Dear Member,

We are pleased to inform you that Value Pick of May 2018 is released by our team today on 08th July 2018. Value Pick stock of the month is Capital First Ltd **(BSE Code: 532938, NSE Code: CAPF)**. Capital First has a market capital of Rs. 5074 crores and operates in finance industry.

IMP Note: We released our Value Pick – May 2018 with delay mainly on account of continuous selling done by mutual funds in small and mid-caps stocks to realign their portfolio to meet guidelines defined by SEBI towards categorization and rationalisation of mutual funds schemes.

We have seen significant fall in stock prices of small and mid-cap stocks in the month of March followed by May and June 2018. Post recent correction in stock prices, valuations of small and mid-cap companies are turning reasonable to attractive for long term investors. Hence, we may release reiterate buy recommendation on some of our previous stocks which can be bought / accumulated at current or lower levels with horizon of 1 to 2 years for decent returns on your investments.

1. Company Background:

Capital First Ltd is a leading Indian Financial Institution specializing in providing debt financing to self-employed Entrepreneurs, MSMEs and consumers in India. The core purpose of Capital First is to provide financing to India's 50 million self-employed entrepreneurs, MSMEs and India's fast-emerging middle class- in a sustainable manner, with a differentiated model based on new technologies.

Capital First Limited was formed in 2012 as a result of a management buyout of an existing NBFC. In Sept 2012, Warburg Pincus acquired 70% stake in the company for Rs. 810 Crores, including fresh investment of Rs. 100 Crores into the company which was the largest FDI in India in financial services in 2012-13.

In November 2012, the long term credit rating of the Company changed to AA+ from the existing AA- by leading credit rating agencies which recognize the experienced management team, strong business model, strong controls and processes, high credit quality, conservative asset liability management with no tenor mismatches and strong promoters in the company.

The company expanded its business operations to more than 225 locations across India. Within eight years, the company has built loan assets of Rs. 26,997 Cr ($4.15 bn) as on 31 March 2018, with 94% of its loan assets in the Consumer & MSME financing space.

Capital First has consistently maintained high asset quality over the years. The Gross and Net NPA of the Company are 1.62% and 1.00% respectively as of 31 March 2018 on 90

DPD NPA recognition basis. The Book Value per Share of Capital First is Rs. 264.49 as of 31 March 2018.

2. Recent Developments:

i) Capital First picks 7% stake in Village Financial Services – July 2018

Capital First has picked up a 7 per cent stake diluted by the promoters of Village Financial Services, a Kolkata-based NBFC-MFI.

This is the second private-equity funding the Kolkata-based NBFC-MFI has received in the past six months. The promoters had earlier diluted around 11.65 per cent stake to raise equity from Mumbai-based Param Capital in March.

According to Kuldip Maity, MD & CEO, Village Financial Services, the total stake diluted currently stands at 18.65 per cent. The company has raised a total of Rs. 40 crore through these two stake dilutions put together. The company will use the proceeds to expand its presence across the country and to increase its gross outstanding loan portfolio.

The company has a total loan book of Rs. 785 crore for the quarter ended June 30, 2018. The company has been growing at around 65 percent, and is expecting to maintain the growth momentum moving forward. The company targets to take its loan book to close to Rs. 1500 crore by March 2019.

The MFI, which currently has operations across 10 States, primarily in the eastern and north-eastern regions, plans to expand into four new States in the northern and western markets this fiscal. Village Financial Services is also looking to raise an additional Rs. 60-70 crore through private equity and institutional investors this year.

ii) RBI gives its nod to Capital First-IDFC Bank merger – Jun 2018

The Reserve Bank of India recently gave its approval for the merger of Capital First Limited, Capital First Home Finance Limited and Capital First Securities Limited with IDFC Bank. The merger had been announced in January and was awaiting necessary regulatory approvals.

In a regulatory filing, IDFC Bank disclosed that the apex bank conveyed its no objection for the voluntary amalgamation, subject to compliance with the terms and conditions specified therein. The share swap ratio for the merger is fixed at 139:10, which means that IDFC Bank will issue 139 shares for every 10 shares of Capital First.

3. Financial Performance:

Capital First consolidated net profit rises 34.48% in the March 2018 quarter

Net profit of Capital First rose 34.48% to Rs 95.25 crore in the quarter ended March 2018 as against Rs 70.83 crore during the previous quarter ended March 2017. Sales rose 45.99% to Rs 1093.96 crore in the quarter ended March 2018 as against Rs 749.32 crore during the previous quarter ended March 2017.

For the full year, net profit rose 37.05% to Rs 327.44 crore in the year ended March 2018 as against Rs 238.92 crore during the previous year ended March 2017. Sales rose 35.98% to Rs 3770.62 crore in the year ended March 2018 as against Rs 2772.87 crore during the previous year ended March 2017.

Capital First consolidated net profit rises 41.72% in the Dec 2017 quarter

Net profit of Capital First rose 41.72% to Rs 86.96 crore in the quarter ended Dec 2017 as against Rs 61.36 crore during the previous quarter ended Dec 2016. Sales rose 36.05% to Rs 987.64 crore in the quarter ended Dec 2017 as against Rs 725.94 crore during the previous quarter ended Dec 2016.

