

Indostar Capital Finance

CMP: INR146

TP: INR175 (+20%)

BUY

Bloomberg	INDOSTAR IN
Equity Shares (m)	123
M.Cap.(INRb)/(USD\$)	18.1 / 0.2
52-Week Range (INR)	198 / 104
1, 6, 12 Rel. Per (%)	16/-6/-14
12M Avg Val (INR M)	14

Financials & Valuations (INR b)

Y/E March	FY23	FY24E	FY25E
NII	4.8	5.7	7.5
PPP	2.0	3.2	5.5
PAT	2.3	1.5	2.6
EPS (INR)	16.5	11.3	19.3
EPS Gr. (%)	-131	-32	72
BV (INR)	229	240	259
Ratios			
NIM (%)	6.7	7.2	7.0
C/I ratio (%)	66.9	57.7	46.5
RoA (%)	2.4	1.5	2.0
RoE (%)	7.5	4.8	7.8
Payout (%)	0.0	0.0	0.0
Valuations			
P/E (x)	8.8	13.0	7.5
P/BV (x)	0.64	0.61	0.56
Div. Yield (%)	0.0	0.0	0.0

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	89.2	89.2	89.2
DII	1.6	1.5	1.6
FII	1.2	1.2	1.3
Others	8.1	8.1	7.9

FII Includes depository receipts

Turnaround in progress; focuses on used CV and housing

Indostar reported an operationally good quarter. Key highlights: 1) strong ~70% QoQ growth in 4QFY23 disbursements to ~INR9b, 2) investment in human capital (+85 employees in 4Q to 2,814), 3) CV segment contributed ~90% to the disbursement mix, and 4) improvement in asset quality.

Key highlights from the results:

- Indostar successfully completed its offer for sale of ~19.3m shares on 3rd and 4th May'23. The public shareholding in Indostar has increased from ~10.8% to 25%, ensuring compliance with SEBI regulations.
- The company reported 4QFY23 PAT of INR760m (v/s net loss of INR7.5b in 4QFY22), driven primarily by provision write-backs of INR47m and lower operating expenses (due to reversal of ESOP costs of ~INR510m in 4QFY23 on unvested options). FY23 PAT stood at ~INR2.3b as against a loss of INR7.4b in FY22.
- Gross AUM declined 19% YoY but grew 2% QoQ to INR78b. Corporate loans declined 25% YoY, with their proportion declining to ~15%. Retail AUM rose ~3% QoQ to INR66.3b, with CV and Housing Finance posting decent sequential growth.
- With its senior leadership team in place, focus on streamlining and improving processes, and improvement in asset quality, Indostar is well-positioned to achieve a steady improvement in its RoA profile.
- With better visibility on disbursement momentum, we estimate 30%/8% AUM/PAT CAGRs over FY23-25 on the back of healthy NIM (7.0-7.2%) and benign credit costs (1.6-2.0%) over FY24 and FY25. After a difficult last one year, we believe this franchise is now on course for a turnaround. We have a BUY rating with a TP of INR175 (0.7x FY25E BVPS).

Strong momentum in Retail disbursements

- Disbursements continued to gain momentum and the company reported disbursements of INR9b in 4QFY23 (PQ: INR5.2b). Disbursements were strong across CV and Housing Finance. CV Finance disbursements for 4QFY23 stood at INR6.6b (PQ: 3.3b).
- Indostar has strategically prioritized the Used CV segment, with ~90% of its 4QFY23 disbursements from this segment. This change in the product mix toward the used CV segment will enable higher blended yields.

Key highlights from the management commentary

- Indostar has guided for monthly disbursements of INR3.5b in the Used CV segment. It expects standalone AUM to grow to ~INR90b and consolidated AUM to grow to ~INR130b by FY25.
- It has guided for NIM to improve to 6.5% (v/s current level of 5.6%), driven by improving proportion of higher-yielding Used CV in the loan mix.

Valuation and view

- The company 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 FY24 onward. It has made conservative provisions on stressed loans and we expect credit costs at ~1.6-2.0% 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 0.6x FY25E P/BV. We have a BUY rating with a TP of INR175 (0.7x FY25E BVPS).

