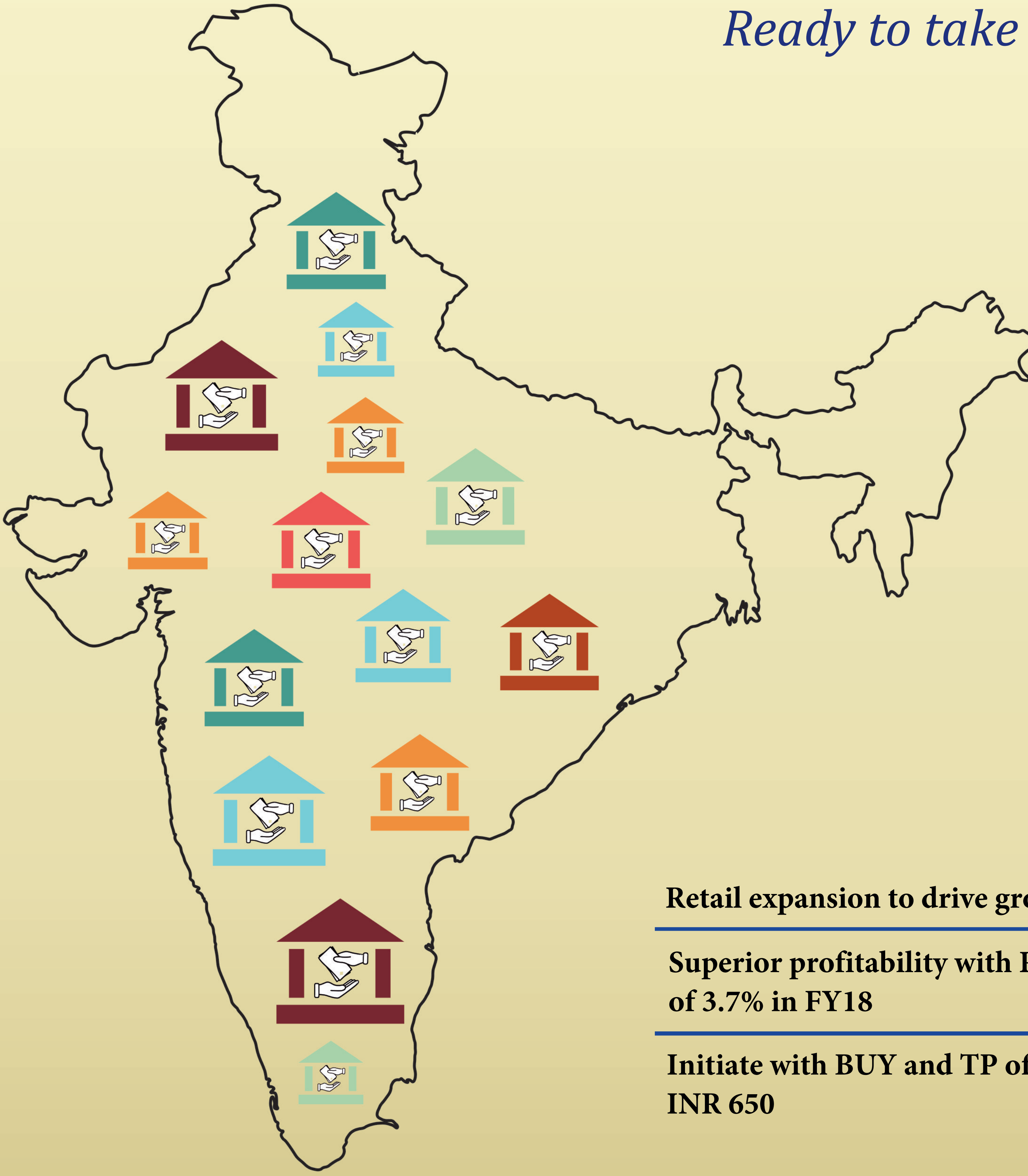
Indostar Capital Finance

Ready to take off



Retail expansion to drive growth

Superior profitability with RoA of 3.7% in FY18

Initiate with BUY and TP of INR 650

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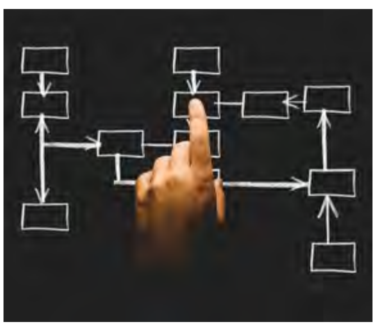
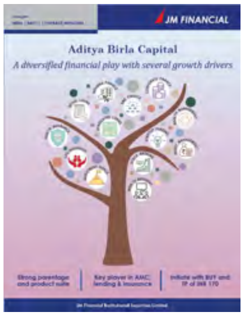


Indostar has demonstrated strong execution capabilities (25% CAGR in loans over FY14-18) by initially building its corporate book (c.74%) and subsequently entering SME financing (c.23% as of FY18). Over the past year, Indostar has focused on balancing its loan book by diversifying to retail-focused segments such as vehicle and housing finance. Incremental growth is expected to be higher than previous years, driven mainly by CV and corporate financing. The strength of Indostar's franchise is exhibited by superior profitability despite the rapid ramp-up in the number of branches.

RECENT INITIATIONS



ADITYA BIRLA CAPITAL

BANDHAN BANK

MAGMA FINCORP

RELIANCE NIPPON LIFE ASSET MANAGEMENT

MID-SIZED PRIVATE BANKS

Indostar Capital Finance

Ready to take off

Indostar Capital Finance (Indostar) is an NBFC promoted by Mauritius-based Indostar Capital (a holding company with a 57.7% stake in Indostar and owned by various institutions, including the Everstone Group, which has a 51.2% stake in Indostar Capital). It commenced operations in 2011. In Apr'17, Mr. Sridhar (ex-CEO of Shriram Transport) was appointed Indostar's CEO to lead its foray into vehicle and housing finance. The company has demonstrated strong execution capabilities (loan book posted a 25% CAGR over FY14-18) by initially building the corporate book (c.74% of loans as of FY18) and subsequently entering SME financing and effectively executing its strategy in the segment (c.23% of loans as of FY18). Over the past year, the company has tried to balance its loan book by diversifying its exposure into retail segments such as vehicle and housing finance.

We forecast a net profit CAGR of 25% over FY18-20E, led by strong loan growth (50%CAGR over FY18-20E) and steady asset quality. We forecasts RoA/RoE of 3.1%/11.2% by FY20E (vs. 3.7%/11.7% in FY17). Indostar trades at 1.3x BV FY20E, which is the cheapest among NBFCs in our coverage. We initiate coverage with a BUY rating and a Mar'19 target price ofINR 650, valuing the stock at 1.7x Mar'20 PB (implied FY20 P/Eof 16x).

Key risks: a) Pressure on Indostar's average yields and spreads due to increased competition; b) execution risks; c) liquidity risks and d) high real estate exposure (c.40% of loan book).

CEO, Mr. Sridhar (ex-CEO of Shriram Transport) to lead Indostar's foray into vehicle finance: Mr. Sridhar was appointed CEO in Apr'17. His expertise in scaling up the commercial vehicle (CV) financing business in Shriram Transport Finance (SHTF) should help Indostar grow its vehicle financing business. Indostar is focusing on 15 key states to lend to small and medium fleet operators primarily focusing on 3-5 year-old used CVs. In affordable housing, it would target the self-employed segment in tier I, II and III cities. In SMEs, it operates across 10 key cities lending to customers with turnovers of c.INR 100mn. The company's attractive remuneration structure (ESOPs outstanding were 10.5% of diluted shares as of Mar'18) drives its entrepreneurial spirit and promotes strong alignment of employee interests with the company's performance.

Focus on secured business lines in India's fast-growing middle-class segment: Indostar's loan book posted a 25% CAGR over FY14-18 (stood at INR 62bn in Mar'18), on SME expansion while largely focusing on secured assets (c.90%). Over the past two years, the company has tried to balance its loan book by moving its exposure away from corporate lending (74% of loan as of FY18) to SME (23%). We expect 50% AUM CAGR over FY18–20E on i) expansion into new markets and ii) higher contribution from the vehicle/housing segments.

Increasing retailization to lead to profitable growth: With retail expansion, geographic penetration and a comfortable tier-I of 28% (c.35% after the recent capital raise of INR 7bn), Indostar has enough headroom to grow at 40-50% over the next 2-3 years. It is planning to expand its branch network from 91 in Mar'18 to 130 by Jun'18. Going ahead, the company plans to add branches in a calibrated manner as existing branches turn profitable. With increasing retailization, we forecast earnings growth of 25%CAGR over FY18-20E.

Recommendation and Price Target	
Current Reco.	BUY
Previous Reco.	
Current Price Target (12M)	650
Upside/(Downside)	28.2%
Previous Price Target Change	NA

Key Data – INDOSTAR IN	
Current Market Price	INR507
Market cap (bn)	INR46.2/US$0.7
Free Float	25%
Shares in issue (mn)	90.9
Diluted share (mn)	
3-mon avg daily val (mn)	INR0.0/US$0.0
52-week range	608/500
Sensex/Nifty	35,217/10,671
INR/US$	68.6

Price Performance			
%	1M	6M	12M
Absolute	-13.8	0.0	0.0
Relative*	-14.5	0.0	0.0

* To the BSE Sensex

Financial Summary					(INR mn)
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Profit	1,916	2,108	2,356	2,906	3,696
Net Profit (YoY) (%)	28.6%	10.0%	11.8%	23.3%	27.2%
Assets (YoY) (%)	17.6%	16.9%	32.9%	37.4%	37.5%
ROA (%)	4.4%	4.1%	3.7%	3.4%	3.1%
ROE (%)	13.6%	12.2%	11.7%	11.0%	11.2%
EPS	26.1	26.9	29.9	32.0	40.6
EPS (YoY) (%)	19.8%	3.0%	11.3%	6.7%	27.2%
P/E (x)	19.9	19.4	17.4	16.3	12.8
BV	210	243	272	344	385
BV (YoY) (%)	11.8%	15.5%	11.9%	26.7%	11.8%
P/BV (x)	2.48	2.15	1.92	1.51	1.35

Source: Company data, JM Financial. Note: Valuations as of 27/Jun/2018

JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet. You can also access our portal: www.jmflresearch.com. Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

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Key financials

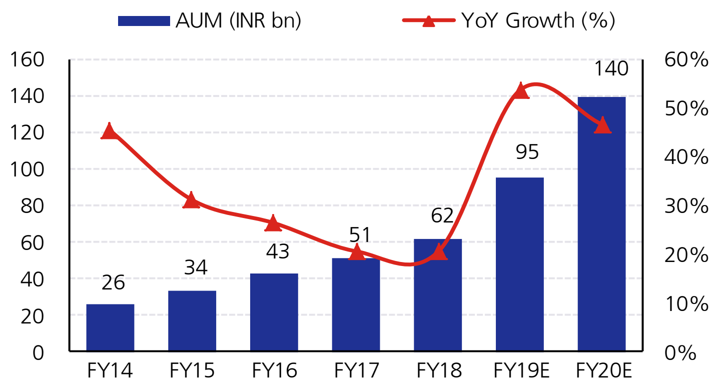
Exhibit 1. Indostar: Key financials

Key Financials	FY15	FY16	FY17	FY18	FY19E	FY20E	CAGR (15-18)	CAGR (18-20E)
NII (INR mn)	2,074	2,748	3,317	3,787	5,602	8,020	22.2%	45.5%
NII (YoY%)	24%	32%	21%	14%	48%	43%		
Net profit (INR mn)	1,490	1,916	2,108	2,356	2,906	3,696	16.5%	25.2%
Net profit (YoY%)	33%	29%	10%	12%	23%	27%		
AUM (INR mn)	34,292	42,651	51,475	62,073	95,447	1,39,949	21.9%	50.2%
AUM (YoY%)	33%	24%	21%	21%	54%	47%		
NIM (%)	5.9%	6.4%	6.6%	6.0%	6.6%	6.9%	0.1%	0.8%
Asset quality	180DPD	150DPD	120DPD	90DPD	90DPD	90DPD		
Gross NPL (%)	0.60%	0.23%	1.41%	1.30%	1.48%	2.05%	0.7%	0.8%
Net NPL (%)	0.52%	0.19%	1.20%	1.10%	1.11%	1.35%	0.6%	0.2%
Coverage (%)	13.2%	20.0%	14.8%	15.7%	25.0%	35.0%	2.5%	19.3%
Profitability								
ROA (%)	4.2%	4.4%	4.1%	3.7%	3.4%	3.1%	-0.5%	-0.6%
Leverage (x)	2.95	3.07	2.96	3.16	3.29	3.60		
ROE (%)	12.3%	13.6%	12.2%	11.7%	11.0%	11.2%	-0.7%	-0.5%
Capital Adequacy								
Tier 1 (%)	32.3%	33.8%	33.4%	27.9%	31.4%	25.6%	-4.4%	-2.3%
CAR (%)	32.6%	34.2%	33.8%	28.3%	31.8%	25.9%	-4.3%	-2.4%

