Ujjivan Financial Services

5 August 2019

1QFY20 Result Update

Reuters: UJVF.BO; Bloomberg: UJJIVAN IN

Standout operational performance while IPO queries persist

Ujjivan Financial Services (UFSL) reported its 1QFY20 results with the key pointers being: (1) Loan growth accelerated to 51% YoY on the back of faster micro banking growth and continued non micro banking traction (2) Net interest margin declined to some extent, lower by ~30 bps YoY, to 10.5%. We think traction for retail liabilities continues to be encouraging (3) Cost to income ratio improved to 64% on the back of cost saving initiatives. (See *comprehensive* conference call takeaways on page 2 for *significant incremental colour*). Per se, on the key P&L items, UFSL posted NII growth of 38% YoY at Rs3,270mn, PPOP growth of 91% YoY at Rs1,459mn and PAT growth of 79% YoY to Rs830mn. We have revised our estimates for FY20/FY21 and retained Buy rating on UFSL, revising our target price to Rs415 (from Rs402 earlier), valuing the stock at 1.7x FY21E P/BV.

Loan growth accelerated to 51% YoY on the back of faster micro banking growth and continued non micro banking traction: Micro banking loan growth was faster at 37% YoY compared with a 4-quarter average of 21% registered over FY19. Within micro banking, group loans and individual loans grew at a similar pace of 33% and 36%. Non micro banking loan growth maintained high growth trajectory, growing 205% YoY. Within micro banking, MSE book grew 145% YoY whereas housing book grew 141% YoY. Personal loans and vehicle finance are segments that UFSL has recently entered. Thus, scalability for UFSL stems from (1) Higher growth in micro banking than guided for earlier during the depth of the microfinance sector crisis (2) Strong traction for non micro banking segments including for new initiatives (3) Greater comfort in dealing with (and strategic shift towards) higher ticket size clients in the non micro banking segments. Management also averred that the general economic slowdown affecting systemic retail lending growth has not impacted them.

Net interest margin declined to some extent, lower by ~30 bps YoY, to 10.5%. We think traction for retail liabilities continues to be encouraging: Rising share of secured lending is bound to have a concomitant impact on overall yield, which has declined ~200 bps YoY to ~20% for 1QFY20. The greatest impact stems from a ~300 bps decline YoY in MSE segment yield to ~18%. Micro banking segment yield declined ~100 bps YoY to ~21%. Share of deposits in total funding rose 1600 bps YoY to 65% whereas share of refinance remained largely stable at 29%, down 200 bps YoY. Share of bank term loans expectedly declined to 2%, down 1000 bps YoY. Share of retail deposits in total deposits has grown to 43%, up ~2300 bps YoY.

Cost to income ratio improved to 64% on the back of cost saving initiatives: Cost saving initiatives include (1) Re-negotiation of long-term contracts with some of its vendors (2) Pan-India tie up for purchase and supply management. Such initiatives led to cost saving of ~10% on like-for-like basis. Some cost saving also emerged since no incremental branch was made operational during the quarter since approval from RBI had not come through (it has now). It is to be noted that fixed and personnel cost for these incremental branches had been incurred during 1QFY20. The cost to income ratio was 72% in 1QFY19 and 78% in 4QFY19.

Valuation and outlook: We have revised our NII estimates by 7.3%/15.2%, PPOP estimates by 38.0%/54.6% and PAT estimates by 11.1%/15.5% for FY20/FY21, respectively. We have retained Buy rating on USFL, valuing the stock at 1.7x FY21E P/BV and revising our target price to Rs415 (from Rs402 earlier).

BUY

Sector: Banking

CMP: Rs284

Target Price: Rs415

Upside: 46%

Shivaji Thapliyal
Research Analyst
shivaji.thapliyal@nirmalbang.com
+91-22-6273 8068

Raghav Garg
Research Analyst
raghav.garg@nirmalbang.com
+91-22-6273 8192

Key Data

Current Shares O/S (mn)	121.4
Mkt Cap (Rsbn/US$mn)	34.6/497.6
52 Wk H / L (Rs)	407/167
Daily Vol. (3M NSE Avg.)	2,331,839

Price Performance (%)

