

January 1, 2018

Capital First Ltd

Capital First (CFL) is a non-deposit-taking NBFC primarily focusing on retail lending. Post management buyout (2012), Mr Vaidynathan, the current chairman, transformed the company's focus from wholesale financier to diversified retail financier. Warburg Pincus in 2012 acquired a majority stake in the company. Focused approach led to decline in wholesale financing to 7% now from 90% in FY2010 and stringent underwriting resulting into GNPA of 5.3% in FY2010 to 1% in FY2017.

Strong AUM CAGR of 27.5% over FY2013-17: CFL registered strong AUM CAGR of 27.5% over FY13-17 post the new strategy adopted by the new management. The aggressive focus towards retail loans and decreasing the wholesale book augured well for CFL. While retail loans grew by 35%, wholesale loans de-grew by 8.2% over FY2013-17. The share of retail loans in the loan book went up to 93% (FY2017) from a level of 10% (FY2010). We expect AUM CAGR of 23.3% over FY2017-20.

Favorable Product mix change, lower bank borrowings to be margin accretive:

The management intends to increase the share of higher yielding consumer durable (CD)/ two wheeler (2W) financing from 13%/10% presently to 16-17% each by FY2019. CFL's high dependence on bank borrowings has reduced to 58% (FY17) v/s. 85% (FY14). However, with better ratings & money market instruments becoming more attractive we expect overall cost of funds to decline, aiding NIM expansion by 80bps over FY17-19.

Impressive asset quality: High asset quality has been maintained due to stringent underwriting process. About 38% of the total applications are disbursed after passing through several levels of scrutiny and checks, mainly centered on cash flow evaluation, credit bureau and reference checks. In FY2010, GNPA of CFL was 5.3%, which has lowered to 1.6% (Q2FY18) post the new management taking charges.

Outlook and valuation: Strong capital adequacy and pick up in retail credit will ensure 24% loan growth over FY2017-20. Favorable loan mix coupled with expansion in NIM would drive 32% earnings CAGR over the same period. Given improving return ratios we believe the stock is poised for further re-rating. The stock is trading at 2.2x its FY2020 ABV. **We have valued the stock at 2.7x its FY2020E ABV and recommend BUY with a target price of ₹850 over the next 12 months.**

Key Financials (Standalone)

Y/E March (₹ cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
NII	501	771	1,228	1,571	2,008	2,536
% chg	53	54	59	28	28	26
Net profit	112	168	240	296	407	550
% chg	89	50	43	23	38	35
NIM (%)	6.1	7.1	8.8	9.2	9.4	9.7
EPS (₹)	11.4	17.1	24.5	30.2	41.6	56.3
P/E (x)	60.5	40.3	28.2	22.9	16.6	12.3
P/ABV (x)	4.3	4.1	3.1	2.9	2.5	2.2
ROA (%)	1.0	1.2	1.4	1.4	1.5	1.7
ROE (%)	8.1	10.2	12.0	12.2	14.9	17.4

Source :Company, Angel Research; Note: CMP as of December 29, 2017

BUY

CMP	₹693
Target Price	₹850

Investment Period	12 Months
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Stock Info

Sector	NBFC
Market Cap (₹ cr)	6,872
Beta	1.5
52 Week High / Low	839/512
Avg. Daily Volume	33,085
Face Value (₹)	10
BSE Sensex	33,848
Nifty	10,478
Reuters Code	CAPF.NS
Bloomberg Code	CAFLIN

Shareholding Pattern (%)

Promoters	36.0
MF / Banks / Indian Fls	13.1
FII / NRIs / OCBs	24.3
Indian Public / Others	26.6

Abs. (%)	3m	1yr	3yr
Sensex	7.4	31.5	53.0
Capital First	(9.6)	33.8	96.1

3-year price chart



Source: Company, Angel Research

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Company Background:

Capital First Ltd (CFL) is one of the leading financial institutions in India focused on providing debt financing to MSMEs and consumers. Capital First Ltd was founded in 2012 through a management buyout of an existing listed NBFC and equity backing by a global private equity. With the help of contemporary scoring solutions and sophisticated technology, the company provides finance to select segments that are traditionally underserved by existing financial systems due to small ticket sizes, difficulties in credit evaluation, collection issues, etc. The company provides financing to salaried and self employed retail customers, which is a growing category in India.

