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Initiating Coverage

Shriram Transport Finance Company Ltd.

30-March-2021

RETAIL RESEARCH

Shriram Transport Finance Company Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.1428.4	Buy on dips to Rs.1225 and add more on Rs.1084	Rs.1362	Rs.1503	2 quarters

HDFC Scrip Code	SHRTRA
BSE Code	511218
NSE Code	SRTRANSFIN
Bloomberg	SHTF
CMP Mar 26, 2021	1428.4
Equity Capital (Rsmn)	2,531
Face Value (Rs)	10
Equity Share O/S (mn)	253
Market Cap (Rs bn)	360.8
Book Value (Rs)	793.6
Avg. 52 Wk Volumes	57325297
52 Week High	1,534.9
52 Week Low	487

Share holding Pattern % (Dec, 2020)	
Promoters	26.48
Institutions	67.16
Non Institutions	6.36
Total	100.0

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Our Take:

With vast 40 years of experience and unique business model, Shriram Transport Finance Co Ltd. (SHTF) is a dominant player in the industry. The company commands 16% share in India's commercial vehicle (CV) financing market and ~40% share in the NBFC CV financing space. As a part of the Shriram Group, the company derives considerable management, operational and financial support from group companies. A faster recovery of the rural sector and a good Rabi harvest is expected to drive rebound in rural demand and SHTF with around 50% of branches in rural & semi urban areas is at clear advantage. An improvement in demand and better availability of funds could further improve SHTF's growth prospects. The Company has a comprehensive Risk Management Policy in place and has laid down a well-defined risk management framework to identify, assess and monitor risks and strengthen controls to mitigate risks. In our view, its undisputed leadership, deep penetration and niche positioning is a strong moat of the company. Once the pandemic easies and economy is back on track, we expect SHFT business to stabilize and is well-placed to capitalize on CV cycle recovery going forward.

Valuations & Recommendation:

Despite a difficult environment, the company delivered decent growth in 9MFY21. There might be near term volatility in the performance of the company due to uncertainty in prevailing in the industry. We expect from FY22 things will be normalize and we will see a sharp uptick in the earnings. Management has guided AUM growth of 6% in FY21 and double digit in FY22.

We have envisaged 6% CAGR for NII and 15% CAGR for Adjusted Net Profit over FY20-23E. With incremental unlocking of the economy the demand will improve from FY22E. We have estimated ~8% CAGR for AUM over FY20-22E. We expect a sharp rise in GNPAs in FY21E. RoAA is estimated at 2.76% in FY23E compared to 2.28% in FY20.

We feel that investors can buy Shriram Transport Finance Co Ltd. (SHTF) on dips to to Rs.1225 (1.3xFY23E ABV) and add more on Rs.1084 (1.15xFY23E ABV). We expect the Base case fair value of Rs.1362 (1.45xFY23E ABV) and the Bull case fair value of Rs.1503 (1.6xFY23E ABV) over the next 2 quarters.

Shriram Transport Finance Company Ltd.

Financial Summary

Particulars (Rsmn)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
NII	21,452	20,641	3.9	20,368	5.3	78,244	79,972	81,744	87,531	95,031
PPOP	16,637	16,307	2.0	15,759	5.6	61,605	62,336	63,612	67,582	73,208
PAT	7,871	8,797	-10.5	7,056	11.6	25,640	25,018	24,598	32,410	38,410
EPS (Rs)	28.8	38.8	-25.8	27.9	3.1	113	110.3	97.2	128.1	151.8
ROAE (%)						17.4	14.8	12.4	13.9	14.5
ROAA (%)						2.53	2.28	2.09	2.56	2.76
ABVPS (Rs)						449	530	597	765	939
P/ABV (x)						3.2	2.7	2.4	1.9	1.5
P/E (x)						12.6	12.9	14.7	11.1	9.4

(Source: Company, HDFC sec)

Recent Developments

Q3FY21 highlights:

The company reported 10.5% YoY decline in PAT in 3QFY21. Pre Provisioning Operating Profit rose 2% YoY and 5.6% QoQ as C/I ratio improved by 53bps YoY to 23.4%. NII grew by 3.9% at Rs. 21,452 mn. Outstanding term loans grew ~10% QoQ. NIM improved by 20bps vs the previous quarter due to increase in Used Vehicle disbursements and low cost of funds. Disbursements grew by 11% on YoY basis and nearly doubled on sequential basis resulting in a 6% growth in AUM. This was mainly driven by used CV segment which grew by 13% YoY/94% QoQ. Used LCV prices are up 20% while HCV prices have remained stable at pre-Covid levels. Post moratorium, the collections for the months of Sept/Oct/Nov and Dec ’20 were at 95%/97%/97% and 104% of the demand respectively SHTF also saw reasonable traction in public deposits, which grew 18.6/10.5%. We believe the sharp fall in funding costs (-16bps QoQ) is indicative of an improvement in SHTF’s ability to access funds, supported by a benign funding environment. We expect FY21E NIM estimates to 7.2%. Expect this to move once the economic activity picks up pace. Management updated that the company has seen some positive rating action in 3QFY21. It is in touch with the rating agencies to reinstate previous ratings, which may take 2-3 quarters. They have guided AUM to grow by 6% in FY21 and in double digit in FY22.

Asset quality and collection trends:

SHTF witnessed a sustained improvement in collection efficiency metrics, with collection efficiency reaching ~104% in December. However, this included overdues. Stage 3 assets were down 160bps YoY and 15bps QoQ. Stage 2 assets have increased marginally from 11.7% in 2QFY21 to 12.1%. On a pro forma basis, Stage 3 assets dipped ~15bps sequentially to ~7.1%.~ 9600 customers (~1% of total AUM) had not paid a single installment since March. The management expects to restructure 2% of the portfolio comprising primarily of loans to taxi aggregators and passenger transport operators. We expect a sharp rise in GNPAs in FY21E to 9.5%.

The lockdown had immediately impacted truck operators choking their cash flows, thereby creating asset quality challenges for the lenders. Disbursements across the segments remained at lower levels during this period vs. last year: used CV (51% of last year), new CV (21% of last year) and other business loans (24% of last year). But after gradual re-opening of the economy post the lock down, the transportation of goods has started to recover fast. We expect this will create the demand for used commercial vehicles (due to less cost) and SHTF being the largest player in the segment will benefit.

Vehicle Manufacturers were giving heavy discount to for their BS-4 inventory so there was less demand for used vehicles. Now, as the time line for shift of BS-4 to BS-6 has expired we think that resale value of used vehicle will go up significantly and for company the asset coverage of their existing portfolio will also go up. Also, the government's proposed scrappage policy could help getting higher demand for pre-owned vehicle. It has been observed that post transitions to BS-6, CV prices have increased ~10-15%; which has translated into about 5-10% rise in used CV prices. As per the management, it expects disbursements to be Rs 12-13K Cr per quarter going ahead and AUM growth is likely to be 5-6% for FY21.

Credit cost to remain higher: We expect STFC's credit cost to remain high at 2.5% in FY21E-22E on the back of elevated writeoffs, increase in slippages from select stressed accounts and improvement in coverage on overall book. It will start moderating from FY22E as overall repayment capability of underlying borrowers improves.

SHTF is adequately capitalized, with Tier-1 ratio improving to 18.1% and Total CAR at 22% post rights issue of Rs.15bn (at Rs. 570 per share) in Aug'20. The liquidity buffer and SLR investments are at Rs.134.3 bn and Rs. 18.12 bn respectively. ALM position is also at comfortable level with positive ALM mismatched in all near-term buckets.

Long term Triggers

Strong Parent

SHTF is part of the Shriram conglomerate which has significant presence in financial services business like, CV financing, consumer finance, life & general insurance, stock broking, chit funds and distribution of financial products such as life & general insurance products and units of mutual funds. Apart from these financial services, the Group is also present in non-financial services such as property development, engineering projects and information technology. As a part of the Shriram Group, the company derives considerable management, operational and financial support from Group companies.

Niche Business

Market for second hand truck financing is under penetrated with 55-60% of the market comprises of private financiers / money lenders who charge high interest rates. To grab this opportunity this segment has been the key focus area for the Company ever since its inception. It has been constantly engaged in initiative to corporatize this untapped segment. And now with its 40 years of existence since 1979, SHTF has become a dominant player in used CV financing business (leader in organized market). Company has AUM of over Rs. 1.1 lk Cr and ~85% of its AUM is Pre Owned Commercial Vehicles. It has strategically positioned itself in a high-yield pre-owned CV financing (5-yr Avg- Yield on advances 15.45%) with un-parallel expertise in loan origination, valuation and collection. Its Cost/income ratio is among the lowest in the industry at ~25% as majority of the business processes are in-house and therefore helps in improving efficiency level and thereby results in costs savings. 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. Management has indicated that the Company will continue focusing on financing of pre-owned CVs and PVs by further strengthening its presence and penetration into rural & urban centers via large network of branches and rural centers.