Quarterly Performance

(INR M)

Y/E March	FY22				FY23				FY22	FY23
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Interest Income	2,416	2,447	2,613	3,196	2,770	2,609	2,626	2,579	10,672	10,584
Interest Expenses	1,387	1,370	1,250	1,389	1,481	1,464	1,354	1,504	5,395	5,803
Net Interest Income	1,029	1,077	1,362	1,808	1,289	1,145	1,272	1,075	5,276	4,782
YoY Growth (%)	-23.4	-12.3	29.9	75.5	25.3	6.3	-6.6	-40.5	13.4	-9.4
Other Income	237	399	268	214	372	336	191	313	1,071	1,212
Total Income	1,266	1,476	1,631	2,021	1,662	1,481	1,463	1,388	6,348	5,994
YoY Growth (%)	-15.1	-3.9	4.6	68.4	31.3	0.4	-10.3	-31.3	9.7	-5.6
Operating Expenses	934	929	1,009	855	1,021	1,120	1,209	662	3,726	4,011
Operating Profit	332	547	622	1,166	641	361	254	726	2,621	1,983
YoY Growth (%)	-52.8	1.0	-22.7	204.8	93.1	-33.9	-59.1	-37.7	-4.0	-24.4
Provisions & Loan Losses	824	16	427	10,363	-23	-202	-132	-47	11,585	-404
Profit before Tax	-493	531	196	-9,197	664	563	386	773	-8,964	2,386
Tax Provisions	-124	136	50	-1,661	55	47	20	13	-1,599	135
Net Profit	-368	394	145	-7,537	609	516	367	760	-7,365	2,252
YoY Growth (%)	-178	25	-40	138	-265	31	152	-110		-130.6
Key Operating Parameters (%)										
Yield on loans (Cal)	13.9	14.0	13.9	16.4	15.4	16.0	16.6	16.1		
Cost of funds (Cal)	10.4	9.7	8.8	9.3	9.8	10.2	9.8	11.0		
Spreads (Cal)	3.4	4.3	5.1	7.1	5.6	5.8	6.8	5.1		
NIMs (Cal)	4.7	5.1	6.1	7.7	5.8	5.7	6.5	5.6		
Credit Cost (Cal)	4.6	0.1	2.2	43.9	-0.1	-1.0	-0.7	-0.2		
Cost to Income Ratio	73.8	63.0	61.8	42.3	61.4	75.6	82.6	47.7		
Tax Rate	25.2	25.7	25.7	18.1	8.3	8.3	5.1	1.7		
Balance Sheet Parameters										
AUM (INR B)	84.3	85.7	92.4	96.6	82.5	79.1	76.7	78.1		
Change YoY (%)	-16.4	-8.2	-1.1	7.4	-2.2	-7.7	-17.0	-19.1		
AUM Mix (%)										
Vehicle	43.8	45.8	48.7	50.8	46.5	45.7	45.2	47.0		
Housing	12.0	12.9	13.2	14.6	17.8	19.5	19.9	20.8		
SME & Others	21.6	22.0	20.3	18.4	20.1	19.5	18.7	16.5		
Corporate	22.5	19.2	17.8	16.2	15.6	15.4	15.9	15.7		
Disbursements (INR B)	6.3	11.3	14.8	17.1	3.4	3.3	5.2	9.0		
Change YoY (%)	623.0	424.5	123.8	98.0	-45.2	-70.4	-64.7	-47.5		
Asset Quality Parameters (%)										
GS 3 (INR B)	3.3	3.6	3.6	6.8	3.4	4.9	5.4	4.8		
Gross Stage 3 (% on Assets)	4.5	4.7	4.3	13.6	8.2	7.1	7.9	6.8		
Net Stage 3 (% on Assets)	2.2	2.3	2.3	6.4	3.6	2.9	3.6	3.2		
PCR (%)	51.0	52.3	48.2	56.8	57.8	60.1	56.2	54.2		

E: MOFSL estimates

Significant improvement in asset quality driven by sale of stressed loans to ARC and recovery efforts

- GNPA/NNPA improved to 6.8%/3.2%, driven by reduction in stress book and improvement in staging of loans. PCR declined to 54% (PQ: 56%).
- Standalone Stage 2 as of FY23 has improved to ~INR11.7b (PY: INR17b) and the company maintained PCR of ~15% (~INR1.7b) on Stage 2 loans.
- Strong collections of ~INR9.2b resulted in gross collection efficiency of 126% in 4QFY23.
- Improved collections against loan pool sold to ARC give the company confidence that there will be additional write-backs of provisions on SRs in future. Indostar expects collections of over INR1.2b from SRs.