Source: Company, JM Financial

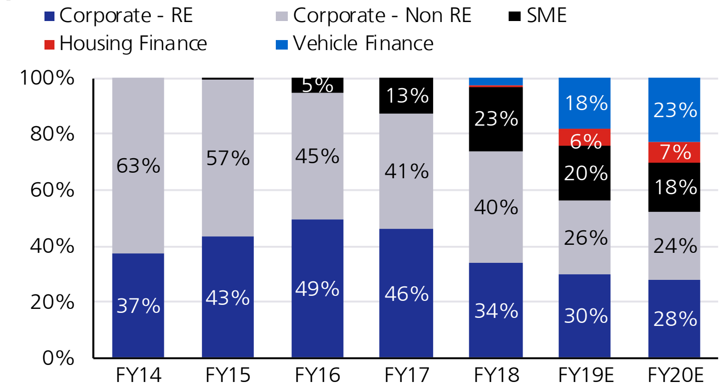
Key Charts

Exhibit 2. Loan book – Expect 50% CAGR over FY18-20E



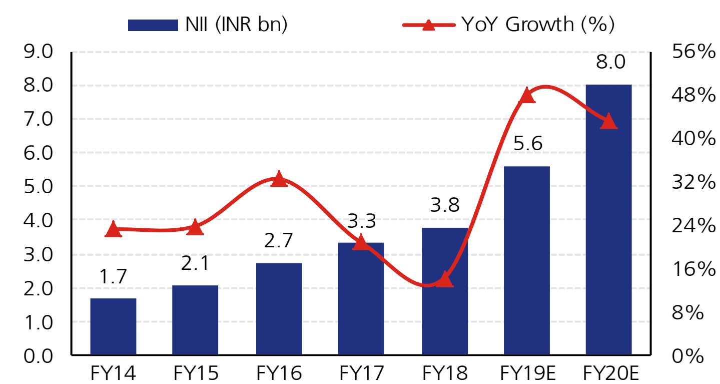
Source: Company, JMFL

Exhibit 3. Loan mix – Focus on retail going forward



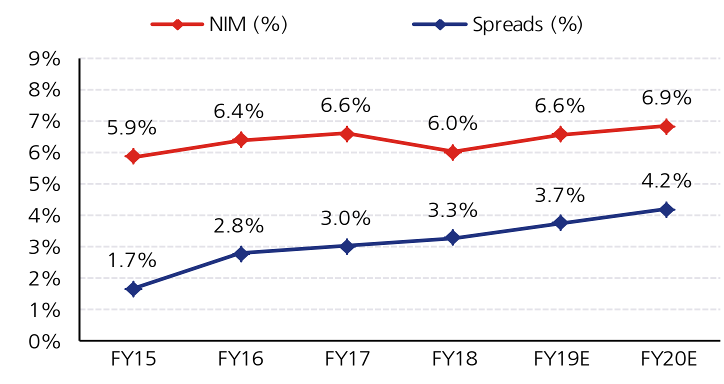
Source: Company, JMFL

Exhibit 4. NII – Expect 46% CAGR over FY18-20E



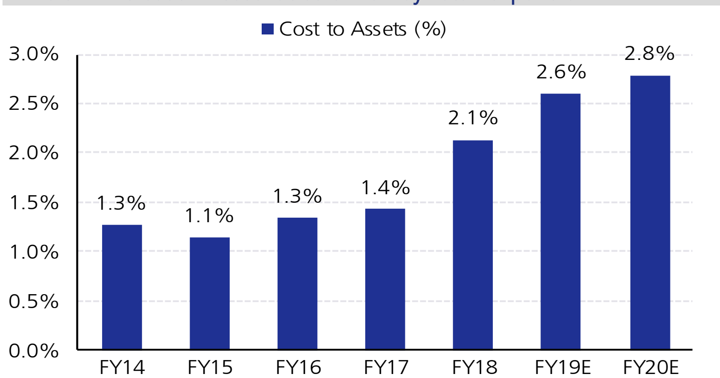
Source: Company, JMFL

Exhibit 5. Expect margins to improve by c.80bps over FY18-20E



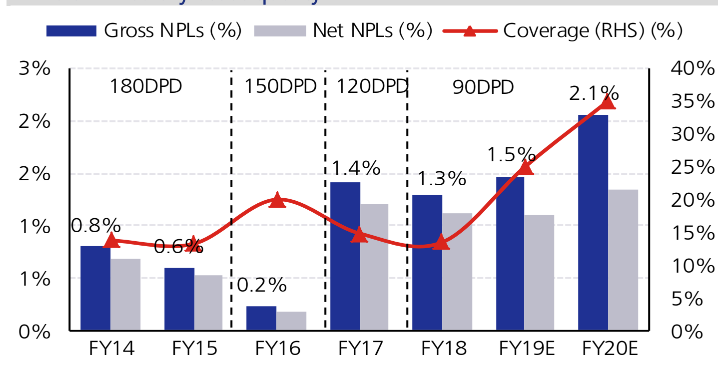
Source: Company, JMFL

Exhibit 6. Increase in cost ratios driven by retail expansion



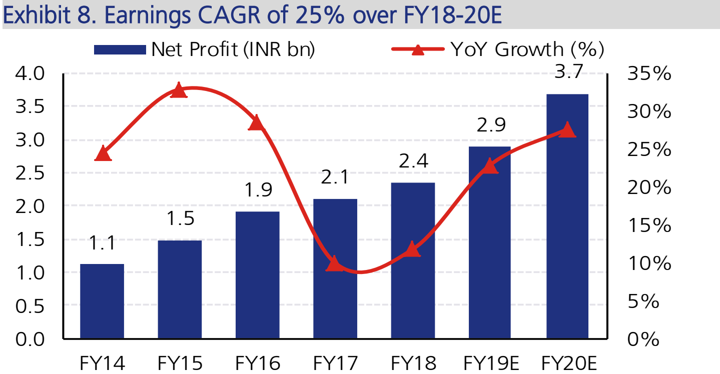
Source: Company, JMFL

Exhibit 7. Healthy asset quality



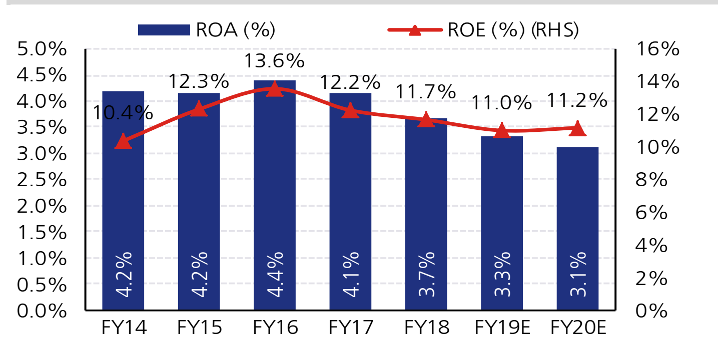
Source: Company, JMFL

Exhibit 8. Earnings CAGR of 25% over FY18-20E



Source: Company, JMFL

Exhibit 9. Trend in return ratios



Source: Company, JMFL

Indostar Capital Finance: Retail expansion to drive growth

- Indostar Capital Finance (Indostar) is promoted by Mauritius-based Indostar Capital (a holding company with a 57.71% stake in Indostar) and owned by various institutions, including the Everstone Group, which has a 51.24% stake in Indostar Capital, Mauritius. It commenced operations in 2011 through corporate lending, providing structured term financing in both real estate and non-real estate segments. Indostar has demonstrated strong execution capabilities by initially building its corporate book (~74% of loans as of FY18) and subsequently entering SME financing and successfully executing its strategy in the segment (~23% of loans as of FY18). Over the past year, Indostar has focused on balancing its loan book by diversifying its exposure away from corporate/SME lending to retail-focused segments such as vehicle and housing finance. It has largely focused on secured assets (c.90% as of Mar'18) while targeting the fast-growing self-employed middle-class segment in 15 key states in India. Given the rising competition in the wholesale lending market from AAA-rated lenders, especially in the developer space, we believe diversification should help Indostar boost growth.

  In Apr'17, Mr. Sridhar (ex-CEO of Shriram Transport) was appointed CEO to lead its foray into vehicle and housing finance. The company has identified and is working on key areas to drive its retail expansion plans going forward:

  i) **Focus on newer used CVs and affordable home finance:** Indostar entered the vehicles finance segment in Nov'17, providing financing for the purchase of used or new CVs, passenger vehicles and two-wheelers. Management has indicated that vehicle finance would be one of the major contributors to growth going ahead with major focus the financing of on 3-5 year-old used CVs for small and medium fleet operators. Within housing finance, the company is focusing on affordable homes and targeting the fast-growing self-employed middle-class segment in 15 key states in India.

Retail expansion - key focus areas:

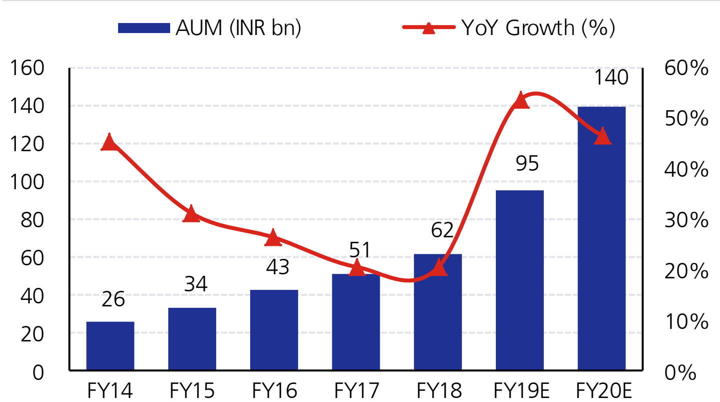
i) To offer vehicle, SME and housing loans from 130 branches by June'18

ii) Corporate lending and vehicle finance to be the primary growth engines. Housing finance and SME lending to also aid growth.

iii) CEO, Mr. Sridhar, to lead Indostar's foray into vehicle finance

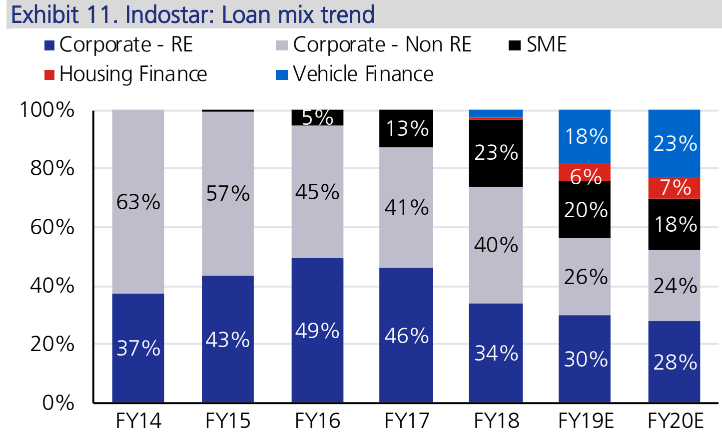
iv) Experienced management team incentivised via ESOPs (10.5% of diluted shares)

Exhibit 10. Indostar: Trends in loan book – 24% CAGR over FY14-18



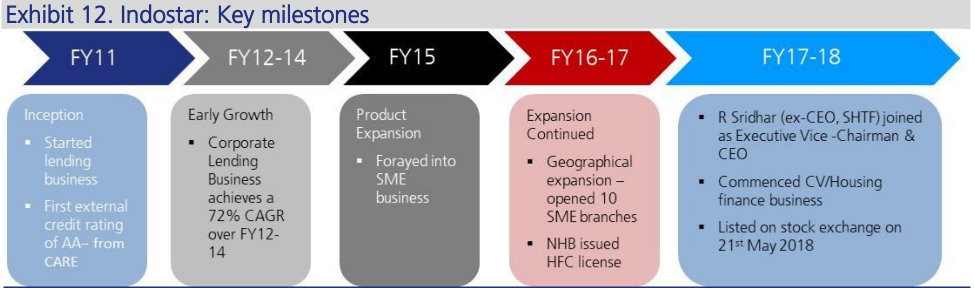
Source: Company, JMFL

Exhibit 11. Indostar: Loan mix trend



Source: Company, JMFL

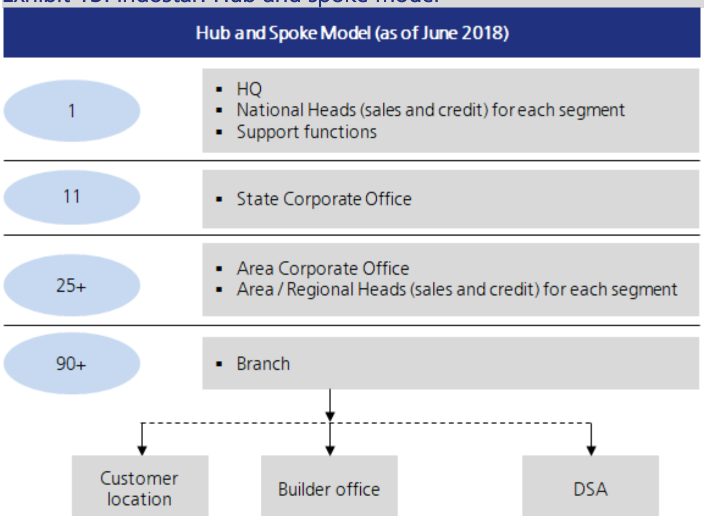
Exhibit 12. Indostar: Key milestones



Source: Company, JMFL

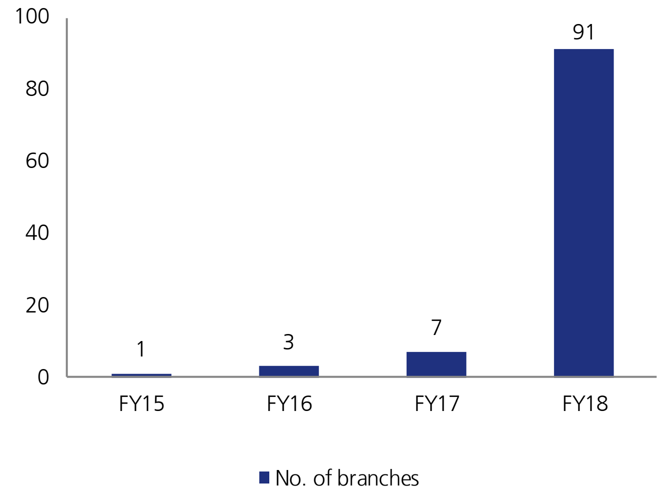
ii) **Selectively expanding its business operations in 15 key states:** Indostar has expanded its presence across 91 branches in 15 key states across India (as of Mar'18); 75 are engaged in vehicle finance, 31 in housing finance (of this 6 are exclusive housing finance branches) and 10 in SME lending as well as the housing finance business. It is planning to expand to 130 branches by Jun'18. Going forward, the company plans to add branches in a calibrated manner as existing branches turn profitable.

Exhibit 13. Indostar: Hub and spoke model



Source: Company

Exhibit 14. Indostar: Number of operational branches



Source: Company

iii) **Experienced management team incentivised via ESOPs:** Indostar has a highly professional and experienced management team, which has led the company through an ever-changing regulatory and economic environment and consistently grown the business. For its retail business, Indostar has hired highly experienced people both at the top management and at the branch level from various companies including Shriram Transport, Cholamandalam and Equitas Small Finance Bank. Many of Indostar's Directors and key management personnel own sizeable shares of the company. The senior and mid-level management team has been incentivised through ESOPs (ESOPs outstanding are 10.5% of diluted shares as of Mar'18), thereby enabling a strong alignment of their interests in line with the company's performance.

Strong alignment through ESOP program (10.5% of diluted shares)

iv) **CEO, Mr. Sridhar (ex-CEO of Shriram Transport) to lead Indostar's foray into vehicle finance:**

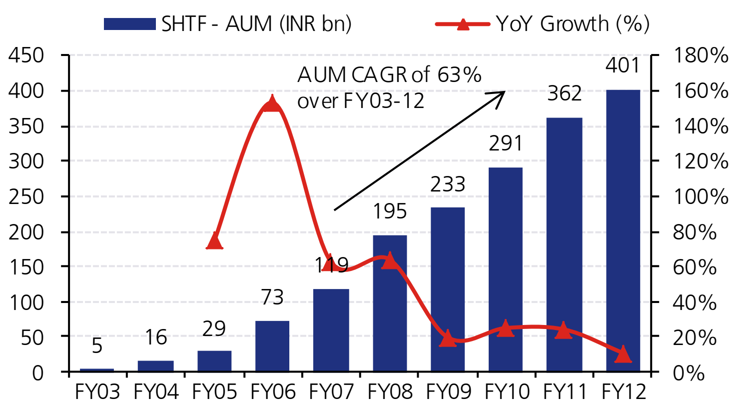
In Apr'17, Mr. Sridhar (ex-CEO of Shriram Transport) was appointed CEO to lead Indostar's foray into vehicle and housing finance. He has three decades of experience in the financial services industry. He was previously associated with various entities forming a part of the Shriram Group, and held the position of MD of Shriram Transport over 2000-12. Prior to that, he was the President of the company over 1994-2000. Under his leadership, SHTF's loan book posted a CAGR of 63%, PAT grew 55% and RoE remained above 20% over FY03-12. Additionally, securitisation was the key focus area for the company given that its off-BS book comprised more than 23% of overall AUM.

We believe his expertise in scaling up SHTF's CV financing business should help Indostar grow its vehicle financing business. However, the competitive landscape would not be the same given: i) **increasing competitive intensity** - SHTF was the only organised financier in the used CV space during 2001-10; however, competition has intensified with many NBFCs and small finance banks entering this space. **ii) A change in regulations** w.r.t securitisation and NPL recognition. **iii) A different customer profile** - SHTF primarily focuses on first-time buyers vs. Indostar, which focuses on small fleet operators.

Mr. R. Sridhar profile

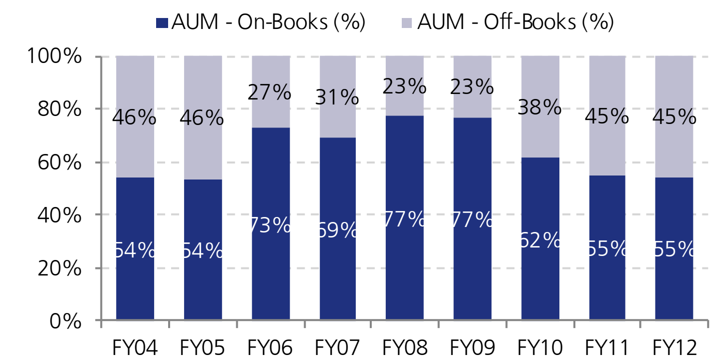
Mr. R. Sridhar has been associated with the company since Apr'17. Mr. Sridhar has over three decades of experience in the financial services industry and had been associated with the Shriram Group since 1985 and held the position of Managing Director & CEO of Shriram Transport Finance Company Limited for over a decade since 2000.

Exhibit 15. SHTF: AUM CAGR of 63%over FY03-12



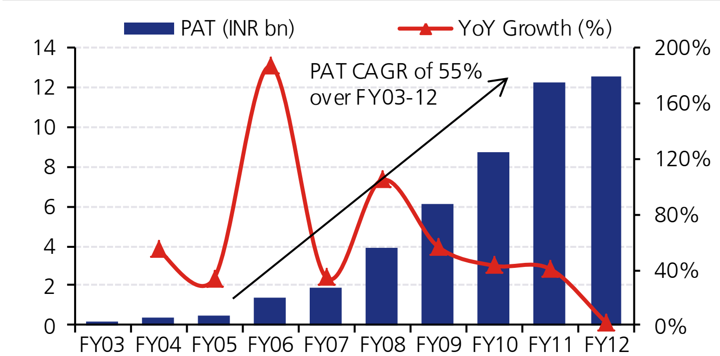
Source: Company

Exhibit 16. SHTF: Securitisation formed more than 23% of overall AUM during FY04-12



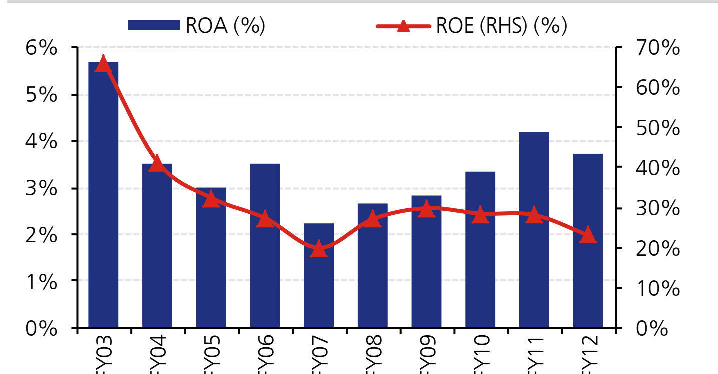
Source: Company

Exhibit 17. SHTF: PAT CAGR of 55% over FY03-12



Source: Company

Exhibit 18. SHTF: RoE remained above 20% over FY00-12



Source: Company

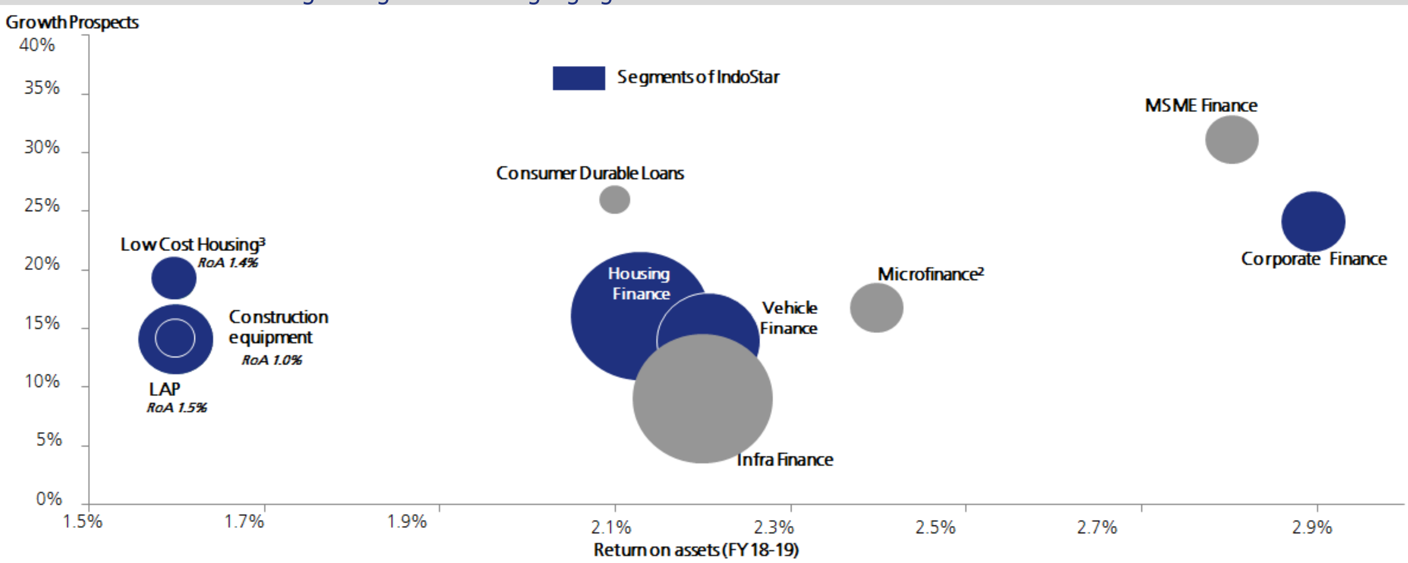
Product offering: High share of corporate and SME lending; focus on retail going forward

Indostar has four business verticals – i) Corporate Lending (started in FY11) ii) SME (started in FY15) iii) Vehicle Financing (started in Nov'17) and iv) Housing Finance (started in Sep'17).

