

Ujjivan Financial Services

7 August 2017

Reuters: UJVF.BO; Bloomberg: UJJIVAN IN

Asset Quality Pain Is Behind

While Ujjivan Financial Services (UFSL) reported that gross non-performing assets or GNPA on Principal at Risk (PAR) 90 increased to 6.2% in 1QFY18 as against 3.7% in the previous quarter on account of shifting of the bucket for over dues, its PAR 0 decreased to 8.8% from 9.9% in the previous quarter. Collection efficiency in new loans given during the current calendar year is back to normal at 99.8%. Given the collection efforts, the management gave guidance of asset quality improving from here on. Significant provision of Rs1.6bn was made during the quarter, which includes additional provision of Rs0.4bn made over and above regulatory requirement. As a result, net non-performing assets or NNPA to that extent were down at 2.3%. Despite the higher provision made during the quarter, the management gave guidance of credit costs remaining below 4% for FY18. We have retained our GNPA estimates at 6.0%/5.5% for FY18/FY19, respectively.

Assets under management or AUM grew 10% for the quarter, a bit slower as the management turned cautious in geographies having a lower collection. Loan disbursement grew 21% sequentially to Rs17bn, but lower than the pre-demonetisation level. The management lowered its guidance on AUM growth for FY18 to 20% from 25% earlier. Net interest margin or NIM improved on a sequential basis by 60bps to 9.2%. Non-interest income growth was healthy at 65%. Operating expenses grew 66% as it is in the process of converting 52 of its existing branches into deposit-taking small finance bank or SFB branches. The management aims to refurbish 160 of its existing 457 branches into SFB branches in FY18 and the rest will be converted over FY18-FY20. 160 branches include 18 in under-banked areas and it will add another 29 in FY18 to comply with the Reserve Bank of India or RBI regulations. Deposit garnering activity has witnessed some pick-up at Rs3bn, which is likely to further accelerate after it gets approval for SCB status. CASA deposit ratio stood at 5.3%. After factoring in the improvement in numbers going forward, we have increased our ABV estimate by 2% for FY19. We have retained Buy rating on the stock with a target price of Rs395, valuing it at 2.7x P/ABV FY19E financials.

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 collection faster than the others. The management has voluntarily done higher than the required provisioning. 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. The UFSL stock currently trades below its -1 standard deviation.

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BUY

Sector: Banking

CMP: Rs321

Target Price: Rs395

Upside: 23%

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Key Data

Current Shares O/S (mn)	119.6
Mkt Cap (Rsbn/US\$m)	38.4/603.4
52 Wk H / L (Rs)	485/285
Daily Vol. (3M NSE Avg.)	1,983,057

Price Performance (%)

	1 M	6 M	1 Yr
Ujjivan Financial Services	3.6	(24.7)	(28.5)
Nifty Index	4.7	15.2	17.7

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)
Interest income	2,955	2,912	2,891	1.5	2.2
Interest expenses	1,573	1,204	1,617	30.6	(2.7)
Net interest income	1,382	1,708	1,274	(19.1)	8.5
NIM (%)	9.2	13.0	8.6	(373bps)	62bps
Fee & other income	631	382	510	65.3	23.7
Operating income	2,013	2,089	1,784	(3.7)	12.8
Staff costs	880	599	765	47.0	15.0
Other op. expenses	688	347	601	98.4	14.5
Total operating expenses	1,568	946	1,366	65.8	14.8
Cost-to-income (%)	77.9	45.3	76.6	3,264bps	132bps
Cost-to-AUM (%)	9.8	6.7	8.4	304bps	134bps
Operating profit	445	1,144	418	(61.1)	6.5
Provision	1,591	62	72	2,446.4	2,109.7
Credit costs (%)	10.6	0.5	0.5	1,015bps	1,014bps
PBT	-1,146	1,081	346	(206.0)	(431.2)
Tax	-397	367	153	(208.1)	(359.5)
-effective tax rate	34.6	34.0	44.2	66bps	(958bps)
PAT	-749	714	193	(204.9)	(488.1)
EPS (Rs)	-6.3	6.0	1.6	(203.7)	(487.4)
BV (Rs)	140.7	137.0	147.0	2.7	(4.3)
AUM	64,593	58,509	63,795	10.4	1.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Net interest income	2,795	5,075	6,831	7,487	9,509
Pre-provision profit	1,356	2,973	3,969	2,828	3,968
PAT	758	1,772	2,076	179	1,994
EPS (Rs)	8.8	17.5	17.4	1.5	16.7
ABV (Rs)	85.4	118.2	146.9	133.7	146.5
P/E (x)	36.5	18.3	18.5	214.6	19.2
P/ABV (x)	3.8	2.7	2.2	2.4	2.2
Gross NPAs (%)	0.1	0.2	0.3	6.0	5.5
Net NPAs (%)	-	-	-	2.4	2.2
RoA (%)	2.5	3.7	2.9	0.2	1.7
RoE (%)	13.7	18.3	14.1	1.0	10.7

