Stock Update

Shriram Transport Finance Company Ltd.

September 23, 2021

Shriram Transport Finance Company Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.1347	Buy at LTP of Rs.1347 & add more on dips of Rs.1198	Rs.1488	Rs.1634	2 quarters

HDFC Scrip Code	SHRTRA
BSE Code	511218
NSE Code	SRTRANSFIN
Bloomberg	SHTF
CMP Sep 22, 2021	1347
Equity Capital (Rs mn)	2,670
Face Value (Rs)	10
Equity Share O/S (mn)	267
Market Cap (Rs bn)	362
Book Value (Rs)	793.6
Avg. 52 Wk Volumes	57325297
52 Week High	1,534.9
52 Week Low	555.9

Share holding Pattern % (Jun, 2021)	
Promoters	25.1
Institutions	69.2
Non Institutions	5.7
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Shriram Transport Finance Company Limited (STFC) is the leader and pioneer in pre-owned CV finance segment. As on Q1FY22, 90.5% of its AUM comprised of used CV financing. With existence of over four decades, the company has been able to gather strong market share and has built a formidable ecosystem of semi-urban and rural financing. Demand for used CV financing is expected to be relatively better due to lower EMI burden, and some replacement demand with the scrappage policy getting implemented. The company is well capitalized post recent series of fund raises. Management believes that good monsoon and festival demand could bring back the rural demand in next two quarters.

However, we will remain watchful on collection efficiencies front and asset quality trend going ahead. Over dependence on financing used vehicles and rural economy brings concentration risk. The possibility of a third Covid wave and fresh lock downs could hurt the business. Demerger related news can keep the stock price volatile.

We had issued Initiating Report on STFC on 30th March, 2021 and recommended Buy on dips to Rs.1225 and add more on Rs.1084, for base case target of Rs.1362 and bull case target of Rs.1503 over the next two quarters. The stock entered our buying range on 23rd August, 2021 and base case target of Rs.1362 was achieved on 3rd September, 2021 yielding return of 11.2%. The time frame for the recommendation is about to end on 30th September, 2021. However, we would like to continue with our Buy view and recommend investor to follow the below mention targets.

Report for the Initiating Coverage:
https://www.hdfcsec.com/hsl.research.pdf/Shriram%20Transport%20Finance%20Company%20Ltd.-%20Initiating%20Coverage-%2030032021.pdf

Valuation & Recommendation:

The company has a healthy financial track record. The average RoE of past ten years is 16%. It has industry best operating efficiencies. We expect, used CV financing uptick to enable book growth for SHTF, but liability/asset quality profile to be watched out. We expect from FY22 things will be normalize and we will see an uptick in the earnings. We have envisaged 9% CAGR for NII and 23% CAGR for Adjusted Net Profit over FY21-23E, while AUM is estimated to grow at ~9% CAGR over same time frame. NIMs may improve with decline in CoF and reduction in excess liquidity. With the current stock of provisions at 7.5% of AUM, we expect normalised provisioning from H2FY22 on the back of resumption of economic activity and improving collections and recoveries. RoAA is estimated at 2.6% in FY23E compared to 2% in FY21. The stock is trading at a significant discount to Cholamandalam and Sundaram Finance, which could reduce going forward given the company's growth and asset quality trajectory. **We believe that investors can buy STFC at LTP (1.4xFY23E ABV) and add more at Rs.1198 (1.25xFY23E ABV) for the base case fair value of Rs.1488 (1.55xFY23E ABV and for the bull case fair value of Rs.1634 (1.7xFY23E ABV) over the next two quarters.**