During its early growth phase (FY12-15), Indostar achieved 58% CAGR over FY12-15 and RoAs in excess of 4% benefiting from lower competition in the developer funding segment. The second phase of growth (FY15-17) came from the SME financing business (started in FY15) when Indostar posted a 23% CAGR over FY15-17 while maintaining RoAs of above 4%. However, the book was still skewed towards corporate (87% as of FY17). Over the past 2 years, the corporate book has slowed down (7% CAGR over FY16-18) due to i) a slowdown in real estate, ii) increased competition from large AAA-rated players in developer funding and iii) a strong capital market leading to higher repayments in the non-real estate segment.

Consequently, over the past year, the company has tried to balance its loan book and diversify its customer base by shifting away from corporate lending to retail/SME. In Nov'17, Indostar ventured into retail segments such as vehicle and housing finance to drive growth going forward. It has largely focused on secured assets (90% as of FY18) while targeting the fast-growing self-employed middle-class segment in 15 key states in India. As of FY18, its loan book comprised corporate lending (74% of total portfolio), SME (23%) and vehicle finance (2%) while housing accounted for less than 1%.

Exhibit 19. Indostar – Focusing on segments offering high growth and returns



Source: CRISIL

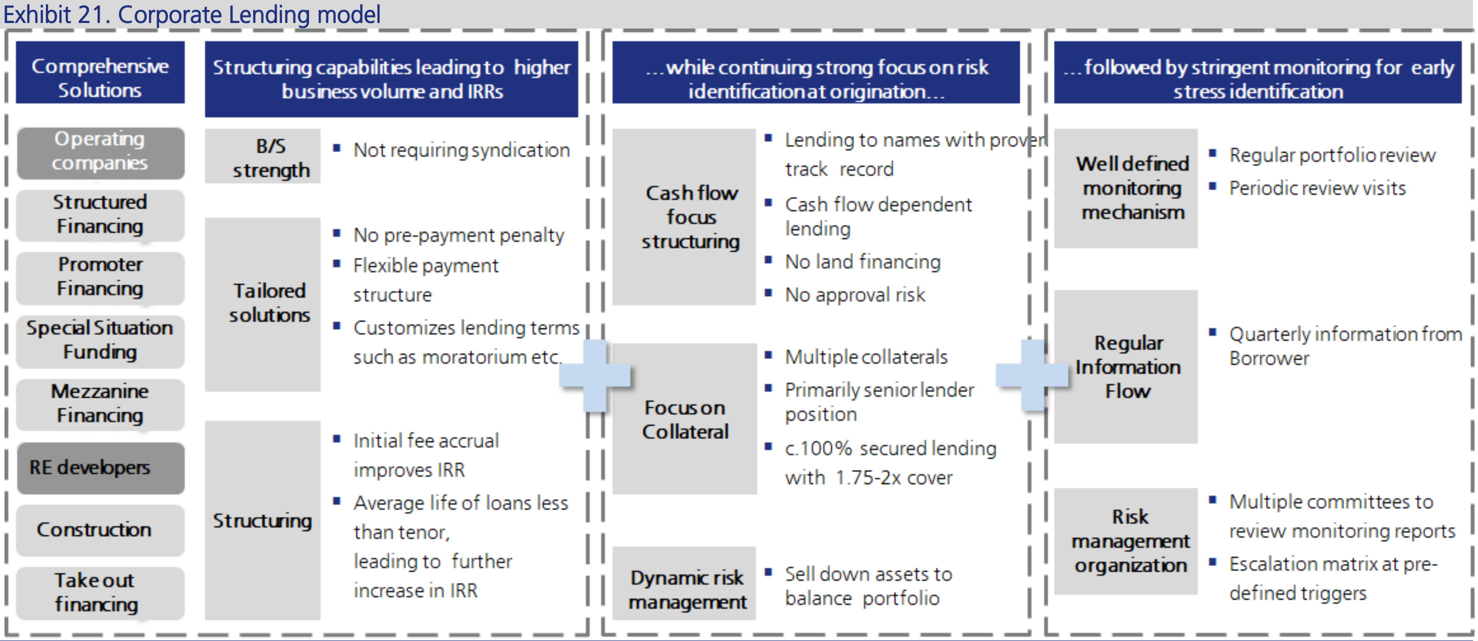
1. Size of the bubble denotes the relative asset size of the segment. 2. Microfinance excludes Andhra Pradesh portfolio for profitability calculations; 3. Low-cost housing is a subset of housing finance.

Exhibit 20. Product portfolio

	Products	Indicative Terms	Portfolio as of Mar'18	Key Features	Yields	Target Customer Base
Corporate Lending - Real estate	Structured loans Project loans	Sourcing: In-house ATS: INR 1-1.5bn Tenor: 3-5yrs	33.8%	Loans for construction of commercial and residential properties	14.0-14.6%	Mid-sized real estate developers
Corporate Lending - Non real estate	Secured lending	Sourcing: In-house ATS: INR 750mn Tenor: 3-5yrs	40.1%	Structured lending to finance strategic objectives and growth plans		Mid-to-large sized corporates
	Capital Market Financing			Offers loans to promoters against listed securities, select unlisted securities and/or other tangible collaterals. The tenor of these loans ranges from one to three years.		
	Special Situation and Acquisition Financing			Offers acquisition funding, promoter funding for equity buy back/take outs, family settlements and asset financing		
	Debt Capital Market			Co-invests alongside reputed Institutional Investors and Private Wealth Investors in various transactions		
SME Financing	Vanilla loans Gross turnover loans Debt consolidator loans Mortgage and top-up loans Loans for purchases of commercial property Banking profile based loans	Sourcing: DSAs LTV: c.65% ATS: INR 30mn Tenor: 10-15yrs/ Working capital	23.1%	**Strategy:** - 50% of SME loans qualify for PSL - Collateral: Secured, typically against residential or commercial property - Customized solutions - 100% loans are i) secured 2) floating 3) monthly interest servicing **Focus areas:** - Refinances mortgages with top-up loans - Loans to purchase commercial property for self-occupation or lease - Offer loans to customers with healthy financial positions **Branches:** 10 **Employees:** 65 **Customers:** 1079	10.4-11.5%	Traders, wholesalers, distributors, retailers, self-employed professionals and small manufacturing companies with turnover of approx. INR 100 million and over 3 years' experience in the profession
Housing Finance	Housing	ATS: INR 3.0mn	0.8%	**Strategy:** - Hired experienced personnel - Leverage relationships with real estate developer customers - Consider developer finance opportunities in select locations - Leverage VF branch network **Focus areas:** - Self-employed individuals in outskirts of urban markets, Tier II cities **Branches:** 31 (of which 7 branches are exclusive home loans branches) **Employees:** 341 **Customers:** 437	9-10.5%	Salaried and documented self-employed like professions
	Affordable Housing				12.5-13%	non-documented self-employed segment
Vehicle Finance	Used or new commercial vehicles	Sourcing: In-house (80%); DSA (20%) ATS: INR 0.3-0.4mn	2.1%	**Strategy:** - Hired experienced personnel - Sourcing through field offices - Leverage SFOs, MFOs and LCV & MCV owners, dealerships - Headquartered in Chennai; initial roll out from Tamil Nadu - Increase ground presence to 15 key states **Focus areas:** - Used CV (5 - 12 years) - Finance purchase of used/new LCVs and HCVs, new utility vehicles, two-wheelers **Branches:** 75 **Employees:** 604 **Customers:** 1876	15-16%	LCVs: medium & small fleet operators HCVs: transport operators & small businesses
	Passenger vehicles					
	Two wheelers					Salaried professionals and self-employed non-professionals

Source: Company

Exhibit 21. Corporate Lending model



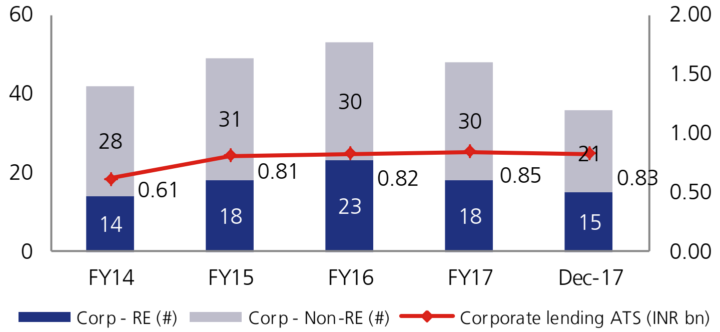
Source: Company

- Corporate Finance – Healthy growth continues: In corporate lending, Indostar provides secured loans to manufacturing and service companies by way of structured financing, promoter financing and special situation funding to leading real estate developers for financing project level construction of residential properties and take-outs of early stage equity investors. Indostar scaled up its corporate book to INR 46bn at end-FY18 (4-year CAGR of 15% over FY14-18) in merely seven years. The success of its corporate lending segment is driven by the company's focus on i) offering customised solutions; ii) direct sourcing of customers; iii) ability to structure loan products to maximise returns, where initial fee accruals and average life of loans being less than the tenor of the loans have allowed the company to enjoy relatively higher internal rates of returns; iv) its balance sheet strength, which enables it to take the lead position in underwriting larger ticket loans for corporates instead of participating in syndicated loans originated by other lenders and have first charge on collateral; and v) lending to customers with a proven track record and strong cash flows while obtaining sufficient collateral. As of Dec'17, the company's highest total credit exposure was in real estate (42%) followed by financial services (10.8%), poultry products (7%), digital cable (4%) and mining (2%). Its corporate lending business comprises two segments:

  (i) Real estate financing: Its real estate financing business is primarily focused on project financing for residential projects to mid-sized developers (with ticket sizes of INR 3-4bn) that have received key regulatory approvals. It offers promoter funding for equity buy-backs and take-outs, mezzanine lending, structured debt and construction finance where disbursements are linked to the sales target milestones for the project. Most of its financed projects are concentrated around the Mumbai Metropolitan Region (MMR) (93.9% of real estate loans as of Dec'17 were disbursed in the MMR); however the company is planning to diversify its exposure outside the MMR.

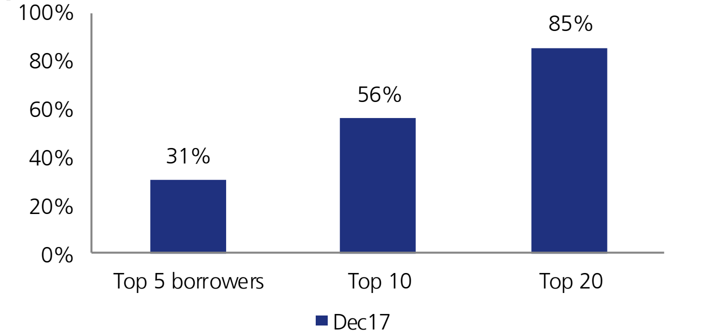
  (ii) Other corporate financing: This includes financing to mid-to-large sized corporate enterprises in the form of i) structured financing, for acquisition funding, family settlements and other asset financings; ii) promoter financing for equity buy-backs and take-outs and iii) special situation funding and mezzanine financing against listed securities, select unlisted securities, operating cash flows and/or other tangible collateral. Collateral is in the form of fixed assets, corporate guarantees, share pledge, escrows on existing and future revenues or a combination of one of these securities. As a prudent measure, Indostar does not provide last-mile funding and funding for greenfield projects.

Exhibit 22. Indostar: Corporate clients and ticket size



Source: Company

Exhibit 23. Loan book concentration (% of corporate book O/S)



Source: Company

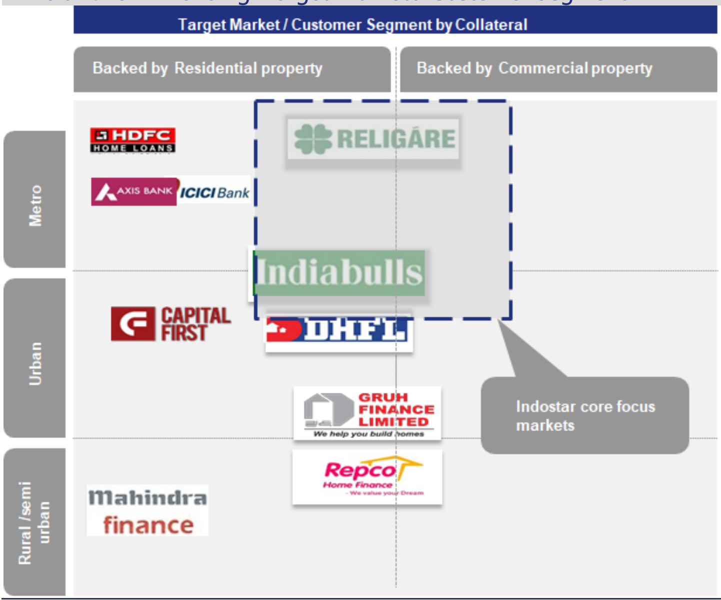
Exhibit 24. Key players in Developer Financing

INR mn	FY16	FY17	FY18	FY16-18 CAGR	FY16	FY17	FY18
Construction Finance/Developer loans					% of overall book		
HDFC	3,84,168	4,05,322	5,18,448	16%	13%	12%	13%
Piramal	1,12,039	1,99,800	2,82,526	59%	84%	80%	67%
Dewan Housing	62,572	1,16,984	1,66,629	63%	9%	14%	15%
Indiabulls	61,815	82,708	1,22,578	41%	9%	9%	10%
Edelweiss	53,470	71,120	1,01,730	38%	27%	26%	24%
LTFH	34,980	48,910	1,00,920	70%	6%	7%	12%
JM	56,600	81,060	92,680	28%	78%	71%	63%
LICHF	34,420	55,100	80,930	53%	3%	4%	5%
PNB Housing	24,631	43,820	77,270	77%	9%	11%	14%
Indostar	15,264	18,673	21,000	17%	36%	36%	34%

Source: Company, JM Financial

- SME Finance – Gearing up for expansion: Indostar started its SME business in 2015 and it formed c.23% of its overall book as of Mar'18. The company has 10 branches in Mumbai, Bengaluru, New Delhi, Pune, Hyderabad, Chennai, Ahmedabad, Jaipur, Indore and Surat which are the key cities for SME lending in India. Indostar's SME lending primarily involves extending secured loans for business purposes such as loan against property (LAP), working capital and purchase of equipment. Its customer profile consists of small and medium size enterprises, businessmen, traders, manufacturers and self-employed professionals with a turnover of approx. INR 100mn. All its SME loans are secured against collateral, typically against residential or commercial property with an average LTV of approximately 65%.

Exhibit 25. SME Lending: Target Market / Customer Segment



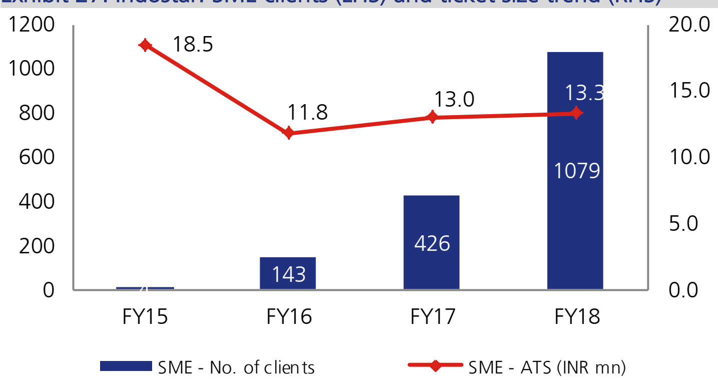
Source: Company
Metro: Cities with pop > 1mn; Urban: cities with pop between 0.1 and 1mn; Rural + Semi urban: Cities with pop< 0.1mn

Exhibit 26. Indostar focus areas in SME

	% Loan Book	% Yield	ATS
Top 10 Metros	c.85%	11-12%	INR 10-15mn
Urban:	c.15%	11-12%	INR 5-10 mn

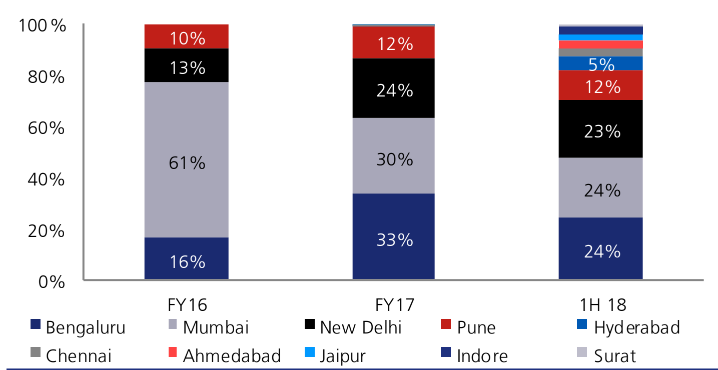
Source: Company

Exhibit 27. Indostar: SME clients (LHS) and ticket size trend (RHS)



Source: Company, JM Financial

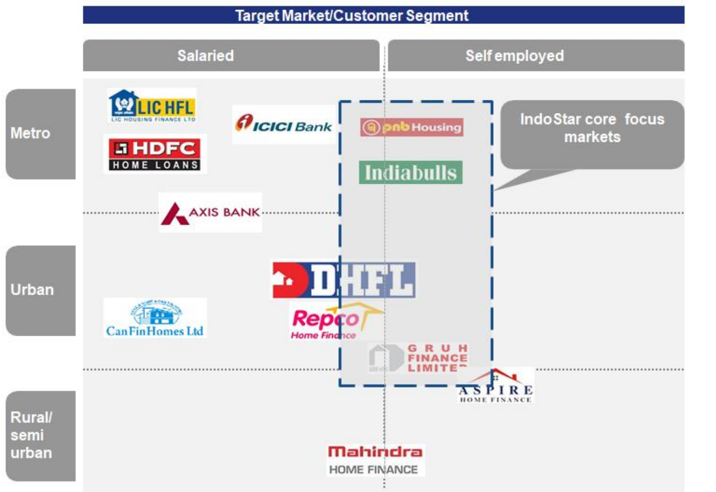
Exhibit 28. Indostar: SME AUM mix – Major focus on metros



Source: Company, JM Financial

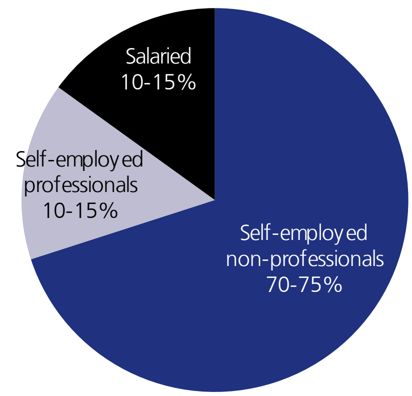
- Housing Finance – Focus on middle class self-employed customers: Indostar started its housing finance business in Sep'17 through its wholly-owned subsidiary - Indostar Housing Finance Private Limited. Its expertise in SME lending and real estate has provided it with a strong platform to enter the housing segment. Due to the varied customer profiles and markets, housing finance is further segmented into:
  - (i) Affordable housing finance: This involves loans for affordable housing projects where the loan amount is capped at INR 3.0mn. The average ticket size for this segment is less than INR 1.5mn. Here, the company intends to source through its own channels and focus on self-employed individuals involved in trade or commercial activities where income is not completely evidenced by documents and requires field based credit assessment.
  - (ii) Retail housing finance: This business was started in Mar'18 with major focus on self-employed customers. This caters to segments where the loan amount is above INR 3.0mn. Given Indostar's expertise in real estate lending, it intends to leverage its existing corporate lending relationships with developers to grow its retail housing finance business. As of Mar'18, the company had 31 housing finance branches (of which 6 branches are exclusively for housing finance). Indostar is planning to increase its housing branch network to over 35 by Jun'18.