	1 M	6 M	1 Yr
Ujjivan Financial Services	(2.9)	0.6	(25.5)
Nifty Index	(7.7)	1.0	(2.2)

Source: Bloomberg

Y/E Mar (Rsmn)	Q1FY20	Q1FY19	Q4FY19	YoY (%)	QoQ (%)
Interest Income	5,901	3,988	NA	*48.0*	*NA*
Interest Expenses	2,631	1,612	2,165	*63.2*	*21.5*
Net Interest Income	**3,270**	**2,376**	**NA**	*37.6*	*NA*
NIM (%)	***12.0***	***12.4***	***NA***	*-40 bps*	*NA*
Fee & Other income	993	583	NA	*70.3*	*NA*
Total Income	**4,263**	**2,960**	**3,735**	*44.0*	*14.1*
Staff Cost	1,637	1,157	1,570	*41.5*	*4.3*
Other Op Exp	1,168	1,040	1,464	*12.3*	*(20.2)*
Total Operating Expenses	2,804	2,197	3,034	*27.6*	*(7.6)*
Cost to Income (%)	*65.8*	*74.2*	*81.2*	*-845 bps*	*-1,546 bps*
Pre-Provisioning Operating profit	**1,459**	**763**	**701**	*91.2*	*108.1*
Provisions	188	58	266	*224.1*	*(29.3)*
PBT	**1,270**	**705**	**435**	*80.1*	*192.0*
Tax	440	242	4	*81.8*	*10,900.0*
-effective tax rate	34.6	34.3	0.8	*30 bps*	*3,380 bps*
PAT	**830**	**463**	**431**	*79.3*	*92.6*
EPS (Rs)	6.9	3.8	3.6	*81.6*	*91.7*
Advances	116,547	75,948	109,305	*53.5*	*6.6*
Deposits	78,351	38,038	72,592	*106.0*	*7.9*

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Listing of SFB

- The management stated that it is working towards listing of the small bank finance by the original deadline of January 31st 2020, as required by the RBI. The board of the SFB has approved the listing via IPO route.
- The management stated that it would ensure that existing shareholders' interests are protected and they are given an opportunity to participate in the bank's listing.
- The bank stated that it has evaluated a number of options over the past few months including various restructuring ideas, scheme of arrangement, issue of shares via trust route, acquisition but decided to not proceed with these due to various challenges such as getting a buy-in from the regulator, time elapsing leading to missing of RBI deadline, significant cash outflow in form of taxes and stamp duty. As of consequence, the bank has decided to proceed with an IPO for the SFB. The bank has already put together a team for the IPO process.
- The bank stated that for the existing retail investors in the holding company, 10% of the IPO-issue will be set aside for subscription at a discount of upto 10%. For other investors, the bank is considering a pre-IPO placement or participation as anchor investors in the IPO.
- For employees, the bank will be offering an employee stock purchase scheme.
- As per SEBI, a company needs to offer a minimum stake of 10% while conducting an IPO, which UFSL has to adhere to. The stake of existing shareholders will, therefore, reduce depending on the extent to which they are able to participate in the IPO (and / or, potentially, the pre-IPO).
- The IPO does not involve any offer for sale and will be a pure issue of fresh shares.
- The management is also currently assessing capital requirements for the small finance bank over the next few years and will factor this into their considerations while executing the IPO.
- The RBI is mulling on-tap licensing guidelines for small finance banks. In this regard, they had asked the existing small finance banks to submit their input in the form of a jointly prepared paper. The existing guidelines, in any case, did not preclude a reverse merger and the paper submitted serves to bolster the likelihood of a reverse merger. The RBI is expected to issue guidelines in this regard in August itself.
- As per UFSL, the RBI sounds positive in terms of allowing a reverse merger after listing of the small finance bank. There is no waiver on the listing, which is a clear guideline mentioned when the banking licence was granted.
- The reverse merger can happen at any point after the completion of 5 years from the date of commencement of operations, which is January 2022.
- UFSL is following the developments with regard to Equitas closely with, especially with respect to the outcome of the structure proposed by them. If the RBI allows their structure, UFSL stands ready to replicate it in a short timespan since they have done all the groundwork.
- As per the scheme of arrangement involving transfer of funds from the holding company to the SFB, stamp duty will be payable in Karnataka as well as Delhi. Plus, there will be income tax impact on shareholders and the holding company as well.

