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DEMOCRATIZING WEALTH CREATION

VALUE PICK

CHASING VALUE, NOT PRICES

April 2019

Company Name	:	**INDOSTAR CAPITAL FINANCE**
BSE Code	:	**541336**
Time Duration	:	**1 year**
CMP	:	**₹404.15 (as on 10 Apr., 2019)**
Target Price	:	**₹490**

The Value Pick for the month of April is Indostar Capital Finance, a non-deposit accepting NBFC. It is engaged mainly in wholesale lending, with products ranging from corporate finance, developer financing, working capital financing, acquisition financing and loan against shares. In addition, the company has also forayed into commercial vehicle financing, SME financing and housing finance segment. In Q3FY19, 66.3 per cent of the company's NII was from corporate lending, while SME lending and vehicle finance contributed nearly 16.8 per cent and 12 per cent, respectively. The rest was from housing finance. The company is sponsored by a group of financial institutions including Everstone Capital, Goldman Sachs Group, Baer Capital Partners and ACPI Investment Managers.

Acquisition of IIFL's CV finance to boost retail mix

The company has completed the acquisition of IIFL's vehicle finance portfolio which has a total AUM of Rs. 3,949 crore along with 1,089 employees employed in 161 branches. Indostar has been establishing its presence in the retail lending business which accelerated last year with the set-up of CV finance and Affordable Housing finance businesses. This acquisition would help Indostar which has a dominating position in the south to expand its presence in the West, North and central India where IIFL has a strong presence. This acquisition would boost the customer base to 75,000 from 15,902. The company said that the transaction is structured in a manner that it would not expect credit losses to hit them. However, the company's management indicated that capital adequacy would dip post this acquisition, but would still remain high at around 25 per cent. Remarkably, the management is confident of achieving over 75 per cent retail mix by FY20E itself as against the earlier target of FY22E.

Efficient, prudent and conservative management

In the recent quarters, the company's disbursement remained weak and indicating the same the company's management in its third quarter's concall said that they have deliberately chosen a strategy of being conservative because of the liquidity issue in the market. The company's management would like to be conservative and doesn't want to lend aggressively as there is uncertainty in the market. During such uncertain market conditions, the company has maintained a healthy cash & cash equivalents of Rs. 2,190.9 crore which is around 35 per cent of its borrowings. With this, we can say that along with growth, the management also focuses on profitability and quality. Further, unlike other NBFCs, the company's leverage ratio stands lower at 3.1x on Q3FY19 which gives further legroom to grow further. Besides, the management is prudent while lending. As on December ended quarter, the real estate sector contributed around 56 per cent of its total AUM, despite this high exposure to the risky sector, the company has kept its GNPAs at a comfortable level of 0.9 per cent. The company has roped in industry veterans like R Sridhar as a CEO who is ex-MD & CEO of Shriram Transport Finance Company and S Shirali, MD, Head- Corp (ex-Capital First and Rabobank).

Scaling up retail business

The company started its operations mainly with corporate lending and later in the fiscal year 2014-15 it expanded its footprint to SME finance, housing finance and vehicle finance in FY17. Also, the company's recent acquisition of IIFL's vehicle finance business would give a big boost to Indostar to scale up its retail business. Indostar's SME business has turned profitable at the beginning of the year and that has continued. Further, the vehicle finance business is just about 6 crores negative at a PBT level and the company is confident to turn it to profitable in the first quarter of FY20. The rising share of retail loans would help Indostar diversify its risk with lower exposure to risky loans. The company's early focus on corporate lending required it to maintain a sufficient amount of capital, thus, the company's focus toward retail business would result in a lower requirement to maintain higher capital buffers. Going forward, tilt towards retail division would drive the growth engine of Indostar as seen in the recent quarters (67 per cent retail disbursement in Q3FY19 as against 23 per cent in Q3FY18).

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Financial performance

Net interest income for Q3FY19 improved to Rs. 173.7 crore from Rs. 114.6 crore in Q3FY18, representing 52 per cent growth. Net interest income for the quarter was at 7.7 per cent as against 8.3 per cent in Q3FY18. Remarkably, the company has been consistently improving its cost-to-income ratio, for Q3FY19 it was 33.4 per cent as against 38.2 per cent in Q3FY18. In terms of asset quality, over the last few quarters, the company has reduced its GNPA and NNPA from 1.7 per cent and 1.4 per cent in Q3FY18 to 0.9 per cent and 0.6 per cent in Q3FY19, respectively. Notably, the capital adequacy ratio in the quarter was at a comfortable level of 30.8 per cent, but going forward, with the acquisition of IIFL CV finance the company indicates that this ratio may come down to 25 per cent. In terms of loan disbursement, the company adopted a conservative approach amid a liquidity crunch in the market. The loan disbursement in the third quarter of FY19 dipped to Rs. 854 crore from Rs. 1,469.4 crore in the corresponding quarter of the previous year. Besides, AUM for the quarter jumped to nearly Rs. 7,748.2 crore from Rs. 5,043.5 crore in the corresponding quarter of the previous year. The consolidated net profit in Q3FY19 jumped to Rs. 71.3 crore from Rs. 39.4 crore in the corresponding quarter of the previous year.

Valuation

The company has been improving its return ratio from the last few quarters. Its ROA in the quarter improved to 3.2 per cent from 2.9 per cent in the corresponding quarter of the previous year. RoE too improved to 9.8 per cent from 7.9 per cent in Q3FY18. Even though the company's return ratios are at a comfortable level, the company is available at an attractive valuation of 1.3x Price-to-Book value on TTM basis. Strong liquidity position, scaling up of the retail division, higher ROA coupled with prudent management provides us with confidence to invest in Indostar Capital Finance. We believe the stock has the potential to touch the mark of Rs. 490 apiece, representing an expected return of almost 21 per cent.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	818.54	714.93	641.32	528.05	394.56
Total Income	831.18	715.54	641.38	528.06	402.90
Total Expenditure	141.38	81.39	59.31	43.17	40.77
PBIDT	689.80	634.15	582.07	484.88	362.13
PAT	235.58	209.04	191.02	149.06	112.14
Dividend %					
Adj. EPS(Rs)	29.94	26.68	26.04	21.80	16.41

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201812	201809	Q on Q Var%	201712	Y on Y Var%
Net Sales	311.92	313.47	-0.49	181.55	71.81
Total Expenditure	47.45	64.33	-26.24	41.34	14.78
PBIDT (Excl OI)	264.47	249.14	6.15	140.21	88.62
PAT	75.49	70.89	6.49	42.69	76.83
PBIDTM% (Excl OI)	84.79	79.48	6.68	77.23	9.79
PBIDTM%	84.79	79.48	6.68	77.23	9.79
PATM%	24.20	22.61	7.03	23.51	2.93
Adj. EPS(Rs)	8.18	7.64	7.07	5.43	50.64