Exhibit 29. Housing Finance: target market / customer segment



Source: Company

Exhibit 30. SENP account for most of NBFCs/HFCs' LAP borrower base in the industry

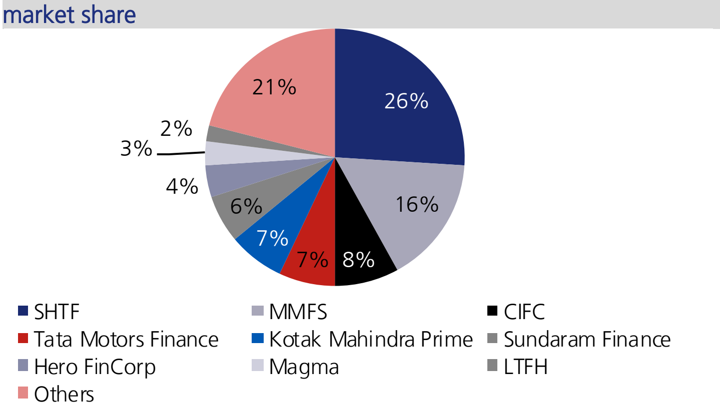


Source: CRISIL

- **Vehicle Finance – Focus on used CVs:** Indostar started its vehicle finance business in Nov'17 after Mr R. Sridhar joined as CEO Apr'17. His expertise in scaling up the CV financing business at SHTF should help Indostar grow its vehicle financing business. Its customer profile comprises farmers, small businesses, salaried/self-employed individuals and transport operators – primarily small and medium fleet operators. It plans to finance various categories of vehicles including used and new commercial vehicles, passenger vehicles, farm equipment and two-wheelers. Its key focus will be on 3-5 years old used commercial vehicles. The company has hired experienced professionals from companies such as Cholamandalam, SHTF and Equitas who have built relationships with their clients over the years. Indostar is looking to tap some of these customers with good track record and who have good relationships with its employees. Sourcing would be largely in-house through its field officers. The company has set up operations with 91 branches (as of Mar'18) and plans to expand its presence to 130 branches in 15 states by Jun'18.

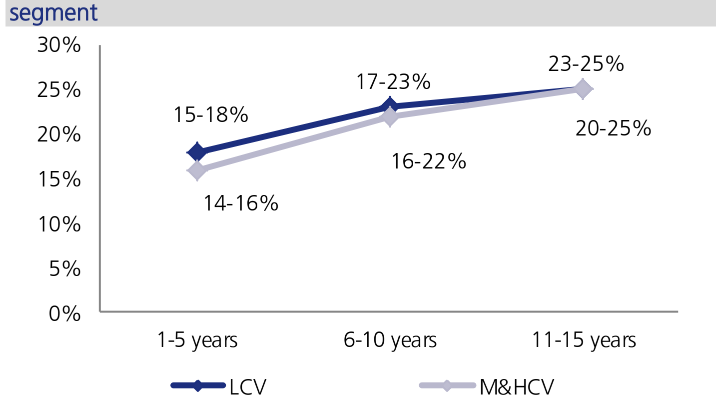
Vehicle Finance: Focus on 3-5 year-old used commercial vehicles

Exhibit 31. Vehicle financiers: Top 9 players account for 80% of the market share



Source: CRISIL, Others include Daimler Financial, Toyota Financial, TVS Credit, Au Financiers, Equitas etc.

Exhibit 32. CV Finance: Interest rates based on vehicle age and vehicle segment



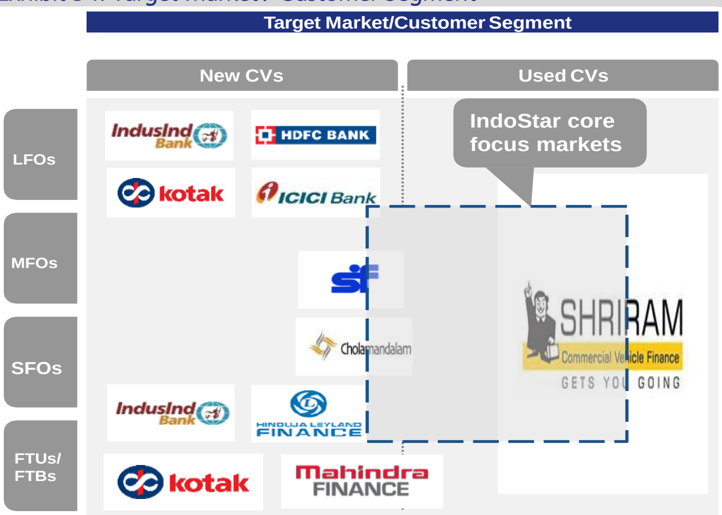
Source: CRISIL

Exhibit 33. Vehicle Finance: Focus on SFOs, MFOs and LCV/MCV within the used CV market

	Market share (Industry)	ATS (Industry)	Indicative yields (Industry)	Gross NPAs (Industry)	Target clients
Used Cars & UVs		Light CV: INR 0.3-0.4 mn	13-17%	6-7%	LCV/MCV
New cars & UVs	Medium Fleet (4-20 vehicles) : 7%	LCV: INR 0.2-0.3 mn	8.5-12.5%	4-5%	SCV/LCV
Used CV	Small Fleet (1-4 vehicles) : 7% First Time users / Buyers : 15%	LCV: INR 0.2-0.3 mn	15-22%	7-8%	
New CV		LCV: INR 0.2-0.3 mn	12-15%	5-6%	

Source: CRISIL, Company

Exhibit 34. Target Market / Customer Segment



Source: Company
FTUs: First Time Users; FTBs: First Time Buyers; SFOs: Small Fleet Operators (1-4 vehicles); MFOs: Medium Fleet Operators (4-20 vehicles); LFOs: Large Fleet Operators (>20 vehicles)

Retail expansion to drive 50% CAGR in AUM over FY18-20E

- **25% CAGR in loans over FY14–18**

Indostar recorded 25% loan CAGR over FY14-18 (INR 62bn as of Mar'18) driven by: i) increasing opportunities in structured lending in both real estate and non-real estate segments and ii) increased focus on new products such as SME, housing and vehicle finance by targeting the fast-growing self-employed middle-class segment.

Over the past year, Indostar has focused on balancing its loan book by diversifying its exposure away from corporate lending (76% as of FY18) to SME (21%) and retail-focused segments such as vehicle and housing finance (<1%).

- **All four principal lines of business poised for healthy growth; expect strong 50% AUM CAGR over FY18-20E**

Expect higher contribution from vehicle and corporate portfolio over the next 2-3 years.

We believe all four principal lines of business – Corporate, SME, Housing and Vehicles – are poised for healthy growth. Indostar is well-positioned to deliver a 50% AUM CAGR over FY18–20E, driven by: i) Expansion into newer markets — currently, the company is in an expansion phase and added 84 branches in FY18; it is planning to add another 40 branches expand its distribution network to 130 branches (by Jun'18). ii) Rising contribution from the vehicle/housing segments — corporate lending and vehicle finance should be the primary growth engines for the company while housing finance and SME lending would also aid growth. We expect the proportion of vehicle finance to increase to c.20% by FY20E, housing to increase to c.7% while corporate lending proportion to reduce to c.50-55%. SME would broadly remain stable at c.20% by FY20.

Exhibit 35. Segment wise loan mix

AUM mix (INR m)	FY15	FY16	FY17	FY18	FY19E	FY20E	CAGR (18-20)
Corporate Lending	34,218	40,419	44,974	45,913	53,450	72,773	25.9%
Real Estate*	10,823	15,264	18,673	21,000	28,634	39,186	36.6%
Non-Real Estate	19,422	19,354	21,301	24,913	24,816	33,588	16.1%
Short term loans	3,973	5,800	5,000				
SME Loans	74	2,232	6,501	14,352	19,089	25,191	32.5%
Housing Finance				501	5,727	9,796	342.2%
Vehicle Finance				1,307	17,180	32,188	396.3%
Total	**34,292**	**42,651**	**51,475**	**62,073**	**95,447**	**1,39,949**	**50.2%**
AUM mix (%)							
Corporate Lending	99.8%	94.8%	87.4%	74.0%	56.0%	52.0%	
Real Estate	31.6%	35.8%	36.3%	33.8%	30.0%	28.0%	
Non-Real Estate	68.2%	59.0%	51.1%	40.1%	26.0%	24.0%	
SME Loans	0.2%	5.2%	12.6%	23.1%	20.0%	18.0%	
Housing Finance	0.0%	0.0%	0.0%	0.8%	6.0%	7.0%	
Vehicle Finance	0.0%	0.0%	0.0%	2.1%	18.0%	23.0%	
AUM mix (YoY growth)							
Corporate Lending	33.0%	18.1%	11.3%	2.1%	16.4%	36.2%	
Real Estate	10.1%	41.0%	22.3%	12.5%	36.4%	36.8%	
Non-Real Estate	47.2%	7.5%	4.6%	-5.3%	-0.4%	35.3%	
SME Loans		2913.1%	191.2%	120.8%	33.0%	32.0%	
Housing Finance					1043.1%	71.1%	
Vehicle Finance					1214.5%	87.4%	
Total	**33.3%**	**24.4%**	**20.7%**	**20.6%**	**53.8%**	**46.6%**	

Source: Company, JMFL

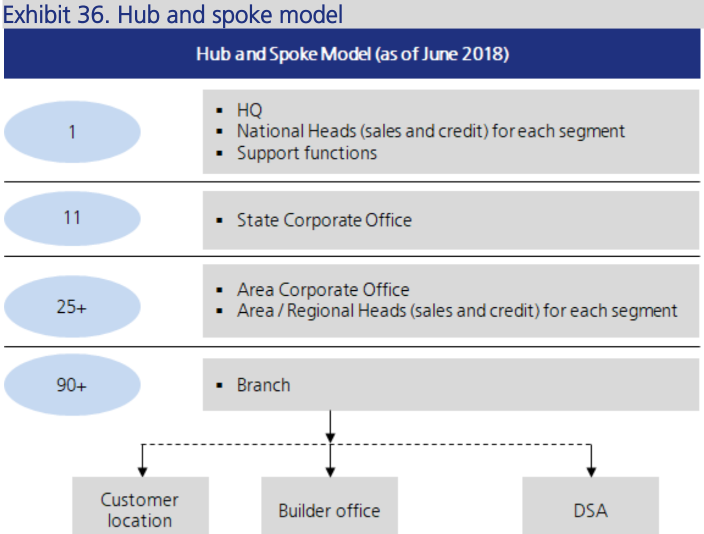
Geographical expansion focused on 15 key states

Branches to increase to 130 by June'18 in tier I, tier II and tier III cities in the northern, southern and western regions of India

- The Company plans to selectively expand its business operations into in tier I, tier II and tier III cities in the northern, southern and western regions of India where its management expects higher loan demand due to increasing urbanisation, commercial activity and rise in household incomes. The company is committed to disciplined branch expansion and most of the new branches will be opened for the vehicle finance business with the potential for affordable housing business to use these branches. Currently, Indostar's corporate operations are conducted from Mumbai; it has 10 SME branches and 75 vehicle finance branches and 31 housing finance (of which 25 are shared with vehicle finance) branches (as of Mar'18) in 15 states. The company intends to expand its branches to130 by June 2018 of which approximately 100 will be focused on the vehicle finance business and remaining 30 on SME lending and housing finance. Going forward, the company plans to add branches in a calibrated manner as existing branches turn profitable.

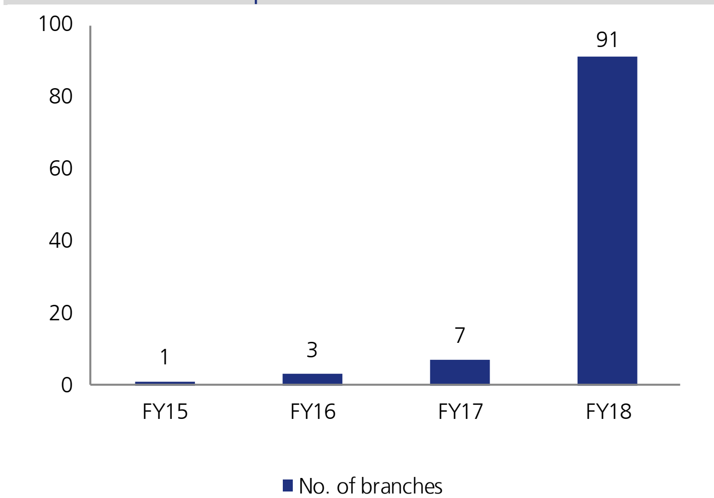
  Indostar operates on a hub-and-spoke model in an effort to leverage common infrastructure and optimise operational efficiency. The branches report to an area corporate office, which in turn reports to the state level corporate office. The business is managed in a centralised manner and the corporate headquarters exercises overall control and supervision. This model allows it to expand with lower marginal costs and increase profitability.

Exhibit 36. Hub and spoke model



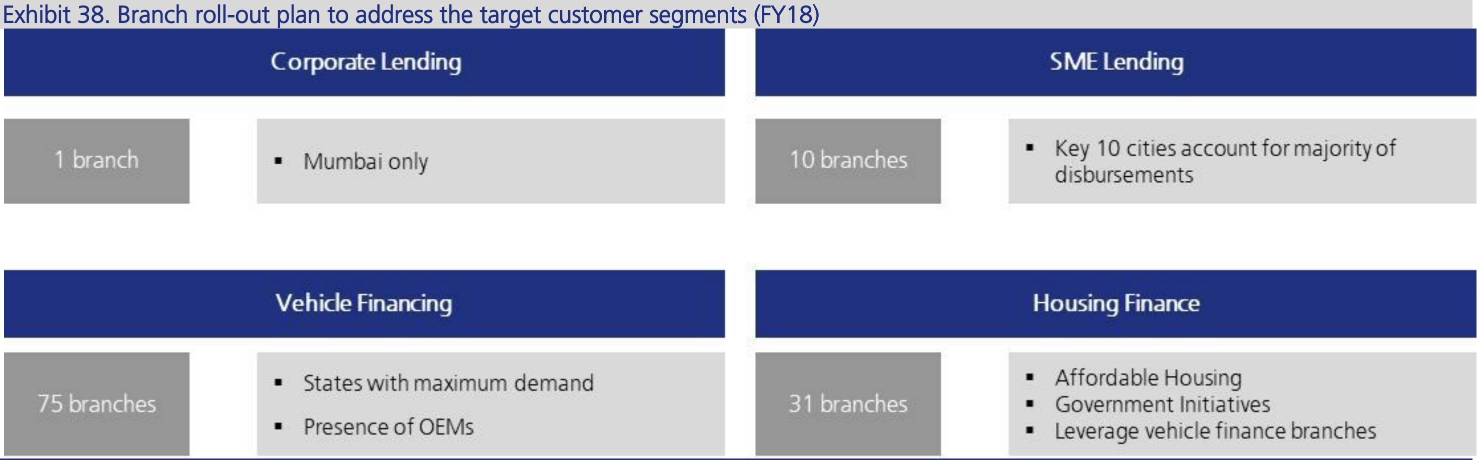
Source: Company

Exhibit 37. Number of operational branches



Source: Company

Exhibit 38. Branch roll-out plan to address the target customer segments (FY18)



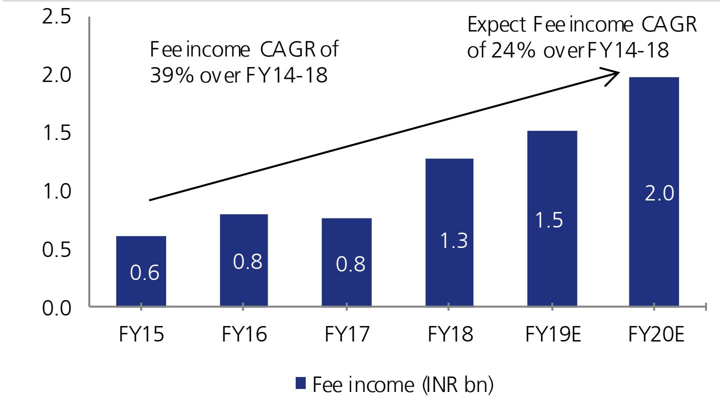
Source: Company

Healthy fee income trend

- **Fee income has posted a 39% CAGR over FY14-18**

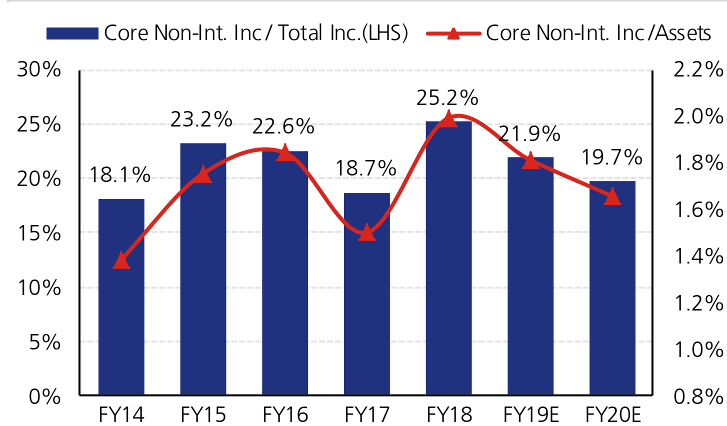
  Indostar's fee income has grown at a healthy rate, recording a CAGR of 39% over FY14-18, driven by healthy traction in corporate and syndication fees. We expect fee income to post a 24% CAGR over FY18-20E, led by diversification of fees sources into retail segments such as vehicle and housing finance.