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)	1QFY18E	Devi. (%)
Net interest income	1,382	1,708	1,274	(19.1)	8.5	1,513	(8.7)
Pre-provision profit	445	1,144	418	(61.1)	6.5	486	(8.4)
PAT	(749)	714	193	(204.9)	(488.1)	(349)	-

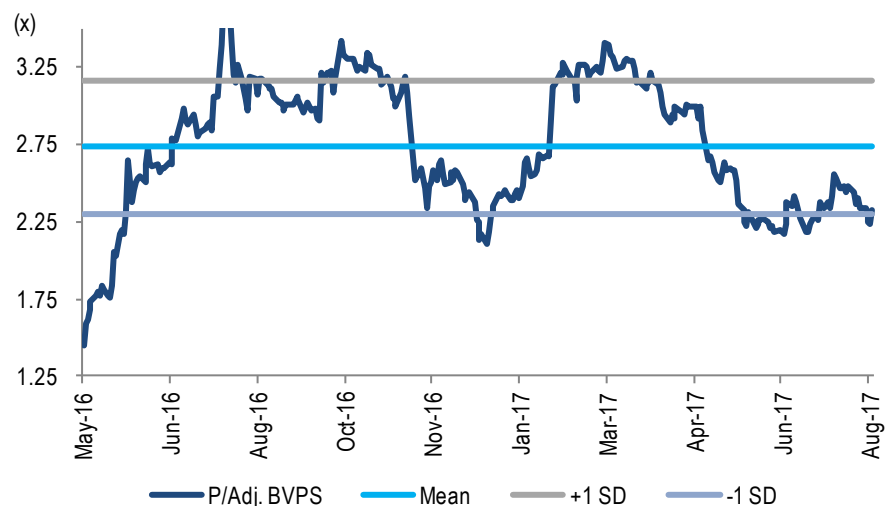
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% revision	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net interest income (Rsmn)	7,487	9,509	7,610	9,573	(1.6)	(0.7)
NIM (%)	9.4	9.6	9.6	9.6	(15bps)	(6bps)
Operating profit (Rsmn)	2,828	3,968	2,749	3,902	2.9	1.7
Profit after tax (Rsmn)	179	1,994	396	2,007	(54.9)	(0.6)
EPS (Rs)	1.5	16.7	3.3	16.8	(54.9)	(0.6)
ABV (Rs)	133.7	146.5	132.0	144.3	1.2	1.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Conference-call highlights