Financial Summary

Particulars (Rs bn)	Q1 FY22	Q1 FY21	YoY (%)	Q4 FY21	QoQ (%)	FY20	FY21	FY22E	FY23E
NII	19.8	18.4	7.9	21.2	-6.3	80.2	80.9	87.1	96.1
PPOP	16.7	15	12	16.6	0.8	62.3	64	67.3	73.9
PAT	1.7	3.2	-46.9	7.5	-77.5	25	24.9	33.1	37.4
EPS (INR)	6.4	14.1	-54.9	29.8	-78.7	110.3	98.3	124	140.2
ROAE (%)						14.8	12.6	13.7	13.1
ROAA (%)						2.3	2	2.5	2.6
ABVPS (INR)						533	662.4	824.4	960.5
P/ABV (x)						2.5	2.0	1.6	1.4
P/E (x)						12.2	13.7	10.9	9.6

(Source: Company, HDFC sec)

Recent Developments

Q1FY22 Result Update

The company derives majority of revenue from semi-urban and rural areas. The second wave and subsequent lock down had impacted rural India, which has ultimately resulted in deterioration in the company' performance this quarter.

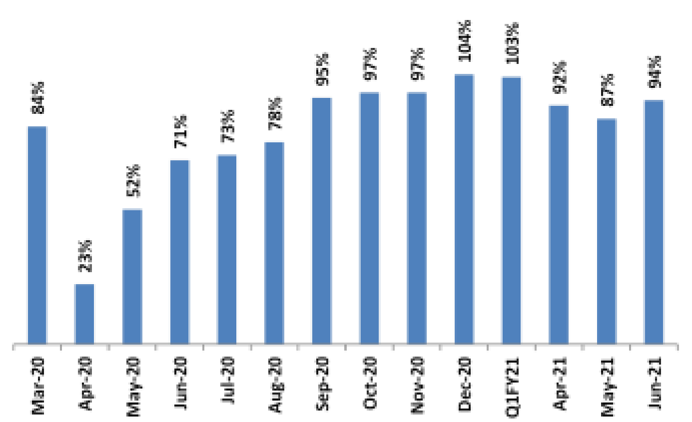
The company has reported Net Interest Income at Rs.19.8bn, up 8% YoY. However, it was down by 6.3% QoQ. NIM stood at 6.4% compared to 6.8% in Q4FY21 due to surplus liquidity and higher interest expenses, which management expects to normalize by Q3FY22. Operating profit grew by 12% YoY. PAT declined by 77% QoQ and 47% YoY because of elevated provisioning. Cost to income ratio stood at 19.11% in Q1FY22 as compared to 18.67% in Q1FY21. Going ahead this could rise as the company is planning to add 1,500-2,000 employees.

AUM grew by 6.8% YoY to Rs.1,193bn. AUM growth was led by pre-owned segment which grew 13% YoY while new CV segment declined 26%. SHTF's disbursements during Q1FY22 were at Rs.127.3bn (~104% of pre-COVID levels), driven primarily by sanctions from earlier quarters. While the HCV segment continues to remain sluggish, the management indicated pent-up demand in LCV and PV segments. Deposit accretion remained strong at 11% QoQ Rs.179bn. The management is confident on its guidance of double digit AUM growth and expects to reach ~2% credit costs by Q4FY22.

