

Indostar Capital Finance

CMP: INR169

TP: INR195 (+16%)

Buy

Disbursement momentum better; asset quality improving

Indostar Capital Finance (Indostar) reported an operationally healthy quarter. Key highlights: 1) 1QFY24 disbursements jumped ~24% QoQ to ~INR11b; 2) invested in human capital (+320 employees in 1Q to 3,134); 3) CV segment contributed ~93% to the disbursement mix, and 4) asset quality improved.

Financial highlights:

- Indostar reported 1QFY24 PAT of INR389m (PQ: INR760m) due to absence of any one-offs in employee expenses like last quarter.
- Gross AUM declined 2% YoY but grew 3% QoQ to ~INR80.6b. Corporate loans dipped 9% YoY, with their proportion at ~15% as of 1QFY24.
- Retail AUM rose ~4% QoQ to INR68.7b, while CV and Housing Finance grew ~7%.
- With its senior leadership team in place, focus remains on streamlining and improving processes, and exhibiting an improvement in asset quality. The company is well-positioned to deliver a steady improvement in its RoA profile.
- With better visibility on disbursement momentum, we estimate 30%/9% AUM/PAT CAGR over FY23-25 aided by healthy NIM (7.0-7.1%) and benign credit costs (1.4-1.9%) over FY24-25. After a difficult FY23, we believe this franchise is now on course for a turnaround. We have a BUY rating with a TP of INR195 (premised on 0.8x FY25E BVPS).

Disbursements in used CV segment continue to gain momentum

- Disbursements continued to gain momentum and the company reported disbursements of INR11b in 1QFY24 (PQ: ~INR9b). Disbursements were strong across CV and Housing Finance. CV Finance disbursements for 1QFY24 stood at INR7.5b (PQ: 6.6b).
- Indostar has strategically prioritized the Used CV segment, with ~93% of its 1QFY24 disbursements coming from this segment. This change in the product mix towards used CV segment will enable higher blended yields.

Key highlights from the management commentary

- Management guided for disbursements of INR44b in FY24.
- Opex was at INR1.15b, which grew 24% QoQ. However, it is important to note that in the previous quarter, there was a one-time reversal of INR506m, and when adjusted for this, the sequential opex growth would have been ~2%.

Housing Finance:

- The company aims to grow its AUM to 2.5x the current AUM within the next two years.
- Indostar has maintained healthy yields of >18% in its Loan Against Property (LAP) business, with a low NS3 of 0.9%.



Bloomberg	INDOSTAR IN
Equity Shares (m)	123
M.Cap.(INRb)/(USD\$)	20.9 / 0.3
52-Week Range (INR)	198 / 104
1, 6, 12 Rel. Per (%)	12/1/9
12M Avg Val (INR M)	18

Financials & Valuations (INR b)

Y/E March	FY23	FY24E	FY25E
NII	4.8	5.6	7.5
PPP	2.0	3.1	5.4
PAT	2.3	1.6	2.7
EPS (INR)	16.5	11.9	19.8
EPS Gr. (%)	-131	-28	66
BV (INR)	229	241	260

Ratios

NIM (%)	6.7	7.1	7.0
C/I ratio (%)	66.9	59.2	47.2
RoA (%)	2.4	1.5	2.0
RoE (%)	7.5	5.1	7.9
Payout (%)	0.0	0.0	0.0

Valuations

P/E (x)	10.1	14.1	8.4
P/BV (x)	0.73	0.69	0.64
Div. Yield (%)	0.0	0.0	0.0

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	75.0	89.2	89.2
DII	1.9	1.6	1.6
FII	1.3	1.2	1.2
Others	21.8	8.1	8.0

FII Includes depository receipts

Valuation and view

- Indostar has strategically prioritized the expansion of its loan book in the used CV and affordable housing finance segments. It anticipates that a strengthened management team, enhanced processes, and a favorable economic climate will serve as catalysts for growth in these segments.
- While the Corporate book will continue to run down, we expect the Retail book to see strong growth from hereon. It has made conservative provisions on stressed loans and we expect credit costs at ~1.2-1.7% over the next two years.
- Over the last two quarters, Indostar has made some sound business decisions, which can help this franchise make a turnaround. Risk-reward is favorable at 0.65x FY25E P/BV. We have a **BUY** rating on the stock with a TP of INR195 (premised on 0.8x FY25E BVPS).