- The company is focusing on managing portfolio quality which was disrupted because of demonetisation. There is increased focus on recovery and collection as well as customer retention in affected branches with a PAR of over 5%.
- For loans with dues over 90 days, a special team comprising both internal employees and external collection agents has been formed to improve collection efficiency. As a result, PAR has come down by Rs790mn.
- The company has not received any dues since demonetisation from a portfolio of ~Rs1,500mn of overdue amount. It has therefore decided to sell the portfolio and make an additional provision of Rs430mn.
- The management expects provision to come down and credit costs for the full year to be contained below 4%.
- Following pressure from demonetisation and political intervention, the company has taken a conservative stand point and stopped up new customer acquisition.
- While the bank has a strong cashless disbursement system, disbursements in cash increased during the demonetisation period (on demand by customers). However, after that disbursements moved back to the cashless mode.
- Transition to SFB conversion is on track and 160 branches are to be converted to SFB branches in the current year, to a total of 189 branches including 29 branches in unbanked areas. SFB branches in rural and unbanked areas are to be either opened via business correspondents (BCs) or by following the brick and mortar model.
- Technology integration has been steady.
- On the liabilities growth front, the bank is yet to see inflow from institutions. Retail deposits are doing well. UFSL has applied for a scheduled bank status and once it gets the approval, deposits from institutions are expected to accelerate.
- Cost-to-income ratio is in line with the management's expectations, but low because of interest reversal to the tune of Rs130mn-Rs140mn.
- ~0.2mn new customers were added and new business collection efficiency stood at 79%.
- NIM was impacted because of regulatory problems, but the management expects the cost of funds to go down by ~150bps.
- Capital adequacy ratio stood at 19.8% and should improve as grandfathered loans run down. The bank is not looking to raise additional capital for the next few months.
- As regards new branch expansion, fixed costs have been fully incurred and the cost of operating a fully fledged SFB branch is expected to be ~Rs170mn per year.
- The management has given absolute cost guidance of ~Rs6bn-Rs7bn for the year.
- Currently, 65 fully fledged SFB branches are in operation and are accepting deposits.
- Marginal cost of funds is down by 150bps as compared to March 2017.
- Impact on business because of loan waiver is as follows:
 - The maximum impact is seen in Karnataka, especially in Bengaluru and Mysore.
 - Maharashtra is also witnessing a lower recovery rate.
 - Business in Uttar Pradesh remains unaffected and the company has observed improved repayment and recovery in that state.
 - 40% of the branches where PAR is greater than 5% are in the above mentioned states. 15% of incremental disbursements have been in Maharashtra, Karnataka, and Uttar Pradesh.
- The management has given growth guidance of 20% for FY18.

- Target AUM mix for the next three to five years is 50% from MFI and 50% from housing and MSE/MSME segments. The bank expects a CAGR of 30% over the next five years.
- Priority sector lending or PSL target of the bank has been met and there was sale of PSL certificates.
- Majority of agricultural loans disbursed were group loans with EMI repayment and linked to PSL activity (agriculture, livestock, and allied activities).
- While average CASA deposit ratio is low, the bank is still garnering current account (CA) deposits and is coming out with a range of features for its CA customers.

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Interest income	5,508	9,310	12,258	14,075	17,353
Interest expense	2,714	4,235	5,427	6,588	7,845
Net interest income	2,795	5,075	6,831	7,487	9,509
Loan origination fees	473	708	776	1,406	1,759
Other income	138	258	943	950	1,224
Net revenues	3,405	6,041	8,550	9,843	12,491
Operating expenses	2,049	3,068	4,581	7,014	8,523
-Employee expenses	1,328	1,967	2,716	3,750	4,279
-Other expenses	722	1,102	1,866	3,265	4,244
Operating profit	1,356	2,973	3,969	2,828	3,968
Provisions	210	253	751	2,553	900
PBT	1,146	2,720	3,217	275	3,068
Tax	388	948	1,141	96	1,074
PAT	758	1,772	2,076	179	1,994

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: 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	16,423	18,302
Net worth	7,364	11,978	17,553	17,617	19,496
Deposits	-	-	1,064	11,415	33,233
Borrowings	31,218	43,380	62,914	66,013	73,279
Other liabilities & provisions	1,180	1,915	3,255	5,249	6,719
Total liabilities	39,763	57,273	84,786	1,00,293	1,32,727
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	1,00,293	1,32,727
AUM	32,741	53,885	63,795	76,737	1,00,979

