

# Indian Railway Finance Corp.

On track with Indian Railways' growth

INDIA | NBFC | IPO Note

18 January 2021

The Indian Railway Finance Corp. (IRFC) plays a strategic role in financing the funding requirements of the Ministry of Railways (MoR); IRFC has been funding 30-45% of Indian Railways (IR)'s capex. Its primary business is financing the acquisition of rolling-stock assets, leasing of railway infrastructure assets, and lending to other entities under the Ministry of Railways. IRFC has a low-risk business model under which MoR takes care of all risk (related to damage to rolling assets, any legal process, or liquidity shortfall) while IRFC enjoys fixed contractual spreads over its cost of funds. IRFC benefits from various exemptions related to tax, single-party exposure, asset classification, and provisioning norms – which directly add to its earnings. Its strong balance sheet size of Rs 2.7tn, with nil GNPA, low overheads, and IR's huge capex needs bode well for its growth prospects. Its earnings CAGR in FY18-20 was 34% aided by 31% CAGR in AUMs. Profitability ratios are reasonable with RoA/RoE of 1.5%/14.9%. Recommend – SUBSCRIBE.

## SUBSCRIBE

### COMPANY DATA

|                           |                           |
|---------------------------|---------------------------|
| ISSUE OPENS               | 18 <sup>th</sup> Jan 2021 |
| ISSUE CLOSES              | 20 <sup>th</sup> Jan 2021 |
| PRICE BAND                | Rs25- 26                  |
| PRE- ISSUE EQUITY SHARES  | 11,880mn                  |
| POST- ISSUE EQUITY SHARE  | 13,069 mn                 |
| FRESH SHARES TO BE ISSUED | 1188 mn                   |
| OFFER FOR SALE            | 594 mn                    |
| ISSUE SIZE                | Rs 463bn                  |
| MKT CAP (at upper band)   | Rs340bn                   |

### Sole lender to the Indian Railways whose huge capex plan equals unwavering growth

It is the primary financier for IR, and as such IRFC will keep getting significant business from here, as IR has planned huge investments in expansion and modernisation. Over FY18-20, IR's borrowing from IRFC saw 40% CAGR; it funded 30-45% of IR's capex. Moreover, National Rail Plan (NRP) aims at increasing the share of railways in transport freight to 45% by 2030 from 27% at present. This would require significant capital, which provides a sizeable opportunity for IRFC over a longer timeframe.

### Pre-IPO SHARE HOLDING PATTERN, %

|                    |        |        |
|--------------------|--------|--------|
| Govt of India (mn) | 11,880 | 100%   |
| Others (mn)        | 0      | 0%     |
| Total (mn)         | 11,880 | 100.0% |

### Low-risk and low-margin business model; spreads controlled by MOR

IRFC has a low-risk business model where all the risk related to damage to rolling assets, any legal process, or liquidity shortfall is taken care of by the MoR, while IRFC enjoys fixed contractual spreads over its cost of funds (including hedging costs for foreign borrowings). While rolling-stock spreads remained steady at 50bps until FY17, they reduced to 30bps in FY18, and have been at 40bps since FY19.

### Financials

| Y/E Mar, Rs mn  | FY20  | FY21e | FY22e |
|-----------------|-------|-------|-------|
| Net Profit      | 36924 | 45778 | 55944 |
| % growth        | 63.8  | 24.0  | 22.2  |
| EPS (Rs)        | 2.8   | 3.5   | 4.3   |
| book value (Rs) | 26.1  | 29.4  | 33.4  |
| RoE (%)         | 14.9  | 13.2  | 13.6  |
| RoA (%)         | 1.5   | 1.4   | 1.3   |
| PER (x)         | 9.2   | 7.4   | 6.1   |
| P/BV (Rs)       | 1.0   | 0.9   | 0.8   |

### AUM to grow at a healthy pace; regulatory exemptions to add to earnings

IRFC's AUM saw 29% CAGR in the last three years to touch Rs 2.7tn in FY20. Increased capital outlay (Rs 1.6tn in FY21) by Indian Railways will continue to drive IRFC's AUM growth. In FY20, its share of lease receivables from rolling-stock assets was 55.8%, project assets (railway infrastructure assets) was 41.8%, and loan assets (other PSU entities) was 2.4%. It enjoys certain exemptions related to tax, RBI exposure norms, asset classification norms, provisioning norms, and concentration norms, which help its profitability.

### Valuation

At the upper end of the price band (Rs 25-26), the issue is valued at 1.0x FY20 BV with an RoA of 1.5% and an RoE of 14.9%. We believe that with high visibility on balance-sheet growth and no risk to asset quality, current valuations look attractive. Hence, we recommend investors subscribe to this issue.

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### NBFC valuations

|      | Loan Book Rs bn |       |       | RoA % |       |       | RoE % |       |       | BV   |       |       | P/BV |       |       |
|------|-----------------|-------|-------|-------|-------|-------|-------|-------|-------|------|-------|-------|------|-------|-------|
|      | FY20            | FY21E | FY22E | FY20  | FY21E | FY22E | FY20  | FY21E | FY22E | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E |
| IRFC | 2661            | 3525  | 4654  | 1.5   | 1.4   | 1.3   | 14.9  | 13.2  | 13.6  | 26.1 | 29.4  | 33.4  | 1.0  | 0.9   | 0.8   |
| STFC | 1,045           | 1,097 | 1,214 | 2.5   | 2.3   | 2.8   | 17.4  | 14.8  | 14.8  | 625  | 711   | 930   | 1.9  | 1.7   | 1.3   |
| SCUF | 296             | 291   | 294   | 3.3   | 3.1   | 3.4   | 16.5  | 14.7  | 13.0  | 968  | 1092  | 1358  | 1.1  | 1.0   | 0.8   |
| MMFS | 671             | 772   | 914   | 2.6   | 1.3   | 1.4   | 15.2  | 8.1   | 7.6   | 88   | 92    | 130   | 2.1  | 2.0   | 1.4   |
| CIFC | 543             | 605   | 754   | 2.3   | 1.8   | 2.3   | 21.0  | 15.3  | 17.2  | 75   | 100   | 136   | 5.6  | 4.2   | 3.1   |
| MUTH | 387             | 471   | 595   | 5.6   | 6.6   | 5.8   | 23.4  | 28.7  | 23.5  | 251  | 299   | 439   | 4.8  | 4.0   | 2.7   |