Exhibit 39. Fee income – 40% CAGR over FY14-18



Source: Company

Exhibit 40. Fee income to assets



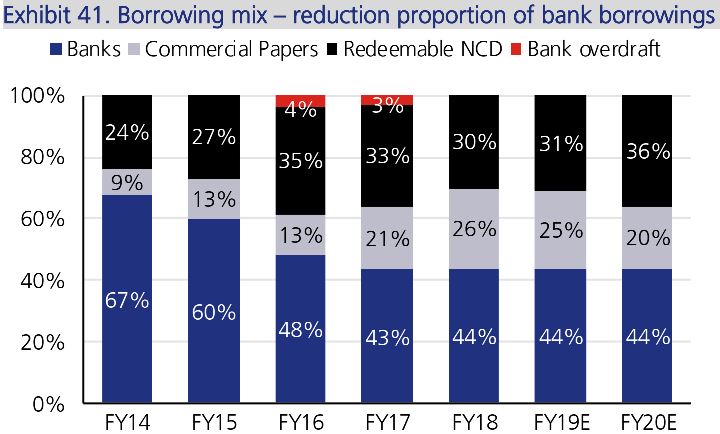
Source: Company, JMFL

Diversification of borrowing profile led to improvement in funding costs

- **Well-diversified borrowing mix**

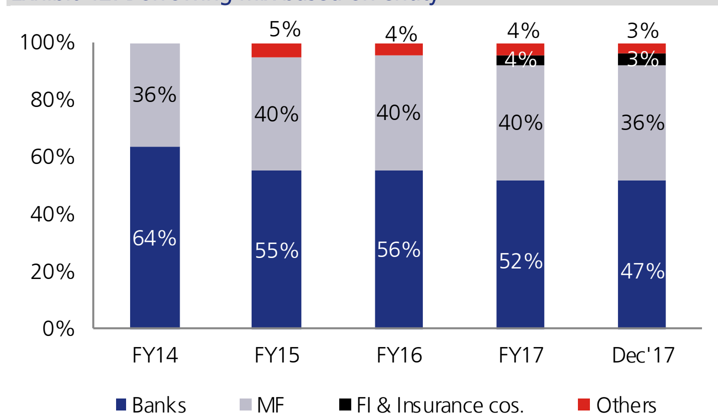
  Indostar has a well-diversified funding profile and is continually securing cost-effective funding through a variety of sources, including banks, mutual funds, insurance companies and other financial institutions. Over the past 3 years, Indostar has diversified its borrowing profile by shifting away from bank funding (44% of total borrowing in FY18 compared with 67% in FY14) to NCDs (30% of total borrowings in FY18 compared with 24% in FY14) and commercial paper (26% of total borrowings in FY18 compared with 9% in FY14).

Exhibit 41. Borrowing mix – reduction proportion of bank borrowings



Source: Company, JMFL

Exhibit 42. Borrowing mix based on entity



Source: Company

- **Credit rating: AA- long-term debt rating and A1+ for Commercial Paper**

  Indostar has a long-term debt rating of CARE AA- and its Commercial Paper is rated ICRA A1+, CRISIL A1+. The company benefits from the strong capital sponsorship of its promoter, the Everstone Group, to obtain strong credit ratings.

Exhibit 43. Indostar: Credit ratings

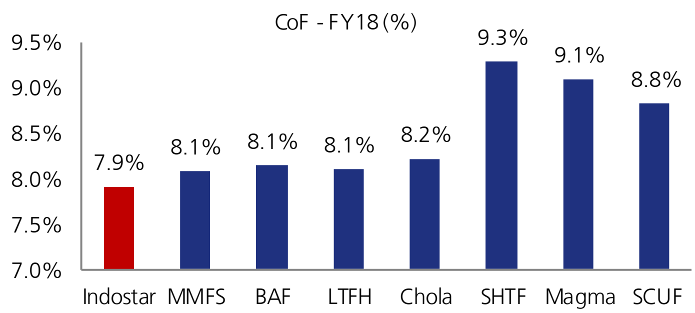
As of FY18	Long Term	Commercial Paper / Short Term
CRISIL		A1+
ICRA		A1+
Fitch India Ratings	AA-	
CARE Ratings	AA-	A1+

Source: Company

- **Funding costs have improved by c.360bps in the past 3 years**

  Diversification of its funding profile and excellent ALM management has contributed to an overall reduction in Indostar's average cost of funds (CoF) in the past few years. Consequently, its average cost of borrowing declined to 7.9% in FY18 from 11.5% in FY15. This is comparable to its peers, enabling it to lend at competitive rates.

Exhibit 44. Funding cost comparison



Source: Company data

Improving margin trajectory

- **23% CAGR in NII over FY14–18**

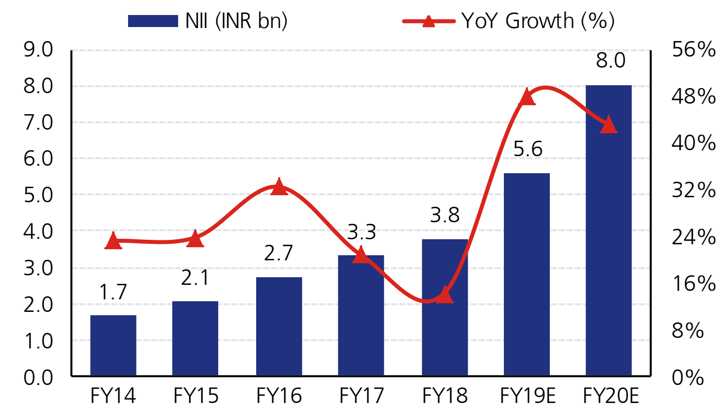
  Indostar saw NII CAGR of 23% over FY14–18, driven by strong loan growth (CAGR of 25% over FY14–18) and healthy margins. Despite a reduction in yields by c.300bps over FY14-18, margins (calculated) have broadly remained stable at 6% in FY18 (vs. 6.3% in FY14) due to a reduction in the average cost of borrowings (declined from 12.7% in FY14 to 7.9% in FY18).

- **Expect c.80bps expansion in margins leading to 46% NII CAGR over FY18–20E**

  Margins to expand 80bps as vehicle segment proportion increases

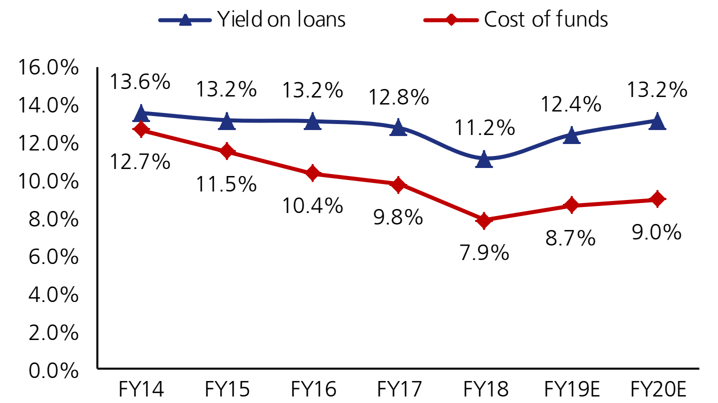
  We expect the proportion of vehicle finance to increase from the current levels due to rapid branch expansion. Given higher yields in used CV segment, we expect yields to improve by c.150bps over FY18-20E while funding costs for Indostar are expected to increase by c.100bps given rising interest rate environment. Consequently, we expect margins to expand c.80bps to 6.8%, leading to a 46% CAGR in NII over FY18–20E.

Exhibit 45. Trend in NII – Expect 46% NII CAGR over FY18-20E



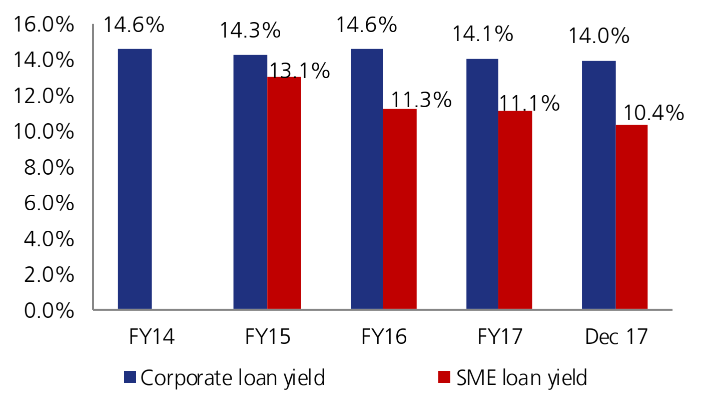
Source: Company, JMFL

Exhibit 46. Indostar: Yield and funding costs



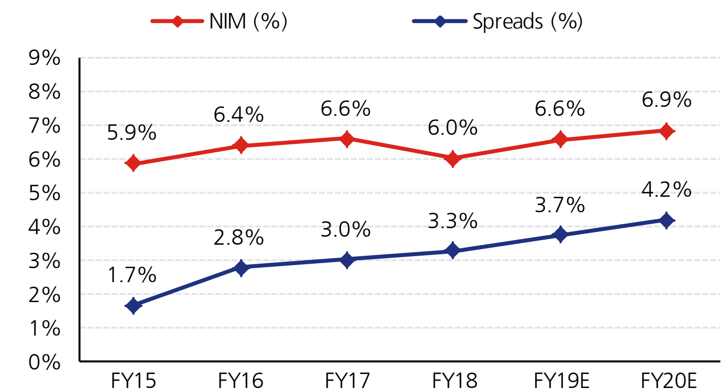
Source: Company, JMFL

Exhibit 47. Indostar: Weighted average loan yield on o/s book



Source: Company

Exhibit 48. Indostar: Margins have remained stable



Source: Company, JM Financial

- **Largely matched in terms of ALM**

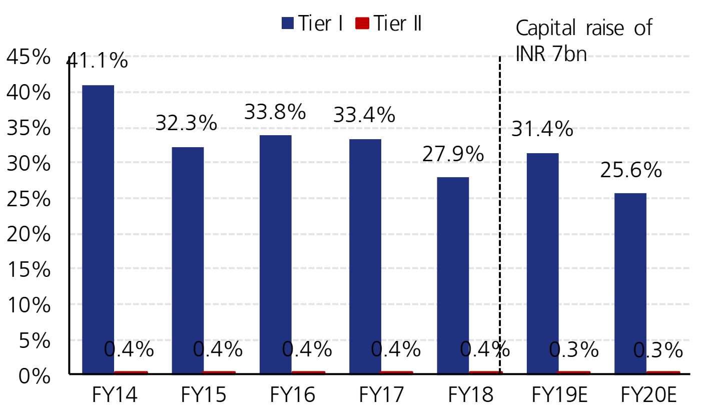
Indostar follows a conservative ALM philosophy based on:

i) ALM mismatch for less than the 1-year bucket should be negligible: Indostar is largely matched in terms of ALM. In the past 5 years, ALM mismatch in less than the 1-year bucket remained negative, implying that its short-term liabilities are adequate to meet short-term assets.

ii) Capital adequacy ratio (CAR) should not fall below 20%: In the past 4 years, its CAR has consistently remained above 25%. Post capital raise, Indostar Tier-I and CAR has improved to 35% and 27.9% as of FY18.

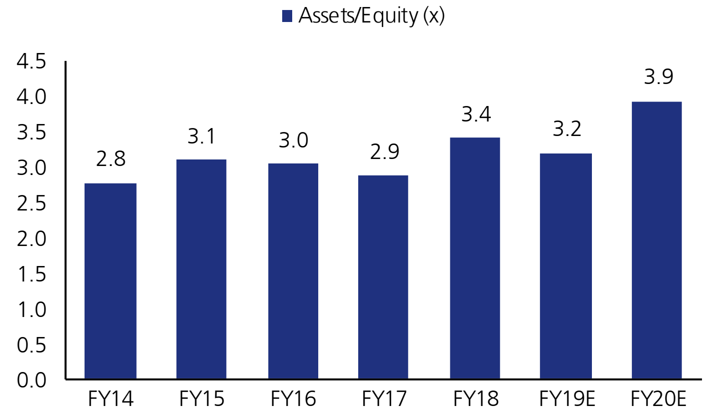
iii) Liquidity reserve: The company maintains 15% of net worth in liquid assets and a minimum of INR 1bn in near-cash assets.

Exhibit 49. Indostar: CAR has remained healthy at 28% as of FY18



Source: Company, JM Financial

Exhibit 50. Leverage to rise as retail penetration increases



Source: Company, JM Financial

Expect cost-assets to increase to 2.8% due to retail expansion

- Cost-to-assets of 2.1% in FY18

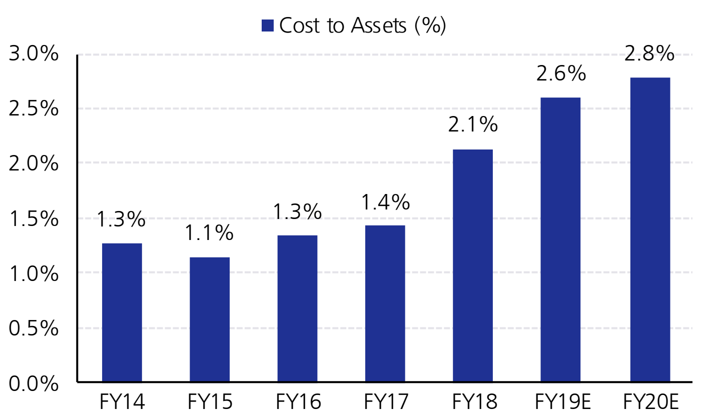
Indostar's cost-asset (C-A) has broadly remained stable over FY14-16 averaging 1.3%. However, C-A started inching up over the last two years to 2.1% in FY18 due to the company's expansion into retail segments - vehicle finance and housing finance. We expect cost-assets to increase to 2.8% and cost-to-income to increase to 33% (from 27% in FY18) by FY20 given:

i) Expansion into new territories – it has added 84 branches (taking it to 91 in Mar'18) in FY18 and is planning to expand its branch network to 130 by Jun'18;

Cost to assets increased from 0.9% in FY16 to 1.1% in FY18 due to expansion in retail

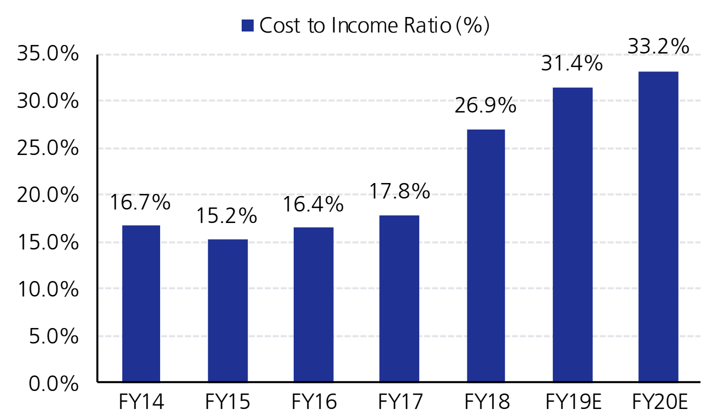
ii) Increased hiring for its new segments (vehicle and housing) – it has hired 1000 employees for vehicle/housing finance business in FY18. Consequently, the employee expense has increased to 1.1% in FY18 from 0.9% in FY16. We expect employee expenses to increase further to 1.3% by FY20 as retail expansion continues.

