

Ujjivan Financial Services

6 February 2018

Reuters: UJVF.BO; Bloomberg: UJJIVAN IN

Liability Profile Transforming Rapidly

Ujjivan Financial Services (UFSL) reported its 3QFY18 results with the key strategic pointers being that: (1) Funding mix is transforming rapidly with strong deposit traction. (2) Conversion of NBFC branches to bank branches is proceeding at a fast pace (please see conference-call highlights). Per se, on the results front, UFSL posted NII growth of 19% QoQ to Rs1,958mn, PPOP growth of 7% QoQ to Rs754mn and PAT of Rs293mn compared with a loss of Rs120mn sequentially. We have marginally modified our legacy estimates for FY18/FY19 and retained Buy rating on UFSL, increasing our target price to Rs459 (from Rs439 earlier), valuing the stock at 2.3x FY20E P/BV.

Rapidly transforming liability profile underlines agile management acting on intent: Having acquired a scheduled bank licence, UFSL is garnering institutional deposits quickly and deposits now form 37% of total borrowings compared with nil contribution a year ago. Legacy NBFC-style borrowings viz. term loans and NCDs have seen their share plummet to 25% and 8.5% from 64% and 15%, respectively. Refinance, which does not require CRR/SLR cover, has risen favourably to garner 24% share compared with 9% a year ago. Consequently, average cost of funds (deposits and borrowings) stands at 9.3% in 3QFY18 compared with 10.4% in FY17. While the share of institutional deposits is high at 89% of total deposits and CASA ratio is low at 3.7%, deposit traction is a significant favourable departure from the erstwhile NBFC-style higher cost funding.

Branch conversion being carried out quickly makes UFSL capacity-ready: 121 out of 441 legacy branches stand converted as of 3QFY18 with a stated target of 188 by the end of FY18. Both achieved and expected pace of branch conversion keeps improving continually compared with earlier indications and augurs well from asset capacity addition perspective. Concomitantly, sticky cost-to-income ratio of 69.05% compared with 68.82% in 2QFY18 is not a concern. Converted branches will be equipped to deliver all asset and liability products and will help register strong traction in new MSE and housing loan businesses, which grew 37% each QoQ. MSE and housing now account for 2.3% and 3.2% of gross loans, respectively.

Sharp contraction in provision makes earlier provision guidance credible: Provision and write-offs fell 67.5% QoQ, indicating the management's earlier guidance that a lion's share of bad loan provisioning on legacy stressed book has been completed by 1HFY18 is credible. 'New book' created after 1 January 2017 (78% of total loan book) continues to see pristine asset quality with a collection efficiency of 99.7%, indicating stress is contained within the legacy book. PAR0 declining sequentially from Rs4.45bn in 2QFY18 to Rs3.84bn in 3QFY18 indicates even legacy stress is diminishing. In any case, provisioning cover remains strong at 76.3% as of 3QFY18.

Valuation and outlook: We have revised our legacy NII estimates by -0.1%/-1.3% for FY18/FY19, our PPOP estimates by -13.9%/4.9% and our PAT estimates by -28.7%/9.1%, respectively. We have rolled forward our valuation of UFSL based on FY20E financials, valuing the stock at 2.3x FY20E P/BV and increasing our target price to Rs459 (from Rs439 earlier).

BUY

Sector: Banking

CMP: Rs347

Target Price: Rs459

Upside: 32%

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Key Data

Current Shares O/S (mn)	120.7
Mkt Cap (Rsbn/US\$m)	41.9/653.9
52 Wk H / L (Rs)	465/285
Daily Vol. (3M NSE Avg.)	2,006,323

Price Performance (%)

	1 M	6 M	1 Yr
Ujjivan Financial Services (15.0)	8.2	(18.5)	
Nifty Index	1.0	6.0	22.0

Source: Bloomberg

Y/E March (Rsmn)	3QFY18	3QFY17	2QFY18	YoY (%)	QoQ (%)
Interest income	3,372	3,313	3,175	1.8	6.2
Interest expenses	1,414	1,332	1,530	6.1	(7.6)
Net interest income	1,958	1,981	1,646	(1.1)	19.0
NIM (%)	11.1	13.2	10.6	(214bps)	(53bps)
Fee & other income	469	400	605	17.3	(22.4)
Operating income	2,428	2,381	2,251	2.0	7.9
Staff costs	932	707	895	31.8	4.1
Other operating exp.	742	463	654	60.4	13.5
Total operating expenses	1,674	1,170	1,549	43.1	8.1
Cos- to-income (%)	69.0	49.1	68.8	1,982bps	14bps
Cost-to-AUM (%)	9.7	7.2	9.4	257bps	29bps
Operating profit	754	1,211	702	(37.8)	7.4
Provisions	287	547	882	(47.6)	(67.5)
Credit cost (%)	1.7	3.6	5.7	(189bps)	(393bps)
PBT	467	663	(180)	(29.7)	(358.8)
Tax	173	225	(61)	(22.8)	(385.7)
-Effective tax rate	37.2	33.8	33.7	332bps	349bps
PAT	293	439	(120)	(33.2)	(345.2)
EPS (Rs)	2.4	3.7	(1.0)	(34.2)	(343.3)
BV (Rs)	140.4	145.8	138.7	(3.7)	1.3
AUM	70,953	65,880	66,692	7.7	6.4
Deposits	23,354	-	12,475	NA	87.2