Quarterly Performance**(INR m)**

Y/E March	FY23				FY24		FY22	FY23	FY24
	1Q	2Q	3Q	4Q	1Q				
Interest Income	2,770	2,609	2,626	2,579	2,723	10,672	10,584	12,514	
Interest Expenses	1,481	1,464	1,354	1,504	1,544	5,395	5,803	6,882	
Net Interest Income	1,289	1,145	1,272	1,075	1,179	5,276	4,782	5,632	
YoY Growth (%)	25.3	6.3	-6.6	-40.5	-8.6	13.4	-9.4	17.8	
Other Income	372	336	191	313	271	1,071	1,212	1,854	
Total Income	1,662	1,481	1,463	1,388	1,450	6,348	5,994	7,486	
YoY Growth (%)	31.3	0.4	-10.3	-31.3	-12.7	9.7	-5.6	24.9	
Operating Expenses	1,021	1,120	1,209	662	1,153	3,726	4,011	4,472	
Operating Profit	641	361	254	726	297	2,621	1,983	3,014	
YoY Growth (%)	93.1	-33.9	-59.1	-37.7	-53.6	-4.0	-24.4	52.0	
Provisions & Loan Losses	-23	-202	-132	-47	-119	11,585	-404	1,105	
Profit before Tax	664	563	386	773	416	-8,964	2,386	1,909	
Tax Provisions	55	47	20	13	27	-1,599	135	355	
Net Profit	609	516	367	760	389	-7,365	2,252	1,554	
YoY Growth (%)	-265	31	152	-110	-36		-130.6	-31.0	
Key Operating Parameters (%)									
Yield on loans (Cal)	15.4	16.0	16.6	16.1	16.3				
Cost of funds (Cal)	9.8	10.2	9.8	10.8	10.7				
Spreads (Cal)	5.6	5.8	6.8	5.3	5.6				
NIMs (Cal)	5.8	5.7	6.5	5.6	5.9				
Credit Cost (Cal)	-0.1	-1.0	-0.7	-0.2	-0.6				
Cost to Income Ratio	61.4	75.6	82.6	47.7	79.5				
Tax Rate	8.3	8.3	5.1	1.7	6.5				
Balance Sheet Parameters									
AUM (INR B)	82.5	79.1	76.7	78.1	80.6				
Change YoY (%)	-2.2	-7.7	-17.0	-19.1	-2.2				
AUM Mix (%)									
Vehicle	46.5	45.7	45.2	47.0	48.7				
Housing	17.8	19.5	19.9	20.8	21.6				
SME & Others	20.1	19.5	18.7	16.5	14.6				
Corporate	15.6	15.4	15.9	15.7	14.8				
Disbursements (INR B)	3.4	3.3	5.2	9.0	11.2				
Change YoY (%)	-45.2	-70.4	-64.7	-47.5	224.4				
Asset Quality Parameters (%)									
GS 3 (INR B)	3.4	4.9	5.4	4.8	4.9				
Gross Stage 3 (% on Assets)	8.2	7.1	7.9	6.8	6.6				
Net Stage 3 (% on Assets)	3.6	2.9	3.6	3.2	3.1				
PCR (%)	57.8	60.1	56.2	54.2	53.6				

E: MOFSL estimates

Asset quality exhibiting gradual improvement

- GNPA/NNPA improved ~20bp/~10bp to 6.6%/3.1%, driven by reduction in stress book and improvement in staging of loans. PCR declined to 53% (PQ: 54%).
- Standalone Stage 2 as of 1QFY24 has improved to ~9% (PQ: ~17%).
- Strong collections of ~INR10.4b resulted in gross collection efficiency of 139% in 1QFY24.