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

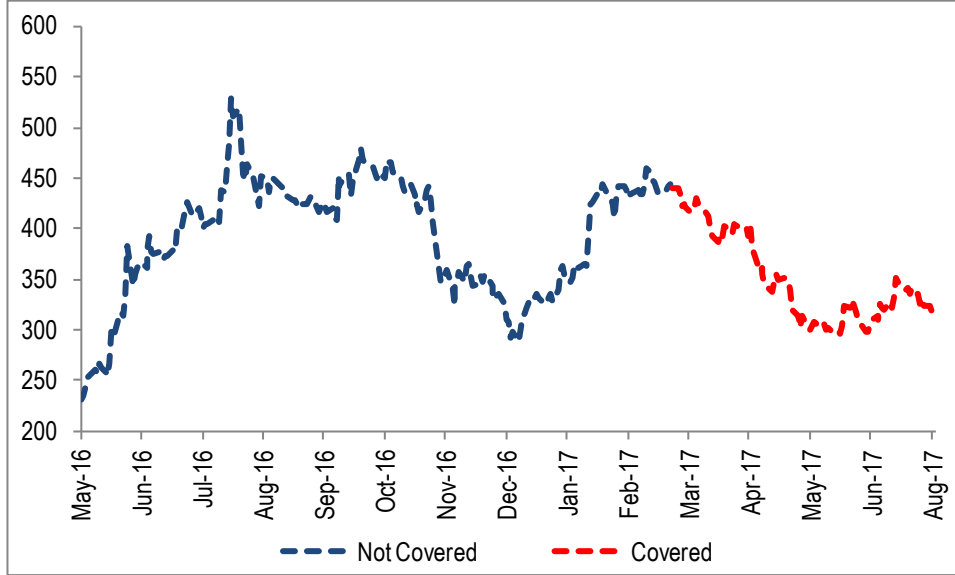
Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Growth (%)					
Net interest income	54.7	81.6	34.6	9.6	27.0
Operating profit	47.1	119.3	33.5	-28.7	40.3
Profit after tax	37.7	133.8	17.2	-91.4	1016.5
Business (%)					
Deposit growth	-	-	-	972.8	191.1
CASA	-	-	3.0	3.0	4.0
Advances growth	99.0	57.3	15.9	17.6	31.6
AUM growth	102.4	64.6	18.4	20.3	31.6
Spread (%)					
Yield on AUM	22.5	21.5	20.6	18.5	18.0
Yield on BS loans	22.8	22.5	22.5	20.6	20.0
Yield on assets	22.8	22.5	21.3	17.9	17.5
Cost of funds	11.5	11.4	10.8	9.3	8.5
Core spreads	11.3	11.1	11.7	11.2	11.5
NIM	11.6	12.3	11.0	9.4	9.6
Operational efficiency (%)					
Cost-to-income	60.2	50.8	53.6	71.3	68.2
Cost-to-AUM	8.4	7.1	7.8	10.0	9.6
Productivity (Rsmn)					
AUM per branch	77.4	114.9	139.6	147.0	193.4
AUM per employee	4.6	6.7	6.3	6.3	8.0
Employee per branch	16.8	17.2	22.2	23.4	24.3
CRAR (%)					
Tier I	21.7	22.4	16.8	15.2	12.8
Tier II	2.5	1.8	1.4	1.5	1.3
Total	24.2	24.1	18.2	16.7	14.1
Asset quality (%)					
Gross NPAs	0.1	0.2	0.3	6.0	5.5
Net NPAs	-	-	-	2.4	2.2
Provision Coverage	74.8	74.3	89.3	60.0	60.0
Credit cost (excluding std. assets)	0.1	0.2	1.1	3.8	0.8
Credit cost (including std. assets)	0.9	0.6	1.4	4.0	1.1
Return ratios (%)					
RoE	13.7	18.3	14.1	1.0	10.7
RoA	2.5	3.7	2.9	0.2	1.7
Per share (%)					
EPS	8.8	17.5	17.4	1.5	16.7
BV	85.5	118.4	147.0	147.5	163.3
ABV	85.4	118.2	146.9	133.7	146.5
Valuation (x)					
P/E	36.5	18.3	18.5	214.6	19.2
P/BV	3.8	2.7	2.2	2.2	2.0
P/ABV	3.8	2.7	2.2	2.4	2.2

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
7 August 2017	Buy	321	395

Rating Track Graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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