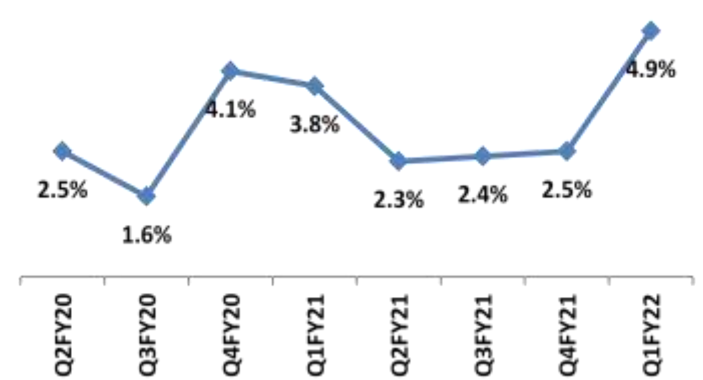
Asset Quality

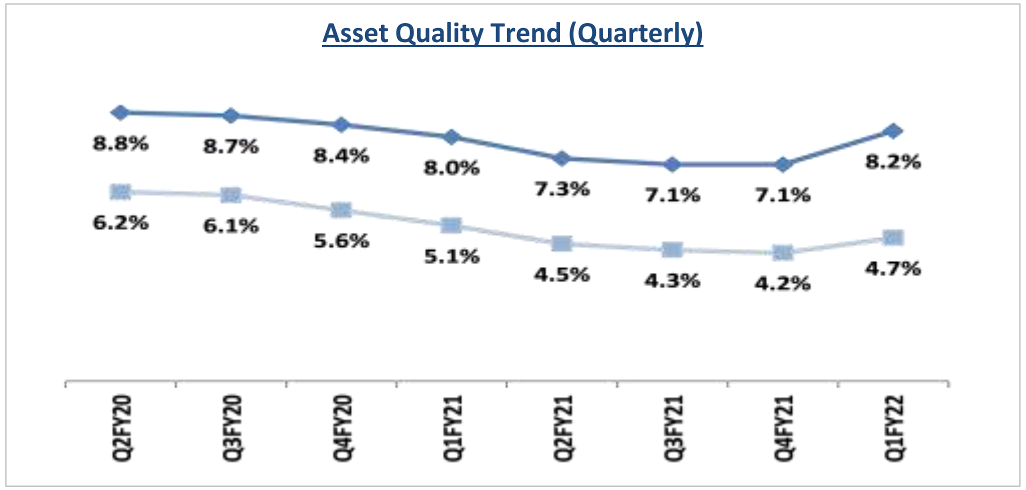
The gross stage-3 during the quarter rose to 8.18% as compared to 7.06% QoQ and 7.98% YoY. The same way net stage-3 was at 4.74% as compared to 4.22% QoQ and 5.06% YoY. However, combined pool of Stage 2 and 3 stood at 22.7% as on Q1FY22 which increased by 270bps on a QoQ basis. It was noteworthy that the build-up of stress (+375bps) was less steep compared to its peers (Cholamandalam/M&M Financial at +1,066bps/1,332 bps). SHTF shored up its GS-2/3 provisioning to 10%/44% (Q4FY21:9.7%/42%) with incremental surplus provisioning towards the PV segment, where the impairment is expected to be higher than the used CV segment. With build-up of provisioning buffer, we expect normalization of credit costs, going forward, if the projected third wave of the pandemic is averted. Restructuring for the quarter stood at Rs3.4bn and management is expecting another Rs.3bn in the next quarter. Write-off was done for Rs3.6bn of loans in Q1FY22, out of which Rs1.12bn was done in the passenger vehicle segment. The collections efficiency for the months of April 2021, May 2021 and June 2021 were 92%, 87% and 94% respectively. From July onwards the rate improved and the management expects rollbacks from GS-2/3 in next quarter.

Collection efficiency



Surge in credit costs





Recent fund raise and capitalization level

STFC has strong liquidity profile and adequate capital buffer. The capital adequacy ratio (CAR) stood at 23.3% and tier-1 at 21%, well above regulatory requirement. Strong parentage helps it in raising the capital at reasonable cost. Overall, the healthy capitalization is expected to be maintained over the medium term, driven by substantial accruals and expected support from promoters group, if required. The company has not been aggressive on the growth front and maintained a well-matched ALM, which should help it sail through the currently challenging operating environment. STFC has also utilized the opportunity to further diversify its liability base, and the share of Foreign liabilities through ECBs increased further to 20.6% v/s 17.9% a year ago and 6.3% in FY19. The share of deposits increased to 15.3% v/s 12.7% a year ago and 11–12% in FY18/FY19.