Source: Company, Nirmal Bang Institutional Equities Research

Key conference-call highlights

- The **MSE and affordable housing businesses** have been separated and new senior managerial personnel have been recruited for each of these businesses.
- There has been a **revision in the capital adequacy computation** as per RBI directive dated 8 November 2017, which states that capital charge related to market and operational risk-weighted assets need no longer be included in the denominator for computing capital adequacy ratios of small finance banks. Consequently, the capital adequacy ratio for UFSL has risen to 22.05% as of 3QFY18.
- There could be **residual provision** of about Rs200mn on legacy-stressed loan book in 4QFY18.
- Break-up of **non-interest income**: Processing fee – Rs180mn, investment income and related – Rs 220mn, miscellaneous (third party fees, securitisation, etc) – Rs80mn.
- Cost of **Certificate of Deposits** ranged between 6.0%-6.5%.
- Products hitherto not available to NBFC clients e.g. **overdraft** have been introduced in MSME segment.
- The management does not see much competition from **public sector banks** in MSME segment as ticket sizes are largely mutually exclusive.
- **Competitive intensity** has declined as several players have reduced activity.
- Branch count where **PAR>5%** is now 149.
- **GNPA movement**: Opening – Rs3,230mn, slippage – Rs350mn, Recovery – Rs310mn, write-off Rs335mn, closing – Rs 2,940mn.
- ~99% of **GNPAs** are in MFI segment.
- **Ticket size of loan growth** is optically higher as the proportion of fresh clients has dropped. Like-to-like loan ticket size growth may only be ~10%-12%.
- **Micro individual loans** slowed during the quarter, but growth in this segment has picked up since.
- **GNPA ratio** on micro individual loans is ~7.5% whereas that for group MFI loans it is ~4%.
- There could be ~25%-30% **recovery** from bad loan book.
- HTM securities account for a lion's share of the **investment book**.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income	5,075	6,831	7,649	9,474	11,831
Pre-Provision Profit	2,973	3,969	3,264	5,027	7,194
PAT	1,772	2,077	227	2,747	3,647
EPS (Rs)	17.5	17.4	1.9	23.0	30.5
BV (Rs)	118.4	147.0	148.0	170.0	199.6
P/E (x)	19.8	19.9	182.1	15.1	11.4
P/BV (x)	2.9	2.4	2.3	2.0	1.7
Gross NPA (%)	0.2	0.3	6.0	5.6	5.4
Net NPA (%)	0.0	0.0	2.1	2.2	2.2
RoA (%)	3.7	2.9	0.2	2.4	2.5
RoE (%)	18.3	14.1	1.3	14.5	16.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	3QFY18	3QFY17	2QFY18	YoY (%)	QoQ (%)
Net interest income	1,958	1,981	1,646	(1)	19
Pre-provision profit	754	1,211	702	(38)	7
PAT	293	439	(120)	(33)	(34)

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)	7,649	9,474	7,658	9,597	(0.1)	(1.3)
NIM (%)	9.7	9.9	9.5	9.7	17bps	21bps
Operating profit (Rsmn)	3,264	5,027	3,789	4,793	(13.9)	4.9
Profit after tax (Rsmn)	227	2,747	319	2,518	(28.7)	9.1
EPS (Rs)	1.9	23.0	2.7	21.1	(28.7)	9.1
ABV (Rs)	135.9	153.8	136.2	152.1	(0.2)	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Interest income	9,310	12,258	14,066	16,804	20,943
Interest expense	4,235	5,427	6,417	7,330	9,112
Net interest income	5,075	6,831	7,649	9,474	11,831
Loan origination fees	708	776	1,273	1,625	2,184
Other income	258	943	1,607	1,970	2,494
Net revenues	6,041	8,550	10,529	13,069	16,509
Operating expenses	3,068	4,581	7,265	8,042	9,315
-Employee expenses	1,967	2,716	4,001	3,799	3,799
-Other expenses	1,102	1,865	3,264	4,243	5,516
Operating profit	2,973	3,969	3,264	5,027	7,194
Provisions	253	751	2,914	800	1,583
PBT	2,720	3,218	350	4,227	5,611
Tax	948	1,141	122	1,479	1,964
PAT	1,772	2,077	227	2,747	3,647