IndoStar Home Finance Pvt Ltd (IHFPL)

- AUM as of Jun'23 stood at ~INR17.4b and grew ~7% QoQ (PQ: INR16.2b).
- Asset quality has improved, with GS3 improving to 1.2% as of Jun'23 (PQ: 1.3%).
- IHFPL reported a PAT of ~INR80m in 1QFY24 (PQ: INR31m).
- The company is in discussions with JM Financial to explore strategic options to unlock value and achieve sustainable long-term growth for the housing finance/mortgage-backed businesses through various corporate actions (e.g., sale, demergers, spin-offs, etc.).



Highlights from the management commentary

- Indostar continues to observe robust growth in the affordable housing and used commercial vehicle (CV) segments.
- The outlook for the CV industry remains favorable driven by economic resilience and healthy GDP growth in 1QFY24.
- The company has a specific focus on tier 3 and 4 markets, which contribute significantly to the overall volumes of the company.
- The company has strengthened its leadership team by appointing a new Chief Risk Officer with the management team now complete.
- In line with its commitment of sustained growth, portfolio excellence, and operational efficiency, Indostar is actively exploring innovative products and strategies to augment growth and yields.
- Used CV contributed 93% of the total disbursements in the quarter
- CRISIL has removed the Rating Watch Negative with Negative Implications. It focuses on strengthening of risk and controls with strong governance mechanism.

Guidance

- The company expects leverage to rise from 2x to 4x in a sustained manner over the next five quarters.
- Management guided for disbursements of INR44b in FY24
- Guided for consol. book to grow over INR130b and standalone book to rise over INR100b by FY25
- Comfortable with RoA of 2.5-3.0% in the medium term and RoE in 14-15%.
- Incremental NIM of 8%, Opex of ~4% (or lower), and credit costs of 1.5-2.0% should lead to an RoA of ~2.0%.

Margins and CoF

- Indostar primarily operates in the used CV segment, and despite the prevailing market conditions, it has not witnessed any compression in margins.
- The company's presence in Tier III and IV markets has contributed to robust yields and demand momentum in the used CV segment, and it anticipates this positive trend to continue in the upcoming quarters as well.
- The company's business model includes financing vehicles up to 12 years old, and it expects the government's scrappage policy to have a favorable impact on the used CV financing sector.
- During the monsoon season (June, July, August), there is typically a slowdown in the demand for new CV vehicles due to reduced construction activity and slower movement of trucks.
- It has engaged with banks after the results for the previous quarter and successfully issued NCDs at competitive interest rate of 9.95%. These NCDs were subscribed by larger entities, giving the company confidence that banks will also begin lending to it in the future.

Opex

- Opex for the current quarter was at INR1.15b, which grew 24% QoQ. However, it is important to note that in the previous quarter, there was a one-time

reversal of INR506m, and when adjusted for this, the sequential opex growth would have been ~2%.

- The company expects a reduction in operating expenses in the upcoming quarters.
- The adjusted PAT grew 50% QoQ at INR390m.

Asset Quality

- The emphasis on portfolio quality has led to notable improvement in GS3 assets to 6.6%, and the company is optimistic about sustaining this positive trend.
- Despite first quarter being a seasonally weak quarter, the collections in the quarter surpassed that of the Mar'23 quarter
- To maintain the quality of its portfolio, the company has implemented a CIBIL score threshold, which considers the repayment track record and credit history of customers. This ensures that the company caters to customers with a lower likelihood of defaulting in the future.
- Additionally, the company proactively engages with customers before they slip into NPA, aiming to prevent delinquencies and arrest movement to higher buckets.
- CV Stage 2 stood at INR1.8b (4.85%) including restructured book of INR600m, while Stage 1 stood at 88%
- Stage 2 has also significantly reduced to 9%.

Housing Finance

- Achieved consistent progress in the affordable housing finance segment, with a strategic focus on small towns and semi-urban areas.
- The company has maintained healthy yields of over 18% in its Loan Against Property (LAP) business, with a low NS3 of 0.9% and favorable spreads across its portfolio.
- In 1QFY24, disbursements reached ~INR1.9b at an average origination yield of 15.8%.
- The company's AUM grew 7% QoQ, indicating successful efforts to expand the customer base in Tier 2 and 3 markets.
- Additionally, Indostar has a presence in the Micro-LAP segment, catering to ticket sizes between INR0.5m and 0.7m.
- The company aims to grow its AUM to 2.5x the current value within the next two years. Further, Indostar is exploring potential collaboration with JM Financial's Housing Finance subsidiary, with ongoing due diligence and updates expected in the future.

