

Ujjivan Financial Services

12 June 2017

Reuters: SKMS.BO; Bloomberg: SKSM IN

Short-term Pain, But Long-term Structural Story Intact

We had a meeting with the management of Ujjivan Financial Services (UFSL) along with a visit to one of their branches. Although the situation on the collection front is stabilising, the improvement was below our expectation. As a result, provisioning will spike up for the next two quarters. Loan disbursement has picked up and the management is targeting loan growth of ~20% in FY18 with higher growth in the secured housing and MSE segments. Transition into a small finance bank or SFB branch will be in phases and the associated costs will be spread accordingly. Liability addition is healthy and UFSL's focus on unbanked/underbanked customers along with targeting of Jan Dhan accounts is likely to build strong traction. While we remain positive on its long-term structural story including a decent franchise in the making, after factoring in higher provisioning over the next two quarters we have cut our ABV estimate by 14% for FY19. We have retained Buy rating on UFSL with a target price of Rs370, valuing the stock at 2.5x P/ABV FY19E financials.

Higher provisioning likely in next two quarters: Collections are improving, but the improvement is below expectation. Collections are happening with a lag. Their Par 0 improved to 8.5% from 9.9% in FY17. Collection efficiency in December 2016/January 2017/February 2017/March 2017/April 2017/May 2017 stood at 96.6%/95.3%/94.1%/93.2%/92.0%/90.5%, respectively. Collections are largely stuck in three geographies viz. Uttar Pradesh (West), Bengaluru, and Pune/Nashik belt. UFSL does have much exposure to Marathwada & Vidharbha region and it also has no exposure to drought-hit North Karnataka. The management expects total provisioning post 1HFY18 to the tune of 3%-4% of loan book, of which ~Rs0.7bn has already been provided for in FY17. We have increased our gross non-performing asset or GNPA estimates by 300bps each to 6.0%/5.5% for FY18/FY19, respectively.

Loan disbursement picks up with focus on the secured segment: Loan disbursement has picked up after a slowdown witnessed on account of demonetisation. The management is targeting overall loan growth of ~20% in FY18 with micro group and individual loans expected to grow ~15%. Higher growth is likely in the secured housing and MSE segments.

Transition to SFB branches will be in phases: Within a quarter, 35 micro finance institution or MFI branches have been converted into SFB branches. The management intends to convert another 170 branches in FY18 and 175 branches in FY19. The remaining 80 branches will be converted in FY20. Conversion into a SFB branch involves capex of Rs2.5mn-Rs3.0mn per branch. Also, to comply with the Reserve Bank of India or RBI guidelines, another 50 branches in FY18 will be added in unserved/underserved areas.

Valuation and outlook: Collections have been impacted post demonetisation for the entire industry and we believe UFSL's management is one of the best in the business to tackle such a situation and improve the collections faster than the others. Converting into a small finance bank will ensure business longevity as well as stability. Branch relocation/refurbishment will be phased over FY18-FY20 and as a result associated costs will be accordingly spread out. Post completion of the transition, return ratios will trend toward the pre-transition level. On an average, mid-cap banks' one-year forward P/ABV is double their RoA potential, whereas NBFC stocks trade fairly close to their RoA level. UFSL is getting transformed from a NBFC to a SFB and hence the valuation multiple should adjust accordingly over the long run. UFSL stock currently trades below its -1 standard deviation.

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Net interest income	2,795	5,075	6,831	7,981	9,829
Pre-provision profit	1,356	2,973	3,969	3,120	4,159
PAT	758	1,772	2,076	638	2,174
EPS (Rs)	8.8	17.5	17.4	5.3	18.2
ABV (Rs)	85.4	118.2	146.9	134.0	147.7
P/E (x)	33.8	17.0	17.1	55.6	16.3
P/ABV (x)	3.5	2.5	2.0	2.2	2.0
Gross NPAs (%)	0.1	0.2	0.3	6.0	5.5
Net NPAs (%)	-	-	-	3.0	2.8
RoA (%)	2.5	3.7	2.9	0.7	1.9
RoE (%)	13.7	18.3	14.1	3.6	11.4

Source: Company, Nirmal Bang institutional Equities Research

BUY

Sector: Banking

CMP: Rs297

Target: Rs370

Upside: 25%

Hatim Broachwala, CFA

Research Analyst

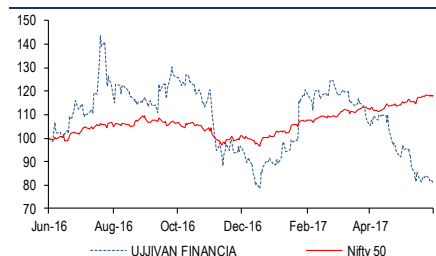
hatim.broachwala@nirmalbang.com

+91-22-3926 8068

Key Data

Current Shares O/S (mn)	119.6
Mkt Cap (Rsbn/US\$m)	35.6/554.1
52 Wk H / L (Rs)	548/285
Daily Vol. (3M NSE Avg.)	1,430,793