IndoStar Home Finance Pvt Ltd (IHFPL)

- AUM as of Mar'23 stood at ~INR16b, up ~15% YoY (PY: INR14.6b).
- Asset quality has improved, with GS3 improving to 1.3% as of Mar'23 (PY: 1.8%).
- IHFPL reported a PAT of ~INR378m in FY23, up ~10% YoY.
- 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.).

IndoStar Capital Finance Limited (ICFL)

- ICFL reported a PAT of ~INR1.9b in FY23 (v/s a loss of INR7.7b in FY22).
- AUM stood at ~INR62b (retail vehicle finance business AUM at INR36.7b). FY23 disbursements stood at ~INR16b (~90% in the vehicle finance business).
- With a strong focus on collections during the year, Gross Stage 3 declined to 8.1% in FY23 (PY: 15.5%) and Net Stage 3 improved to 3.8% (PY: 7.3%).

Highlights from management commentary

Business update

- The company has a strategic focus on expanding its loan book in the used CV and affordable housing finance segments.
- To drive this growth, the management team in the CV segment is being scaled up with the addition of a new business and product head.
- The company expects that a strong management team, improved processes, favorable liquidity, and a buoyant economy should drive growth in the used CV segment.
- In line with its growth strategy, Indostar has shifted its focus to Tier III and IV markets.
- In the current quarter, there was a YoY decline in opex, which can be attributed to the reversal of invested ESOP costs that were previously charged to the profit and loss account.



Guidance

- The company has guided for monthly disbursements of INR3.5b in the used CV segment and aims to grow the loan book to INR40b by FY24.
- Indostar expects total standalone AUM to grow to ~INR90b by FY25 and consolidated AUM to INR130b.
- The company expects margins to improve to 6.5% from the current level of 5.6%, driven by improving proportion of high-yielding Used CV in the loan mix.
- The management expects to maintain an opex-to-AUM ratio at ~4% on a steady state basis.
- The credit cost is expected to be in the range of ~1.5%-2% in FY24.
- It has guided for RoA of 1.5% in FY24 and ~2.25-2.5% in FY25.
- The key factors that could drive RoA improvement include growth in the higher-yielding Used CV loan book.
- Additionally, the company plans to assess the profitability of each branch to identify opportunities for reducing opex, which would in turn boost ROA.

Guidance for Housing finance business

- In the affordable housing segment, the company expects to grow the loan book to INR11b by FY24.
- It has guided for credit costs of 0.5% and RoA of 2.6-2.7% in the housing finance business in FY24.

CV segment

- Indostar has strategically focused on the Used CV segment, with ~90-95% of total disbursements from this segment.
- This shift is motivated by higher yields available in the Used CV segment. Key competitors in this segment are CIFC and SHFL.
- Around 40% of the Used CV segment is still unorganized. The company plans to capture this unorganized market in Tier III and IV locations by leveraging its improved digital processes.
- The tenor for Used CV loans is typically 3-3.5 years.
- The company earns yields of 18-18.5% in the Used CV segment, with overall yields of the standalone business in the range of 15-15.5%.

Asset quality

- Indostar is committed to maintaining high credit standards and gradually improving asset quality.
- To address past challenges, the company has implemented a business rule to minimize errors and enhance the accuracy of credit assessments.
- Moreover, the company has focused on enhancing underwriting metrics to ensure higher quality of its loan portfolio.
- Employees have been instructed to prioritize policy and compliance adherence over loan growth objectives.
- Further, improved collections against loan pool sold to ARC give the company confidence that there will be additional write-backs of provisions on SRs in future.
- It expects collections of over INR1.2b from SRs.

- Standalone Stage 2 as of Mar'23 improved to ~INR11.7b (PY: INR17b) and the company maintains provisions of ~15% of ~INR1.7b on the same.
- Bounce rates are elevated on account of a higher number of new-to-credit customers. The same is expected to improve as vintage of borrowers increases.

Housing finance business

- The company charges yields in the range of 14.5% to 15.5% on its affordable housing loans.
- The average ticket size for these loans is ~INR0.8-0.9m.
- With its robust branch infrastructure and dedicated employees, the company expects to double its AUM under this segment in the next two years.
- Furthermore, the company has a clear visibility on liquidity and funding sources to support its growth initiatives. It has a CAR of 80.5% as of FY23.
- Asset quality has improved, with GS3 ratio improving to 1.3% as of Mar'23 v/s 1.8% as of Mar'22.
- Though the focus will be on affordable home loans, the company will also undertake LAP and other mortgage loans to maintain spreads at the current levels.
- The Housing segment is primarily focused on catering to self-employed customers in Tier III and IV cities.
- In this market, Indostar faces competition from other players such as Aptus and Aavas, which also have a similar focus on these markets and customer segment. The company's key area is in the southern region of India.