Source: Company, PhillipCapital India Research Estimates

## Company Background

- IRFC was incorporated in 1986 by the Government of India (GoI), Ministry of Railways (MoR), as a financing arm of the Indian Railways (IR).
- It is registered as a systemically important non-deposit-taking, non-banking financial company (NBFC – ND-SI) and infrastructure finance company (NBFC- IFC) with RBI.
- Its primary objective is to raise necessary resources for meeting IR’s developmental needs. IRFC borrows funds from the financial markets to finance the acquisition and creation of assets, which are then leased out to the Indian Railways as finance leases.
- The company finances the acquisition of rolling-stock assets, which includes both powered and unpowered vehicles (for example locomotives, coaches, wagons, trucks, flats, electric multiple units, containers, cranes, trollies of all kinds and other items of rolling stock components - collectively called rolling stock assets), leasing of railway infrastructure assets, and national projects of the GoI (collectively called project assets), and lending to other entities under the MoR, GoI.

## Key Management

| Name                 | Designation                    | Profile   |
|----------------------|--------------------------------|---|
| Mr. Amitabh Banerjee | Chairman and Managing Director | <ul style="list-style-type: none"> <li>• Bachelor’s degree (honours) in commerce from the Shri Ram College of Commerce, University of Delhi and a master’s degree in commerce from University of Delhi</li> <li>• Term: From 12 October 2019 till 31 December 2023.</li> <li>• Was associated with Konkan Railway Corporation Limited as well as the Hindustan Paper Corporation Limited in the capacity of director (finance) and with Delhi Metro as General Manager (Finance).</li> </ul>      |
| Ms. Shelly Verma     | Director (Finance) and CFO     | <ul style="list-style-type: none"> <li>• Term: Five years with effect from 1 September 2020 or till the date of her superannuation (being 30 April 2025), whichever is earlier</li> <li>• Bachelor’s degree in commerce from the University of Delhi; fellow member of the Institute of Chartered Accountants of India.</li> <li>• Has more than 30 years of experience in power sector financing.</li> <li>• Has served as executive director with Power Finance Corporation Limited.</li> </ul> |

Source: RHP, Company, PhillipCapital India Research

## Offer for sale

- The issue: Fresh issue (9.09% of post-issue equity share capital) and Offer for Sale (4.55% of post-issue equity share capital).
- The proceeds of the Offer for Sale will be received by the Selling Shareholder only; IRFC will not receive any proceeds.
- Primary objective: Augmenting equity capital base to meet future capital requirements arising out of growth in business; general corporate purposes.

## GoI stake will come down from 100% to 86% post IPO

|              | Pre IPO Shares | Holding     | Post IPO      | Holding     |
|--------------|----------------|-------------|---------------|-------------|
| GoI          | 11,880         | 100%        | 11,286        | 86%         |
| public       | 0              | 0%          | 1,782         | 14%         |
| <b>Total</b> | <b>11,880</b>  | <b>100%</b> | <b>13,069</b> | <b>100%</b> |

Source: RHP, Company, PhillipCapital India Research Note: 1188mn Fresh shares issuances and 594mn offer for sale

**Product and client matrix**

| Parameter        | Lease Receivables               | Project assets   | Loan to other entities under MoR   |
|------------------|---------------------------------|--|------------------------------------|
| Clientele        | MoR                             | MoR  | RVNL, IRCON                        |
| Tenure           | 15 year+15 year Lease           | 15-30 year Lease   | 15/ 5 year                         |
| Rate of Interest | 40bps over cost / 7.37% in FY20 | 35 bps over cost / 7.31% (National. Proj)/ 7.76% ( EBR-IF) | 65-88bps over cost , 8.42% / 8.77% |
| AUM Mix (%)      | ~56                             | ~42  | ~2                                 |

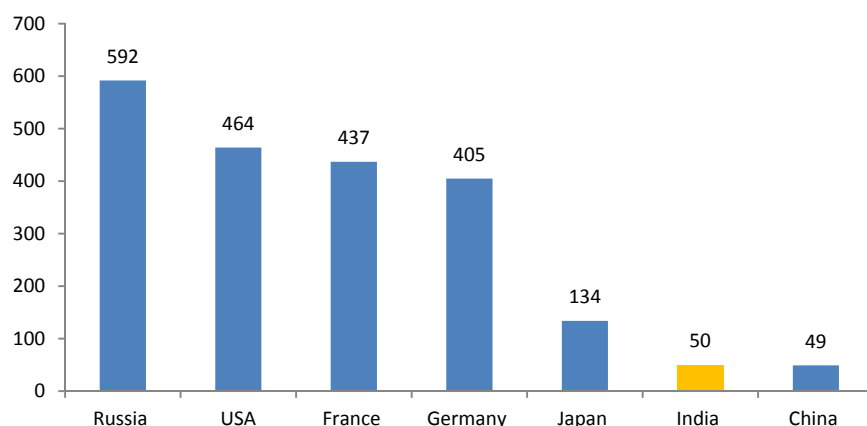
Source: RHP, Company, PhillipCapital India Research