Exhibit 51. Indostar: Trend in cost to assets



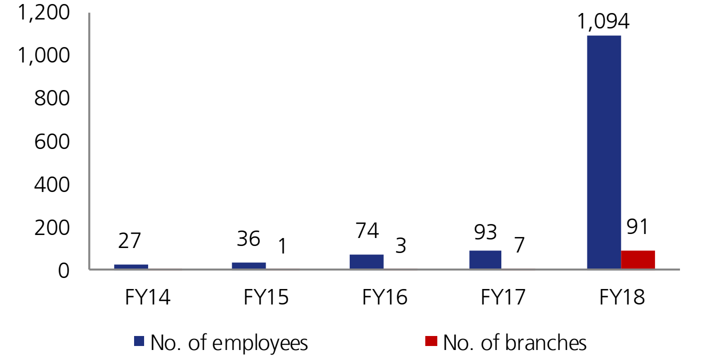
Source: Company, JM Financial

Exhibit 52. Indostar: Trend in cost to income



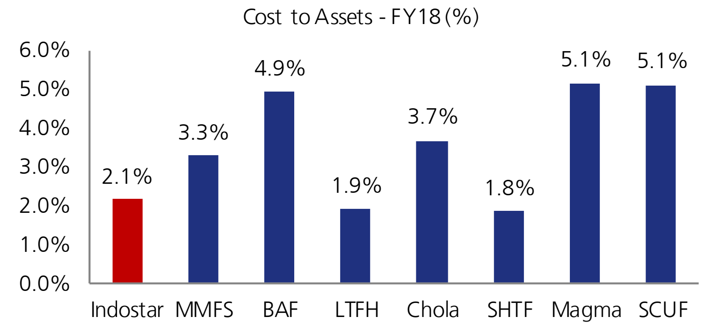
Source: Company, JM Financial

Exhibit 53. Trend in number of employees and branches



Source: Company, JM Financial

Exhibit 54. Peers: Trend in cost-to-assets



Source: Company, JM Financial

Healthy asset quality trends; expect 90bps credit cost by FY20E

- **Gross NPA ratio of 1.3% and provision coverage of 16% as of FY18**

Indostar follows a stringent credit/underwriting processes with robust monitoring mechanisms, which has helped it grow its loan portfolio without compromising on the credit quality. It has largely focused on secured assets; c.90% (as of Mar'18) of the book is secured. Indostar actively monitors the performance of its loans and the quality of its loan portfolio is reflected by the company's low rates of GNPAs and NNPAs. The GNPL of its total portfolio stood at 1.3% in FY18 (on 90DPD) compared with 0.8% (180DPD) in FY14 while coverage ratio stood at 16% as of FY18 compared with 14% in FY14.

Only 1 NPL account in corporate book

Corporate loans: Indostar has a robust credit assessment and comprehensive risk management framework to identify, monitor and manage risks inherent in its corporate and retail lending operations. Its corporate NPA stood at 1% in FY18 on 90DPD (compared with 0.8% in FY14 on 120DPD) comprising of only one NPA account as of Mar'18. The corporate lending credit assessment and risk management framework comprises of a 4-stage framework, spanning:

(a) The screening stage, where the credit and sourcing teams conduct an initial screening of their prospective borrowers;

(b) The evaluation stage, where the credit team evaluates the prospective borrower's business and financing needs and investigates the prospective borrower's track record, market reputation and ability to repay any loans extended to it, before presenting the proposal to their corporate lending committee;

(c) The approval stage, where the loan proposal is presented to the credit committee for final approval and loan disbursement; and

(d) The sanction and monitoring stage, where the credit team regular monitors the loan portfolio to allow for early identification of problematic loans.

For its real estate and non-real estate business, it follows a rigorous underwriting and monitoring process which is as follows:

1. Real estate financing: During the screening process, focus is on i) operating cash flow, ii) lending to well-established developers, iii) limited exposure to the commercial segment, iv) understanding of relevant micro-markets and v) ensuring no approval risks and no Holdco financing. The evaluation process focuses on a) higher asset security cover, b) controls on cash flows through escrow mechanism and c) additional security promoter guarantee and cash flows from other projects. During the monitoring process, the company conducts periodic review of its portfolio and regularly reviews due diligence reports from an independent agency. Robust monitoring mechanisms and

regular portfolio reviews helps in early identification of stress while allowing timely corrective action.

2. Non-real estate financing: For transactions other than real estate, and in particular project loans: i) The company's internal officer conducts a review visit that assesses the current status of the project and the condition of assets. ii) The company also monitors the monthly manufacturing activity of the borrowing entity to regularly assess its business condition. iii) As a prudent measure, Indostar does not provide last mile funding and funding for greenfield projects.

Retail loans: The company has streamlined its credit assessment and risk management framework for SME, housing and vehicle finance businesses by implementing rule-based loan approval engine which helps in faster turnaround times and credit decisions. It has a strong monitoring mechanisms and early payment alert systems, which help it mitigate asset quality risks on the book. As of FY18, GNPLs in the SME segment stood at 2.4% (on 90DPD) compared with 0.9% (on 120DPD) at end FY17. For its retail businesses, the company follows a rigorous screening and monitoring process including:

1. SME financing: During the screening process, the company focuses on i) cash flows, ii) reference checks and iii) the DSA empanelment processes. Collateral is residential or commercial property where over 70% of loans have LTVs of less than 80%.

2. Vehicle financing: During the screening process, the company focus on client and truck-wise exposure limits, earning capacity of assets while ensuring field officers are responsible for loans they originate.

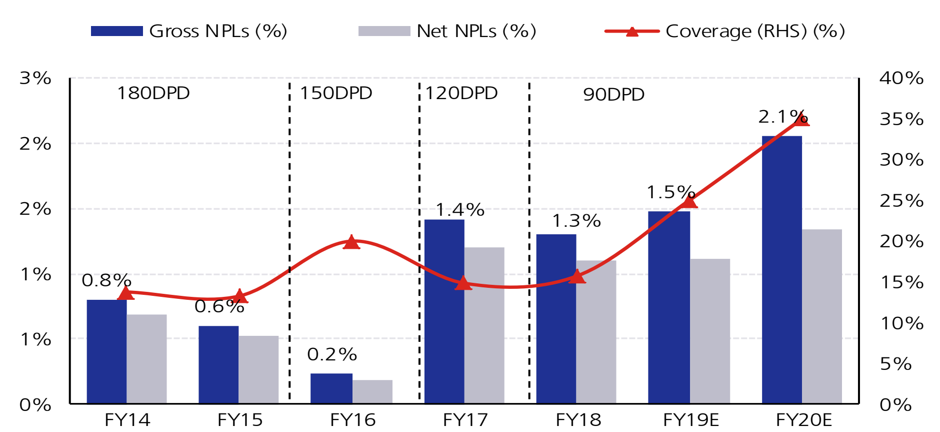
3. Housing finance: The company has specialised underwriters for its self-employed/affordable housing and portfolio quality is an integral part of sales teams' KRAs and incentives.

For all its business lines, it has built-in escalation matrices at pre-defined credit and risk triggers. This allows the company to filter risky credits which are managed by the appropriate decision-making authority. Most of its collections are non-cash and done through the PTC/ECS route, which helps it monitor financial transactions and lowers cash management risks.

- **Factoring 90bps credit costs by FY20E**

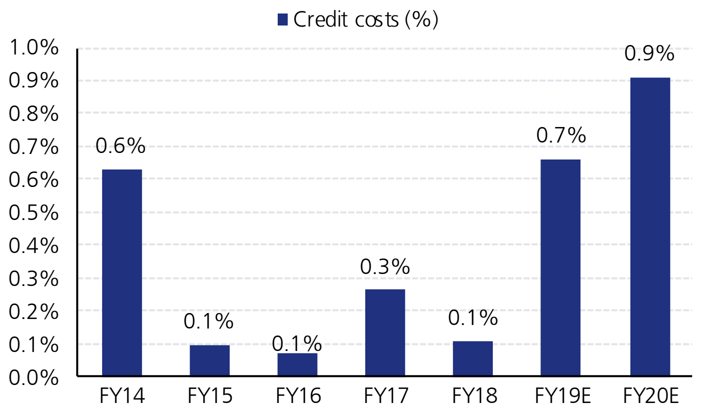
We expect GNPLs to increase for Indostar as it gets into vehicle financing; however, given the excellent credit appraisal policy, continuous monitoring and recovery mechanism, we expect gross NPLs of 2.1% by FY20E along with an improving coverage ratio of 35% by FY20E (from 16% in FY18). Consequently, we factor 90bps credit costs by FY20E.

Exhibit 55. Indostar: Trend in NPAs



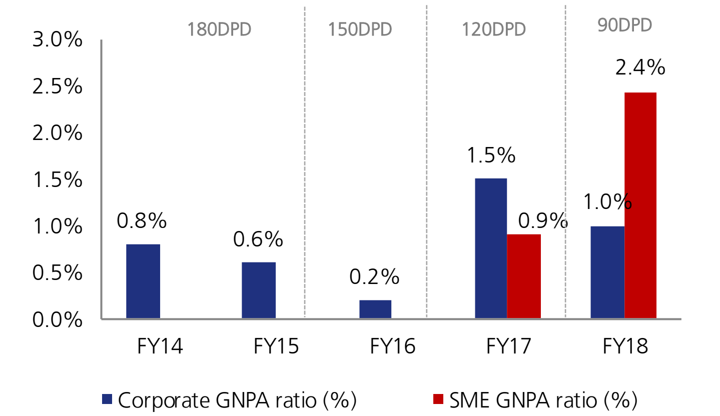
Source: Company, JM Financial

Exhibit 56. Indostar: Trend in credit cost



Source: Company, JM Financial

Exhibit 57. Segment wise NPL trend – Corporate and SME



Source: Company

Exhibit 58. Stringent screening and collateral / security criteria applied to each loan

Corporate Real Estate Financing

Screening
- Lending to well established developers
- Focus on operating cashflow
- Less exposure to commercial segment
- Understanding of all relevant micro-markets

Security
- Higher asset security cover
- Additional security : promoter guarantee, CF from other projects
- Control on cash flows through escrow mechanism

Corporate Non-Real Estate Financing

Screening
- Focus on lending to "bigger groups"
- Avoiding sectors linked to government regulations
- Limited greenfield financing
- Cash Flows analysis
- Internal ratings process

Security
- Higher asset security cover
- Additional security : promoter guarantee, other project CF

SME Financing

Screening
- Understanding of cash flows
- Reference checks
- DSA empanelment process

Security
- 100% collateralized
- Preference for self occupied residential properties
- Adequate LTV

Vehicle Financing

Screening
- Client and truck-wise exposure limits
- Field officers responsible for loans they originate
- Focus on earning capacity of asset

Security
- Adequate LTV
- Repossession easy with immediate liquidity

Housing Finance

Screening
- Specialised underwriters for self employed / affordable housing
- Portfolio quality to be an integral part of sales teams KRAs and incentives

Security
- Adequate LTV

Source: Company

Expect earnings CAGR of 26% over FY18-20E driven by strong loan growth and stable credit costs

- **Healthy earnings CAGR of 20% over FY14-18**

Indostar has a proven track record of delivering results with earnings posting a 20% CAGR over FY14–18, driven by strong loan growth, steady margins and healthy fee income. Over FY14–17, Indostar's RoA has broadly remained healthy at 4.1% in FY17 compared with 4.2% in FY14. However, RoE remained low at 12% in FY17 (vs. 10% in FY14) due to lower leverage (3x in FY17). RoA/RoE reduced to 3.7%/11.7% in FY18 due to a rise in opex on account of retail expansion.

RoA has remained above 4% over FY14-17

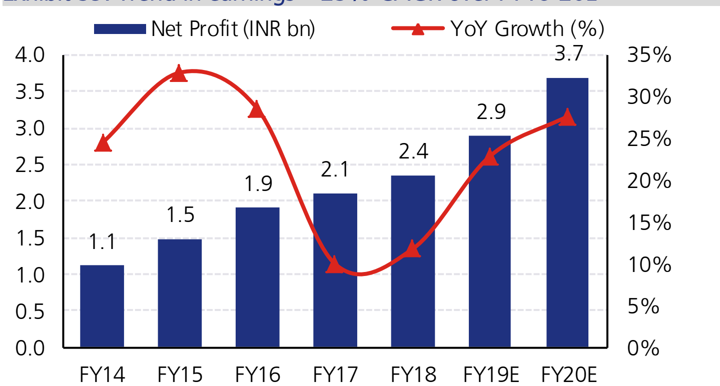
- **Low levels of leverage at c.3x over FY14-18; expect leverage to improve to c.4x by FY20E**

All through the years of fast-paced expansion, Indostar has operated at leverage levels of c.3x, which is a sign of prudent risk management when it comes to a wholesale lending business. We expect leverage to improve to c.4x by FY20E as the retail proportion increases.

- **Forecasts RoA/RoE of 3.1%/11.2% by FY20E**

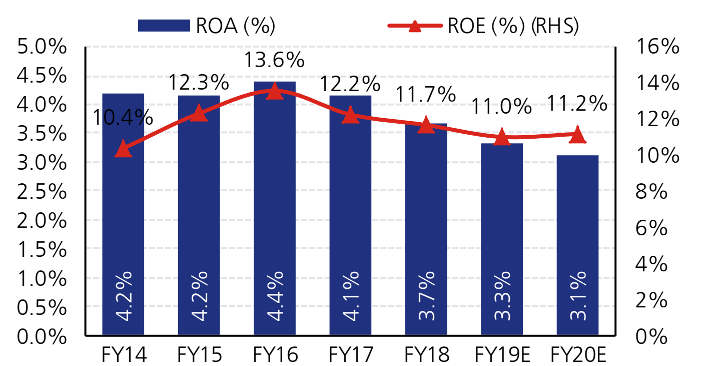
We forecast a net profit CAGR of 26% over FY18–20E, led by strong loan growth, We expect RoA to moderate to 3.1% by FY20E (from 3.7% in FY18) due to high opex on account of retail expansion. However, we expect RoE to remain broadly stable at 11.2% by FY20E due to the increase in leverage from c.3.4x currently to c.4x.

Exhibit 59. Trend in earnings – 25% CAGR over FY18-20E



Source: Company, JM Financial

Exhibit 60. Trend in return ratios



Source: Company, JM Financial

Exhibit 61. DuPont analysis

Du-pont Analysis (%)	FY16	FY17	FY18	FY19E	FY20E
NII / Assets (%)	6.3%	6.5%	5.9%	6.5%	6.7%
Other income / Assets (%)	1.8%	1.5%	2.0%	1.8%	1.7%
Total Income / Assets (%)	**8.2%**	**8.0%**	**7.9%**	**8.3%**	**8.4%**
Cost to Assets (%)	**1.3%**	**1.4%**	**2.1%**	**2.6%**	**2.8%**
PPP / Assets (%)	6.8%	6.6%	5.8%	5.7%	5.6%
Provisions / Assets (%)	0.1%	0.2%	0.1%	0.6%	0.9%
PBT / Assets (%)	6.8%	6.3%	5.6%	5.1%	4.7%
Tax Rate (%)	34.6%	34.7%	34.7%	34.0%	34.6%
ROA (%)	**4.4%**	**4.1%**	**3.7%**	**3.3%**	**3.1%**
Leverage (x)	3.1	3.0	3.2	3.3	3.6
ROE (%)	**13.6%**	**12.2%**	**11.7%**	**11.0%**	**11.2%**

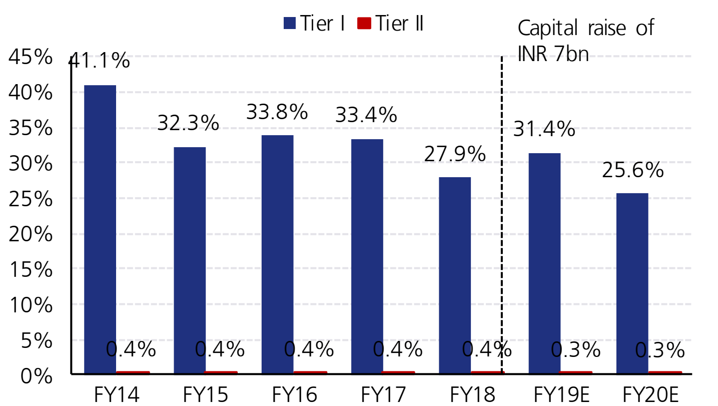
Source: Company, JM Financial

Well capitalised for growth over the next 2-3 years

- **Tier-I of 27.9% as of FY18**

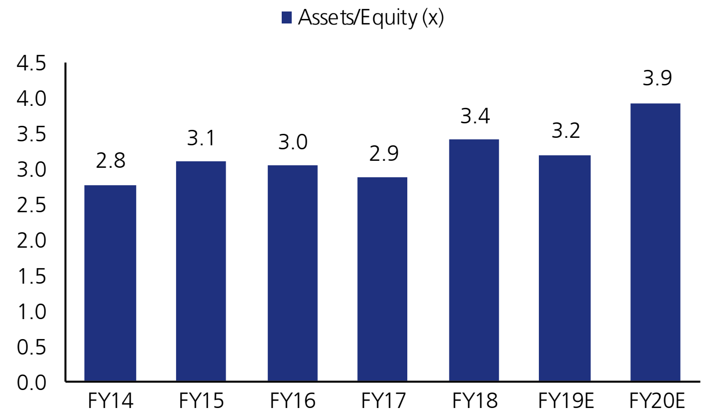
After the recent capital raising of INR 7bn, Indostar's Tier I ratio has improved to 35% (vs. 27.9% in FY18). With rapid expansion into retail, we believe Indostar is well-placed to grow at 40-50% over FY18-20E without raising any capital for the next 2-3 years.

Exhibit 62. Indostar: Trend in capital ratio



Source: Company, JM Financial

Exhibit 63. Indostar: Trend in leverage (x)



Source: Company, JM Financial

Initiate coverage with BUY and TP of INR 650

- Indostar is currently trading at P/B of 1.3x & P/E of 12x FY20E. We value Indostar at 1.7x Mar'20 BV (implied P/E of 16x) and arrive at a Mar'19 TP of INR 650 based on a normalized RoE of 13.4%. The target multiple of 1.7x P/B FY20E is at a c.40% discount to average P/B multiple of 2.3x P/B FY20E for NBFC coverage universe.

