

## Shriram City Union Finance: Small loans, big yields

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*The high potential SME and two-wheeler segments are key drivers*

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Niche focus in the small enterprises finance space and healthy presence in the two-wheeler segment have kept the performance of Shriram City Union Finance (a subsidiary of Shriram Capital) in good stead. While migrating to the more stringent non-performing asset (NPA) recognition norms has impacted its earnings in the latest March quarter, healthy provision cover provides cushion as the company switches to the 120-day norm by March 2017 and 90-day norm by end-March 2018.

Good prospects in the small and medium enterprises (SME) segment and the two-wheeler business driving credit offtake, a kicker to growth from likely improvement in the economy a year from now, and healthy provision, should drive an annual average earnings growth of 15-17 per cent over the next two years. Investors with a two to three years horizon can buy the stock.

At the current price, the stock trades at two times its one-year forward book value. This is a 30-50 per cent discount to players such as Sundaram Finance, Bajaj Finance and Cholamandalam Investment and Finance.

### Healthy growth prospects

Aside from tapping into its existing chit fund customer base in the traditional markets of Andhra Pradesh, Telangana, Tamil Nadu and Maharashtra, the company has also been focussing on newer markets, building its presence in the northern and western regions. The company continues to see good traction in SME loans across regions, with its loan book growing by 18 per cent in 2015-16 over the previous year. This segment constitutes a chunk — 54 per cent — of the company's loan portfolio as of March 2016.

Shriram City has also made use of opportunities in the two-wheeler and gold loan segment to build its retail presence. In 2015-16, two-wheeler loans went up by 16 per cent; these now account for 18 per cent of total loans. The recovery in the economy is expected to pick up pace in FY18. But strong presence in the high-yielding SME space, which offers a large lending opportunity, is expected to keep the overall growth intact in the interim.

While the underpenetrated SME market has been keenly eyed by many banks, risks within this segment have kept them wary. Shriram City Union Finance, having built competencies to assess the risk within this segment over the last decade or so, though is well placed to cater to the demand with its focus on Tier II and Tier III towns.

The two-wheeler segment too offers immense scope for growth, as the economy gathers pace. Shriram City's housing finance subsidiary, with its focus on the affordable home loan segment, also has good growth potential. The company's loan book grew 73 per cent in 2015-16, though on a small base.

### Smooth transitioning

The RBI in 2014 tightened the NPA recognition norms for NBFCs to bring them on a par with banks. Shriram City Union, which followed a 180-day norm — loans, where borrowers have defaulted in their payments for 180 days or more, are classified as NPAs — will have to comply with the 90-day norm by March 2018.

This will impact the company's earnings in two ways. One will be the reversal in interest income on migrating to the 90-day norm and, two, the increase in provisioning on account of incremental NPAs.

In 2015-16, the company moved to the 150-day norm, which has led to an increase in NPAs. From 3.1 per cent in 2014-15, gross NPAs have gone up to 5.15 per cent in 2015-16 on a 150-day cut off (3.6 per cent under 180-days). Earnings have dipped by 5 per cent in FY16 over the previous year. Additional provision of ₹139 crore during the latest March quarter was due to the shift from 180-day to 150-day norm for NPA recognition.

While there can be volatility in earnings through this transition over the next two years, Shriram City's healthy provision cover (70 per cent) should provide cushion to earnings. On the margin front, the company should benefit from a benign interest rate environment. About 59 per cent of the borrowings are on a floating rate basis.

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