Strong play on rural recovery

A faster recovery of the rural sector and a good Rabi harvest is expected to support vehicle demand. SHTF has around 50% of branches in rural & semi urban areas, which gives them a clear advantage to capitalize on the rebound in rural demand. In the last one year the company has been adding new branches, majority of which are the satellite branches outside the semi-urban centers. Consequently, the share of rural AUM has also risen to 48.7% of total AUM as on December 31, 2020 as against 46% end September 2019. In order to further leverage its network and diversify its offerings, SHTF has expanded its product portfolio in high margin rural financing business of tractors, small CV, three wheelers, passenger commercial vehicles and construction equipment.

Risk Management Policy

The Company has a comprehensive Risk Management Policy in place and has laid down a well-defined risk management framework to identify, assess and monitor risks and strengthen controls to mitigate risks. Established procedures are periodically place before the Risk Management Committee. It is based on a meticulous assessment of risks through proper analysis and understanding of the underlying risks before undertaking any transactions and changing or implementing processes and systems. We believe that the company's long track record in the vehicle financing business, understanding of the target customer segment and robust underwriting practices should help company in this troubled time of asset quality deterioration.

What could go wrong?

- The prospects of Commercial Vehicle industry are largely linked to economic activity, so any prolonged slowdown in the economy will impact the sale of Commercial Vehicles and ultimately to the vehicle financing companies both in terms of loan growth and asset quality.

- The commercial vehicle industry was already under pressure due to the demand slow-down, axle load norms, GST etc. and now due to Corona virus outbreak, the whole new set of challenges have been emerged. But now the situation seems improving as the gradually economy is opening up.

- The company has witnessed significant improvement in collection efficiencies but Gross stage 3 & 2 loans are still very high. Most of these customers belong to the stressed sectors including taxi and cab aggregator, school buses and vehicles involved in tourism and hospitality. The management expects to restructure 2% of the portfolio comprising primarily of loans to taxi aggregators and passenger transport operators.

- The company is heavily dependent on CV industry and especially pre-owned vehicles. Over 85% of the loan book is concentrated in vehicles over five years old. The company has high-risk customer base as it offers loan to economically lower class, who have no credit ratings.

- The company has also large dependence on rural and semi-urban areas. Poor rainfall could lead to slowdown in rural areas compounding problems for SHTF.

Shriram Transport Finance Company Ltd.

- Prolonged COVID-19 lead slow down might impact negatively to the company on multiple fronts i.e. liquidity, asset quality, loan growth etc.

- The possibility of a merger within the group remains an overhang.

Company Profile:

Shriram Transport Finance Co Ltd. (SHTF) is the largest asset financing NBFC in India with Assets under management Rs. 1,149.3 bn. The company is a leader in organized financing of pre-owned trucks with strategic presence in 5-10 year old trucks. It has a pan-India presence with a network of 1,799 branches, and employs 24,670 employees. The company has built a strong customer base of approx. 2.12 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.

SHTF has also stake in Shriram Automall India Ltd (SAMIL), a reliable platform for sale, refurbishment, and auction of pre-owned vehicles, besides enabling better price discovery of such vehicles. While the company sold majority stake in SAMIL in April 2018, it will continue to hold a large minority stake.

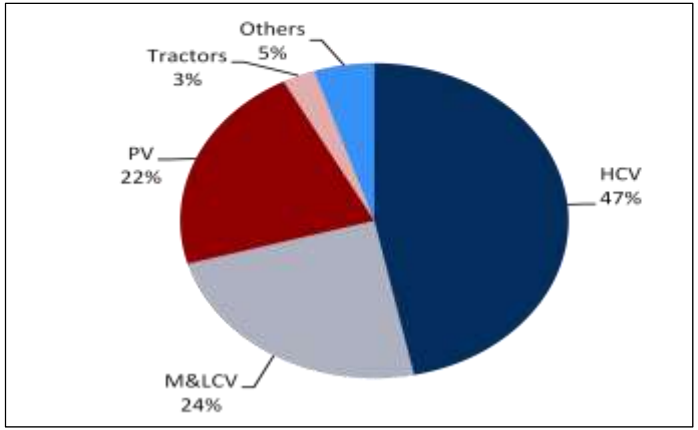
Peer Comparison:

	Mcap (Rs bn)	CMP	P/E			P/BV			AUM(Rs. Bn)	FY20 NIM	FY20 NNPA	FY20 ROAA
			FY21	FY22	FY23	FY21	FY22	FY23				
CIFC	455	555	27.8	27.3	17.9	5.7	4.4	3.6	606	6.2	2.2	1.6
MMFS	255	207	25.9	15.0	12.9	2.5	1.9	1.6	772	7.0	6.0	1.3
SHTF	361	1428	14.7	11.1	9.4	2.4	1.9	1.5	1098	7.5	5.6	2.3

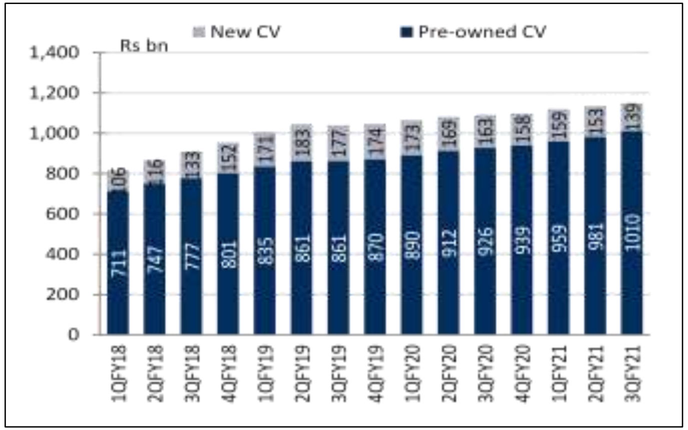
(Source: Company, HDFC sec)

Shriram Transport Finance Company Ltd.