SME Finance

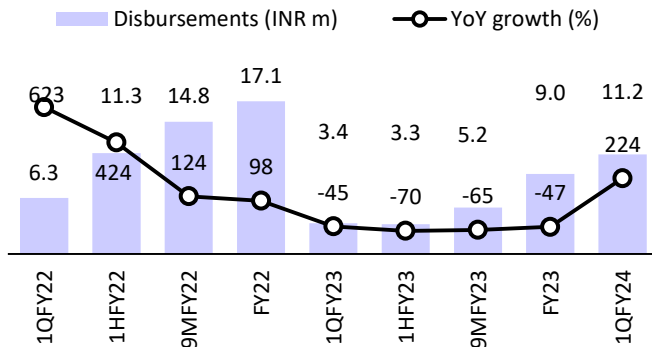
- Focusing on reducing the Stage 3 and then it will come back to investors with a clear strategy.
- Average LTV at 50-55%.
- The company is running down the SME book without any significant losses

Others

- Corporate book will run down significantly by Mar24. Three accounts are in Stage 1 and two accounts worth ~INR8.7b are in Stage 2.
- SME book yields at 13% and Corporate book yields at 15%.

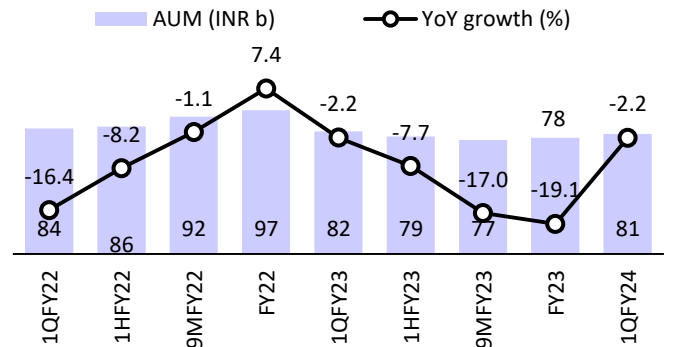
Key Exhibits

Exhibit 1: Disbursements grew 24% QoQ...