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Ujjivan Financial Services	(14.8)	(13.1)	(19.0)
Nifty Index	2.8	18.3	18.3

Source: Bloomberg

Other highlights:

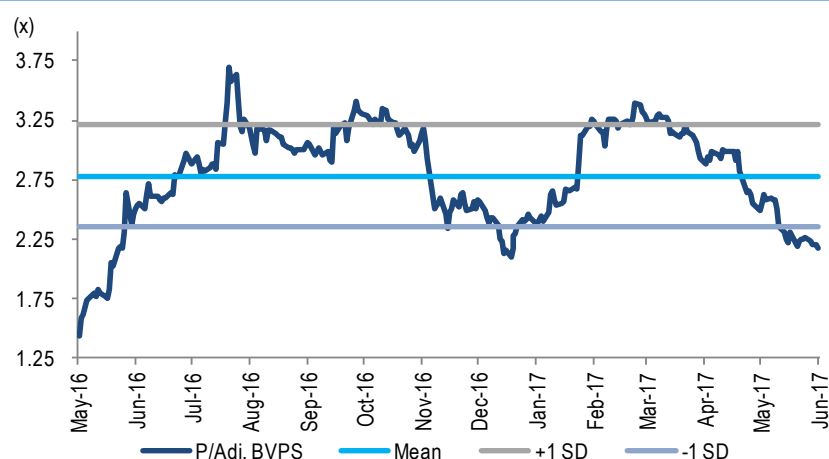
- Customer and employee perspectives have changed post conversion of UFSL into a SFB as they are now dealing with a bank instead of a NBFC.
- Branch look and feel is structured in such a way that it attracts unbanked or underserved customers. UFSL will strongly target Jan Dhan accounts for building its liability franchise.
- UFSL has garnered ~Rs5bn of deposits, with retail deposits still at a nascent stage at ~Rs0.2bn.
- Interbank funding lines from banks will open up after getting a SCB licence which is expected over the next couple of months.
- Around 50% of existing MFI customers opened deposit accounts with UFSL. Once a deposit account is opened, all incremental loan disbursement takes place through the bank account. Also, every SFB branch will have two sales officers targeting external inbound as well as outbound customers for liability products.
- UFSL currently offers liability products like CASA, FD & RD deposits. It plans to offer third-party products like life insurance and mediclaim. Also, it may add OD facility for MSE customers and personal loans to salaried customers.
- Average balance in deposit account in case of MFI customers is ~Rs1,000-Rs2,000, whereas for non- MFI customers it is ~Rs3,000-Rs5,000.
- Currently, a MFI borrower is eligible for individual loan after successful completion of 20 months under group lending.
- All loan officers as well as liability executives are given Aadhar-linked tablets which can instantly open a deposit account within three minutes. Also, the customers can deposit or withdraw up to Rs5,000 through this device. It has three ways of authentication viz. biometric, iris scan and OTP number.
- Every customer is given a biometric debit card along with a welcome kit which can be used at any ATM.
- UFSL has no plan to change the yields on its lending products in the near future.
- UFSL offers maximum ticket size of Rs60,000 for group loan customers and Rs1,50,000 for individual loan customers.

Exhibit 1: Change in our estimates

	Revised estimate		Earlier estimate		% revision	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net interest income (Rsmn)	7,981	9,829	8,394	10,511	(4.9)	(6.5)
NIM (%)	10.1	9.9	10.4	10.2	(32bps)	(34bps)
Operating profit (Rsmn)	3,120	4,159	3,565	4,918	(12.5)	(15.4)
Profit after tax (Rsmn)	638	2,174	1,559	2,873	(59.1)	(24.3)
EPS (Rs)	5.3	18.2	13.1	24.1	(59.1)	(24.3)
ABV (Rs)	134.0	147.7	150.1	172.4	(10.7)	(14.3)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 3: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Interest income	5,508	9,310	12,258	15,196	18,625
Interest expense	2,714	4,235	5,427	7,215	8,795
Net interest income	2,795	5,075	6,831	7,981	9,829
Loan origination fees	473	708	776	1,086	1,519
Other income	138	258	943	559	720
Net revenues	3,405	6,041	8,550	9,626	12,068
Operating expenses	2,049	3,068	4,581	6,506	7,909
-Employee expenses	1,328	1,967	2,716	3,318	3,798
-Other expenses	722	1,102	1,866	3,187	4,112
Operating profit	1,356	2,973	3,969	3,120	4,159
Provisions	210	253	751	2,139	814
PBT	1,146	2,720	3,217	981	3,345
Tax	388	948	1,141	343	1,171
PAT	758	1,772	2,076	638	2,174