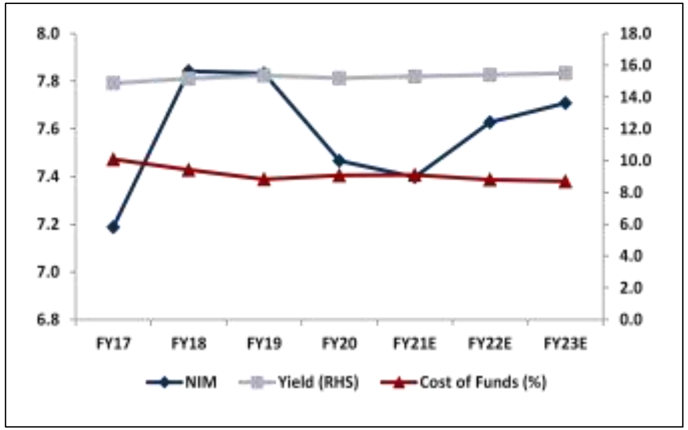
AUM Mix%



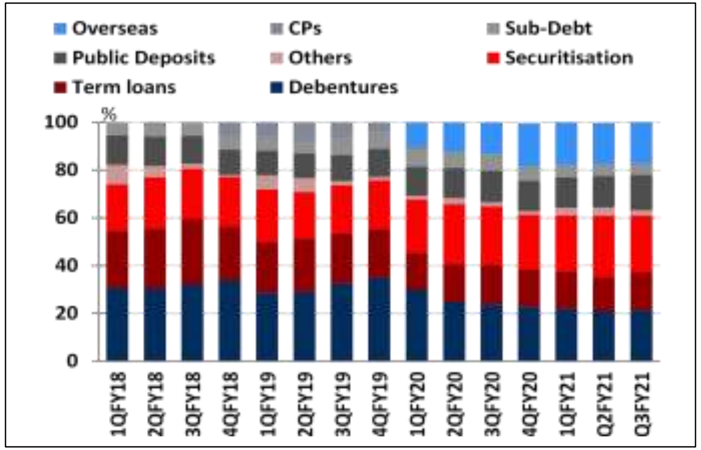
Pre-owned vehicles dominate AUM mix



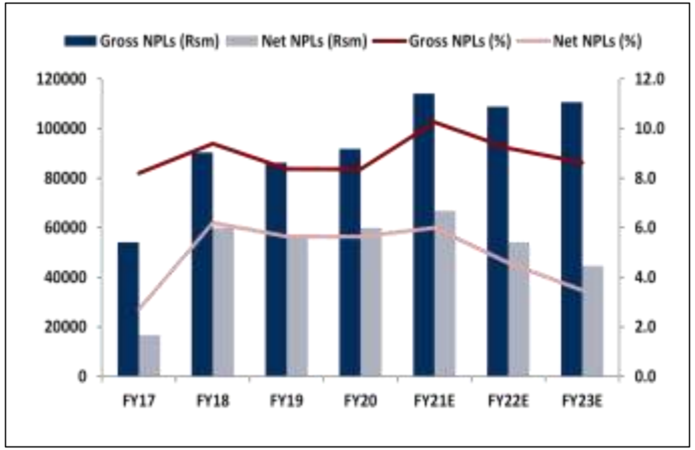
NIM Trend



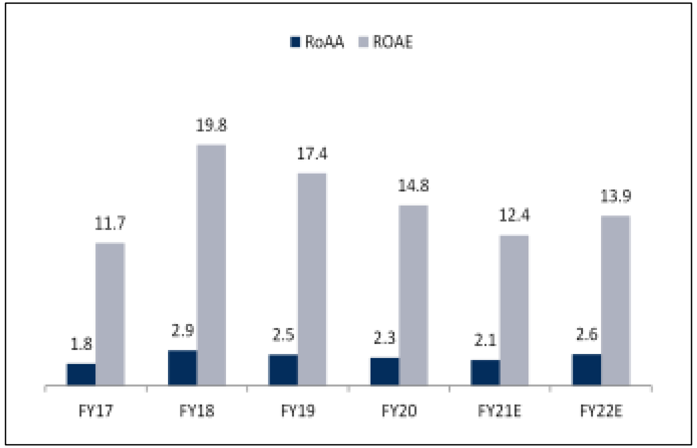
Borrowing Profile



NPA Trend



Return Ratios



(Source: Company, HDFC sec)

RETAIL RESEARCH

Shriram Transport Finance Company Ltd.

Financials

Income Statement

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Interest Earned	1,53,357	1,62,675	1,69,074	1,76,724	1,91,097
Interest Expended	75,113	82,703	87,329	89,193	96,065
Net Interest Income	**78,244**	**79,972**	**81,744**	**87,531**	**95,031**
Other Income	2,210	3,152	3,015	3,086	3,197
Total Income	80,454	83,124	84,760	90,617	98,228
Total Operating Exp	18,849	20,788	21,148	23,035	25,020
PPOP	**61,605**	**62,336**	**63,612**	**67,582**	**73,208**
Provisions & Contingencies	23,823	27,949	30,740	24,271	21,878
PBT	37,783	34,387	32,872	43,312	51,330
Provision for Tax	12,143	9,368	8,274	10,902	12,920
PAT	**25,640**	**25,018**	**24,598**	**32,410**	**38,410**

Balance Sheet

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
SOURCES OF FUNDS					
Share capital	2,269	2,269	2,531	2,531	2,531
Reserves and surplus	1,56,094	1,77,783	2,15,196	2,45,176	2,79,745
Shareholders' funds	1,58,363	1,80,052	2,17,727	2,47,706	2,82,275
Total Borrowings	8,79,144	9,43,718	9,75,602	10,51,513	11,56,883
Other Liabilities, provisions	15,418	17,517	19,269	21,196	23,316
Total	**10,52,925**	**11,41,286**	**12,12,598**	**13,20,415**	**14,62,473**
APPLICATION OF FUNDS					
Advances	9,67,515	10,22,316	10,68,114	11,35,202	12,31,930
Investments	39,991	27,985	30,783	33,862	37,248
Fixed assets	1,475	4,824	4,921	5,019	5,119
Other Assets	43,944	86,161	1,08,779	1,46,332	1,88,176
Total assets	**10,52,925**	**11,41,286**	**12,12,598**	**13,20,415**	**14,62,473**

(Source: Company, HDFC sec Research)

Shriram Transport Finance Company Ltd.