Exhibit 1: Key milestones

FY10	Wholesale NBFC+ Broking subsidiary
FY11	Launched durable financing business with credit scoring
FY12	Merged subsidiary NBFC with parent and launched two wheeler financing
FY13	Capital First was formed as a result of management buyout of an existing NBFC
FY13	Warburg Pincus acquires 70% stake in the company for ₹810cr in September 2012
FY14	Closed broking business, acquired HFC license via subsidiary
FY15	Closed gold loan business, AUM crosses ₹12,000 cr
FY16	AUM crosses ₹16,000 cr, no of customers financed since inception crosses 2.25 mn
FY17	AUM crosses ₹ 20,000 cr, no of customers financed since inception crosses 4 mn

Source: Company, Angel Research

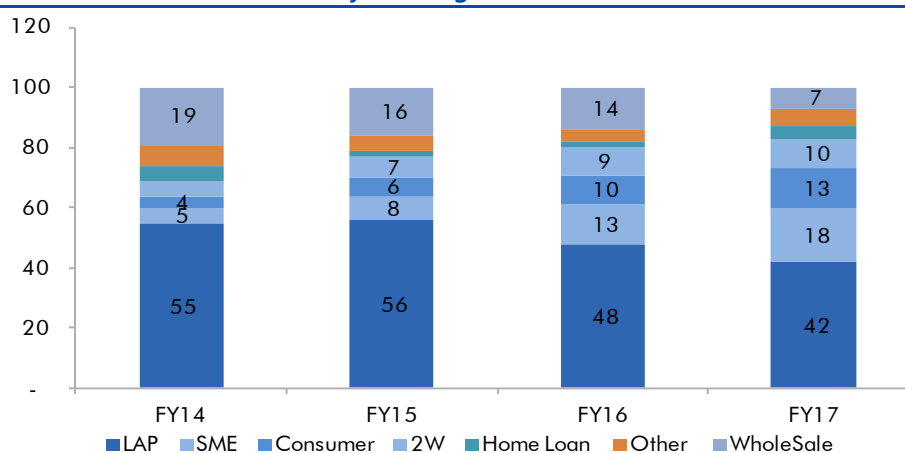
Exhibit 2: Types of loans offered by CFL

Products	Ticket Size(₹)	Tenor (Months)	Average Loan to Value Ratio
MSME Loans	9,60,000	60	42%
CFL provides long term loans to MSMEs after proper evaluation of cash flows. Backed by collateral of residential or commercial property. Monthly amortizing products with no moratorium. CFL also provides unsecured short tenure working capital loans to the MSMEs.			
Two Wheeler Loans	44,000	24	70%
CFL provides financing to salaried segment as well as self employed individuals like small traders, shop keepers for purchase of new two-wheelers.			
Consumer Durables Loans	30,000	8	76%
CFL provides financing to salaried and self-employed customers for purchasing of LCD/LED panels, Laptops, Air-conditioners and other such white good products. They are also availed by small entrepreneurs for official purposes.			

Change in ownership & management brings new life to the company: The company was first listed on Stock Exchanges in January 2008. Between 2010 to 2012, Mr Vaidyanathan acquired a stake in the company, changed the business model to retail, and executed a Management Buyout of the company with equity backing from Warburg Pincus for ₹810cr and changed the name to Capital First. Post 2012, CFL raised ₹178cr from Warburg Pincus and HDFC Standard Life. AS CFL was growing at 25%+ CAGR it raised ₹300cr through QIP in FY2015 subscribed by Goldman Sachs. In Q4FY2017, it raised ₹340cr through preferential allotment to GIC, Singapore.

Transition from a wholesale financier to a retail financier: The new management led by Mr Vaidyanathan focused more on the granular retail loan category, and thus successfully transitioned as a retail lender. The share of wholesale finance has been brought down to 7% by FY2017 from 90% in FY2010. CFL still has a high dependency on the Loan against Property, 42% of the overall loan book, which it intends to bring down to 33% by FY2019. Simultaneously, the company intends to increase CD/2W financing from 13%/10% presently to 16-17% each by FY19. The company also has an unsecured SME loan book accounting for ~18% of the total loans.