Asset Quality

- In West Bengal, the bank has not faced any material challenges though it remains watchful of the political developments in the state. In terms of repayments rates in WB, they have been consistent over the last 6 months.
- In Orissa, the bank has limited presence and does not face any challenges in the regions where it is operating except due to cyclone Fani, The management expects the business impact of Fani to abate going forward.
- In addition to repayment rates, the bank is also monitoring on-time repayment rates as well as bureau rejection rates. As per the bank, increase in bureau rejection rate signals that the market is overheating.

- The bank stated that it continues to limit per state exposure at 20%.
- Reduction in PCR is mainly due to the write off during the quarter. As far as incremental delinquencies are concerned, they were largely on account of stress from Orissa due to cyclone Fani.

Business and Loan Growth

- High growth in PAT during the quarter was on account of high growth in business as well as due to cost control measures taken by the bank.
- Majority of the growth in advances was driven by micro banking. In turn, micro banking growth was fueled by new product launches, expansion in new areas, process improvisation, productivity improvement and growth in borrower base and individual lending push.
- The bank stated that it continues to focus on building a mass market brand. In line with this strategy, the bank launched a new product called Sampoorna Banking program, which offers a whole range of banking products to the family of micro banking customers. This will enable the bank to develop a deeper and more focused engagement with customers.
- The bank said it would continue to focus on micro and rural banking and would be looking to expand product baskets and customer base.
- The bank launched new products under the MSE segments, with larger ticket sizes.
- 100% of the disbursements under MSE segment during the quarter were of secured nature.
- As per the bank, it would build MSE and housing lending businesses through increasing geographical footprint and adding new products. The bank expects these two businesses to break-even this year and start contributing to profitability.
- The bank stated that it has benefitted from the NBFC liquidity crisis since it has been able to lending to MBFCs, particularly MFIs, with focus on rated corporates and without significant ALM mismatch.
- The bank stated that it has disbursed Rs. 1.48 bn to NBFC-MFIs during the quarter.
- As per the bank, its NBFC lending would be limited and will not exceed a certain cap. Overall, NBFC-lending will not be a significant portion of the total portfolio.
- The bank stated that it has recently started the personal loans and vehicle finance segment and both are still very small. Though, going forward, these businesses are expected to see high growth.
- New customer addition during the quarter was ~0.3 mn.
- Growth in last two quarters has been good on account of the infrastructure established earlier, which is now paying dividends. The company will remain watchful of how the economy performs.
- Average ticket size across products has gone up, especially in MSE and housing segment. In MSE segment, the bank has completely moved towards secured lending which is one of the reasons for the said rise. Further, the bank has increased its maximum exposure in MSE segment from Rs. 5 mn to Rs. 20 mn but will execute this only in graded manner. In the housing segment, the bank has created additional focus on high ticket segments, particularly for the ready property segment.
- Number of unique customers, as percentage of total, stands at ~30%.

Margin, Liabilities and Liquidity

- The bank stated that retail deposits and particularly CASA, is a focus area. The bank has introduced a feature rich corporate salary program which can handle bulk salary disbursement for a huge employee base.
- Housing loan yields have been stable whereas yields in the MSE segment have come down a bit as a result of focus on secured lending.
- Regarding their strategy with respect to deposits, the bank stated they are following a multi-channel approach and have been promoting differentiated products and services on the CA and SA side. The bank stated it has identified segments where it can offer specifically tailored products to ensure they

stay ahead of the competition. The bank is focusing on providing solutions-based products and has been seeing traction build up in this.

- Percentage of SA customers from asset side customer base is about 50% and largely from the micro banking customers.

Fee and Other Income

- Break up of other income during the quarter:
  - Rs. 370 mn of processing fee
  - Rs. 416 mn of PLSC income
  - Rs. 76.4 mn of income through bad debt recovery
  - Rs 37 mn of third party product distribution
  - Rs. 100 mn of miscellaneous income
- Securitization income during the quarter was Rs. 27 mn.