Tie-up with JM Financial

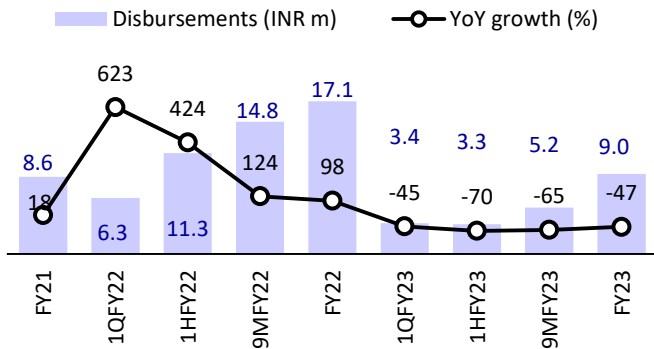
- Discussions ongoing with JM Financial on tie-ups with Indostar home finance and other mortgage businesses.

Digital initiatives

- Indostar is actively embracing digitalization to empower branch-level decision-making and foster a culture of accountability and credibility among branch heads and employees to enhance customer delivery efficiencies.
- The implementation of digital loan origination on mobile and web platforms facilitates a seamless customer journey while enabling sales, credit, and operations teams to improve both the quantity and quality of their services.

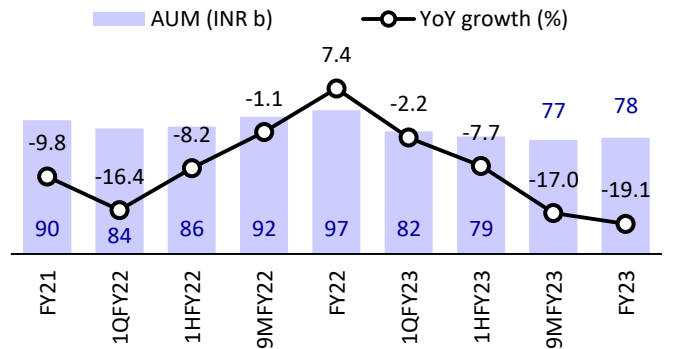
Key Exhibits

Exhibit 1: Disbursements grew 72% QoQ...



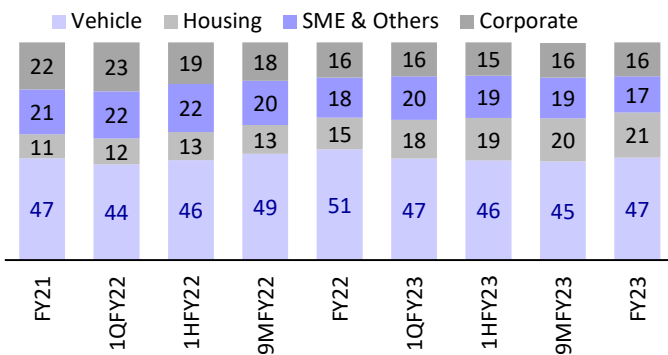
Source: MOFSL, Company

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



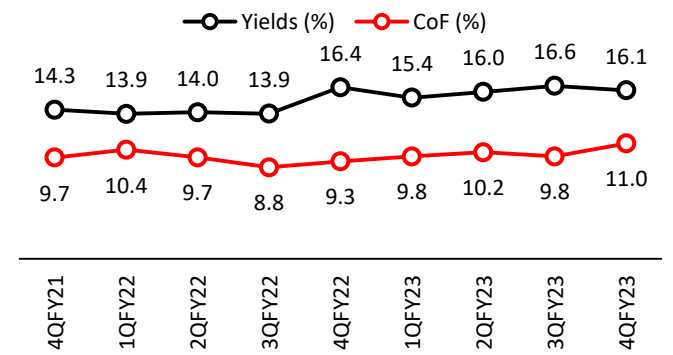
Source: MOFSL, Company

Exhibit 3: Share of corporate book was stable sequentially



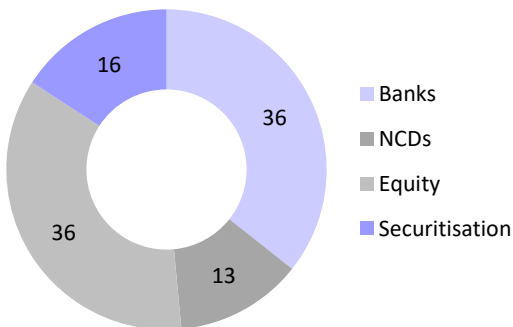
Source: MOFSL, Company

Exhibit 4: Spreads declined 100bp QoQ (%)