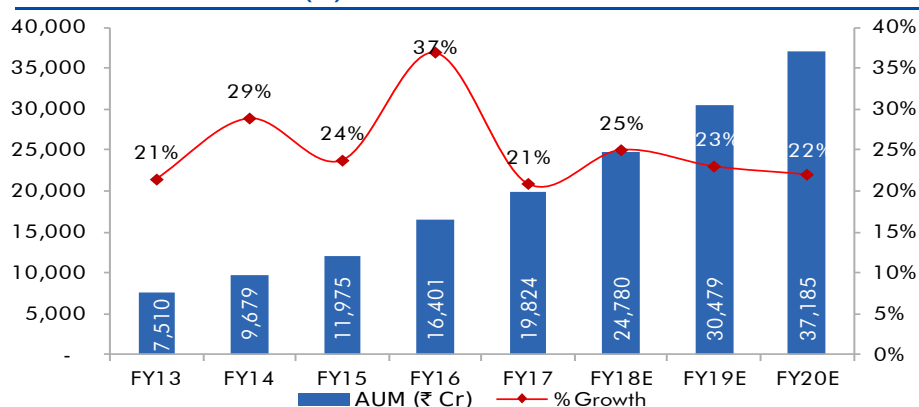
Exhibit 3: Loan book driven by new segments like 2W/CD



Source: Company, Angel Research

Strong AUM CAGR of 27.5% over FY2013-17, expect 23.3% CAGR over FY2017-20: CFL registered strong AUM CAGR of 27.5% over FY13-17 post the new strategy adopted by the new management. The aggressive focus towards retail loans and decreasing the wholesale book augured well for CFL. While retail loans grew by 35%, wholesale loans de-grew by 8.2% over FY2013-17. The share of retail loans in the loan book went up to 93% (FY2017) from a level of 10% (FY2010). We expect AUM CAGR of 23.3% over FY2017-20.

Exhibit 4: AUM Growth (%)



Source: Company, Angel Research

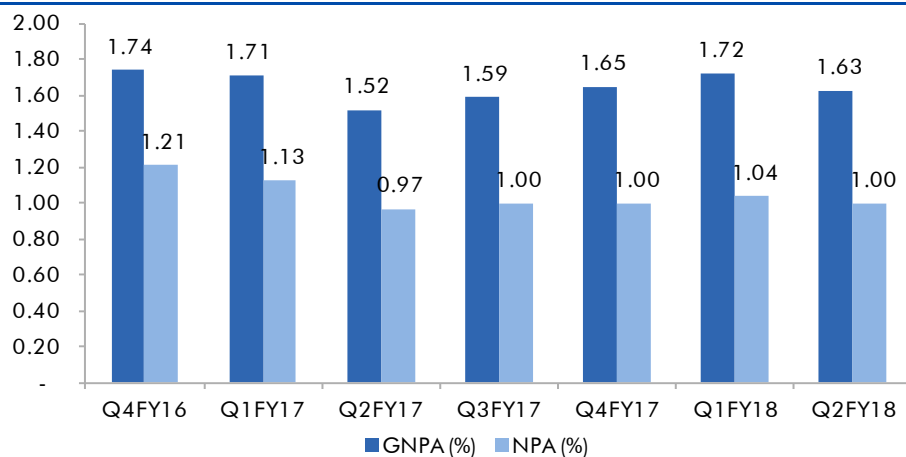
Increasing number of MSME/ SME coming under the formal sector, opens newer opportunities for the company: The Indian economy is going through a paradigm shift, backed by new initiatives by the government. Further, measures like GST, Aadhar card based e-KYC, etc. will have far reaching impact and enable augmenting financial inclusion. Hence, NBFCs like CFL will be able to tap the vast underserved individuals whose credit needs have been growing with the change in aspirations and income levels. CFL is well placed to take advantage of these opportunities going ahead.

Housing Finance, still small but has huge potential for CFL: in order to diversify the loan book further, the management ventured into retail home loans in 2015, via its wholly owned subsidiary, Capital First Home Finance Ltd. With an average ticket size of ~₹15 lakhs, the loans are targeted primarily to the self employed professionals in the affordable housing segment. The opportunity of lending towards self employed segment remains huge with very few players operating in the segment. Within a short span of time the AUM in the housing finance has reached a level of ~₹800cr (~₹600cr at the end of FY17) and we expect the growth rate to be 40-50% over the next few years.

Despite higher share of LAP/ SME lending, the NPAs are largely under control:

The GNPA of the company was as high as 5.3% in FY2010, which was brought down to 1% (FY2017). The CFL has started complying with RBI regulations recognizing NPAs on 90 days overdue basis (90 DPD), at par with banks now. Earlier it had migrated to 120 DPD in Q1FY17. Though the company migrated to 90 DPD it already had done adequate provisions.