Consistent track record and high growth potential has attracted reputed institutional and private equity investors to infuse growth capital. In the last one year the company has done three fund raisings. On July 8, 2021, the company has allotted 1.736 mn equity shares of FV of Rs.10/- each aggregating to Rs.2.5 bn on a preferential basis to Shriram Capital Limited (promoter) at Rs. 1440 per share as well as the same amount of warrants convertible into these many equity shares and same price per share at Rs.360 per warrant. On June 12, 2021, the company has done QIP of Rs.19.99 bn by issuing 13.986 mn equity shares at Rs.1430. The right issue of Rs. 14.92 bn was done by allotting 26.179 mn equity shares at Rs.570 per share. The ratio was 3 rights equity shares for every 26 equity shares held by the eligible equity shareholders.

Focus area

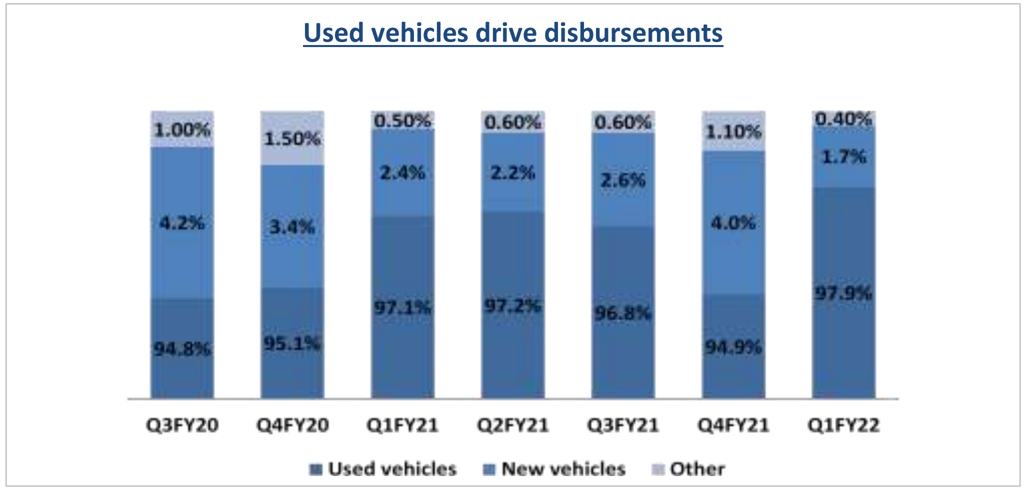
The key focus area of the company will be digitization. It has created a Digital Roadmap, where it would like to launch a totally new platform. It outlined its strategy on digital front by building business enablers for trucking ecosystem (app on load availability) and Shriram Pay for ease of payments. To go deeper into rural pockets this roadmap along with other means will also be helpful. The management has also stated that they are planning to enter alternative fuel financings as majority of the manufacturers have announced their plan to launch electronic vehicles.

Well placed to capture the cyclical turn in the used CV segment

Commercial vehicle (CV) segment is a cyclical industry and over the past two-three years we have seen a down cycle. The commercial vehicle industry was already under pressure due to the demand slowdown, axle load norms, GST etc. and Corona virus outbreak had brought a whole new set of challenges. But now the situation seems improving as gradually the economy is opening up. Industry majors like Tata Motors, Ashok Leyland, M&M and Eicher Motors have started showing improvement in the monthly sales figures. Going forward, we believe that lower base along with favourable environment like Government's infrastructure push, normal monsoon and rise in E-commerce activities etc. are the early indicators of an uptrend in CV segment.

We like the used CV segment and we believe that STFC, being the leader in the segment is well placed to capture the cyclical turn in the used CV segment. The scrappage policy implementation would fuel the demand for used trucks as small truck owners would prefer to buy relatively-newer used trucks to replace their 15-year-old trucks, given that new trucks are expected to become more expensive with the BS-VI regime kicking in. Normally, when the economy is weak, the demand for new vehicles comes down. Typically, transport operators stick to old vehicles because market conditions are not conducive. The company also anticipates jump in its business of financing pre-owned vehicles.

For rural business the management believes that cash flow from agriculture segment was good (which would improve rural economic growth) and post-monsoon, the festival season ending up to March would be a very exciting time to look at. It expects that growth could come back to normal and it could get aggressive growth position post-September.