**Indian Railways: Largest network in Asia, but still underpenetrated...**

The Indian Railways, which is a departmental undertaking of the GoI, owns and operates India's rail transport through the MoR, GoI. It has the largest rail network in Asia, running approximately 13,523 passenger trains every day to transport c.23mn passengers per day. As of March 31, 2019, the total running track kilometres (total all gauges) was 95,981 kilometres. Nonetheless, on per million population metric, it has one of the lowest penetration at 50 rail route km vs. a significantly higher number for countries like USA (464), Russia (592), and Germany (405).

| Indian Railways                       | FY01   | FY11   | FY12   | FY13   | FY14   | FY15   | FY16   | FY17   | FY18   | FY19   | FY20   |
|---------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total running kilometres track        | 81,865 | 87,114 | 89,801 | 89,236 | 89,919 | 90,803 | 92,081 | 93,902 | 94,270 | 95,981 |        |
| Route kilometres                      | 63,028 | 64,460 | 64,600 | 65,436 | 65,808 | 66,030 | 66,687 | 67,368 | 66,935 | 67,415 | 68,155 |
| Electrified running track kilometres  | 27,937 | 36,007 | 38,669 | 38,524 | 39,661 | 41,038 | 43,357 | 48,239 | 51,242 | 59,142 |        |
| Electrified kilometres route          | 14,856 | 19,607 | 20,275 | 20,884 | 21,614 | 22,224 | 23,555 | 25,367 | 29,228 | 34,319 | 39,866 |
| Number (in units) of stations         | 6,843  | 7,133  | 7,146  | 7,172  | 7,112  | 7,137  | 7,216  | 7,309  | 7,318  | 7,321  |        |
| Passengers (million) originating      | 4,833  | 7,651  | 8,224  | 8,421  | 8,397  | 8,224  | 8,107  | 8,116  | 8,286  | 8,439  | 8,109  |
| Passenger earnings (Rs bn)            | 105    | 257    | 282    | 313    | 365    | 422    | 443    | 463    | 486    | 510    | 506    |
| Tonnes originating (mn tonnes)        | 504    | 926    | 975    | 1,014  | 1,059  | 1,101  | 1,109  | 1,111  | 1,163  | 1,225  | 1,208  |
| Earnings from freight carried (Rs bn) | 230    | 607    | 677    | 835    | 916    | 1,031  | 1,069  | 1,020  | 1,135  | 1,226  | 1,231  |
| <b>YoY growth</b>                     |        |        |        |        |        |        |        |        |        |        |        |
| Total running kilometres track        |        | 6.4    | 3.1    | -0.6   | 0.8    | 1.0    | 1.4    | 2.0    | 0.4    | 1.8    |        |
| Route kilometres                      |        | 2.3    | 0.2    | 1.3    | 0.6    | 0.3    | 1.0    | 1.0    | -0.6   | 0.7    | 1.1    |
| Electrified running track kilometres  |        | 28.9   | 7.4    | -0.4   | 3.0    | 3.5    | 5.7    | 11.3   | 6.2    | 15.4   |        |
| Electrified kilometres route          |        | 32.0   | 3.4    | 3.0    | 3.5    | 2.8    | 6.0    | 7.7    | 15.2   | 17.4   | 16.2   |
| Number (in units) of stations         |        | 4.2    | 0.2    | 0.4    | -0.8   | 0.4    | 1.1    | 1.3    | 0.1    | 0.0    |        |
| Passengers (million) originating      |        | 58.3   | 7.5    | 2.4    | -0.3   | -2.1   | -1.4   | 0.1    | 2.1    | 1.8    | -3.9   |
| Passenger earnings (Rs bn)            |        | 144.8  | 9.7    | 11.0   | 16.6   | 15.6   | 5.0    | 4.5    | 5.0    | 4.9    | -0.8   |
| Tonnes originating (mn tonnes)        |        | 83.7   | 5.3    | 4.0    | 4.4    | 4.0    | 0.7    | 0.2    | 4.7    | 5.3    | -1.4   |
| Earnings from freight carried (Rs bn) |        | 163.9  | 11.5   | 23.3   | 9.7    | 12.6   | 3.7    | -4.6   | 11.3   | 8.0    | 0.4    |

Source: Indian Railways

**India rail network underpenetrated vs other global peers**


Source: World Bank

### ...which leaves significant scope for expansion, translating into more business for IRFC

Being the primary financier for Indian Railways, the company will continue to get significant business from IR, as the latter plans to make huge investments in expansion/modernisation of its railway network. Over FY18-20, IR's borrowing from IRFC saw 40% Cagr and it has been funding 30-45% of IR's capex. Moreover, the National Rail Plan (NRP) aims at increasing the modal share of railways from 27% currently – to 45% in freight by 2030. Such plans require significant capital, and thus provide a sizeable opportunity for IRFC over a longer period.

#### Indian Railways Capital expenditure & sources of Financing

| Capital expenditure & sources of Financing ( Rs bn) | FY13       | FY14       | FY15       | FY16       | FY17         | FY18         | FY19         | FY20         | FY21E         |
|---|------------|------------|------------|------------|--------------|--------------|--------------|--------------|---------------|
| Gross Budgetary Support                             | 241        | 271        | 301        | 350        | 345          | 270          | 349          | 456          | 467           |
| Internally generated funds                          | 95         | 97         | 153        | 168        | 105          | 18           | 16           | 17           | 25            |
| PPP   |            |            |            | 151        | 268          | 221          | 243          | 126          | 253           |
| <b>IRFC</b>   | <b>151</b> | <b>152</b> | <b>110</b> | <b>141</b> | <b>143</b>   | <b>188</b>   | <b>237</b>   | <b>334</b>   | <b>300</b>    |
| <b>EBR-IF through IRFC**</b>                        |            |            |            | <b>99</b>  | <b>115</b>   | <b>146</b>   | <b>279</b>   | <b>329</b>   | <b>280</b>    |
| Railway Safety Fund                                 | 16         | 20         | 22         | 26         | 107          | 16           | 30           | 69           | 85            |
| RRSK  |            |            |            |            |              | 161          | 180          | 150          | 200           |
| <b>Total Capital Outlay</b>                         | <b>503</b> | <b>540</b> | <b>587</b> | <b>935</b> | <b>1,083</b> | <b>1,020</b> | <b>1,334</b> | <b>1,481</b> | <b>1,610*</b> |
| YoY growth  |            | 7%         | 9%         | 59%        | 16%          | -6%          | 31%          | 11%          | 9%            |

