's portfolio, overall spreads has declined from 10.4% in FY06

to 8.3% in FY07. In fact the spreads in 4Q were lower at 7.4%, as the proportion of new trucks had increased significantly in 4QFY07. Overall, used truck proportion declined to 68% in FY07 from 73% in FY06. Management has stated that going forward it would maintain a ratio of 70:30 for used truck and new trucks. Also, cost of funds increased sharply in FY07, while yield benefits are yet to come, as it has further raised rates from April onward. We expect stable spreads going forward.

BREAKUP OF AUMS

	FY06	FY07	FY06 (%)	FY07 (%)
Used Truck	53.1	82.4	73.0	68.4
New Truck	19.6	38.1	37.0	46.2
Total Aum (Rs b)	72.7	120.5		

Source: Company/ Motilal Oswal Securities

Aggressive provisioning leads to lower profitability

Shriram intends to adopt global best practices for making provisions and, as a result, it is moving towards a provisioning ratio of 2% (historical loss rate over last 27 years). While, the management believes that the end losses are lower than 2%, it would still move towards making a 2% asset provision over the next couple of fiscals.

Shriram has made additional provisions during FY07 (mainly in 2HFY07) to the tune of Rs300m and would also make additional provisions over the next couple of fiscals, in order to reach its target provisioning of 2% of assets. During FY07, Shriram also provided Rs150m for its securitized assets as required by regulations, despite no change in asset quality expectations. The higher-than-expected provisions has resulted in a lower-than-expected growth in profitability in FY07.

Increasing NPLs – needs to be watched closely

STFC's provisions/ write offs for the quarter increased sharply to Rs542m (up 125% YoY). Even Gross NPLs increased to 1.97% in March 2007 from 1.21% December 2007. Despite higher provisions, net NPLs have also been higher at 1.19% in March 2007 from 0.48% in December 2007. The management attributed this to technically classifying few loan accounts as NPAs (Shriram has grown its loan book very strongly over last few years, which has

resulted in higher than normal accounts being classified as NPAs in FY07).

However, as the nature of the business stands, often repayments are delayed and are paid at a later date. The management is comfortable with the current NPLs, which are in line with historic trends. Nevertheless, NPAs needs to be monitored very closely going forward.

Expanding branches and employee base

In order to cater to the underlying growth opportunities, Shriram is aggressively expanding its distribution and employee base. It has increased its branch network from ~300 in FY06 to 339 by FY07 and intends to increase it to 400 by FY08. Employee base has increased from ~3,650 in FY06 to 4,950 in FY07 in order to support the strong growth

Outlook on loan growth remain positive

With aggressive expansion of its distribution network as well as the new segments into which Shriram is getting into, we believe the growth prospects for Shriram continue to be huge. New truck sales have grown at >25% CAGR over the last 3 years, which should result in the used truck market being strong over the next 2-3 years (Shriram mainly finances, 4-10 year old trucks). Further, Shriram has a 23-25% share amongst used truck financing, with the remainder being with the unorganized players. Thus, with a strong outlook for growth coupled with market share gains, growth outlook continues to remain strong (we expect 25% CAGR growth in AUM over FY07-FY09).

Apart from its core business, Shriram is also expanding its product portfolio, by getting into new ventures.

Freight bill discounting: The company is set to enter the freight discounting market, which is a totally unorganized market. Shriram would discount the trucker's receivables and would collect it from the transport company. These are very short duration loans (15-60 days), but the margins are higher (2-5% p.m.). Thus, even net of delinquencies, net return is higher than the present used truck financing business. Shriram already has relations with these truckers

and the present field force is well equipped to conduct this business. As per management, size of this market is Rs700b-Rs800b and Shriram intends to have a 5% market share.

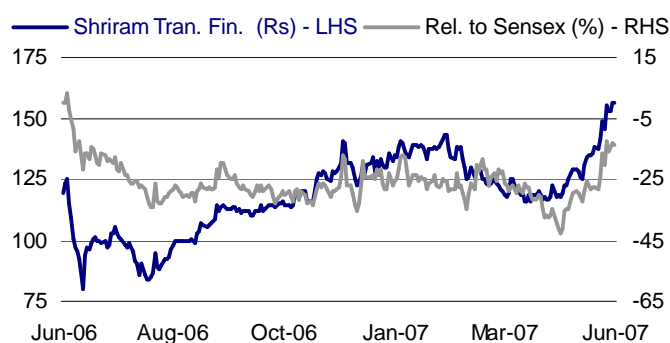
Tapping private financiers: With the used truck financing being primarily catered to by private financiers (they have 75% share), Shriram has also started to utilize their distribution network for growing its loan book. These financiers would source and manage the assets for Shriram and share 50% of profits, but 100% of losses. Currently there about 200 such people disbursing Rs1bn a month, which could scale up to 500 people in 3 years.

Apart from these key initiatives, Shriram has tied up with Ashok Leyland to target freight exchange utilizing its distribution network (would earn fees). It has tied up with UTI Bank for credit cards for transport operators (another avenue to grow its loan book). Further it intends to get into used tractor financing with the Mahindras which is at a very intital stage.

