

28 May 2018

Ujjivan Financial– BUY

CMP :396
Target Price :494
Upside : 24%+
Stop Loss :349(closing basis)

Investment Thesis

Recently, the stock price of Ujjivan Financial Services Ltd. (Ujjivan Financial) corrected by ~14% from 52-week high of Rs.435 despite reporting good set of numbers in the recent quarters.

Ujjivan Financial received an approval from the RBI to set up small finance bank (SFB) in October 2015. It started operation in February 2017 as Ujjivan Small Finance Bank and started converting its asset branch into full-fledged bank branch right from inception. As an NBFC-MFI, Ujjivan Financial was constrained to focus primarily on microfinance (keep >85% assets qualifying). It is now free to diversify into any loan segment, augmenting scalability. It also gets to move away from NBFC-style funding and build a deposit base, which has grown from nil to 37% share in funding over 12 months. Refinance cost, which requires no CRR/SLR cover, is lower by up to ~200bps from its NBFC days and its share has risen from 9% to 24% in a year. We believe, Ujjivan Financial will pass on cost of funds benefits to borrowers since no margin cap applies to SFBs.

Ujjivan Financial has already converted 121 into bank branches and plans to completely convert all into bank branch by end of FY19E. Expected pace of branch conversion keeps improving continually and augurs well from asset capacity addition perspective. Cost-to-income ratio improved significantly (~1966bps YoY) to 56.9% compared with 76.6% in 4QFY17 and 69.05% in 3QFY18 due to most of the branch openings being low cost URCs. Branch conversion will be accelerated and completed in FY19 leading to opex spike but this would augment business capacity. Importantly, 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% and 42% QoQ respectively. MSE and housing now account for 3% and 4% of gross loans, respectively.

Financials

- During the past 5 years, NII of Ujjivan Financial grew at CAGR of 47.5% while PAT de-grew at CAGR of 26.5% in the same period.

Consol. (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
NII	5,075	6,831	8,385	9,642	11,089
% growth	81.6	34.6	22.7	15.0	15.0
PAT	1,772	2,076	73	1,820	2,093
ABV (INR)	118.1	144.8	144.5	161.1	179.7
P/ABV (x)	3.4	2.8	2.8	2.5	2.3
EPS (INR)	17.5	17.4	0.6	15.1	17.3
P/E (x)	23.1	23.3	672.4	26.9	23.4
RoE (%)	14.8%	11.8%	0.4%	9.3%	9.6%

- Ujjivan Financial's Q4FY18 NII grew by 64.4% YoY to Rs.2,110mn, driven by healthy AUM growth of 18.5% to Rs.75.6bn.

Stock Data

Market Cap (INR MN)	47,887
Market Cap (\$ MN)	704.22
Shares O/S (in MN)	120.9
Avg. Volume (3 month)	1,548,000
52-Week Range (Rs.)	435 / 285

Shareholding Pattern

Promoters	0.00%
FII's	9.52%
Institutions	46.92%
Others (incl. body corporate)	43.56%

Performance (%)	1M	6M	1Yr
Absolute	0.1%	2.7%	12.8%
BSE Bankex	3.4%	1.6%	12.6%

Key Ratios

Div Yield	0.2%
TTM PE	675.8x
ROE	0.4%
TTM EPS (INR)	0.6/-

- Ujjivan Financial reported its NIM at 11.6% in Q4FY18, increased 300bps YoY, mainly driven by 332bps YoY decline in cost of funds.
- Loan disbursements grew by 60.8% YoY in Q4FY18, led by 134% YoY growth in non-MFI portfolio.
- As a result, PAT grew by 235.2% YoY and 121.2% QoQ to Rs.650mn.

Key Business Highlights

- Ujjivan Financial is a NBFC engaged in the micro finance lending business. Its products and services include Microfinance, Micro and Small Enterprise Business (MSE) Finance, Agriculture and Animal Husbandry Finance, and Housing Finance.
- Ujjivan Financial serves over 37.1 lakh active customers through 464 branches and 11,242 employees spread across 209 cities in 24 states of India. Its Gross Loan Book stands at Rs.75.6bn as of March 31, 2018.
- Ujjivan Financial has started operation of 'Ujjivan Small Finance Bank' from February 2017 and rolled out 121 full service banking outlets spread across 20 states to reach to unserved and under-served in the rural areas. It has deposit base of Rs.37.7bn as of March 31, 2018.