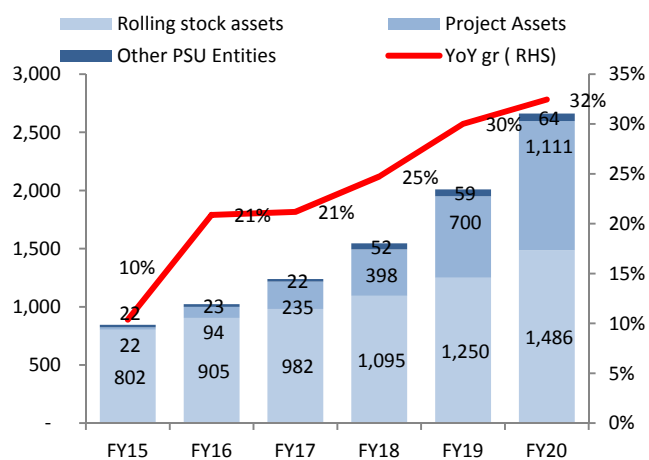
| Mix (%)                    | FY13      | FY14      | FY15      | FY16      | FY17      | FY18      | FY19      | FY20      | FY21E     |
|----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Gross Budgetary Support    | 48        | 50        | 51        | 37        | 32        | 26        | 26        | 31        | 29        |
| Internally generated funds | 19        | 18        | 26        | 18        | 10        | 2         | 1         | 1         | 2         |
| PPP                        | 0         | 0         | 0         | 16        | 25        | 22        | 18        | 9         | 16        |
| <b>IRFC</b>                | <b>30</b> | <b>28</b> | <b>19</b> | <b>15</b> | <b>13</b> | <b>18</b> | <b>18</b> | <b>23</b> | <b>19</b> |
| <b>EBR-IF through IRFC</b> | <b>0</b>  | <b>0</b>  | <b>0</b>  | <b>11</b> | <b>11</b> | <b>14</b> | <b>21</b> | <b>22</b> | <b>17</b> |
| Railway Safety Fund        | 3         | 4         | 4         | 3         | 10        | 2         | 2         | 5         | 5         |
| RRSK                       | 0         | 0         | 0         | 0         | 0         | 16        | 13        | 10        | 12        |

Source: Ministry of Railways \*Budgetary Estimates \*\*\*Extra Budgetary Resources (Institutional Financing)

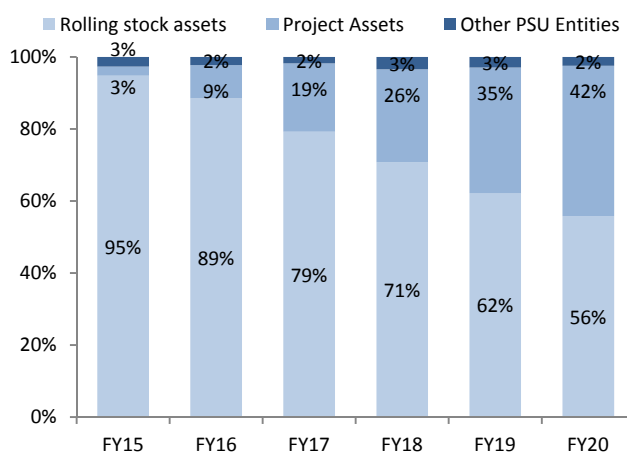
### ...AUM is expected to grow at healthy pace

AUM has seen 29% CAGR in the last 3 years to touch Rs 2.6tn. With increased capital outlay by Indian Railways, AUM growth is likely to remain strong for the next 5-10 years. As of FY20, share of lease receivables from rolling-stock assets was 55.8%, project assets (railway infrastructure assets) was 41.75% and loan assets (other PSU entities) was 2.42%.

#### AUM growth rising consistently



#### ...aided by rising share of Project assets



Source: RHP, Company, PhillipCapital India Research

## Diversified borrowing profile with the ability to raise funds at lower costs

IRFC has a well-diversified borrowing profile ranging from bonds, term loans, ECBs, and commercial paper, etc. Bonds' share, at 65%, is the biggest source of borrowing for the company, followed by term loans at 22%, ECB at 4%, National Small Savings Fund at 7.5% and commercial paper at 1.6%. IRFC's diversified borrowing profile, along with its AAA rating and strategic relationship with MoR, enables it to raise funds at lower costs. Its average cost of funds in FY20 was 7.27%.