Merger with group companies back on cards

The management has informed in the Q1FY22 result concall that they have restarted the merger process. They further informed that they should be able to come up with a roadmap over the next two-three quarters. They believe that the merger will bring in synergy benefits like ability to cross-sell, offer multiple products, lower cost of funds, better digital roadmap etc. So far it seems that SCUF and STFC merger is on cards. There was no clarity on whether Shriram Capital will be part of the scheme.

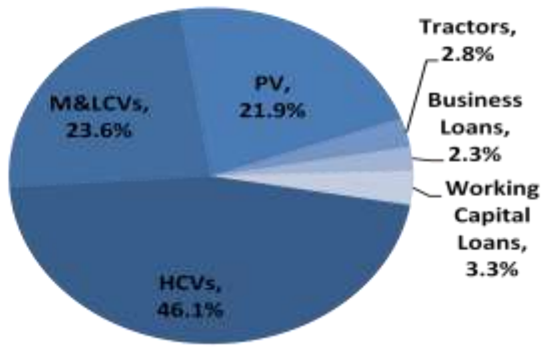
A well-established payer

STFC is the leader and pioneer in pre-owned CV segment. With over 40 years of existence the company has institutionalized its expertise in loan origination, valuation and collection. Over the years, STFC has created "an ecosystem of empowerment" by expanding its products and services to encompass similar asset classes (pre-owned and new commercial and passenger vehicles, tractors, 3 wheelers, multi-utility vehicles, etc.) and ancillary services (finance for working capital, engine replacement, small business finance loans, tyre-loans and fuel loans as holistic financing support). Its credit evaluation techniques, relationship-based approach, extensive branch network and strong valuation skills make its business model unique and sustainable as compared to other financiers. As a part of the Shriram Group, the company derives considerable management, operational and financial support from group companies.

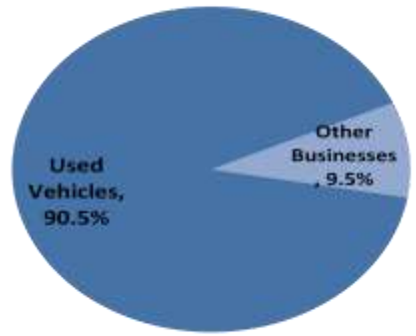
The segment is quite niche and under penetrated with majority of the market is captured by private financiers / money lenders who charge high interest rates. Here the competition from organized payers is low. Majority of the company's customers are lower income class and new to credit or have suboptimal credit profile. However, vast experience in the segment and huge data to analyse about the (target) market behavior helps it in maintaining asset quality.

The company also has well-entrenched pan India network of 1821 branches and 809 rural centres. It has 24K+ employees who cater to 2.11 mn customers. Majority of the company's branches are located in rural and semi-urban areas.

Segment-wise AUM Break up



Used vehicles dominates the AUM



Risk & Concern

- The possibility of a third Covid wave and fresh lock downs could hurt the business on multiple fronts i.e. liquidity, asset quality, loan growth, collections etc.
- The retail financing business is highly competitive due to its nature of attractive yield. It has always faced competition from small finance banks, banks and other NBFCs. Banks with wider branch and distribution network and cheaper cost of funds have greater competitive advantage. In the LCV segment new age tech enabled players like Kogta & Ess Kay can offer stiff competition going forward. The stiff competition from banks may pose increasing challenges by way of lower-than-expected loan growth and lower NIM. However, STFC's niche business model (focus on used vehicles) mitigates this risk up to some extent.
- STFC's performance has faced several challenges over the past few years including economy slowdown, transition from BSIV to BSVI and IL&FS crisis that led to poor performance in FY20 while COVID led to weakest FY21. It seems that the business model is a hugely cyclical one with a large dependence on continued rural prosperity. We believe that the rural economy recovery is now largely dependent on good agriculture season, which again relies on good monsoon. Slower-than-expected pick-up in the rural economy

could impact the growth of the company's Assets Under Management. Over dependence on used vehicles and rural economy brings concentration risk.