4. Investment Rationale:

i) Mr. V. Vaidyanathan is the Chairman and Managing Director of Capital First Limited. Prior to his role he was the MD and CEO of ICICI Prudential Life Insurance Company and Executive Director on the Board of ICICI Bank. In order to take an entrepreneurial role, he acquired a stake in an existing NBFC, and later got a 150 m$ equity backing from Warburg Pincus and formed Capital First Ltd in 2012. This transaction is India's largest Management Buyout of a listed company and is one of his significant professional achievements.

ii) The merger of Capital First and IDFC Bank is a positive development. The merger will create a lender with a portfolio diversified across large corporate lending, small and medium enterprise loans and retail credit. V. Vaidyanathan, chairman and managing director of Capital First, will take over as the CEO of the combined entity while IDFC Bank's CEO Rajiv Lall will transition to chairman. The bank will have a 38 per cent stake in the merged entity as per their arrangement.

iii) Warburg Pincus is a leading and highly reputed global private equity firm. Founded in 1966, Warburg Pincus is among the largest Private Equity firms in the world, and highly renowned for corporate governance. In India, Warburg Pincus has supported and built large and reputed corporations like HDFC Limited, Kotak Mahindra Bank Limited, Bharti Tele-ventures Limited and Ambuja Cements Ltd. Post this merger, the Warburg Pincus-backed non-banking financial company and IDFC Bank will create a combined entity enjoying assets under management (AUM) of Rs 88,000 crore. In addition, it will boast a distribution network comprising 194 branches, 353 dedicated banking correspondent outlets, over 9,100 micro ATM points, and will serve more than 5 million customers.

iv) Micro, Small and Medium enterprises form a large part of the Indian Economy. They generate employment and act as a catalyst for socio-economic transformation in India. MSMEs account for 45% of the Indian Industrial output and 40% of the total exports. Capital First is a specialized MSME Financing player with credit evaluation methodology for this segment. Capital First offers different financing options to different categories of MSMEs catering to their financing needs at different stages of the business life cycle.

v) Capital First had ended with 24% AUM growth YoY in FY17 because of demonetisation impacting growth of its retail loan book which contributes around 93% of total loans. There has been continuous improvement on the growth front with AUM growth moving up to 36% YoY by end of FY18. Also, post-merger with IDFC Bank, the growth of the merged entity is expected to remain healthy under the leadership of Mr Vaidyanathan.

vi) Gross NPA ratio of Capital First moved to 1.62% at the end of March quarter FY18 compared with 1.59% in Dec quarter of FY18. Capital First asset quality control is particularly admirable given that it operates primarily in the MSME space where credit appraisal is fairly challenging and peers have generally witnessed significantly higher GNPA ratios. Gross and net NPAs are expected to remain low and decline to 1.18% and 0.65% respectively by FY20.

vii) Capital First has grown its AUM at 26% CAGR over last 5 years without compromising on its asset quality. The company has a diversified loan portfolio in retail NBFC space and offers high growth potential with robust profitability. Post merger with IDFC Bank, Capital First will get a banking platform and the merged entity will be headed by Mr. V. Vaidyanathan which is expected to augur well for the company in long term.

viii) Capital First has registered profit CAGR of 43.2% with ROE of 10.6% over last 5 years. The company's management has paid uninterrupted dividend since 2010, dividend yield at current price is 0.55%. The company price to book value is 264.50 and is currently available at price to book ratio of 1.94.

ix) As of Mar'18, promoter's shareholding in the company is 35.55%. Institution shareholding in the company is 35.08% which includes major investments from Foreign Portfolio Investors (19.55%) and mutual funds like Aditya Birla Sun Life Fund (4.98%), HDFC Fund (4.15%) and Kotak Equity Fund (1.22%).

5. Key Concerns & Risks:

i) Incremental slippages with increasing retail unsecured loans.

ii) Slowdown in economic recovery & higher competition in certain segments.

6. Saral Gyan Recommendation:

Capital First stock price made 52 week high of Rs. 901.85 on 15th January 2018 after merger announcement with IDFC Bank and recently made 52 week low of Rs. 499.40 on NSE. The stock price has witnessed correction of nearly 45% from its 52 week high with severe sell off in small and mid-caps over last 6 months. At current share price of Rs. 512.40, we find valuations attractive with limited downside risk and significant upside potential.

Considering company as one of the fastest growing NBFC with its focus on MSME/retail segment, strong track record with sound fundamentals, attractive valuations with price to book of 1.94 and expected synergy in business with access to banking platform with merger of IDFC Bank to transform as a retail focused bank in long term from a wholesale-focused bank, Saral Gyan team recommends **"Buy"** on **Capital First Ltd** at current market price of Rs. 512.40 for target of 780 over a period of 12 to 24 months.

Buying Strategy:

- 80% at current market price of 512.40
- 20% at price range of 450 – 470 (in case of correction in stock price in near term)

Portfolio Allocation: 4% of your equity portfolio.

Regards,

Team – Saral Gyan,
Saral Gyan Capital Services.

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Definitions of Terms Used:
a. Buy recommendation: This means that the investor could consider buying the concerned stock at current market price keeping in mind the tenure and objective of the recommendation service.
b. Hold recommendation: This means that the investor could consider holding on to the shares of the company until further update and not buy more of the stock at current market price.
c. Buy at lower price: This means that the investor should wait