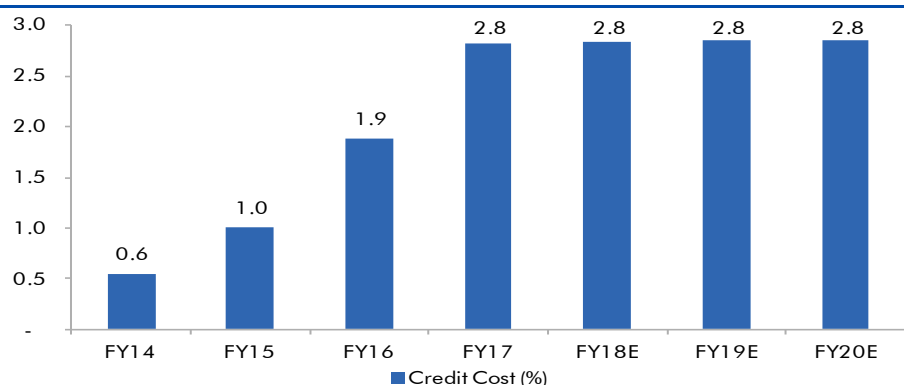
Exhibit 5: Comparative NPA trend- On 90 DPD basis



Source: Company, Angel Research

With 90 days NPA recognition norm, the credit cost is more comparable with peers: The credit cost of CFL has gone up in FY17 partly due to demonetization and impact of slowdown in the economy. Also, the nature of consumer lending in retail space will have higher credit cost. However, we believe the company is at the peak of its credit cost cycle and there could be a moderation in the same going ahead. We have factored in 280bps credit cost in FY2018E/FY2019E/FY2020E each.

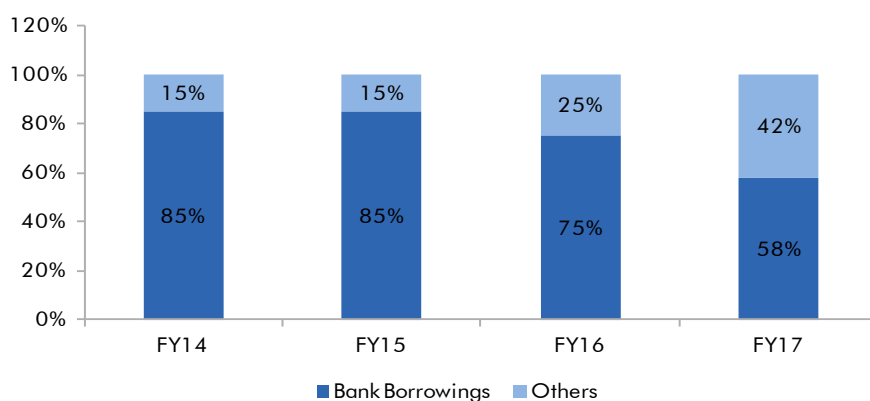
Exhibit 6: Credit cost trend (%)



Source: Company, Angel Research

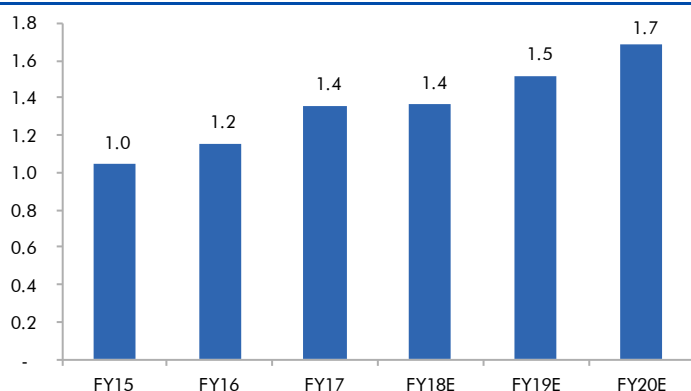
Reducing dependence on bank borrowings, to help lower cost of funds: Historically, CFL had high dependency on bank borrowings for its business. The share of bank borrowings in its sources of funds was as high as 85% in FY2014, which has gradually been brought down to 58% by FY2017. The management expects the share of bank borrowings to reduce to ~40% of total by FY2019. With overall softening of interest rates and G-Sec yields, the cost of borrowings via money market instruments have become attractive, and hence, the share of borrowings from the same source has gone up to 42% from 15% (FY15). The NBFC has a AA+ rating for its borrowings from CARE and based on the current spread between AA+ and 10 Yr G-Sec yield, we believe there is further scope for re-pricing its high cost bank borrowings as well as re-pricing of old NCDs with fresh NCDs at a much attractive rate.