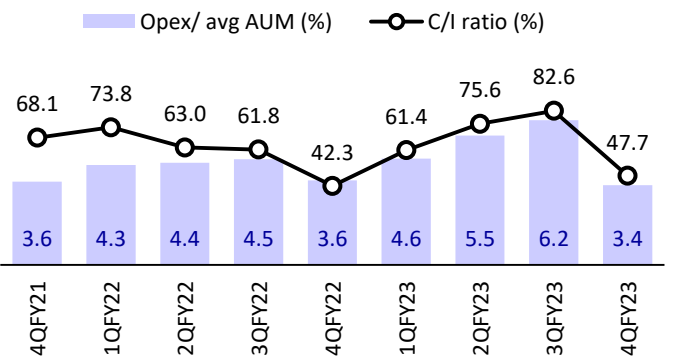
Source: MOFSL, Company;

Exhibit 5: Borrowings mix as on FY23



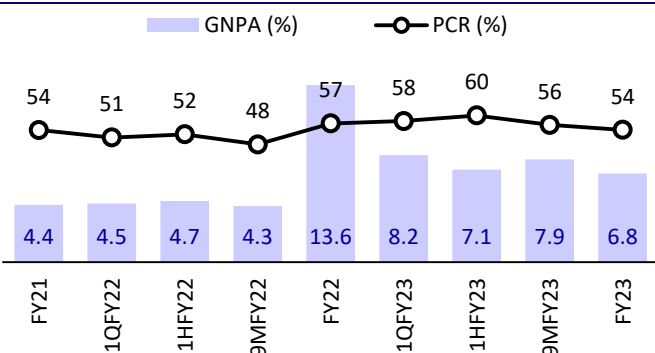
Source: MOFSL, Company

Exhibit 6: C/I ratio moderated to ~48%



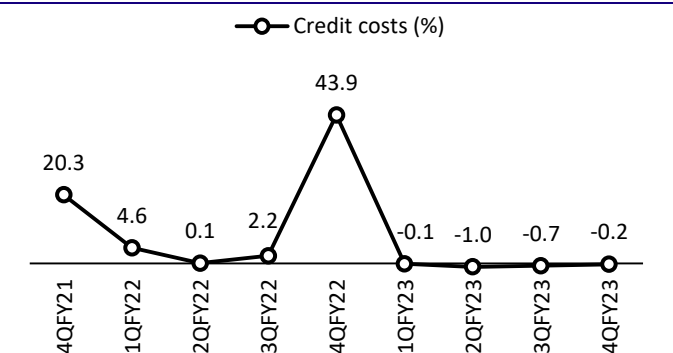
Source: MOFSL, Company; One-off accounting adjustment in 4QFY20