- STFC is highly dependent on used CV financing where it deals more with small sized self-employed operators who have experienced dip in savings and are more vulnerable to any potential slowdown compared to large fleet operators which are relatively better placed. Also low freight rates and rising fuel costs will continue to pressurise commercial vehicle operators' financial viability, which in turn reduce their ability to service commercial vehicle loans. Most commercial vehicle operators will find it difficult to pass on additional costs to their customers in the weak operating environment.
- The possibility of a merger within the group and its terms remains an overhang.

Company Background:

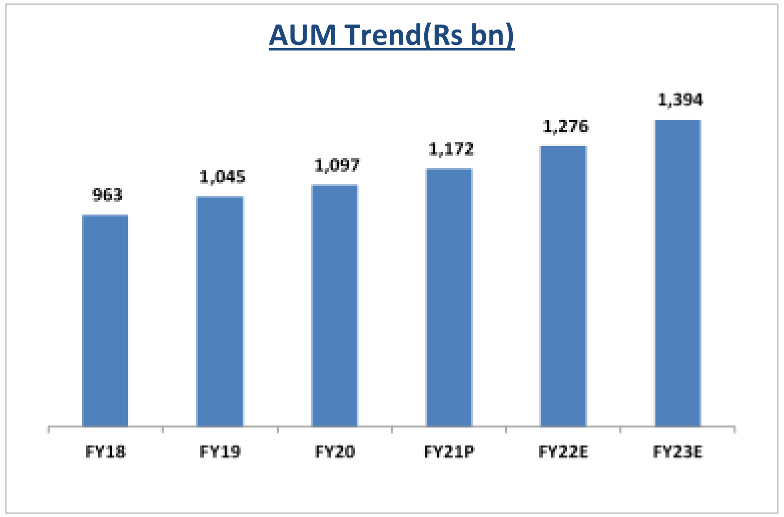
Shriram Transport Finance Company Limited (STFC) is the flagship company of the Shriram group which has significant presence in Consumer Finance, Life Insurance, General Insurance, Stock Broking and Distribution businesses. Established in 1979, Shriram Transport is today one of the largest asset financing NBFCs in the country and holistic finance provider for the commercial vehicle industry and seeks to partner small truck owners for every possible need related to their assets. It has PAN India presence with 1,821 branch offices. Based at Mumbai, it manages assets over Rs. 1193 bn and has a live customer base exceeding 2.1 mn.

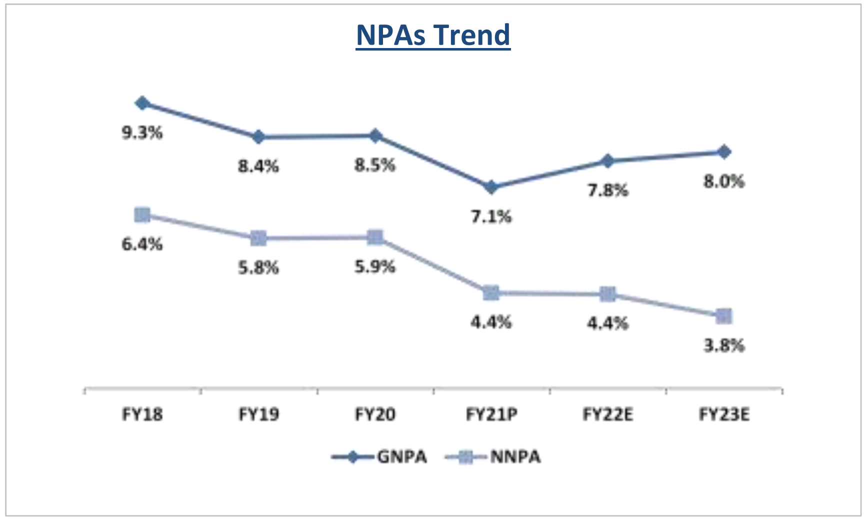
Over the past 40 years, it has developed robust competencies in the areas of loan origination, valuation of pre-owned trucks and collection. It has a vertically integrated business model and offers a number of products which include: Pre-owned CV financing, New CV financing and other loans like accidental repair loans, tyre loans and working capital finance, etc.