| Particulars                             | FY20<br>Rs mn    | H1FY21<br>Rs mn  | FY20<br>%    | H1FY21<br>% of Total |
|---|------------------|------------------|--------------|----------------------|
| <b>Secured Long Term Borrowings</b>     |                  |                  |              |                      |
| Bonds from Indian Capital Market        | 1,157,599        | 1,233,735        | 49.4         | 50.3                 |
| Rupee Term Loans from Banks             | 496,250          | 553,500          | 21.2         | 22.6                 |
| Foreign Currency Term Loans             | 455              | 334              | 0.0          | 0.0                  |
| Others -National small saving fund      | 175,000          | 175,000          | 7.5          | 7.1                  |
| <b>Unsecured Long Term Borrowings</b>   |                  |                  |              |                      |
| Bonds from International Capital Market | 151,671          | 148,370          | 6.5          | 6.0                  |
| Bonds from Indian Capital Market        | 205,000          | 205,000          | 8.7          | 8.4                  |
| Foreign Currency Term Loans             | 96,539           | 96,363           | 4.1          | 3.9                  |
| <b>Unsecured Short Term Borrowings</b>  |                  |                  |              |                      |
| Rupee Term Loan from Banks              | 22,619           | 15,710           | 1.0          | 0.6                  |
| Commercial Paper                        | 38,634           | 25,482           | 1.6          | 1.0                  |
| <b>Grand Total</b>                      | <b>2,343,767</b> | <b>2,453,493</b> | <b>100.0</b> | <b>100.0</b>         |

Source: RHP, Company, PhillipCapital India Research

## Enjoys highest credit rating helped by strong parentage

IRFC enjoys the highest possible credit ratings for an Indian issuer, both for domestic and international borrowings. It has received the highest credit ratings from CRISIL – CRISIL AAA and CRISIL A1+, ICRA – ICRA AAA and ICRA A1+, and CARE – CARE AAA and CARE A1+. It has been accorded with Baa3 (Negative) rating by Moody's, BBB- (Stable) rating by Standard and Poor's, BBB- (Negative) rating by Fitch and BBB+ (Stable) rating by the Japanese Credit Rating Agency.

| Rating agency                 | Rating     | Outlook  |
|-------------------------------|------------|----------|
| <b>Domestic Rating Agency</b> |            |          |
| <b>Long term rating</b>       |            |          |
| CRISIL                        | CRISIL AAA | Stable   |
| ICRA                          | ICRA AAA   | Stable   |
| CARE                          | CARE AAA   | Stable   |
| <b>Short term rating</b>      |            |          |
| CRISIL                        | CRISIL A1+ | -        |
| ICRA                          | (ICRA) A1+ | -        |
| CARE                          | CARE A1+   | -        |
| <b>International Ratings</b>  |            |          |
| <b>Long term rating</b>       |            |          |
| Moody's                       | Baa3       | Negative |
| Fitch                         | BBB-       | Negative |
| Standard & Poor's             | BBB-       | Stable   |
| Japan Credit Rating Agency    | BBB+       | Stable   |

Source: RHP, Company, PhillipCapital India Research

### Strong asset-liability management

IRFC's asset-liability management model is structured in a manner that ensures it has minimum asset-liability mismatches. It borrows on a long-term basis to align with the long-term tenures of the assets funded. In the event of insufficient funds to redeem bonds or repay term loans (owing to inadequate cash flows during the year) the MoR is required under the Standard Lease Agreement to provide for such a shortfall through bullet payments in advance, prior to the maturity of the relevant bonds or term loans. Such payments are then required to be adjusted in the subsequent lease rentals payable under the respective Standard Lease Agreement.

| Rs bn   | < 1 Mths   | 1- 2 Mths  | 2- 3 Mths  | 3-6 Mths   | 6m- 1Yr    | 1-3 Yrs    | 3-5 Yrs   | 5+ Yrs |
|---|------------|------------|------------|------------|------------|------------|-----------|--------|
| Total Outflows (A)                            | 81         | 14         | 14         | 37         | 91         | 289        | 227       | 2,168  |
| Cumulative Total Outflows (B)                 | 81         | 94         | 109        | 145        | 236        | 525        | 752       | 2,920  |
| Total Inflows (C)                             | 60         | 0.02       | 0.02       | 0.00       | 69         | 295        | 271       | 2,225  |
| Cumulative Total Inflows (D)                  | 60         | 60         | 60         | 60         | 129        | 424        | 695       | 2,920  |
| Mismatch [(E) = (C) – (A)]                    | -20        | -14        | -14        | -37        | -22        | 6          | 44        | 57     |
| Cumulative Mismatch [(F) = (B) – (D)]         | 20         | 34         | 48         | 85         | 107        | 101        | 57        | -      |
| <b>Cumulative Mismatch as a % [(F) / (B)]</b> | <b>25%</b> | <b>36%</b> | <b>45%</b> | <b>59%</b> | <b>45%</b> | <b>19%</b> | <b>8%</b> | -      |

Source: RHP, Company, PhillipCapital India Research

### Low risk business model; IFRC enjoys stable spreads as MoR bears all the risks

IFRC has a low-risk business model where all risk related to damage to rolling assets, any legal process, or liquidity shortfall is taken care of by the MoR, while IFRC enjoys fixed contractual spreads over its cost of funds (including hedging cost for foreign borrowings). While rolling-stock spreads remained steady at 50bps until FY17, it was reduced to 30bps in FY18, and has been at 40bps since FY19.

#### Entitled margin rate over weighted average cost of incremental borrowings

| Particulars    | FY17   | FY18   | FY19   | FY20   | H1FY21 |
|----------------|--------|--------|--------|--------|--------|
| Project Assets | 50 bps | 25 bps | 35 bps | 35 bps | 35 bps |
| Rolling Stock  | 50 bps | 30 bps | 40 bps | 40 bps | 40 bps |

Source: RHP, Company, PhillipCapital India Research

#### Financing of rolling stock assets

|      | Cost to MoR | Wt. avg cost of incremental borrowing | Margin on incremental rolling assets leased |
|------|-------------|---------------------------------------|---|
| FY18 | 8.05%       | 7.75%                                 | 0.30%                                       |
| FY19 | 8.49%       | 8.09%                                 | 0.40%                                       |
| FY20 | 7.77%       | 7.37%                                 | 0.40%                                       |

Source: RHP, Company, PhillipCapital India Research

### Stable performance with reasonable return ratios

IRFC's NII saw 19% CAGR over FY18-20, led by 31% CAGR in AUM and stable spreads. Moreover, with just 1.7% cost-to-income ratio and negligible credit cost and no tax liability in FY20, earnings saw a CAGR of 34% over FY18-20. As a result, the company made a decent RoA/ RoE of 1.5%/ 14.9% in FY20.