Investment conclusion

Shriram Transport Finance is a play on high yielding retail assets. With a huge market for used truck financing yet unexplored, we believe the company should continue to see robust growth. While spreads are likely to remain stable despite growth loan book, we expect higher operating costs and provisions. Shriram currently trades at 1.9x FY08E BV. We value the current business at 2.5x FY09E BV (RoA of >2%, RoEs of 23.4%). Reiterate **Buy** with a revised target price of Rs207.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005*	2006	2007E	2008E	2009E	
Interest Income	7,123	9,032	13,964	20,118	26,344	
Interest Expended	3,278	4,104	7,239	10,953	14,786	
Net Interest Income	3,845	4,927	6,724	9,164	11,557	
Change (%)	185.4	28.2	36.5	36.3	26.1	
Other Income	79	103	192	237	312	
Net Income	3,924	5,030	6,916	9,402	11,869	
Change (%)	172.5	28.2	37.5	35.9	26.2	
Employee Cost	347	467	631	852	1,022	
Brokerage & Commission	470	619	805	1,127	1,296	
Other Operating Expenses	962	949	911	1,275	1,504	
Operating Income	2,144	2,994	4,569	6,147	8,047	
Change (%)	206.3	39.6	52.6	34.5	31	
Provisions for NPAs	59	164	350	525	700	
Bad-debts Written-off	388	681	1,327	1,720	2,220	
PBT	1,697	2,149	2,892	3,902	5,127	
Tax	622	741	988	1,311	1,723	
Tax Rate (%)	36.6	34.5	34.2	33.6	33.6	
PAT	1,075	1,408	1,904	2,591	3,404	
Change (%)	196	31	35	36	31	
Proposed Dividend	289	126	460	577	673	

*Effective merger of SIF and SOF with STF in FY06; FY05 merged to maintain consistency

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005*	2006	2007E	2008E	2009E	
Capital	1,473	1,662	1,842	1,922	1,922	
Preference Capital	539	199	0	0	0	
Reserves & Surplus	2,680	6,392	9,023	11,287	14,018	
Net Worth	4,692	8,254	10,865	13,209	15,941	
Secured Loans	25,480	38,886	63,152	85,255	109,126	
Change (%)	192.7	52.6	62.4	35.0	28.0	
Unsecured Loans	3,073	5,005	23,995	29,273	35,128	
Other Liabilities & Prov.	6,653	9,484	13,297	16,394	20,266	
Total Liabilities	39,899	61,629	111,308	144,132	180,461	
Cash and bank balance	4,731	2,078	18,120	20,605	22,612	
Investments	89	91	2,246	1,347	1,482	
Change (%)	87.6	2.1	2,363.2	-40.0	10.0	
Advances	30,425	53,128	83,833	114,200	147,750	
Change (%)	235.7	74.6	57.8	36.2	29.4	
Net Fixed Assets	1,354	1,313	1,648	1,409	1,419	
Deferred Tax Assets	8	4	0	0	0	
Other Assets	3,292	5,015	5,463	6,282	6,910	
Total Assets	39,899	61,628	111,308	143,843	180,173	

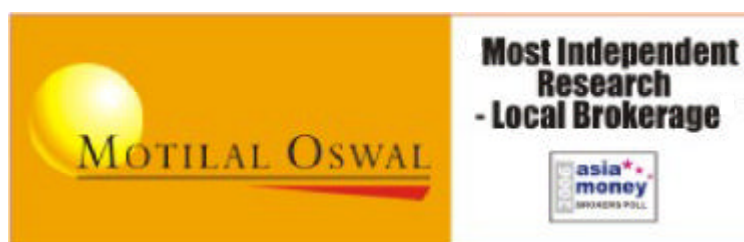
ASSUMPTIONS	(%)				
Deposit Growth	192.7	52.6	62.4	35.0	28.0
Advances Growth	235.7	74.6	57.8	36.2	29.4
Investments Growth	87.6	2.1	2,363.2	-40.0	10.0
Dividend	19.6	20.0	25.0	30.0	35.0

E: M O S t Estimates

RATIOS		2005	2006	2007E	2008E	2009E
Y/E MARCH						
Spreads Analysis (%)						
Avg. Yield - Earning Assets		28.1	18.3	16.4	16.0	16.4
Avg. Cost-Int. Bear. Liab.		17.4	11.3	11.0	10.9	11.4
Net Interest Margin		15.2	10.0	7.9	7.3	7.2
NIM (ex securitization)		11.1	8.7	6.9	6.4	6.5
Profitability Ratios (%)						
RoE		42.4	23.1	20.1	21.5	23.4
RoA		4.1	2.8	2.2	2.0	2.1
Int. Expended/Int. Earned		46.0	45.4	51.8	54.4	56.1
Other Inc./Net Income		2.0	2.0	2.8	2.5	2.6
Efficiency Ratios (%)						
Op. Exps./Net Income		45.3	40.5	33.9	34.6	32.2
Empl. Cost/Op. Exps.		19.5	23.0	26.9	26.2	26.7
Net NPAs to Adv.		0.6	0.5	0.4	0.3	0.3
CAR		17.3	18.2	15.4	14.1	13.3
VALUATION						
Book Value (Rs)		28.2	48.5	59.0	68.7	82.9
Price-BV (x)		5.5	3.2	2.6	2.3	1.9
Adjusted BV (Rs)		27.3	47.5	57.9	67.5	81.7
Price-ABV (x)		5.7	3.3	2.7	2.3	1.9
EPS (Rs)		7.3	8.5	10.3	13.5	17.7
EPS Growth (%)		-17.5	15.9	22.0	30.4	31.4
Price-Earnings (x)		21.4	18.4	15.1	11.6	8.8
OPS (Rs)		14.6	18.0	24.8	32.0	41.9
OPS Growth (%)		-12.0	23.7	37.7	28.9	30.9
Price-OP (x)		10.7	8.7	6.3	4.9	3.7

E: M O S t Estimates

N O T E S



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Disclosure of Interest Statement	Shriram Transport Finance
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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