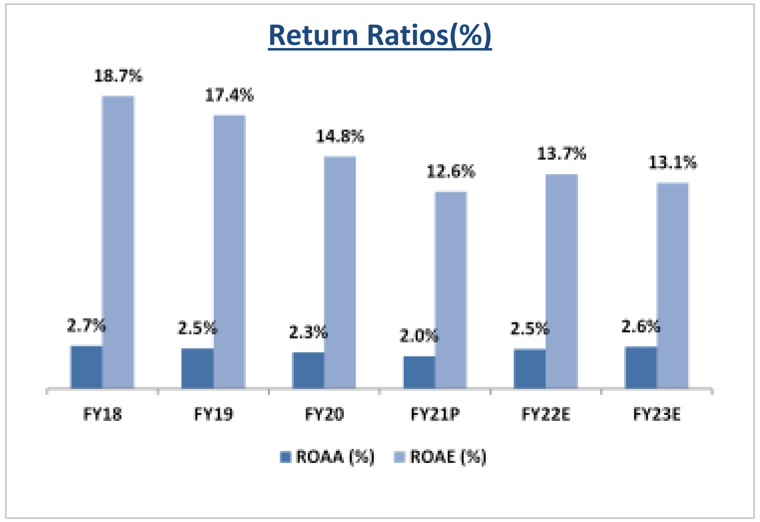
Peer Comparison:

	Mcap (Rs bn)	CMP	P/E			P/BV			AUM(Rs. Bn)	FY21NIM	FY21	FY21
			FY21	FY22E	FY23E	FY21	FY22E	FY23E			NNPA	ROAA
CIFC	468	571	33.4	26.2	29.4	5.8	4.6	3.8	700	7.1	2.3	2.2
MMFS	224	181	67.0	16.9	12.3	1.8	1.7	1.5	817	8.9	4.1	0.4
SHTF	362	1347	13.7	10.9	9.6	2	1.6	1.4	1172	7.1	4.4	2

Shriram Transport Finance Company Ltd.







Financials

Income Statement

(Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Interest earned	153632	162877	171441	181786	197588
Interest expended	75113	82703	90543	94735	101464
Net interest income	**78519**	**80175**	**80898**	**87051**	**96124**
Other income	1935	2949	2923	3337	3263
Total income	**80454**	**83124**	**83821**	**90388**	**99387**
Operating expenditure	18849	20788	19857	23045	25535
Pre-provisioning operating profit	61605	62336	63964	67343	73852
Non-tax provisions	23823	27949	31184	23783	24589
Profit before tax	37783	34387	32780	43560	49263
Tax expenditure	12143	9368	7908	10454	11823
Profit after tax	**25640**	**25018**	**24873**	**33106**	**37440**

Balance Sheet

(Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	2269	2269	2531	2670	2670
Reserves and surplus	156094	177783	213153	265790	299485
Net worth	**158363**	**180052**	**215684**	**268460**	**302156**
Borrowings	879144	943718	1061964	1070367	1147434
Other liabilities and provisions	15418	17517	19141	21055	23160
Total equity and liabilities	**1052925**	**1141286**	**1296789**	**1359882**	**1472750**
Cash and cash equivalents	39815	73149	164418	109194	108035
Investments	39991	27985	31979	33577	35928
Advances	967515	1022316	1083030	1199302	1310590
Fixed assets	1475	4824	4373	4461	4550
Other assets	4130	13012	12988	13348	13647
Total assets	**1052925**	**1141286**	**1296789**	**1359882**	**1472750**

(Source: Company, HDFC sec)

Shriram Transport Finance Company Ltd.