Exhibit 7: Changing funding profile

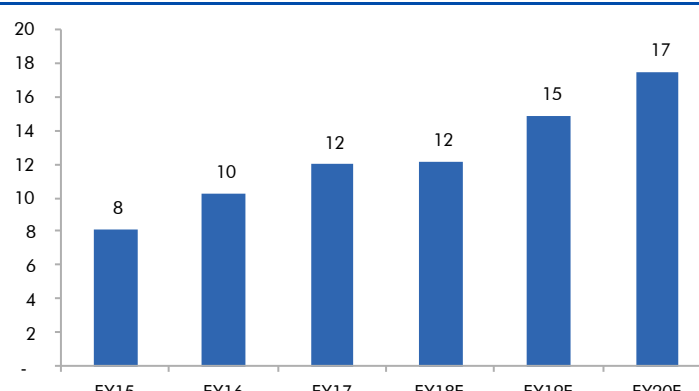


Source: Company, Angel Research

Shift towards higher yielding assets and lower Opex cost on incremental business in 2W/CD to result in ROE improvement: CFL has successfully transitioned from a wholesale financier to a retail financier over the last five years. However, within the retail space higher dependency on LAP and front loading of operating cost, both in terms of technology and manpower had impacted the cost structure. With maturing business in the consumer durable financing and two wheeler financing segments, Opex cost would reduce for incremental business in 2W/CD. In the absence of major equity dilution in the near term and moderating Opex cost, we expect ROE to improve from 11.9% in FY2017 to ~17% by FY2020.

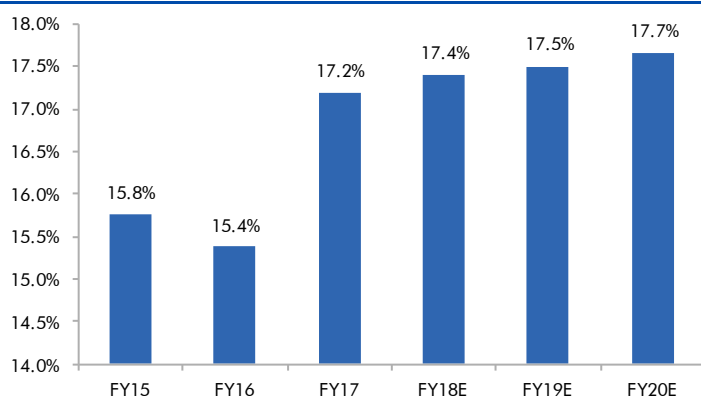
Exhibit 8: ROA (%)


Source: Company, Angel Research

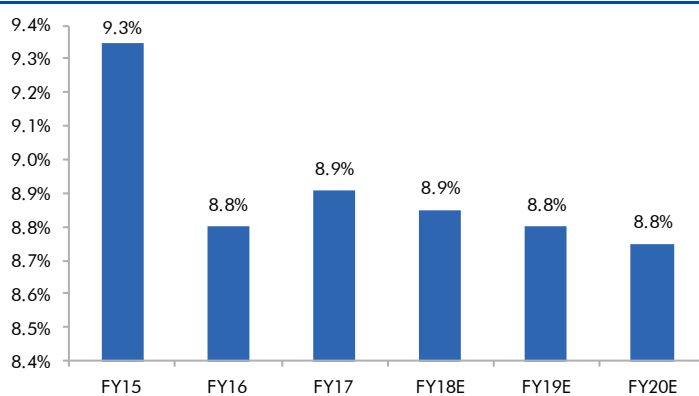
Exhibit 9: ROE (%)


Source: Company, Angel Research

Product mix revival, lower bank borrowings to be margin accretive: CFL has gradually reduced its share of wholesale book and is focusing more on the retail lending. Within the retail space, the company is still highly dependent on the mortgage based SME lending (LAP). However, as a strategy, it intends to further reduce its dependence on the LAP and is now focusing more on the granular retail loans like Consumer durables and two wheelers, which also generates higher yield, and hence, we expect yield on advances to improve further.

Exhibit 10: Yield (%)


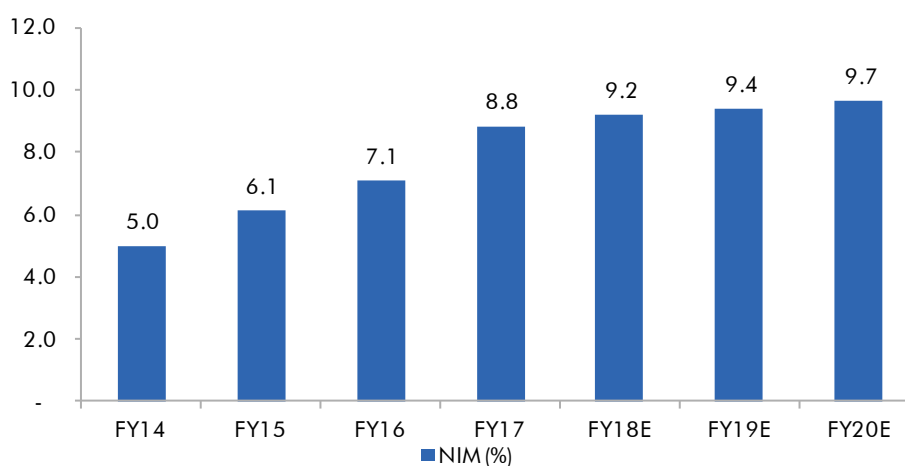
Source: Company, Angel Research

Exhibit 11: Cost of funds (%)