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Balance sheet

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Share capital	861	1,012	1,194	1,194	1,194
Reserves & surplus	6,503	10,966	16,359	16,882	18,941
Net worth	7,364	11,978	17,553	18,076	20,135
Deposits	-	-	1,064	9,345	26,799
Borrowings	31,218	43,380	62,914	68,083	79,713
Other liabilities & provisions	1,180	1,915	3,255	4,790	6,080
Total liabilities	39,763	57,273	84,786	100,293	132,727
Fixed assets	179	242	1,398	2,374	3,100
Investments	1	1	14,467	16,231	22,267
Loans	32,187	50,643	58,712	69,063	90,881
Cash	6,448	4,913	7,601	9,496	12,723
Other assets	947	1,475	2,608	3,130	3,756
Total assets	39,763	57,273	84,786	100,293	132,727
AUM	32,741	53,885	63,795	76,737	100,979

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

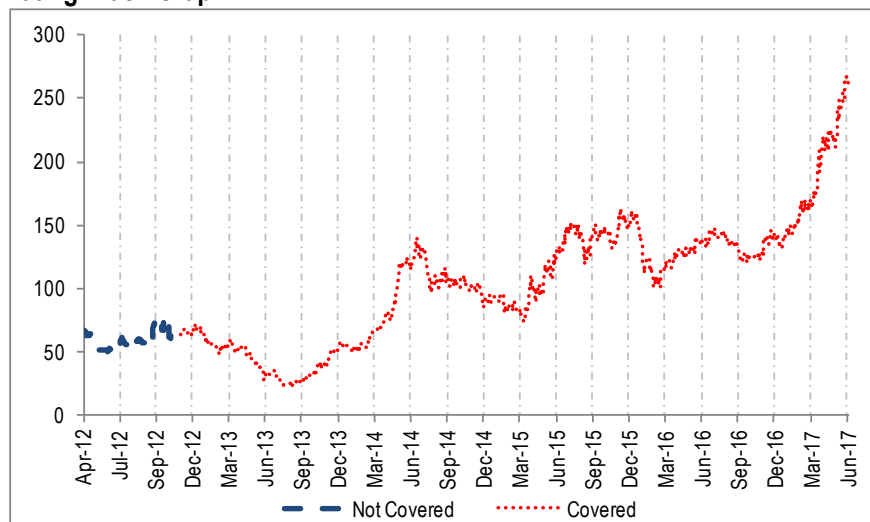
Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Growth (%)					
Net interest income	54.7	81.6	34.6	16.8	23.2
Operating profit	47.1	119.3	33.5	(21.4)	33.3
Profit after tax	37.7	133.8	17.2	(69.3)	241.0
Business (%)					
Deposit growth	-	-	-	778.3	186.8
CASA	-	-	3.0	3.0	4.0
Advances growth	99.0	57.3	15.9	17.6	31.6
AUM growth	102.4	64.6	18.4	20.3	31.6
Spread (%)					
Yield on AUM	22.5	21.5	20.6	20.1	19.4
Yield on BS loans	22.8	22.5	22.5	22.3	21.6
Yield on assets	22.8	22.5	21.3	19.3	18.8
Cost of funds	11.5	11.4	10.8	10.2	9.6
Core spreads	11.3	11.1	11.7	12.1	12.0
NIM	11.6	12.3	11.0	10.1	9.9
Operational efficiency (%)					
Cost-to-income	60.2	50.8	53.6	67.6	65.5
Cost-to-AUM	8.4	7.1	7.8	9.3	8.9
Productivity (Rsmn)					
AUM per branch	77.4	114.9	139.6	147.0	193.4
AUM per employee	4.6	6.7	6.3	6.8	8.6
Employee per branch	16.8	17.2	22.2	21.6	22.5
CRAR (%)					
Tier I	21.7	22.4	16.8	15.6	13.2
Tier II	2.5	1.8	1.4	1.6	1.4
Total	24.2	24.1	18.2	17.2	14.6
Asset quality (%)					
Gross NPAs	0.1	0.2	0.3	6.0	5.5
Net NPAs	-	-	-	3.0	2.8
Provision coverage	74.8	74.3	89.3	50.0	50.0
Credit cost (excluding std. assets)	0.1	0.2	1.1	3.1	0.6
Credit cost (including std. assets)	0.9	0.6	1.4	3.3	1.0
Return ratios (%)					
RoE	13.7	18.3	14.1	3.6	11.4
RoA	2.5	3.7	2.9	0.7	1.9
Per share (%)					
EPS	8.8	17.5	17.4	5.3	18.2
BV	85.5	118.4	147.0	151.4	168.6
ABV	85.4	118.2	146.9	134.0	147.7
Valuation (x)					
P/E	33.8	17.0	17.1	55.6	16.3
P/BV	3.5	2.5	2.0	2.0	1.8
P/ABV	3.5	2.5	2.0	2.2	2.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
17 March 2017	Buy	444	570
2 May 2017	Buy	381	480
12 June 2017	Buy	297	370

Rating Track Graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 3926 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830
Atul Vitha	Dealing Desk	atul.vitha@nirmalbang.com	+91 22 3926 8071 / +91 22 3926 8226

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1; Fax. : 022 3926 8010