### IRFC enjoys the following income tax exemptions / RBI exemptions

- Tax savings bonds (long-term - specified asset) issued by the Indian Railway Finance Corporation Limited are eligible for tax exemption u/s 54EC (ba) of the Income Tax Act 1961.
- Rate of TDS on lease income received from Ministry of Railway (MOR) is reduced from 1.5% to 0.75% up to 31 March 2021.

- It has adopted section 115BAA w.e.f April 2019 due to which it is not required to pay tax under MAT; now it has to pay tax @ 25.18%. Considering adjustment of brought-forward unabsorbed depreciation, tax liability of the company should remain nil until the unabsorbed depreciation full adjustment.
- The company is not liable to pay dividend distribution tax (DDT) due to abolition of Section 115O of Income Tax Act w.e.f A.Y. 2021-22.
- Services of leasing of assets (rolling stock assets including wagons, coaches, locos) by the Indian Railways Finance Corporation to Indian Railways is exempt from GST.
- RBI's asset classification norms to the extent of its direct exposure on the Sovereign - MoR.
- RBIs provisioning norms to the extent of its direct exposure on the Sovereign - MoR.
- RBIs exposure norms to the extent of its direct exposure on the Sovereign - MoR.
- IRFC was granted an exemption by the RBI from credit concentration norms to the extent of 100% of owned funds for its exposure to railways entities in which ownership of the state/central government is 51%.

## Risks

**Sole dependence on MOR for business:** IRFC depends entirely upon Indian Railways for business as 97% of the business comes from MoR. Any loss of business from Indian Railways or direct borrowing by railways from the market will significantly impact the growth of the company. Further, the business of IRFC is vulnerable to government policies regarding the railways.

**No control on managing spreads:** The margin on lease rentals is decided by MOR at the end of the fiscal year in which the assets are leased. IRFC has little power in terms of deciding margins. Unfavourable margins can have an adverse impact on profitability.

**Opening up of the railways for the private sector may impact business and profitability:** GoI Is increasingly looking at public-private partnerships (PPP) to drive infrastructure growth in the country. Increased private participation in railways would provide stiff competition to IRFC. This would lead to lower lease rentals.

## Valuation

At the upper end of the price band (Rs25-26), the issue is valued at 1.0x FY20 BV with RoA of 1.5% and RoE of 14.9%. We believe with high visibility on balance-sheet growth and no risk to asset quality, current valuations look attractive. Hence, we recommend investors subscribe to this issue.

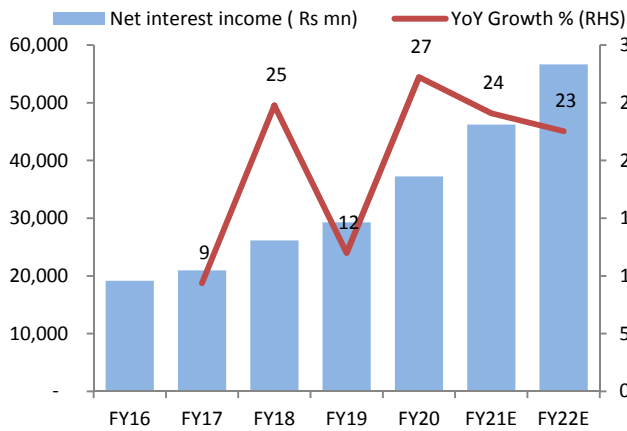
### NBFC valuations

|      | Loan Book Rs bn |       |       | RoA % |       |       | RoE % |       |       | BV Rs |       |       | P/BV |       |       |
|------|-----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|-------|-------|
|      | FY20            | FY21E | FY22E | FY20  | FY21E | FY22E | FY20  | FY21E | FY22E | FY20  | FY21E | FY22E | FY20 | FY21E | FY22E |
| IRFC | 2661            | 3525  | 4654  | 1.5   | 1.4   | 1.3   | 14.9  | 13.2  | 13.6  | 26.1  | 29.4  | 33.4  | 1.0  | 0.9   | 0.8   |
| STFC | 1,045           | 1,097 | 1,214 | 2.5   | 2.3   | 2.8   | 17.4  | 14.8  | 14.8  | 625   | 711   | 930   | 1.9  | 1.7   | 1.3   |
| SCUF | 296             | 291   | 294   | 3.3   | 3.1   | 3.4   | 16.5  | 14.7  | 13.0  | 968   | 1092  | 1358  | 1.1  | 1.0   | 0.8   |
| MMFS | 671             | 772   | 914   | 2.6   | 1.3   | 1.4   | 15.2  | 8.1   | 7.6   | 88    | 92    | 130   | 2.1  | 2.0   | 1.4   |
| CIFC | 543             | 605   | 754   | 2.3   | 1.8   | 2.3   | 21.0  | 15.3  | 17.2  | 75    | 100   | 136   | 5.6  | 4.2   | 3.1   |
| MUTH | 387             | 471   | 595   | 5.6   | 6.6   | 5.8   | 23.4  | 28.7  | 23.5  | 251   | 299   | 439   | 4.8  | 4.0   | 2.7   |