Source: Company, Angel Research

Historically, CFL had high dependency on bank borrowings for its business. However, with better ratings & money market instruments becoming more attractive, it has started raising funds via NCDs. This, together with lower cost of funds, due to reduction in MCLR based borrowings will help in NIM improvement. We have factored in an 80bps improvement in NIM over FY2017-20.

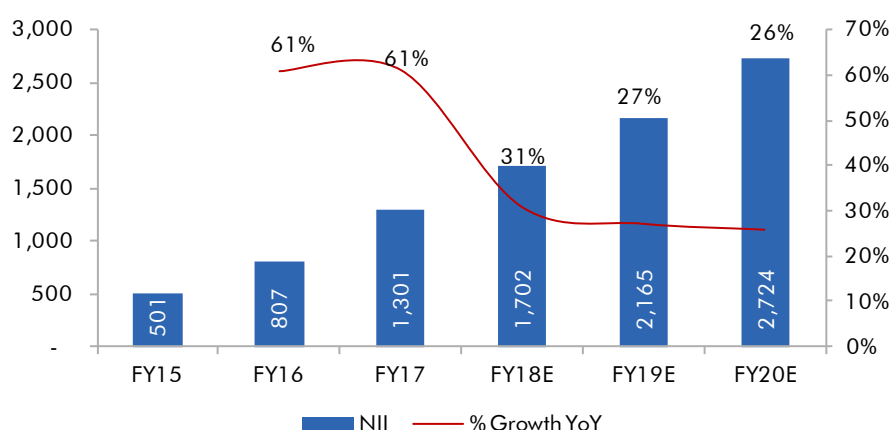
Exhibit 12: NIM to increase 80bps with product mix shift



Source: Company, Angel Research

NII growth will be in sync with AUM growth: We expect NII to grow at healthy CAGR of 27.3% over FY2017-20. NII growth would be backed by (a) AUM growth of 23.3%, (2) change in product mix from low yielding loan book to high yielding loan book (2W/CD), (3) Reduction in cost of funds due to higher borrowing from market instrument and cut in MCLR rates to help in refinancing existing high cost borrowing at lower cost.

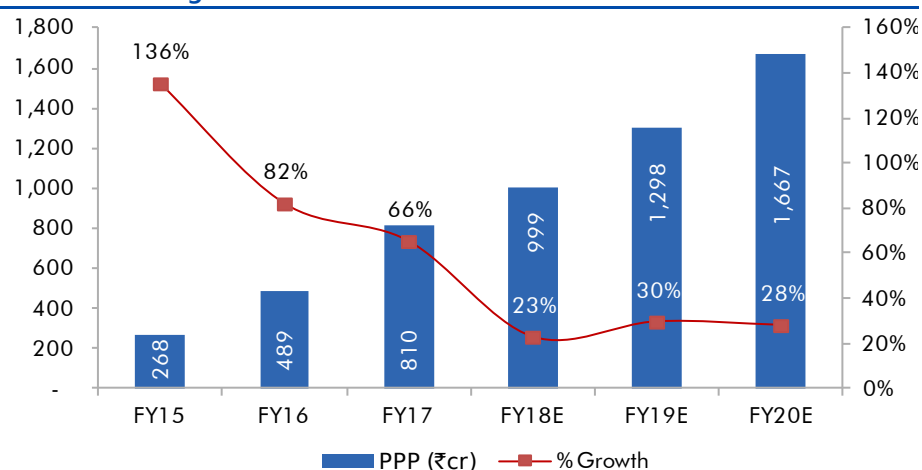
Exhibit 13: NII Growth has been in sync with AUM growth



Source: Company, Angel Research

Pre-provisioning profit (PPP) to get a boost from fee income: The granular asset base of the company has helped in strong growth in fee income as well, and we expect fee income to contribute meaningfully to the pre-provisioning profit. CFL has incurred capex to develop 2W/CD financing business since 2011; hence going forward C/I ratio would witness a declining trend.