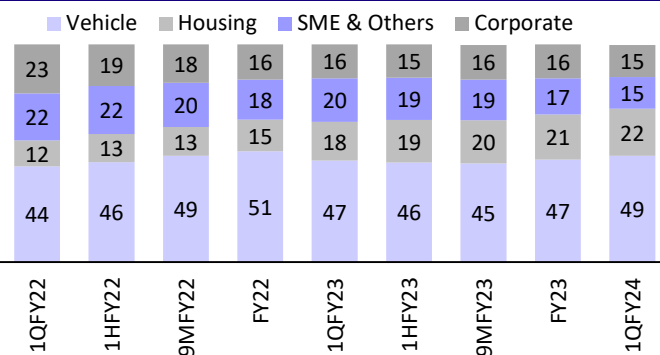
Source: MOFSL, Company

Exhibit 2: ...while AUM grew ~3% QoQ



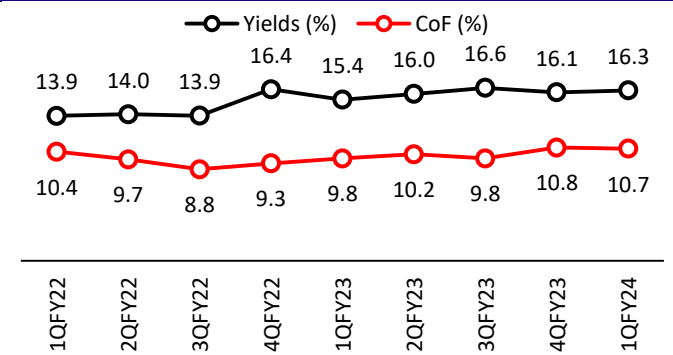
Source: MOFSL, Company

Exhibit 3: Share of corporate book moderated sequentially



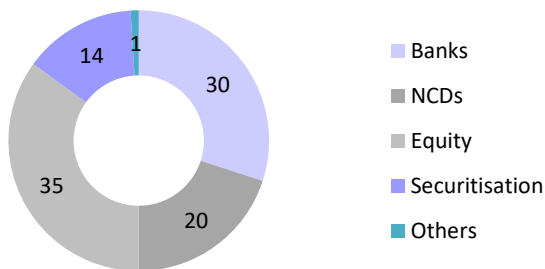
Source: MOFSL, Company

Exhibit 4: Spreads expanded 30bp QoQ (%)



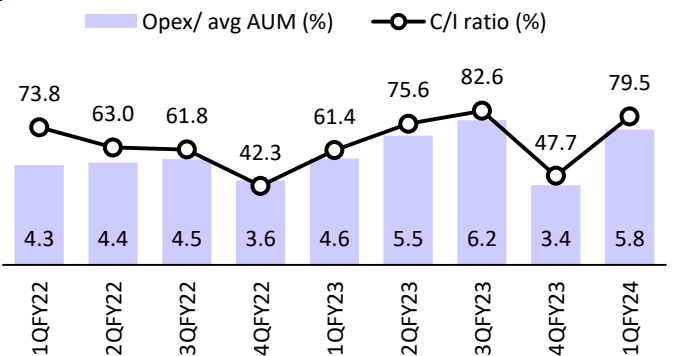
Source: MOFSL, Company;

Exhibit 5: Borrowings mix as on 1QFY24



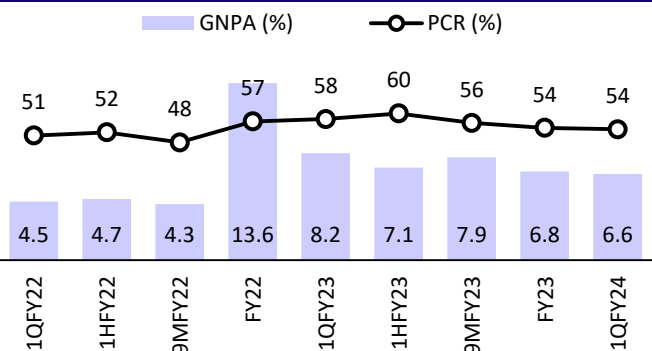
Source: MOFSL, Company

Exhibit 6: C/I ratio increased to ~80%



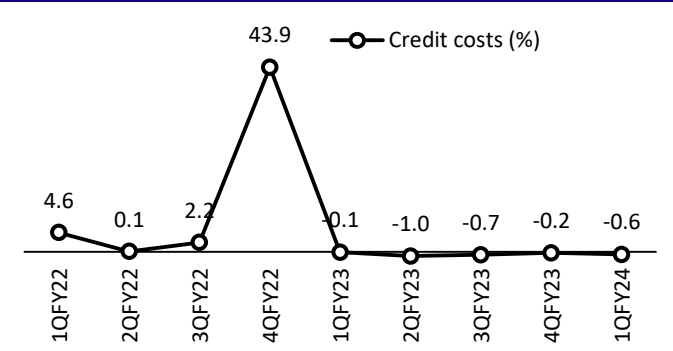
Source: MOFSL, Company; One-off accounting adjustment in 4QFY20

