INVESTMENT IDEAS | Mon Aug 07,2017

Capital First is in right direction

Edelweiss reports Capital First has sustained its momentum for retail book and optical rise in GNPAs

By [illegible]

Capital First Limited (CAPF) is a leading Indian financial institution, specializing in providing debt financing to MSMEs and Consumers in India. It is a non-banking finance company (NBFC) specializing in micro, small and medium enterprises (MSME) and consumer financing supported by proprietary credit evaluation methodologies and strong credit scoring platform. The Company also offers loans to salaried consumers and small enterprises primarily for home loans, 2 wheeler (2W) loans, consumer durable loans, working capital, short term business needs and for consumption. It has the highest long term credit rating of AAA.

The founding theme of Capital First is that financing India's 50 million MSMEs and its emerging middle class, with a differentiated model, based on new technologies and deep analytics provides a large and unique opportunity. Unlike traditional models of financing, Capital First has successfully created new models to finance MSMEs and Indian consumers, in the hitherto unbanked and under-penetrated segments.

Mr. Vaidyanathan, with financial backing from Warburg Pincus' for Rs 810 Crores, bought out majority shareholders of an existing NBFC which was primarily into wholesale financing and the brand Capital First was born. Post that, Mr. Vaidyanathan changed the key constituents of the company. In the process the company got new shareholders, fresh capital of Rs 100 crore was infused, a new board was reconstituted and the business line was changed from wholesale to retail lending.

During the first quarter of 2018 fiscal, Capital First clocked decent performance. The profit after tax (PAT) posted at Rs 60.3 crore jumped 33 per cent on year to year basis. This was driven by sustained momentum on the revenue front, which increased by more than 45 per cent YoY.

Retail thrust sustains

CAPF's retail lending business has clocked a commendable growth from assets under management (AUM) of Rs 3,500 crore in fiscal 2012 to Rs 15,900 crore currently. Within the retail book as well, the company has built a granular book with incremental focus on high-growth high-yield segments such as consumer durable, 2-wheeler loans, et.al.

The assets under management have posted healthy and robust 24 per cent year on year owing to sustained traction in the retail AUM book, which increased by 30 per cent versus previous sequential year, increasing its proportion to 93 per cent. This surge was driven by robust spurt of 57 per cent in consumer durables and 92 per cent jump in business loan segments, in line with the company's strategy to shift towards higher yielding products.

Despite the uncertain environment, Capital First's strong growth momentum reinforces the conviction that it will post 25 to 27 per cent AUM CAGR over the upcoming period of 2017-19 on expanding footprint and untapped credit demand.

Asset Quality front

During the first quarter of 2018, Capital First transitioned to 90 days per due (dpd) non-performing assets (NPA) recognition norms, consequently GNPAs rose on quarter to quarter basis. On like-to-like basis asset quality was broadly stable with GNPAs- on 90dpd stood at 1.72 per cent versus 1.65 per cent in 2017. The company's strong asset quality position vindicates its sound under-writing skills and collection efficiency given robust business analytics, cutting-edge technology and competent score cards.

Notwithstanding this, it is expected that optimal product strategy anchored by stringent risk mitigants to fuel a smart J-shaped surge in return ratios-- return on assets (RoA) of 2 per cent and return on equity (RoE) of 16 to 18 per cent by 2019.

However, following limited profit and loss impact due to adequate provisioning, provision coverage dropped to 40 per cent, which is adequate at this juncture although it is believed that this will be increased over a period of time.

Outlook

Over the forthcoming 2017-19 period, CAPF's earnings are poised to post greater than 40 per cent CAGR riding on healthy and strong AUM CAGR, prudent product shift strategy, operating leverage benefits, and higher cross-sell opportunities.

Given the sustainable growth phase and sharp RoE recovery, further re-rating of the stock is expected based on consistent earnings delivery and visibility.

Only over the last five to six years, Capital First has built the retail book registering more than 40 per cent CAGR over 2012 to 2016 periods. The risk for the company is that the book is yet to face an economic down cycle. The lender's growth and profitability can be impacted by adverse regulatory changes such as increase in risk weights, securitization norms, capital adequacy requirement, et al.