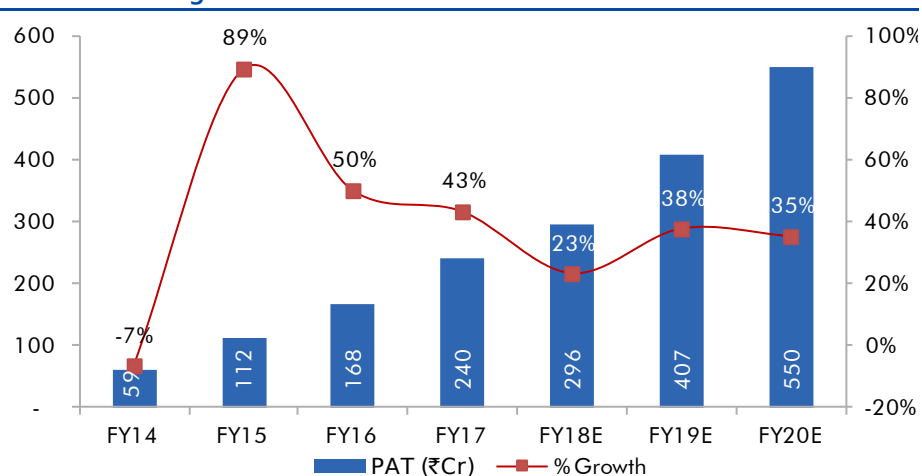
Exhibit 14: PPP growth trend



Source: Company, Angel Research

PAT growth will outpace NII growth, backed by moderating cost: We expect the PAT growth of the company to outpace its loan and NII growth, largely backed by lower cost structure and stable credit cost. With higher adoption of technology and Algo based lead generation, the company intends to reduce its cost structure, and this should aid the bottom-line growth. The cost income ratio of the company has already come down to 50.6% in FY2017 from a high of 59% in FY2015. However, it still remains high and we believe there is scope for the same to come down further.

Exhibit 15: PAT growth trend



Source: Company, Angel Research

Outlook and valuation

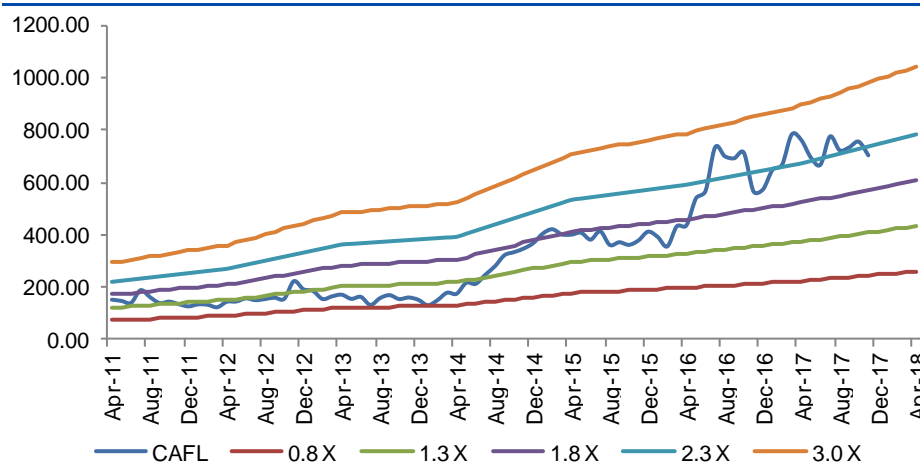
Strong capital adequacy and pick up in retail credit will ensure 24% loan growth over FY2017-20. Favorable loan mix coupled with expansion in NIM would drive 32% earnings CAGR over the same period. Given improving return ratios we believe the stock is poised for further re-rating. The stock is trading at 2.2x its FY2020 ABV. **We have valued the stock at 2.7x its FY2020E ABV and recommend BUY with a target price of ₹850 over the next 12 months.**

Exhibit 16: Comparative valuations & return ratios

	P/BV (x)			ROE%			ROA%		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Capital First	3.0	2.7	2.4	12.0	12.2	14.9	1.4	1.4	1.5
Bajaj Fin	9.5	6.1	5.1	21.6	20.5	20.2	3.3	3.5	3.6
L&T Fin	3.6	3.2	2.7	12.1	14.9	16.9	1.5	1.7	1.9
M&M Fin	3.7	3.2	2.8	7.6	13.5	15.5	1.1	1.8	2.2
Chola	4.6	3.9	3.3	18.1	19.3	19.9	2.5	2.6	2.7
Shriram City	2.6	2.3	2.1	11.8	15.1	16.4	2.3	2.9	3.0
Magma	1.8	4.7	4.2	0.9	9.3	12.3	0.1	1.3	1.8
STFC	2.9	0.9	0.8	11.7	13.9	16.5	1.7	2.2	2.6
Sundaram Fin	4.2	1.3	1.1	15.2	16.1	16.1	2.3	2.8	2.9