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	1,012	1,194	1,194	1,194	1,194
Reserves & surplus	10,966	16,359	16,472	19,104	22,636
Net worth	11,978	17,553	17,666	20,298	23,830
Deposits	-	1,064	20,899	38,397	64,643
Borrowings	43,380	62,914	55,949	61,722	69,153
Other liabilities & provisions	1,915	3,255	5,186	5,726	6,346
Total liabilities	57,273	84,786	99,698	126,143	163,972
Fixed assets	242	1,398	2,374	3,100	3,826
Investments	1	14,467	16,129	21,102	27,533
Loans	50,643	58,712	68,629	86,127	112,374
Cash	4,913	7,601	9,437	12,058	15,732
Other assets	1,475	2,608	3,130	3,756	4,507
Total assets	57,273	84,786	99,698	126,143	163,972
AUM	53,885	63,795	76,255	95,697	124,860

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

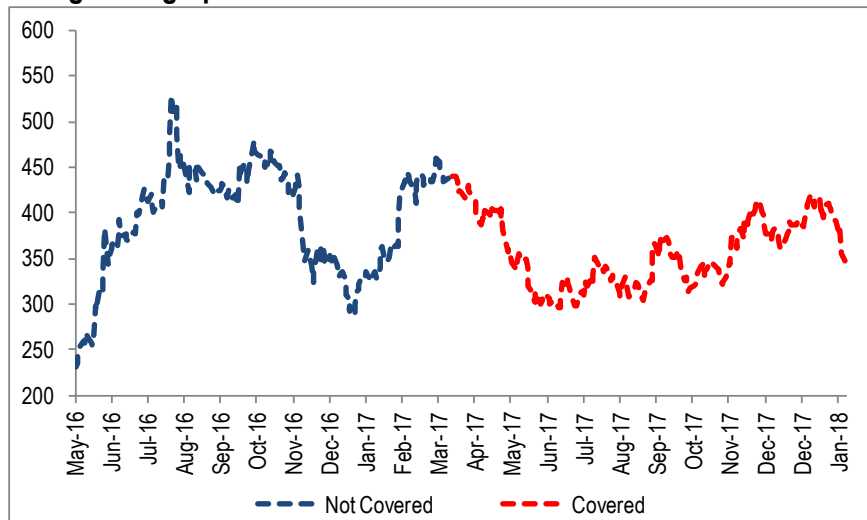
Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
Net interest income	81.6	34.6	12.0	23.9	24.9
Operating profit	119.3	33.5	(17.8)	54.0	43.1
Profit after tax	133.8	17.2	(89.0)	1,108.0	32.7
Business (%)					
Deposit growth	-	-	1,864.1	83.7	68.4
CASA	-	3.0	3.0	4.0	7.0
Advance growth	57.3	15.9	16.9	25.5	30.5
AUM growth	64.6	18.4	19.5	25.5	30.5
Spread (%)					
Yield on AUM	21.5	20.8	18.7	18.3	17.8
Yield on BS loans	22.5	22.4	20.5	20.3	19.7
Cost of funds	11.4	10.8	9.1	8.3	7.8
Core spread	11.1	11.7	11.4	12.0	11.9
NIM	12.3	12.5	9.7	9.9	9.6
Operational efficiency (%)					
Cost-to-income	50.8	53.6	69.0	61.5	56.4
Cost-to-AUM	7.1	7.8	10.4	9.4	8.4
Productivity (Rsmn)					
AUM per branch	114.9	139.6	146.1	183.3	239.2
AUM per employee	6.7	6.3	6.6	7.6	9.9
Employee per branch	17.2	22.2	22.1	24.3	24.3
CRAR (%)					
Tier I	22.4	16.8	18.8	18.7	16.8
Tier II	1.8	1.4	1.6	1.5	1.3
Total	24.1	18.2	20.4	20.2	18.1
Asset quality (%)					
Gross NPAs	0.2	0.3	6.0	5.6	5.4
Net NPAs	-	-	2.1	2.2	2.2
Provision coverage	74.3	89.3	65.0	60.0	60.0
Credit cost (excluding std asset)	0.2	1.4	4.1	0.7	1.2
Credit cost (including std asset)	0.6	1.4	4.6	1.0	1.6
Return ratios (%)					
RoE	18.3	14.1	1.3	14.5	16.5
RoA	3.7	2.9	0.2	2.4	2.5
Per share (%)					
EPS	17.5	17.4	1.9	23.0	30.5
BV	118.4	147.0	148.0	170.0	199.6
ABV	118.2	146.9	135.9	153.8	179.1
Valuation (x)					
P/E	19.8	19.9	182.1	15.1	11.4
P/BV	2.9	2.4	2.3	2.0	1.7
P/ABV	2.9	2.4	2.6	2.3	1.9

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
6 November 2017	Buy	373	439
6 February 2018	Buy	347	459

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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