Operating Expenses

- The bank did not open any new branches during the quarter as they were awaiting RBI approval. Further, while the costs for setting up the branches and placing manpower has been incurred during the quarter, the business operations could not start. Now, since the approval has come from the RBI, branches established during Q1 will contribute to the business.
- On the digital front, on the front end, such as mobile and internet banking, the bank stated it has done significant amount of work and is ready to go ahead in terms of generating asset side and deposits business. Allowance of Aadhar-based enrolment is an additional positive, and the bank has made appropriate changes to its digital platforms in this regard.
- On the back end, the bank recently started working on analytics and has started building scorecards, the impact of which will be felt at some point in the future.
- In terms of cost control measures, the bank stated that it has renegotiated some of its long terms contracts with vendors and has executed a pan-India tie-up for purchase and supply management. Further, the bank is also looking at introducing robotics to improve processes and productivity.
- Cost control measures in Q1 have resulted in ~10% savings.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Net Interest Income	6,831	7,068	10,029	14,219	19,347
Pre-provisioning operating profit	3,969	3,226	3,105	6,759	10,613
PAT	2,077	73	1,984	3,093	4,477
EPS (Rs)	17.4	0.6	16.4	25.5	34.5
BV (Rs)	147.0	145.7	160.1	187.3	239.1
P/E (x)	16.3	472.1	17.4	11.1	8.2
P/BV (x)	1.9	2.0	1.8	1.5	1.2
Gross NPA (%)	*0.3*	*3.6*	*0.9*	*1.5*	*1.5*
Net NPA (%)	*0.0*	*0.7*	*0.3*	*0.3*	*0.3*
RoA (%)	*2.9*	*0.1*	*1.7*	*1.7*	*1.6*
RoE (%)	*14.1*	*0.4*	*10.7*	*14.7*	*16.7*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	1QFY20	1QFY19	4QFY19	*YoY (%)*	*QoQ (%)*	1QFY20E	*Devi. (%)*
Net interest income	3,270	2,610	3,457	*25.3*	*(5.4)*	3,134	*4.3*
Pre-provisioning operating profit	1,459	763	701	*91.2*	*108.2*	865	*68.7*
PAT	830	463	431	*79.3*	*92.4*	492	*68.6*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		*% Revision*	
	FY20E	FY21E	FY20E	FY21E	*FY20E*	*FY21E*
Net interest income (Rsmn)	14,219	19,347	13,256	16,788	*7.3*	*15.2*
NIM (%)	*9.1*	*8.0*	*9.4*	*9.3*	*-28 bps*	*-128 bps*
Operating profit (Rsmn)	6,759	10,613	4,898	6,866	*38.0*	*54.6*
Profit after tax (Rsmn)	3,093	4,477	2,785	3,875	*11.1*	*15.5*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Interest income	12,258	13,117	17,313	25,537	37,307
Interest expense	5,427	6,049	7,284	11,319	17,960
Net interest income	**6,831**	**7,068**	**10,029**	**14,219**	**19,347**
Loan origination fees	776	713	900	1,394	2,010
Other income	943	1,986	2,246	3,617	5,066
Net revenues	**8,550**	**9,768**	**13,175**	**19,229**	**26,423**
Operating expenses	4,580	6,542	10,070	12,471	15,810
-Employee expenses	2,716	3,664	5,260	6,218	7,994
-Other expenses	1,864	2,877	4,810	6,253	7,816
Pre-Provisioning Operating profit	**3,969**	**3,226**	**3,105**	**6,759**	**10,613**
Provisions	751	3,108	406	2,142	3,931
PBT	3,218	118	2,699	4,616	6,682
Tax	1,141	46	715	1,523	2,205
PAT	**2,077**	**73**	**1,984**	**3,093**	**4,477**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Share capital	1,194	1,209	1,212	1,212	1,297
Reserves & surplus	16,359	16,405	18,198	21,484	29,715
Net worth	**17,553**	**17,613**	**19,410**	**22,696**	**31,011**
Deposits	1,064	37,725	72,585	148,915	255,443
Borrowing	62,914	38,528	41,661	42,751	44,390
Other liabilities & provisions	3,255	4,272	4,483	7,396	3,882
Total liabilities	**84,786**	**98,139**	**138,139**	**221,759**	**334,726**
Fixed assets	1,398	1,984	2,845	3,571	4,892
Investments	14,467	12,325	15,266	32,011	48,400
Loans	58,712	75,596	105,530	160,051	241,996
Cash	7,601	5,937	10,952	20,807	31,459
Other assets	2,608	2,297	3,546	5,319	7,979
Total assets	**84,786**	**98,139**	**138,139**	**221,759**	**334,726**
AUM	**63,795**	**75,600**	**110,490**	**168,475**	**254,732**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