Key Ratios:

	FY19	FY20	FY21E	FY22E	FY23E
VALUATION RATIOS					
EPS	113.0	110.3	97.2	128.1	151.8
Earnings Growth (%)	4.2	-2.4	-1.7	31.8	18.5
BVPS (ex reval.)	697.9	793.6	860.4	978.8	1115.5
Adj. BVPS (ex reval. & 100% cover)	448.7	529.5	596.7	764.9	939.4
RoAA (%)	2.5	2.3	2.1	2.6	2.8
ROAE (%)	17.4	14.8	12.4	13.9	14.5
P/E (x)	12.6	12.9	14.7	11.1	9.4
P/ABV (x)	3.2	2.7	2.4	1.9	1.5
P/PPOP (x)	5.3	5.2	5.7	5.3	4.9
Dividend Yield (%)	0.8	0.4	0.5	0.7	1.1
PROFITABILITY					
Yield on Advances (%)	15.4	15.2	15.3	15.4	15.5
Cost of Funds (%)	8.8	9.1	9.1	8.8	8.7
Core Spread (%)	6.5	6.1	6.2	6.6	6.8
NIM (%)	7.8	7.5	7.4	7.6	7.7
OPERATING EFFICIENCY					
Cost/Avg. Asset Ratio (%)	1.9	1.9	1.8	1.8	1.8
Cost-Income Ratio (%)	23.4	25.0	25.0	25.4	25.5

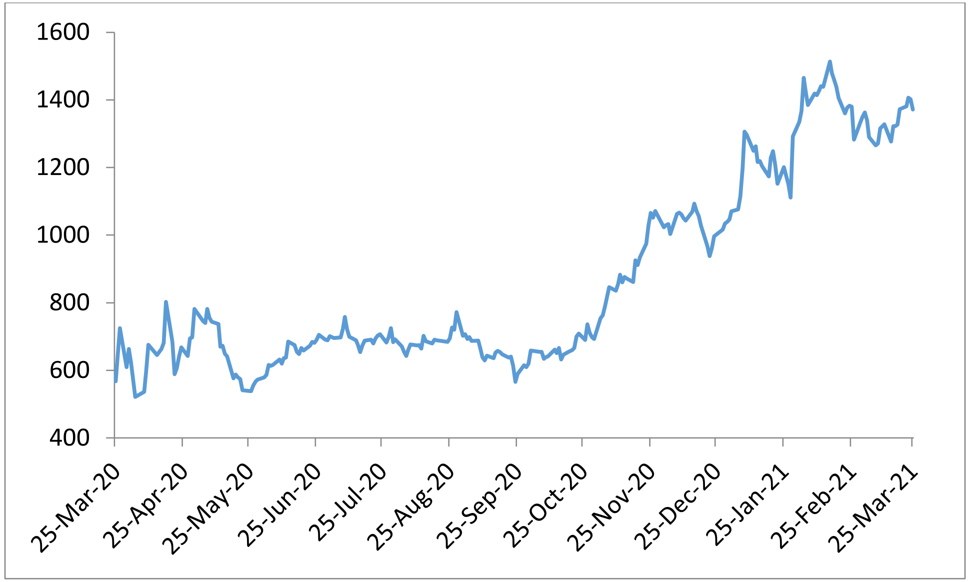
(Source: Company, HDFC sec Research)

Key Ratios:

	FY19	FY20	FY21E	FY22E	FY23E
BALANCE SHEET STRUCTURE RATIOS					
AUM Growth (%)	9.6	5.0	1.4	6.3	8.5
Borrowing Growth (%)	6.2	7.3	3.4	7.8	10.0
Equity/Assets (%)	15.0	15.8	18.0	18.8	19.3
Equity/Loans (%)	16.4	17.6	20.4	21.8	22.9
Total Capital Adequacy Ratio (CAR)	20.3	22.0	21.8	21.3	21.5
Tier I CAR	15.6	18.1	18.0	17.9	18.4
ASSET QUALITY					
Gross NPLs (Rsm)	86,223	91,797	1,14,116	1,08,858	1,10,618
Net NPLs (Rsm)	56,553	59,911	66,721	54,132	44,557
Gross NPLs (%)	8.4	8.4	10.3	9.2	8.6
Net NPLs (%)	5.7	5.6	6.0	4.6	3.5
Coverage Ratio (%)	34.4	34.7	41.5	50.3	59.7
Provision/Avg. AUM (%)	2.4	2.6	2.8	2.1	1.8

Shriram Transport Finance Company Ltd.

One Year Price Chart



Disclosure:

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