Exhibit 7: PCR on S3 loans declined to 54%



Source: MOFSL, Company

Exhibit 8: Provision write-backs of ~INR119m in 1QFY24

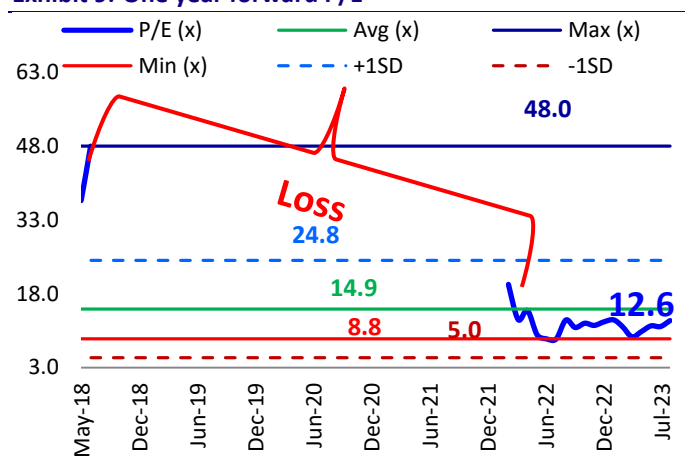


Source: MOFSL, Company

Valuation and view

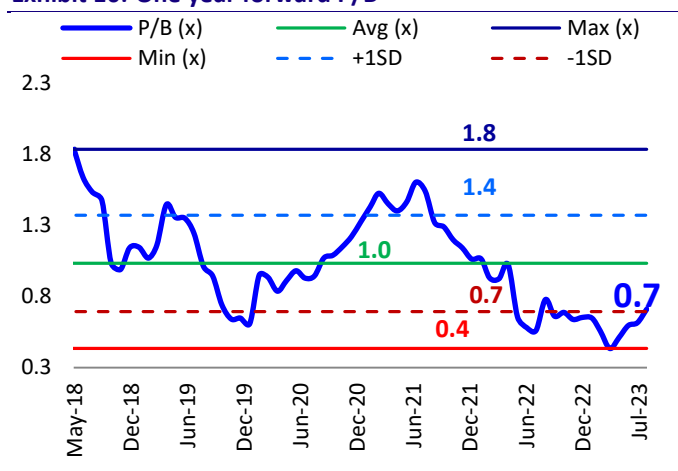
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Exhibit 9: One year forward P/E



Source: MOFSL, Company

Exhibit 10: One year forward P/B



Source: MOFSL, Company

Financials and valuations

Income Statement							(INR m)	
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Interest Income	7,631	10,813	14,662	11,739	10,672	10,584	12,514	17,122
Interest Expended	3,255	5,636	8,634	7,086	5,395	5,803	6,882	9,632
Net Interest Income	4,376	5,177	6,028	4,653	5,276	4,782	5,632	7,490
Change (%)	31.9	18.3	16.4	-22.8	13.4	-9.4	17.8	33.0
Fee Income	159	620	515	327	444	542	758	1,024
Other Income	99	624	812	806	627	671	1,159	1,703
Net Income	4,634	6,420	7,355	5,786	6,348	5,994	7,550	10,217
Change (%)	13.6	38.5	14.6	-21.3	9.7	-5.6	26.0	35.3
Operating Expenses	1,548	2,466	3,120	3,055	3,726	4,011	4,472	4,825
Operating Income	3,087	3,954	4,235	2,731	2,621	1,983	3,078	5,392
Change (%)	-8.0	28.1	7.1	-35.5	-4.0	-24.4	55.2	75.2
Provisions and W/Offs	-38	162	8,602	4,920	11,585	-404	1,105	2,030
PBT	3,125	3,792	-4,367	-2,189	-8,964	2,386	1,973	3,362
Tax	1,121	1,384	-1,120	-48	-1,599	135	355	672
Tax Rate (%)	35.9	36.5	25.7	2.2	17.8	5.6	18.0	20.0
PAT	2,003	2,408	-3,246	-2,141	-7,365	2,252	1,617	2,689
Change (%)	-5.0	20.2	-234.8	-34.0	244.0	-130.6	-28.2	66.3