Key Ratios

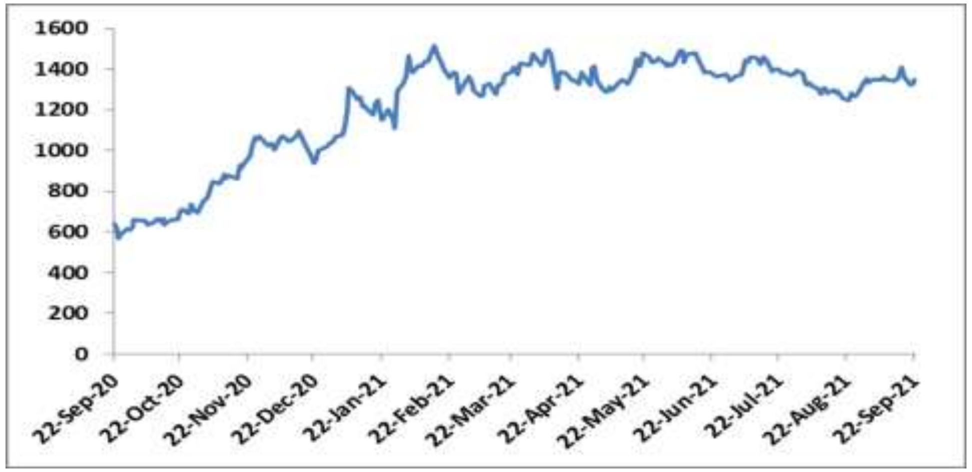
	FY19	FY20	FY21	FY22E	FY23E
Valuation metrics					
EPS	113	110.3	98.3	124	140.2
BVPS	698	794	852	1,005	1,131
Adj. BVPS	449	533	662	824	960
ROAA (%)	2.50%	2.30%	2.00%	2.50%	2.60%
ROAE (%)	17.40%	14.80%	12.60%	13.70%	13.10%
P/E (x)	11.9	12.2	13.7	10.9	9.6
P/ABV (x)	3	2.5	2	1.6	1.4
Dividend Yield (%)	0.90%	0.40%	0.40%	0.70%	1.00%
Profitability ratios					
Yield on Advances (%)	16.40%	16.40%	16.30%	15.90%	15.70%
Cost of Funds (%)	8.80%	9.10%	9.00%	8.90%	9.20%
Core Spread (%)	7.60%	7.30%	7.30%	7.00%	6.60%
NIM (% of AUM)	7.80%	7.50%	7.10%	7.10%	7.20%
Operating efficiency ratios					
Cost/Avg. AUM Ratio (%)	1.90%	1.90%	1.70%	1.90%	1.90%
Cost-Income Ratio (%)	23.40%	25.00%	23.70%	25.50%	25.70%

(Source: Company, HDFC sec)

Key Ratios

	FY19	FY20	FY21	FY22E	FY23E
Balance sheet structure ratios					
Loan growth (%)	6.60%	5.70%	5.90%	10.70%	9.30%
AUM growth (%)	8.50%	5.00%	6.80%	8.80%	9.30%
Borrowing growth (%)	6.20%	7.30%	12.50%	0.80%	7.20%
Debt/Equity (x)	6.2	5.9	5.5	4.5	4.3
Total Capital Adequacy Ratio (CAR)	20.30%	22.00%	22.50%	19.10%	19.80%
Tier I CAR	15.60%	18.10%	19.90%	16.40%	17.30%
Asset quality metrics					
Gross NPL	86,163	91,771	82,928	93,629	1,05,392
Net NPL	56,465	59,117	48,067	48,320	45,665
Slippages (%)	6.60%	7.40%	4.80%	6.50%	6.70%
Gross NPLs (%)	8.40%	8.50%	7.10%	7.80%	8.00%
Net NPLs (%)	5.80%	5.90%	4.40%	4.40%	3.80%
Coverage Ratio (%)	34.50%	35.60%	42.00%	48.40%	56.70%
Provision/Avg. AUM (%)	2.40%	2.60%	2.70%	1.90%	1.80%

One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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