Exhibit 64. Peer valuation table

	RoA			RoE			P/E			P/B			PAT CAGR
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18-20E
Indostar	3.7%	3.4%	3.1%	11.7%	11.0%	11.2%	16.8	15.7	12.4	1.9	1.5	1.3	25%
BAF	3.6%	3.6%	3.5%	20.5%	20.1%	22.1%	50.2	36.7	27.6	8.1	6.8	5.5	35%
Chola	2.8%	2.9%	2.9%	20.6%	22.2%	22.6%	25.2	19.2	15.3	4.8	3.9	3.1	28%
LTFH	1.8%	2.0%	2.2%	14.3%	15.2%	17.4%	20.8	15.0	11.4	2.4	2.1	1.9	35%
Magma	1.7%	2.0%	2.2%	10.3%	10.9%	11.4%	16.8	14.9	11.8	1.7	1.4	1.3	27%
MMFS	1.8%	2.4%	2.5%	11.3%	14.9%	16.8%	32.2	19.7	15.7	3.1	2.8	2.5	43%
SHTF	1.9%	2.5%	2.7%	13.1%	18.0%	19.9%	19.8	12.7	9.8	2.5	2.1	1.8	42%
HDFC	3.2%	2.1%	2.1%	23.3%	14.1%	14.5%	18.3	16.9	14.5	2.4	2.2	2.0	16%
LICHF	1.2%	1.2%	1.3%	16.7%	16.8%	17.2%	12.1	10.5	8.9	1.9	1.7	1.4	16%
PNBHF	1.6%	1.5%	1.5%	14.0%	16.9%	19.8%	24.9	18.2	13.3	3.3	2.9	2.4	37%
Repco	2.2%	2.2%	2.2%	16.8%	16.2%	15.8%	16.7	14.9	13.1	2.6	2.2	1.9	15%
Average	**2.3%**	**2.4%**	**2.4%**	**15.7%**	**16.0%**	**17.2%**	**23.1**	**17.7**	**14.0**	**3.1**	**2.7**	**2.3**	

Source: Company, JM Financial

- Indostar is currently trading at P/B of 1.3x & P/E of 12x FY20E. We value Indostar at 1.7x Mar'20 BV (implied P/E of 16x) and arrive at a Mar'19 TP of INR 650 based on a normalized RoE of 13.4%. The target multiple of 1.7x P/B FY20E is at a c.40% discount to average P/B multiple of 2.3x P/B FY20E for NBFC coverage universe.

Exhibit 65. Indostar's normalised earnings

2-stage Gordon growth model	Normalised	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Net margin (as % of avg. IEA)	**7.1%**	**6.3%**	**5.9%**	**6.4%**	**6.6%**	**6.0%**	**6.6%**	**6.9%**
NIM (as % of avg. Assets)	**7.0%**	**6.2%**	**5.8%**	**6.3%**	**6.5%**	**5.9%**	**6.5%**	**6.7%**
Core Non-IR/Asset	1.8%	1.3%	1.7%	1.8%	1.5%	2.0%	1.8%	1.7%
Core Non-IR/Revenues	20.0%	17.8%	22.9%	22.6%	18.6%	25.2%	21.3%	19.7%
Core Revenue/Assets	**8.8%**	**7.6%**	**7.5%**	**8.2%**	**8.0%**	**7.9%**	**8.2%**	**8.4%**
Cost/Core income	33.7%	16.7%	15.3%	16.4%	17.8%	26.9%	31.6%	33.2%
Cost/Assets	**3.0%**	**1.3%**	**1.1%**	**1.3%**	**1.4%**	**2.1%**	**2.6%**	**2.8%**
Core operating profits	**5.8%**	**6.3%**	**6.4%**	**6.8%**	**6.6%**	**5.8%**	**5.6%**	**5.6%**
LLP/Loans	**1.1%**	**0.1%**	**0.1%**	**0.1%**	**0.3%**	**0.2%**	**0.7%**	**0.9%**
Loans/Assets	96.0%	80.9%	83.2%	88.0%	92.5%	88.8%	90.6%	95.1%
Pre-Tax	4.8%	6.3%	6.3%	6.8%	6.3%	5.6%	5.1%	4.7%
Effective tax rate	34.0%	33.7%	34.1%	34.6%	34.7%	34.7%	34.0%	34.6%
RoA	3.2%	4.2%	4.2%	4.4%	4.1%	3.7%	3.4%	3.1%
Equity/Assets	19.9%	40.3%	33.8%	32.6%	33.8%	31.6%	30.4%	27.8%
RoE	15.9%	10.4%	12.3%	13.6%	12.2%	11.7%	11.0%	11.2%
g (high growth phase)	20%							
g (perpetual)	4%							
COE	15.3%							
Fair P/BV	1.70							

Source: Company, JM Financial

Key risks

a) **Volatility in interest rates:** Being a wholesale funded institution, any sustained liquidity shocks could impact Indostar's spreads. Approximately c.30% of Indostar's borrowings comprises short-term instruments (less than 1 year) and these could re-price higher if interest rates continue to rise.

b) **Increase in competitive intensity:** Increasing competition especially in the retail segments – SME, housing and vehicle finance – may adversely affect the company's net interest margins, income and market share.

c) **High real estate exposure:** Given its high exposure to real estate (c.40%), any sustained correction in property prices could adversely impact the company's asset quality. Furthermore, construction finance loans may be exposed to risks related to time and cost overruns and related increases which may affect real estate developers' ability to repay their loans.

d) **Execution of retail strategy remains the key:** Indostar has diversified into new lines of business and is expanding its businesses into new regions. In these businesses and regions, the company could face challenges related to higher competitive intensity, governmental approvals, establishing new relationship, attracting customers in a market in which the company does not have significant experience or visibility, expanding its technological infrastructure and branch integration. Indostar is a late entrant in LAP, vehicle finance and housing finance. Therefore, a lot would depend on the company's ability to retain talent and create niches in these segments.

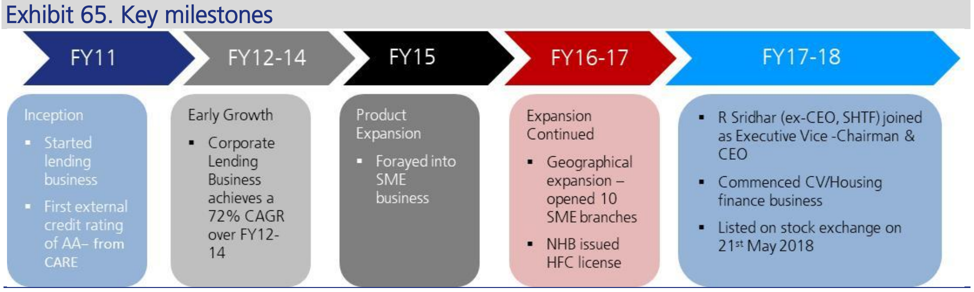
e) **High concentration risk:** Indostar's business is heavily dependent on its operations in the MMR (94% of corporate disbursements to real estate as of Dec'17), and any adverse changes in the conditions affecting these markets can adversely impact its business. Given the wholesale nature of its corporate book, c.59% of its loan book is towards its top 20 borrowers, which exposes it to client-specific risks.

Company background

- Indostar Capital Finance - promoted by Mauritius-based Indostar Capital - commenced operations in 2011. Indostar Capital is a holding company which has a 57.71% stake in Indostar and is a part of the Everstone Group (Everstone Group, is an India and Southeast Asia focused investor, with approximately USD 4.0 bn of AUM), which has a 51.24% stake in Indostar Capital.

  During its initial years, Indostar focused on corporate lending, providing structured term financing in both real estate and non-real estate segments. The second phase of growth came from SME financing, which it started in FY15. Over the past year, it has diversified into vehicle financing and housing financing, enabling it to transform from a corporate lender to a retail lender. Over the past 4 years, its loan book has posted a 25% CAGR (over FY14-18) to INR 62bn. The company operates through 91 branches nation-wide (as of Mar'18) with a central support office in Mumbai.

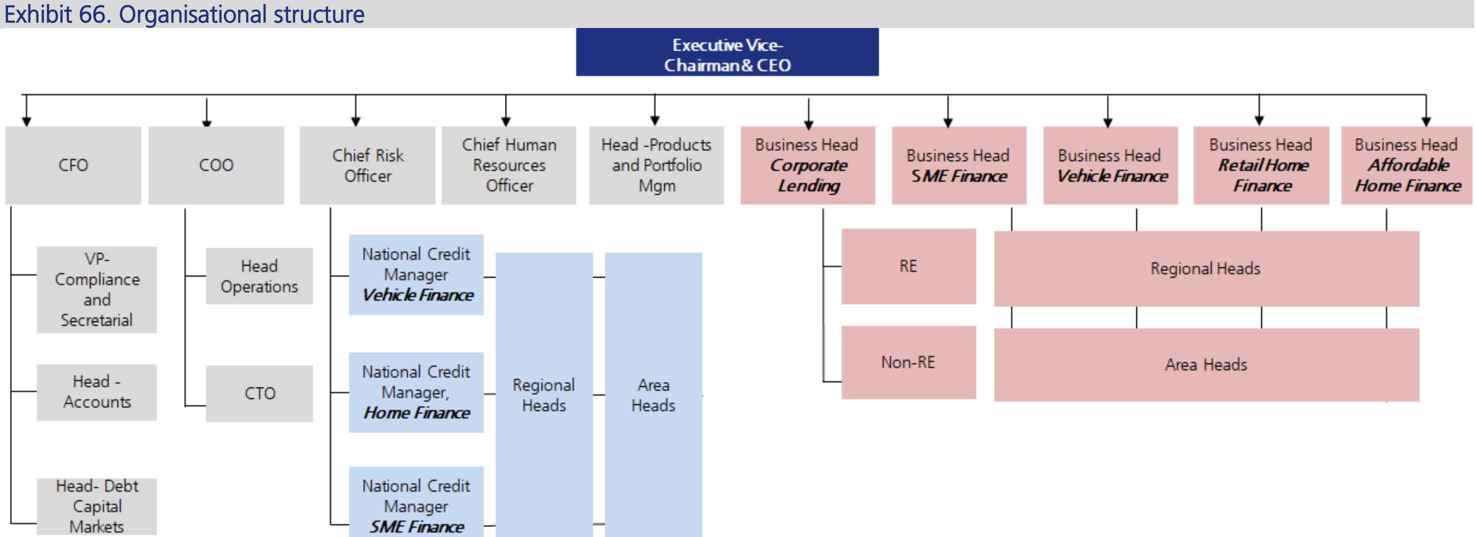
Exhibit 65. Key milestones



Source: Company

- **Organisational structure:** Indostar has five business verticals - i) Corporate Lending, ii) SME Finance, iii) Vehicle Finance, iv) Retail Home Finance and v) Affordable Housing. Each has a different business head. These are supported by three independent verticals - credit, sourcing and operations. This structure enables each segment to function independently while sharing common infrastructure.

Exhibit 66. Organisational structure



Source: Company

Highly experienced management team

- **Management has a strong track record of execution with long-standing experience in relevant domains**

Indostar's management team – led by Mr. R. Sridhar – comprises highly experienced professionals, who have in-depth industry knowledge and experience in the financial services and banking industries in India. Many of them hold senior positions at leading banks and financial services companies such as ICICI Bank, Standard Chartered Bank and Citibank. Mr. R. Sridhar, Vice-Chairman and CEO has been with the Shriram Group since 1985 and previously served as MD & CEO of Shriram Transport Finance (SHTF). Under his leadership, SHTF grew into the largest AFC in India with loans of INR 953bn as of Mar’18. Each member of the senior management team has over 20 years of experience in the finance/banking industry and possesses in-depth understanding of the specific industry, products and geographic regions they cover. Many of Indostar’s Directors and key management personnel own sizeable shares of the company. The senior and mid-level management team has been incentivised through ESOPs (ESOPs outstanding were 10.5% of diluted shares as of Mar’18), thereby enabling a strong alignment of their interests in line with the company’s performance.

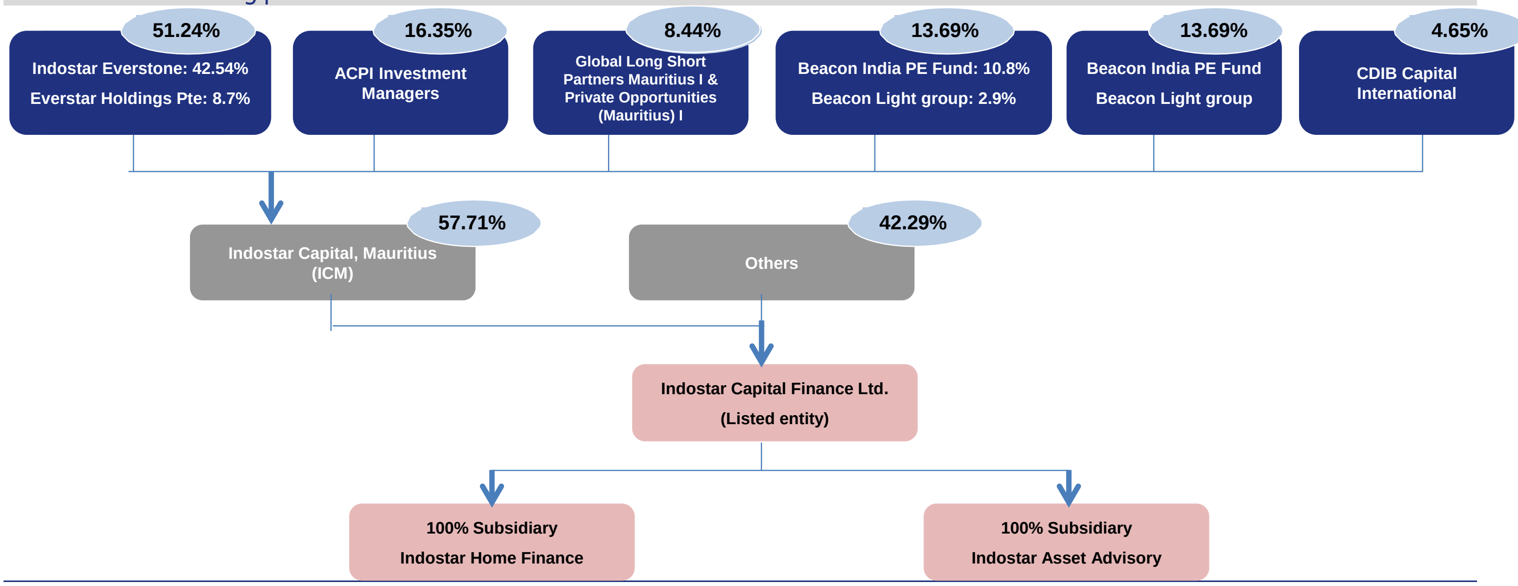
Exhibit 67. Management profile

Name	Designation	Age	Description
R. Sridhar	Executive Vice-Chairman and CEO	59	He has been associated with Indostar since Apr'17. Mr. Sridhar has over three decades of experience in the financial services industry and had been associated with the Shriram Group since 1985 and held the position of Managing Director & CEO of Shriram Transport Finance Company Limited for over a decade since 2000. He is a qualified Chartered Accountant from the ICAI and holds a Bachelor’s degree in Science.
Pankaj Thapar	CFO	56	He has been associated with Indostar since Nov'11. He has more than 30 years of experience in various fields including corporate finance with Indian and international entities such as Everstone Investment Advisors, Dentsu Marcom Private Limited, Coca-Cola India Inc., ANZ Grindlays Bank Limited, Citibank India and ICICI Limited. He holds a Bachelor of Commerce degree and an MBA from the University of Delhi.
Prashant Joshi	COO	46	He has been associated with the company since Aug'16. He has more than 20 years of experience across small and medium enterprises, and corporate banking. He has previously worked with ICICI Bank, Standard Chartered Bank, IDBI Bank, and Deutsche Bank. He holds a bachelor’s degree in commerce from University of Bombay and a PGDM from the Indian Institute of Management, Calcutta.
Sanjay Athalye	Chief Risk Officer	51	He has been associated with the company since Jan'17. He has several years of experience in the fields of commercial finance, managing credit and risk, and portfolio quality. He has previously worked with Reliance Capital, Centurion Bank of Punjab, IDBI Bank, ICICI Limited, Reliance Telecom and Modi Xerox.
Shailesh Shirali	MD, Head – Corporate Lending and Markets	48	He has been associated with the company since Nov'12. He has over 24 years of experience in the financial services space and has previously worked at Future Capital Holdings. He is a qualified Chartered Accountant from the ICAI.
Hansraj Thakur	Business Head - SME Finance	47	He has been associated with the company since Apr'17. He has several years of experience in the fields of small and medium enterprises, commercial banking, and sales and relationship management. He has previously worked at IDFC Bank Limited and Standard Chartered Bank. He holds a bachelor’s degree in commerce from University of Mumbai, and a PGDM from Ramprasad Khandelwal Institute of Management and Research.
A. Gowthaman	Business Head – Vehicle Finance	53	He has been associated with the company since Jul'17. He has more than 20 years of experience in financial institutions and has previously worked with Cholamandalam Investment & Finance, Shriram Transport Finance, Shriram Investments and Inter Trim Linings Super Markets.
Prabhat Kumar Tripathy	Business Head – Retail Home Finance	55	He has been associated with the company since Sep'17. He has more than 20 years’ experience with financial institutions such as Equitas Small Finance Bank, ICICI Limited, Dewan Housing Finance and Maharishi Housing Development Finance.
Shreejit Menon	Business Head – Affordable Home Finance	40	He has been associated with the company since May'17. He has several years of experience with financial institutions like Religare Housing Development Finance, Muthoot Housing Finance and HSBC Limited.

Source: Company

Shareholding pattern

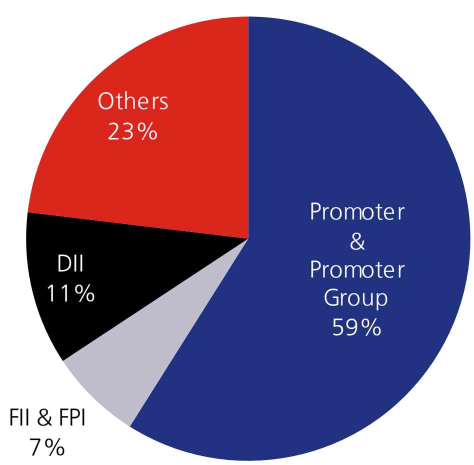
Exhibit 68. Shareholding pattern



Source: Company, JM Financial

*Others include Everstone Capital Partners II LLC (1.44%) and other institutional / individual investors (including employees).