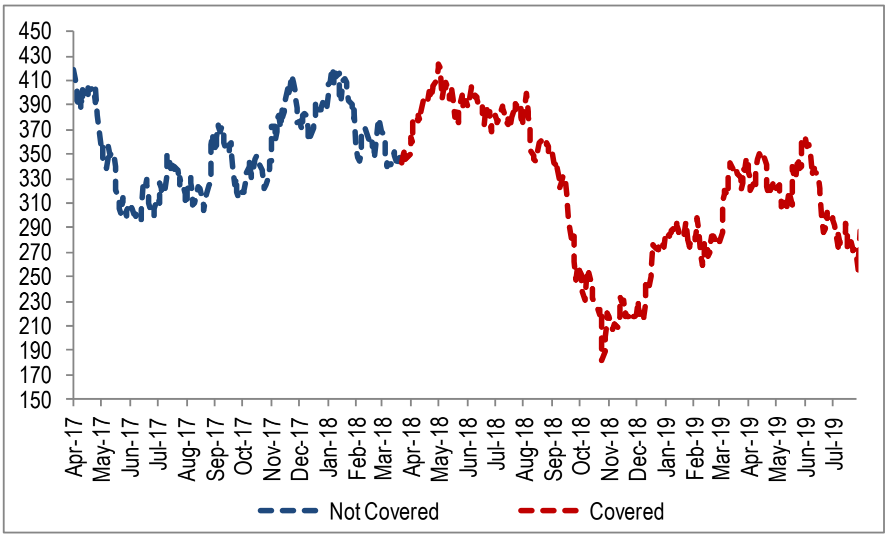
Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Growth (%)					
Net interest income	34.6	3.5	41.9	41.8	36.1
Operating profit	33.5	(18.7)	(3.8)	117.7	57.0
Profit after tax	17.3	(96.5)	2,624.7	55.9	44.8
Business (%)					
Deposit growth	NA	3,445.6	92.4	105.2	71.5
CASA	3.0	3.7	10.6	12.0	14.0
Advance growth	15.9	28.8	39.6	51.7	51.2
AUM growth	18.4	18.5	46.2	52.5	51.2
Spread (%)					
Yield on AUM	20.8	18.8	17.5	17.4	16.6
Yield on BS loans	22.4	19.5	17.9	18.3	17.4
Cost of funds	10.8	8.6	7.6	7.4	7.3
Core spread	11.7	10.9	10.3	10.9	10.1
NIM	12.5	10.5	9.6	9.1	8.0
Operational efficiency (%)					
Cost-to-income	53.6	67.0	76.4	64.9	59.8
Cost-to-AUM	7.8	9.4	10.8	8.9	7.5
Productivity (Rsmn)					
AUM per branch	139.6	162.9	210.9	298.7	414.9
AUM per employee	6.3	6.7	7.5	10.8	14.0
Employee per branch	22.2	24.2	28.2	27.6	29.6
CRAR (%)					
Tier I	16.8	22.3	18.4	14.3	14.8
Tier II	1.4	0.7	0.6	0.6	0.6
Total	18.2	23.0	18.9	15.0	15.4
Asset quality (%)					
Gross NPAs	0.3	3.6	0.9	1.5	1.5
Net NPAs	0.0	0.7	0.3	0.3	0.3
Provision coverage	89.0	81.9	71.9	80.0	80.0
Credit cost (excluding std asset)	1.4	4.6	0.4	1.1	1.3
Credit cost (including std asset)	2.6	4.9	1.0	1.6	2.0
Return ratios (%)					
RoE	14.1	0.4	10.7	14.7	16.7
RoA	2.9	0.1	1.7	1.7	1.6
Per share (%)					
EPS	17.4	0.6	16.4	25.5	34.5
BV	147.0	145.7	160.1	187.3	239.1
ABV	146.9	141.5	157.9	183.3	233.5
Valuation (x)					
P/E	16.3	472.1	17.4	11.1	8.2
P/BV	1.9	2.0	1.8	1.5	1.2
P/ABV	1.9	2.0	1.8	1.6	1.2

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	343	437
11 May 2018	Buy	404	467
7 August 2018	Buy	384	479
9 October 2018	Buy	231	389
15 November 2018	Buy	218	341
24 January 2019	Buy	284	401
8 April 2019	Buy	327	402
31 May 2019	Buy	340	406
8 July 2019	Buy	292	402
5 August 2019	Buy	284	415

Rating track graph



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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 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 6273 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

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 6273 8000/1; Fax. : 022 6273 8010