Exhibit 7: PCR on S3 loans declined to 54%



Source: MOFSL, Company

Exhibit 8: Provision write-backs of ~47m in 4QFY23

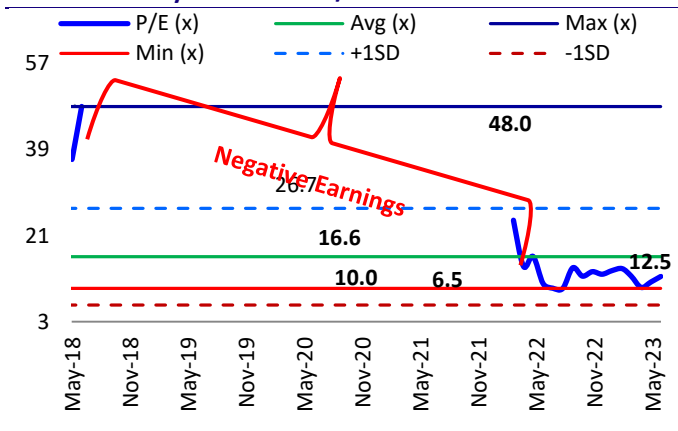


Source: MOFSL, Company

Valuation and view

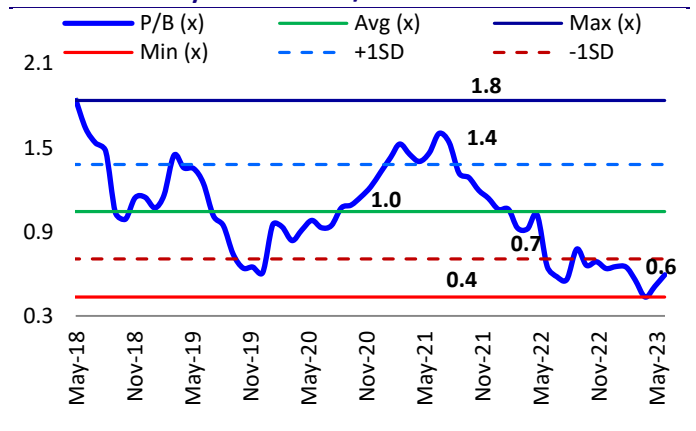
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- While the Corporate book will continue to run down, we expect the Retail book to see strong growth from FY24 onward. It has made conservative provisions on stressed loans and we expect credit costs at ~1.6-2.0% over the next two years.
- Over the last two quarters, Indostar has made some sound business decisions, which can help this franchise script a turnaround. Risk-reward is favorable at 0.6x FY25E P/BV. We have a BUY rating with a TP of INR175 (0.7x FY25E BVPS).

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	12,593	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	5,711	7,490
Change (%)	31.9	18.3	16.4	-22.8	13.4	-9.4	19.4	31.1
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	7,629	10,217
Change (%)	13.6	38.5	14.6	-21.3	9.7	-5.6	27.3	33.9
Operating Expenses	1,548	2,466	3,120	3,055	3,726	4,011	4,400	4,747
Operating Income	3,087	3,954	4,235	2,731	2,621	1,983	3,229	5,470
Change (%)	-8.0	28.1	7.1	-35.5	-4.0	-24.4	62.9	69.4
Provisions and W/Offs	-38	162	8,602	4,920	11,585	-404	1,263	2,094
PBT	3,125	3,792	-4,367	-2,189	-8,964	2,386	1,966	3,376
Tax	1,121	1,384	-1,120	-48	-1,599	135	432	743
Tax Rate (%)	35.9	36.5	25.7	2.2	17.8	5.6	22.0	22.0
PAT	2,003	2,408	-3,246	-2,141	-7,365	2,252	1,533	2,633
Change (%)	-5.0	20.2	-234.8	-34.0	244.0	-130.6	-31.9	71.7

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	31,288	33,922
Net Worth	20,747	30,063	26,806	36,982	29,291	31,116	32,649	35,282
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	1,19,179	1,49,760
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	11,113	12,356
Total Assets	71,938	1,23,002	1,01,286	1,00,815	96,614	91,222	1,19,179	1,49,760

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	15.7	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	5.8	5.8
Net Interest Margin	8.0	6.4	6.5	6.0	7.1	6.7	7.2	7.0
Profitability Ratios (%)								
RoE	10.2	9.5	-11.4	-6.7	-22.2	7.5	4.8	7.8
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	3.7	4.2
Efficiency Ratios (%)								
Int. Expended/Int.Earned	42.7	52.1	58.9	60.4	50.6	54.8	54.6	56.3
Op. Exps./Net Income	33.4	38.4	42.4	52.8	58.7	66.9	57.7	46.5
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	9.9	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	240	259
BV Growth (%)	12.3	23.6	-11.0	3.1	-28.0	6.2	4.9	8.1
Price-BV (x)			0.5	0.5	0.7	0.6	0.6	0.6
Adjusted BV (INR)	257	303	262	279	153	204	218	235
Price-ABV (x)	0.6	0.5	0.6	0.5	1.0	0.7	0.7	0.6
EPS (INR)	25.5	26.1	-35.1	-17.3	-54.1	16.5	11.3	19.3
EPS Growth (%)	-5.4	2.5	-234.5	-50.7	212.8	-130.6	-31.9	71.7
Price-Earnings (x)			-4.2	-8.4	-2.7	8.8	13.0	7.5
Dividend per share			2.0	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)			1.4	0.0	0.0	0.0	0.0	0.0

E: MOFSL Estimates

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NOTES

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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