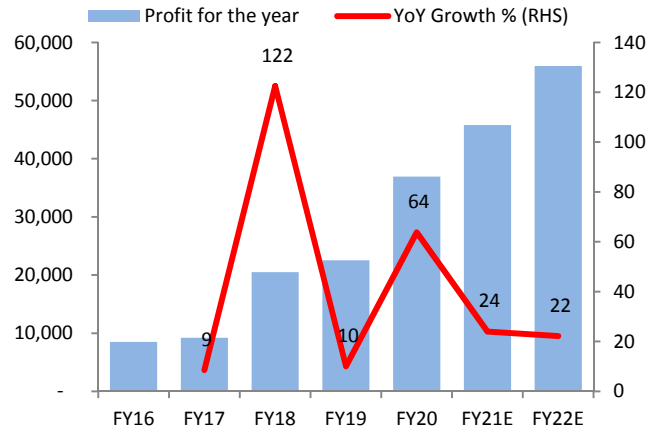
Source: Company, PhillipCapital India Research Estimates

### Key charts

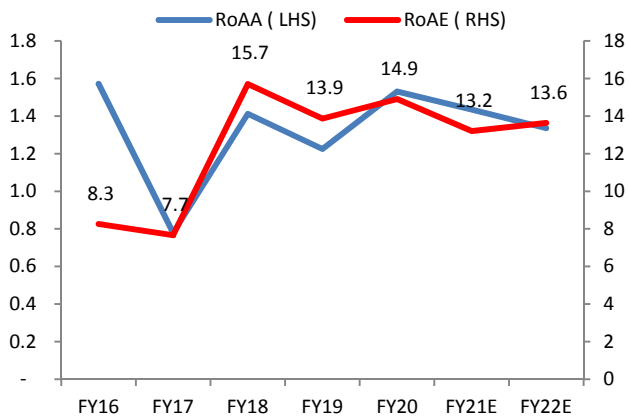
#### Healthy NII Growth (Rsmn, %)



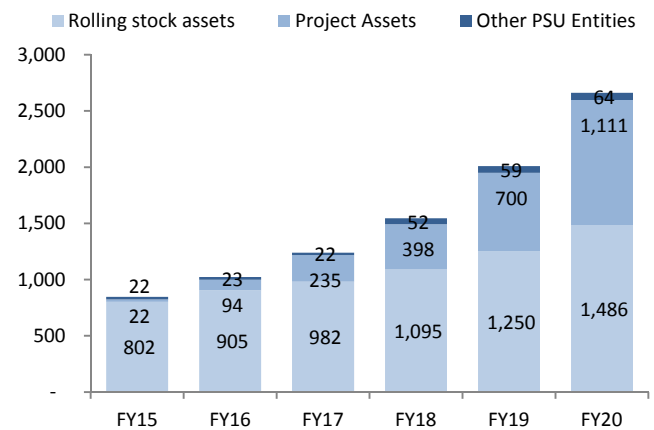
#### ...driving earnings growth (Rsmn, %)



#### Profitability Ratios (%)

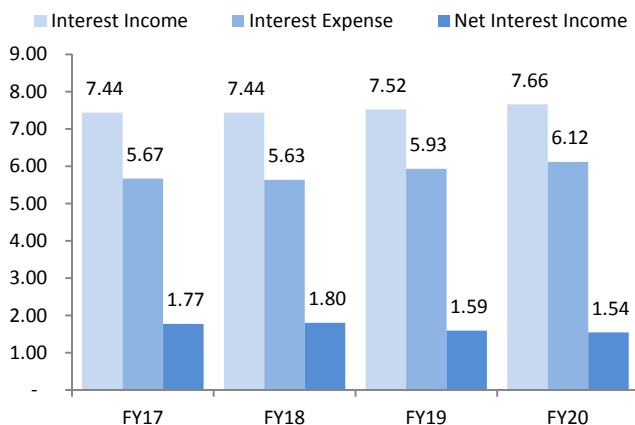


#### AUM break-up segment-wise (Rsbn)

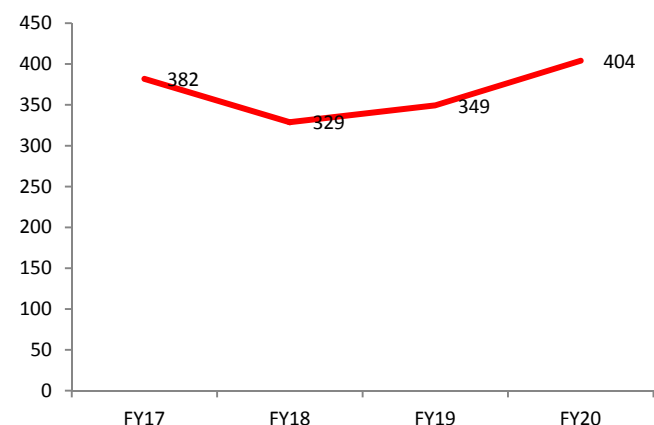


Source: RHP, Company, PhillipCapital India Research

#### Margins (%)



#### Capital adequacy comfortable (%)



Source: RHP, Company, PhillipCapital India Research



## Financials

### Profit and loss

| (Year Ending Mar 31)      | FY19  | FY20  | FY21E | FY22E |
|---------------------------|-------|-------|-------|-------|
| Net interest income       | 29278 | 37249 | 46223 | 56641 |
| Other income              | 227   | 339   | 339   | 339   |
| Net Income                | 29505 | 37587 | 46562 | 56980 |
| Operating expenses        | 214   | 642   | 756   | 998   |
| Preprovision profit       | 29291 | 36946 | 45807 | 55982 |
| Provisions                | 275   | 21    | 28    | 37    |
| Profit before tax         | 29016 | 36924 | 45778 | 55944 |
| Tax                       | 6469  | 0     | 0     | 0     |
| Tax rate %                | 22    | 0     | 0     | 0     |
| Adjusted Profit after tax | 22547 | 36924 | 45778 | 55944 |