Exhibit 69. Indostar Capital Finance – shareholding pattern (May 2018)



Source: Company, JM Financial

Other includes employees, Management team and employees additionally holds ESOP for ~ 10.5% of fully diluted equity

Peer Comparison

Exhibit 70. Du-pont analysis

Du-pont Analysis (%)	Indostar	MMFS	BAF	LTFH	Chola	SHTF	Magma	SCUF
NII / Assets (%)	5.9%	8.3%	10.2%	4.5%	8.8%	8.2%	9.1%	12.5%
Core other income / Assets (%)	2.0%	0.1%	1.3%	1.9%	0.0%	0.1%	1.1%	0.3%
Other income / Assets (%)	2.0%	0.1%	1.5%	1.9%	0.1%	0.2%	1.1%	0.3%
Total Income / Assets (%)	**7.9%**	**8.4%**	**11.7%**	**6.4%**	**8.9%**	**8.4%**	**10.2%**	**12.8%**
Employee Cost to Assets (%)	1.1%	1.6%	1.9%	0.6%	1.5%	0.9%	2.7%	2.6%
Other Cost to Assets (%)	1.0%	1.6%	3.0%	1.3%	2.2%	0.9%	2.4%	2.5%
Cost to Assets (%)	**2.1%**	**3.3%**	**4.9%**	**1.9%**	**3.7%**	**1.8%**	**5.1%**	**5.1%**
PPP / Assets (%)	5.8%	5.1%	6.8%	4.5%	5.2%	6.6%	5.1%	7.7%
Provisions / Assets (%)	0.1%	2.4%	1.4%	2.3%	1.0%	3.8%	2.7%	3.9%
PBT / Assets (%)	5.6%	2.7%	5.4%	2.2%	4.2%	2.7%	2.3%	3.8%
ROA (%)	**3.7%**	**1.7%**	**3.6%**	**1.8%**	**2.8%**	**1.8%**	**1.7%**	**2.5%**
Leverage	3.16	6.75	5.76	7.88	7.42	7.49	6.08	5.05
ROE (%)	11.7%	11.8%	20.5%	14.3%	20.6%	13.1%	10.3%	12.6%

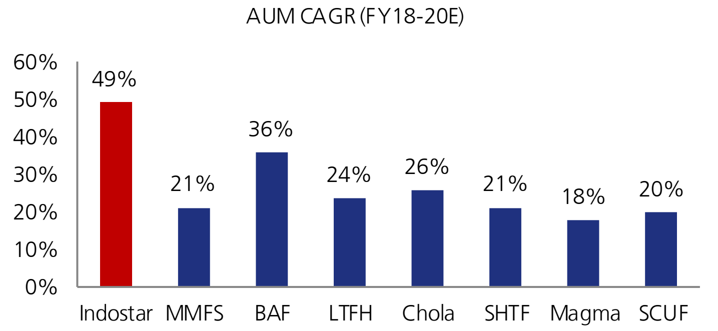
Source: Company, JM Financial

Exhibit 71. Segment wise portfolio composition

	Corporate	SME	Housing	Vehicle	Consumer	Gold loans	Rural
Indostar Capital Finance	74%	23%	1%	2%			
BAF		30%	14%	8%	41%		7%
MMFS		11%	10%	79%			
Cholamandalam		27%		73%			
SCUF		56%		24%	8%	12%	
LTFH	56%		23%				22%
STFH				100%			
Magma		13%	18%	70%			

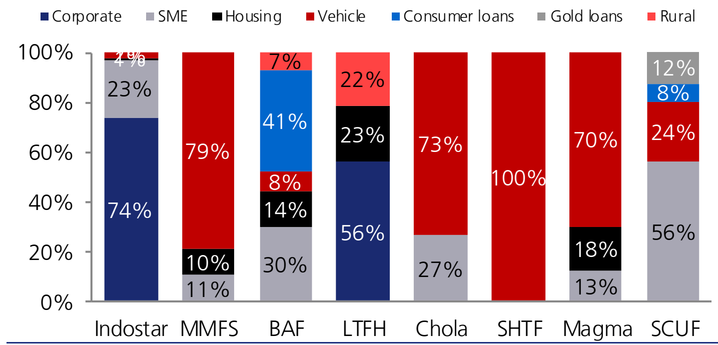
Source: Company, JM Financial

Exhibit 72. Trend in Loan book growth



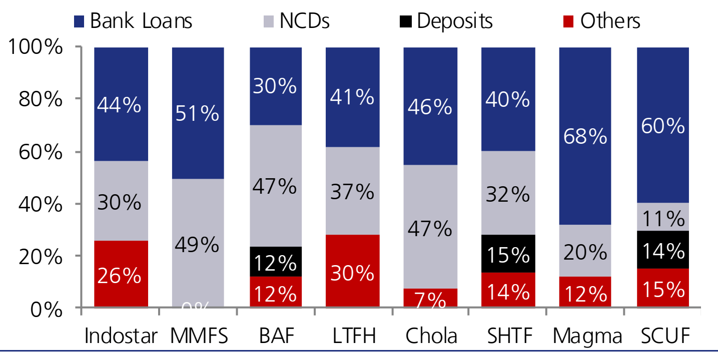
Source: Company

Exhibit 73. Trend in loan mix (FY18)



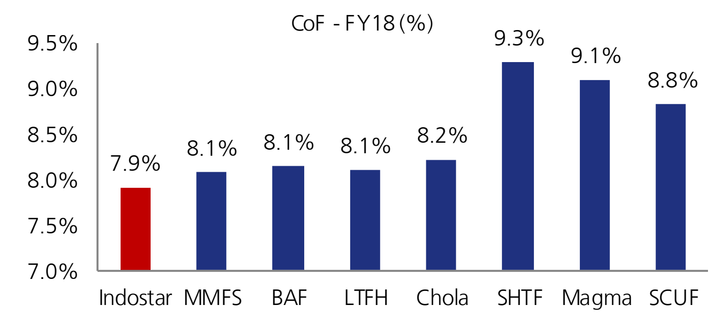
Source: Company

Exhibit 74. Trend in Borrowing mix (FY18)



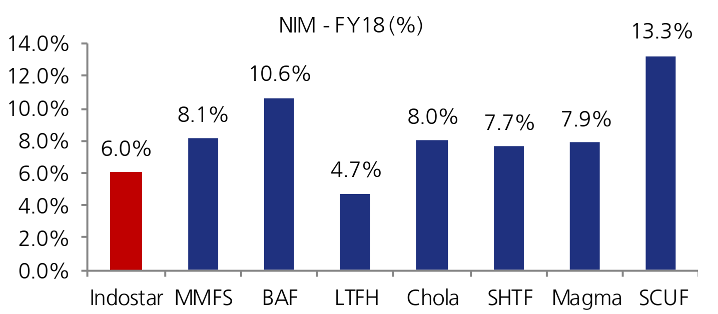
Source: Company

Exhibit 75. Trend in cost of funds



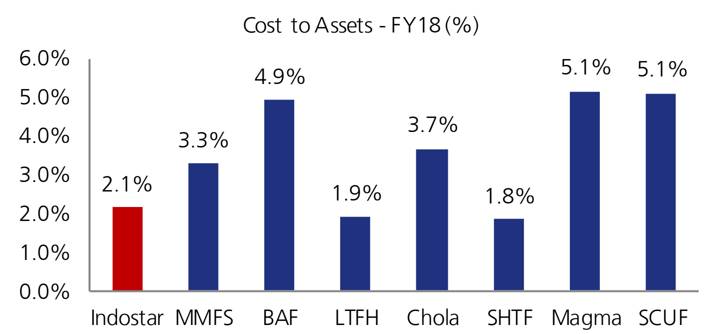
Source: Company

Exhibit 76. Trend in margins



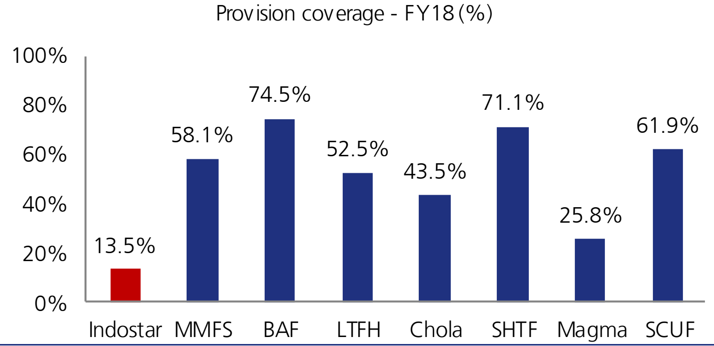
Source: Company

Exhibit 77. Trend in cost-to-assets



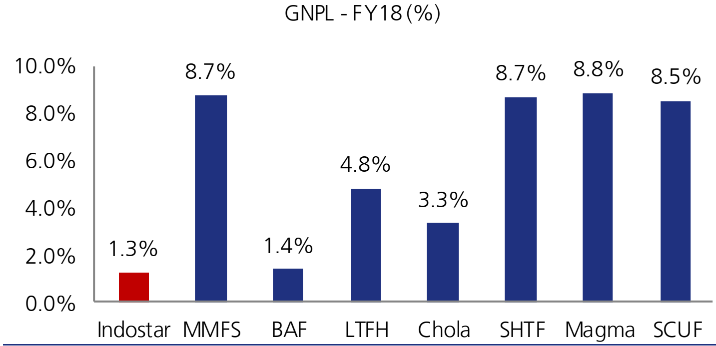
Source: Company

Exhibit 78. Provision coverage



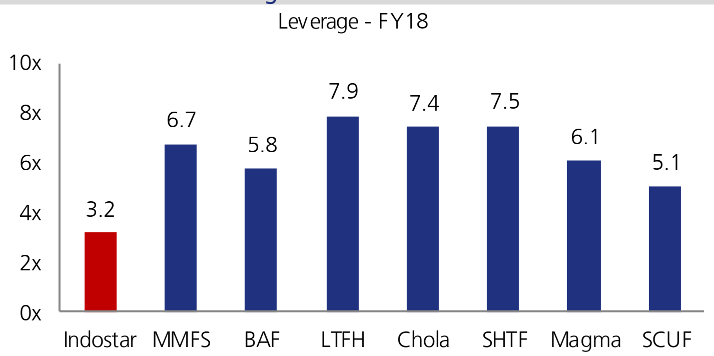
Source: Company

Exhibit 79. Trend in GNPL



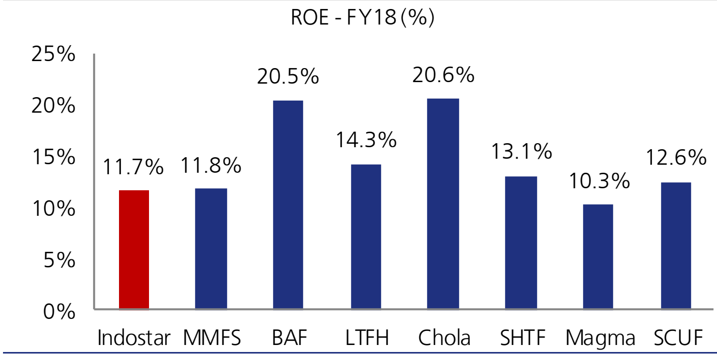
Source: Company

Exhibit 80. Trend in leverage



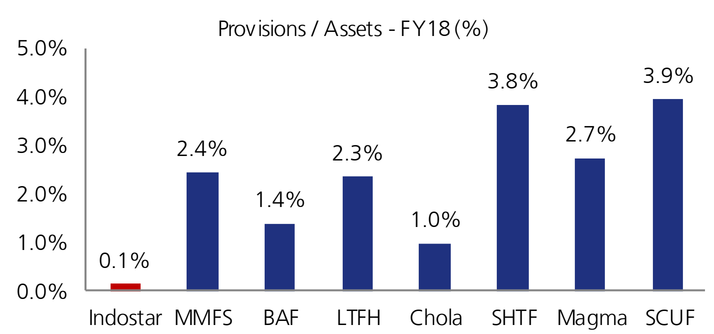
Source: Company

Exhibit 81. Trend in RoE



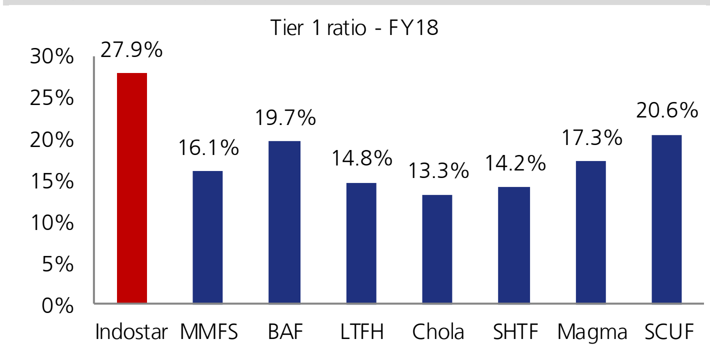
Source: Company

Exhibit 82. Provisioning



Source: Company

Exhibit 83. Tier1 ratio



Source: Company

Financial Tables (Standalone)

Income Statement					(INR mn)
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Net Interest Income (NII)	2,748	3,317	3,787	5,602	8,020
Non Interest Income	800	763	1,273	1,570	1,973
Total Income	**3,548**	**4,081**	**5,060**	**7,172**	**9,994**
Operating Expenses	582	727	1,364	2,251	3,314
Pre-provisioning Profits	**2,966**	**3,354**	**3,697**	**4,920**	**6,679**
Loan-Loss Provisions	34	123	88	518	1,029
Others Provisions	0	0	0	0	0
Total Provisions	**34**	**123**	**88**	**518**	**1,029**
PBT	**2,932**	**3,230**	**3,609**	**4,402**	**5,651**
Tax	1,016	1,122	1,253	1,497	1,955
PAT (Pre-Extra ordinaries)	**1,916**	**2,108**	**2,356**	**2,906**	**3,696**
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	**1,916**	**2,108**	**2,356**	**2,906**	**3,696**
Dividend	0	0	0	0	0
Retained Profits	**1,916**	**2,108**	**2,356**	**2,906**	**3,696**

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Equity Capital	734	784	787	909	909
Reserves & Surplus	14,684	18,244	20,584	30,367	34,063
Stock option outstanding	0	0	0	0	0
Borrowed Funds	30,009	33,733	48,228	66,072	98,976
Deferred tax liabilities	0	0	0	0	0
Preference Shares	179	120	130	130	130
Current Liabilities & Provisions	1,328	2,007	3,235	2,804	3,859
Total Liabilities	**46,933**	**54,888**	**72,964**	**1,00,283**	**1,37,937**
Net Advances	42,670	51,475	62,073	94,970	1,31,552
Investments	0	1,870	7,931	2,564	3,026
Cash & Bank Balances	3,596	651	1,278	665	855
Loans and Advances	169	131	320	237	289
Other Current Assets	357	509	581	836	887
Fixed Assets	38	88	616	846	1,164
Miscellaneous Expenditure	0	0	0	0	0
Deferred Tax Assets	103	164	165	165	164
Total Assets	**46,933**	**54,888**	**72,964**	**1,00,283**	**1,37,937**

Source: Company, JM Financial

Key Ratios					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Growth (YoY) (%)					
Borrowed funds	16.6%	12.4%	43.0%	37.0%	49.8%
Advances	26.4%	20.6%	20.6%	53.0%	38.5%
Total Assets	17.6%	16.9%	32.9%	37.4%	37.5%
NII	32.5%	20.7%	14.2%	47.9%	43.2%
Non-interest Income	27.7%	-4.6%	66.8%	23.3%	25.7%
Operating Expenses	41.8%	24.9%	87.6%	65.1%	47.2%
Operating Profits	29.5%	13.1%	10.2%	33.1%	35.8%
Core Operating profit	30.2%	12.9%	10.4%	31.7%	37.1%
Provisions	11.3%	264.5%	-28.7%	489.4%	98.6%
Reported PAT	28.6%	10.0%	11.8%	23.3%	27.2%
Yields / Margins (%)					
Interest Spread	2.78%	3.01%	3.27%	3.74%	4.20%
NIM	6.41%	6.60%	6.02%	6.59%	6.85%
Profitability (%)					
ROA	4.41%	4.14%	3.69%	3.35%	3.10%
ROE	13.6%	12.2%	11.7%	11.0%	11.2%
Cost to Income	16.4%	17.8%	26.9%	31.4%	33.2%
Asset quality (%)					
Gross NPA	0.23%	1.41%	1.30%	1.48%	2.05%
LLP	0.07%	0.26%	0.11%	0.66%	0.91%
Capital Adequacy (%)					
Tier I	33.82%	33.40%	27.90%	31.43%	25.64%
CAR	34.21%	33.80%	28.30%	31.77%	25.91%

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
NII / Assets	6.33%	6.52%	5.92%	6.47%	6.73%
Other Income / Assets	1.84%	1.50%	1.99%	1.81%	1.66%
Total Income / Assets	8.17%	8.02%	7.92%	8.28%	8.39%
Cost / Assets	0.91%	0.95%	1.13%	1.23%	1.28%
PPP / Assets	6.83%	6.59%	5.78%	5.68%	5.61%
Provisions / Assets	0.08%	0.24%	0.14%	0.60%	0.86%
PBT / Assets	6.75%	6.35%	5.65%	5.08%	4.74%
Tax rate	34.6%	34.7%	34.7%	34.0%	34.6%
ROA	4.41%	4.14%	3.69%	3.35%	3.10%
Leverage	3.0	2.9	3.4	3.2	3.9
ROE	13.6%	12.2%	11.7%	11.0%	11.2%

Source: Company, JM Financial

Valuations					
Y/E March	FY16A	FY17A	FY18A	FY19E	FY20E
Shares in Issue	73.4	78.4	78.7	90.9	90.9
EPS (INR)	26.1	26.9	29.9	32.0	40.6
EPS (YoY) (%)	19.8%	3.0%	11.3%	6.7%	27.2%
P/E (x)	19.9	19.4	17.4	16.3	12.8
BV (INR)	210	243	272	344	385
BV (YoY) (%)	11.8%	15.5%	11.9%	26.7%	11.8%
P/BV (x)	2.48	2.15	1.92	1.51	1.35
DPS (INR)	0.0	0.0	0.0	0.0	0.0
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, JM Financial

APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081
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Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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