Valuation

- Average ticket size for microfinance loans for Ujjivan Financial is ~Rs.23,000 while that for the micro and small enterprise (MSE) lending book are ~Rs.69,000 for MSE-unsecured loans and ~Rs.0.4mn for MSE-secured loans. For the small-ticket affordable housing loan book, the average ticket sizes are ~Rs.67,000 for housing-unsecured loans and ~Rs.0.38mn for housing-secured loans. This clearly shows that Ujjivan Financial is operating well below the Rs.2.5mn ticket size. Low ticket-sizes also imply Ujjivan Financial is catering to clientele that is largely under-served by universal banks and even key NBFCs. Other than its tiny micro-LAP book, which sits inside its small-ticket affordable housing book, the entire portfolio for Ujjivan Financial is PSL-compliant. This means about 99% of its loan book is PSL-compliant as against a requirement of 75%.
- Ujjivan Financial has adopted a decentralized management structure, which comprises four regional offices at Bengaluru, New Delhi, Kolkata and Pune. It has a two-tiered management hierarchy consisting of a national leadership team (NLT) providing overall direction to the business and four regional leadership teams (RLT) responsible for taking on-ground operational decisions. NLT and RLT members have significant experience in the banking and financial services industry. This structure enables Ujjivan Financial with advantage of understanding ground realities and local diversity of a particular region, enabling quick decision making and proactive responses to regional market changes.
- With started operation of Small Finance Bank, converting its asset branch into full - fledged bank branch, improvement in CI ratio, catering to clientele that is largely under-served by universal banks and adopted a decentralized management structure, we value Ujjivan Financial at 2.75x FY20E ABV of Rs.17.30 to arrive at target price of Rs.494, an upside of ~22%.

Risk & Concern

- Any slowdown in uptick of economic cycle will affect the collection efficiency thus affecting the asset quality of Ujjivan Financial.
- Ujjivan Financial is converting existing asset branches to full-fledged banking branches and will convert all branches by March 2019. Any unprecedented increase in expense on Infrastructure and technology may dent its profits in short term.
- Any disruption in the access to funds would adversely impact business growth and financial condition of Ujjivan Financial.

Graphs & Charts

Figure 1: Interest Income Trend

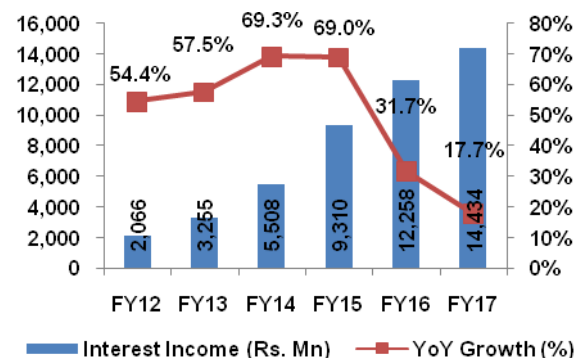


Figure 2: NII Trend

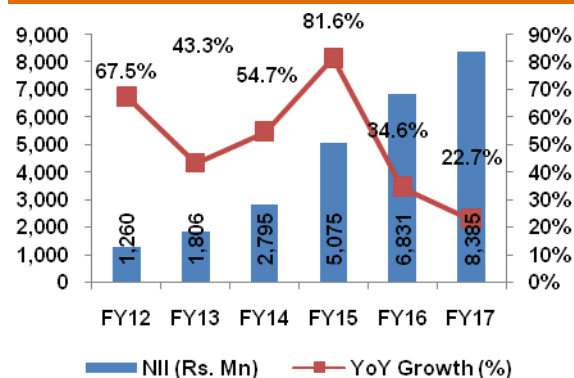


Figure 3: PAT Trend

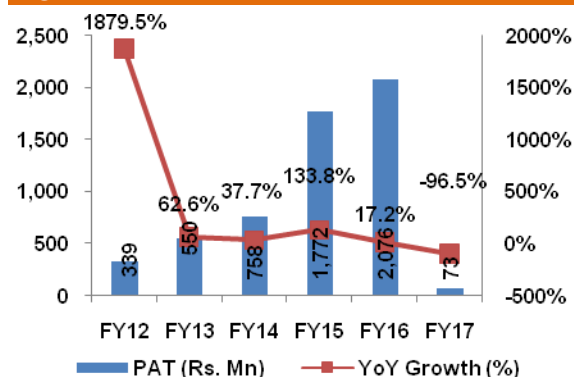
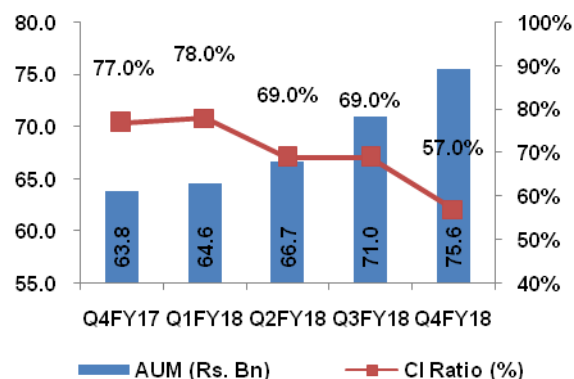


Figure 4: AUM and CI ratio Trend



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