### Dupont (as % of Assets)

| (Year Ending Mar 31)                    | FY19 | FY20 | FY21E | FY22E |
|---|------|------|-------|-------|
| Interest Income                         | 7.5  | 7.7  | 7.7   | 7.7   |
| Interest Expense                        | 5.9  | 6.1  | 6.2   | 6.3   |
| Net Interest Income                     | 1.6  | 1.54 | 1.4   | 1.4   |
| Other income total                      | 0.0  | 0.0  | 0.0   | 0.0   |
| Net Income total                        | 1.6  | 1.6  | 1.5   | 1.4   |
| Operating expenses total                | 0.0  | 0.0  | 0.0   | 0.0   |
| Pre-provision profit                    | 1.6  | 1.5  | 1.4   | 1.3   |
| Provisions                              | 0.0  | 0.0  | 0.0   | 0.0   |
| Profit before tax and exceptional items | 1.6  | 1.5  | 1.4   | 1.3   |
| Profit before tax                       | 1.6  | 1.5  | 1.4   | 1.3   |
| Tax total                               | 0.4  | 0.0  | 0.0   | 0.0   |
| Profit after tax                        | 1.2  | 1.5  | 1.4   | 1.3   |

### Growth (%)

| (Year Ending Mar 31) | FY19 | FY20 | FY21E | FY22E |
|----------------------|------|------|-------|-------|
| Net interest income  | 12.0 | 27.2 | 24.1  | 22.5  |
| Net Income total     | 12.2 | 27.4 | 23.9  | 22.4  |
| Pre-provision profit | 13.0 | 26.1 | 24.0  | 22.2  |
| Profit before tax    | 11.9 | 27.3 | 24.0  | 22.2  |
| Profit after tax     | 10.0 | 63.8 | 24.0  | 22.2  |
| Loan                 | 30.0 | 32.5 | 32.5  | 32.0  |
| Disbursement         | 43.1 | 35.9 | 30.0  | 30.0  |
| AUM                  | 30.0 | 32.5 | 32.5  | 32.0  |

Source: RHP, Company, PhillipCapital India Research

### Balance sheet

| (Year Ending Mar 31)    | FY19    | FY20    | FY21E   | FY22E   |
|-------------------------|---------|---------|---------|---------|
| Equity                  | 93805   | 118805  | 130685  | 130685  |
| Reserves                | 92051   | 190820  | 252993  | 306324  |
| Net worth               | 185855  | 309624  | 383678  | 437009  |
| Borrowings/ Deposits    | 1739327 | 2343767 | 3134069 | 4209857 |
| Current liab & others   | 140854  | 105951  | 105971  | 105995  |
| Total liabilities       | 2066036 | 2759342 | 3623718 | 4752860 |
| Net block               | 112     | 105     | 106     | 107     |
| Investments             | 131     | 115     | 115     | 115     |
| Loans                   | 2009137 | 2661112 | 3525341 | 4654309 |
| Current assets & others | 56656   | 98009   | 98156   | 98330   |
| Total assets            | 2066036 | 2759337 | 3623718 | 4752860 |

### Key ratios

| (Year Ending Mar 31) | FY19   | FY20    | FY21E   | FY22E   |
|----------------------|--------|---------|---------|---------|
| NIM (%)              | 1.6    | 1.5     | 1.4     | 1.4     |
| NIM (%) - on AUM     | 1.6    | 1.6     | 1.5     | 1.4     |
| Cost/ Income (%)     | 0.7    | 1.7     | 1.6     | 1.8     |
| Credit cost (%)      | 0.0    | 0.0     | 0.0     | 0.0     |
| RoA (%)              | 1.2    | 1.5     | 1.4     | 1.3     |
| RoE (%)              | 13.9   | 14.9    | 13.2    | 13.6    |
| Leverage (x)         | 11.3   | 9.7     | 9.2     | 10.2    |
| Tier I (%)           | 349.4  | 404.0   | 385.6   | 350.6   |
| CAR (%)              | 349.4  | 404.0   | 385.6   | 350.6   |
| No. of shares (mn)   | 9380.5 | 11880.5 | 13068.5 | 13068.5 |
| Gross NPA (%)        | 0.0    | 0.0     | 0.0     | 0.0     |
| Net NPA (%)          | 0.0    | 0.0     | 0.0     | 0.0     |

### Valuation ratios

| (Year Ending Mar 31)     | FY19 | FY20 | FY21E | FY22E |
|--------------------------|------|------|-------|-------|
| FDEPS (Rs)               | 2    | 3    | 4     | 4     |
| PER (x)                  | 15   | 9    | 7     | 6     |
| Book value (Rs)          | 19.8 | 26   | 29    | 33    |
| P/BV (Rs)                | 1.3  | 1.0  | 0.9   | 0.8   |
| Adjusted book value (Rs) | 14   | 24   | 29    | 33    |
| P/ABV (Rs)               | 1.8  | 1.1  | 0.9   | 0.8   |
| P/ PPP                   | 8.4  | 8.4  | 7.4   | 6.1   |

## Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

### Large cap stocks

| Rating  | Criteria                    | Definition  |
|---------|-----------------------------|---|
| BUY     | $\geq +10\%$                | Target price is equal to or more than 10% of current market price |
| NEUTRAL | $-10\% > \text{to} < +10\%$ | Target price is less than +10% but more than -10%                 |
| SELL    | $\leq -10\%$                | Target price is less than or equal to -10%.                       |

### Mid cap and Small cap stocks

| Rating  | Criteria                    | Definition  |
|---------|-----------------------------|---|
| BUY     | $\geq +15\%$                | Target price is equal to or more than 15% of current market price |
| NEUTRAL | $-15\% > \text{to} < +15\%$ | Target price is less than +15% but more than -15%                 |
| SELL    | $\leq -15\%$                | Target price is less than or equal to -15%.                       |

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