Source: Company, Angel Research, based on closing price of 26th Dec 2017, other NBFC estimates taken from Bloomberg,

Exhibit 17: One Year Forward P/BV



Source: Company, Angel Research

Income statement

Y/E March (₹ cr)	FY16	FY17	FY18E	FY19E	FY20E
NII	771	1,228	1,571	2,008	2,536
- YoY Growth (%)	54	59	28	28	26
Other Income	221	412	424	525	643
- YoY Growth (%)	45	86	3	24	22
Operating Income	992	1,640	1,995	2,533	3,179
- YoY Growth (%)	52	65	22	27	26
Operating Expenses	503	830	996	1,234	1,511
- YoY Growth (%)	30	65	20	24	22
Pre - Provision Profit	489	810	999	1,298	1,667
- YoY Growth (%)	82	66	23	30	28
Prov. & Cont.	236	453	558	691	846
- YoY Growth (%)	125	92	23	24	22
Profit Before Tax	252	357	441	608	821
- YoY Growth (%)	55	42	23	38	35
Prov. for Taxation	85	117	146	200	271
- as a % of PBT	34	33	33	33	33
PAT	168	240	296	407	550
- YoY Growth (%)	50	43	23	38	35

Balance Sheet

Y/E March (₹ cr)	FY16	FY17	FY18E	FY19E	FY20E
Share Capital	91	97	97	97	97
Reserve & Surplus	1,612	2,206	2,465	2,820	3,301
Net Worth	1,703	2,304	2,562	2,918	3,398
Borrowings	11,955	14,108	17,635	21,691	26,246
- Growth (%)	42	18	25	23	21
Other Liabilities	65	80	88	109	133
Total Provisions	113	119	142	175	214
Current Liabilities	689	1,044	1,270	1,886	2,645
Total Liabilities	14,525	17,655	21,697	26,779	32,637
Total Loans & Advances	12,656	15,136	19,071	23,648	28,851
- Growth (%)	40	20	26	24	22
Cash and Cash equivalents	1,113	1,594	1,648	2,042	2,489
Investments	184	259	269	334	407
Fixed Assets	29	65	57	71	86
Other CA	333	392	441	546	666
Other Non Current Assets	210	211	210	138	138
Total Assets	14,525	17,655	21,697	26,779	32,637

Exhibit 18: Key Ratio

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Profitability ratios (%)					
NIMs	7.1	8.8	9.2	9.4	9.7
RoA	1.2	1.4	1.4	1.5	1.7
RoE	10.2	12.0	12.2	14.9	17.4
Cost/Income	50.7	50.6	49.9	48.7	47.5
Asset Quality (%)					
Gross NPAs %	1.1	1.7	1.8	1.9	1.9
Net NPAs %	0.6	1.0	1.1	1.1	1.2
Credit Cost	1.9	2.8	2.8	2.8	2.8
PCR %	48.6	39.4	38.9	42.1	39.5
Per Share Data (₹)					
EPS	17	25	30	42	56
BVPS	174	236	262	298	347
Adj BV	167	220	240	272	313
DPS	2.2	2.6	3.2	4.4	5.9
Valuation Ratios					
PER (x)	40.3	28.2	22.9	16.6	12.3
P/BVPS (x)	4.0	2.9	2.6	2.3	2.0
P/ABVPS (x)	4.1	3.1	2.9	2.5	2.2
Dividend Yield (%)	0.3	0.4	0.5	0.6	0.9
DuPont Analysis					
Interest Income	11.5	13.5	13.7	14.0	14.2
Interest Expenses	6.2	6.6	6.5	6.5	6.4
NII	5.3	7.0	7.2	7.5	7.8
Provision	1.6	2.6	2.6	2.6	2.6
Fees & Other	1.5	2.3	2.0	2.0	2.0
Total Income Adj Prov	5.2	6.7	6.6	6.9	7.1
Opex	3.5	4.7	4.6	4.6	4.6
PBT	1.7	2.0	2.0	2.3	2.5
Tax	0.6	0.7	0.7	0.7	0.8
ROA	1.2	1.4	1.4	1.5	1.7
Leverage	8.9	8.8	8.9	9.8	10.3
ROAN	10.2	12.0	12.2	14.9	17.4

Source: Note - Valuation done on closing price of 28/12/2017

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)