Balance Sheet							(INR m)	
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	787	923	925	1,237	1,361	1,361	1,361	1,361
Reserves & Surplus	19,960	29,140	25,881	35,745	27,930	29,755	31,373	34,062
Net Worth	20,747	30,063	26,806	36,982	29,291	31,116	32,733	35,423
Other Capital Instruments	0	0	0	0	0	0	0	0
Borrowings	48,834	90,617	71,419	60,076	62,234	56,481	82,542	1,10,091
Change (%)	39.3	85.6	-21.2	-15.9	3.6	-9.2	46.1	33.4
Other liabilities	2,357	2,321	3,061	3,757	5,089	3,626	3,988	4,387
Total Liabilities	71,938	1,23,002	1,01,286	1,00,815	96,614	91,222	1,19,263	1,49,900
Investments	10,070	3,009	2,306	15,914	5,477	10,394	11,225	12,123
Change (%)	439.2	-70.1	-23.4	590.2	-65.6	89.8	8.0	8.0
Loans and Advances	59,004	1,03,637	82,931	71,393	77,069	65,157	92,743	1,20,979
Change (%)	16.8	75.6	-20.0	-13.9	8.0	-15.5	42.3	30.4
Net Fixed Assets	641	3,704	4,214	3,865	3,990	3,902	4,098	4,302
Other Assets	2,222	12,652	11,835	9,643	10,078	11,769	11,197	12,496
Total Assets	71,938	1,23,002	1,01,286	1,00,815	96,614	91,222	1,19,263	1,49,900

E: MOFSL Estimates

Financials and valuations

AUM Details							(INR m)	
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Consol. AUM (INR B)	62	117	100	90	97	78	102	133
AUM Mix								
Corporate	74	39	29	22	16	16	9	5
Retail	28	61	71	78	84	84	91	95
Vehicle	2	41	45	47	51	47	57	62
SME	26	16	18	21	18	17	10	7
Housing	1	5	8	11	15	21	24	26
Ratios							(%)	
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Spreads Analysis (%)								
Yield on Portfolio	13.1	13.0	15.6	14.9	14.1	14.6	15.6	15.8
Cost of Borrowings	7.8	8.1	10.7	10.8	8.8	9.8	9.9	10.0
Interest Spread	5.3	4.9	4.9	4.1	5.3	4.9	5.7	5.8
Net Interest Margin	8.0	6.4	6.5	6.0	7.1	6.7	7.1	7.0
Profitability Ratios (%)								
RoE	10.2	9.5	-11.4	-6.7	-22.2	7.5	5.1	7.9
RoA (on balance sheet)	3.2	2.5	-2.9	-2.1	-7.5	2.4	1.5	2.0
Debt: Equity (x)	2.4	3.0	2.7	1.6	2.1	1.8	2.5	3.1
Leverage (x)	3.5	4.1	3.8	2.7	3.3	2.9	3.6	4.2
Efficiency Ratios (%)								
Int. Expended/Int. Earned	42.7	52.1	58.9	60.4	50.6	54.8	55.0	56.3
Op. Exps./Net Income	33.4	38.4	42.4	52.8	58.7	66.9	59.2	47.2
Empl. Cost/Op. Exps.	68.8	60.6	60.5	56.9	55.0	44.3	47.7	46.9
Fee income/Net Income	3.4	9.7	7.0	5.6	7.0	9.0	10.0	10.0
Asset quality								
GNPA	768	3,051	3,652	3,441	12,030	4,790	4,265	4,803
NNPA	640	1,995	2,893	1,580	5,190	2,190	1,919	2,161
GNPA %	1.3	2.9	4.4	4.7	13.6	6.8	4.5	3.9
NNPA %	1.1	1.9	3.5	2.2	6.7	3.4	2.1	1.8
PCR %	16.7	34.6	20.8	54.1	56.9	54.3	55.0	55.0
Valuation								
Book Value (INR)	264	326	290	299	215	229	241	260
BV Growth (%)	12.3	23.6	-11.0	3.1	-28.0	6.2	5.2	8.2
Price-BV (x)			0.6	0.6	0.8	0.7	0.7	0.6
Adjusted BV (INR)	257	303	262	279	153	204	219	236
Price-ABV (x)	0.7	0.6	0.6	0.6	1.1	0.8	0.8	0.7
EPS (INR)	25.5	26.1	-35.1	-17.3	-54.1	16.5	11.9	19.8
EPS Growth (%)	-5.4	2.5	-234.5	-50.7	212.8	-130.6	-28.2	66.3
Price-Earnings (x)			-4.8	-9.7	-3.1	10.1	14.1	8.4
Dividend per share			2.0	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)			1.2	0.0	0.0	0.0	0.0	0.0
E: MOFSL Estimates								

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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