

Sector Thematic

Indian microfinance

Should you look micro as macros disappoint?

Fast growth, high return ratios, and social impact have drawn investors to microfinance over the years, despite the business being inherently risky. In the past two years, while broader credit growth has slowed considerably, microcredit growth has fared better. The microfinance sector had seen benign asset quality trends until 1QFY21. However, it had the highest proportion of loans under moratorium, and PAR 30 for the industry has started to inch up. COVID-19 may prove to be the biggest credit event in recent times. Nevertheless, we believe that certain microfinanciers' prospects remain intact, and they provide attractive long-term investment opportunities. We initiate coverage on BANDHAN with a BUY (TP of Rs 367), UJJIVAN with a BUY (TP of Rs 356), USFB with an ADD (TP of Rs 40) and CREDAG with an ADD (TP of Rs 797).



Darpin Shah

Banks, NBFCs

darpin.shah@hdfcsec.com

+91-22-6171-7328



Aakash Dattani

Banks, NBFCs

aakash.dattani@hdfcsec.com

+91-22-6171-7337



Punit Bahlani

Banks, NBFCs

punit.bahlani@hdfcsec.com

+91-22-6171-7354

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- Growth opportunity:** At present, active microcredit borrowers are just 4.3% of the population. 10 Indian states account for >80% of outstanding microcredit and the average outstanding per borrower is ~Rs 39.3k. The clichéd premise of under-penetration and increasing financial inclusion forms an essential part of the investment thesis for microfinanciers. There is potential for further geographic diversification and consequent growth in borrowers and an increase in loan sizes. While in the near term, growth is likely to be tepid, we expect it to rebound sharply in FY22E and FY23E.
- High RoAE business:** Fat spreads permit microlenders to earn higher RoAEs than most other types of lenders. One can argue that eventually returns line up with those of other lending businesses, across cycles, given the event-based asset quality risks (AP microfinance crisis, demonetisation, etc.). However, few lenders have managed to buck industry-wide asset quality trends, allowing them to earn superior returns (e.g. BANDHAN/CREDAG delivered RoAEs of 21.5/~17% over FY16-20). We expect microfinanciers within our coverage to see a sharp fall in RoAEs to 7-17% in FY21E, followed by a recovery to 13.7-20% over FY22-23E.
- Asset quality challenges:** Historically, microcredit asset quality issues have been event-based and/or associated with specific locations, rather than tied with broader economic activity. Post demonetisation, asset quality trends have been relatively benign across lenders. COVID-19 poses a significant challenge on this front, as this segment saw the highest proportion of loans under moratorium (18% to 50%, last reported).
- The investment opportunity:** Most microfinanciers saw a significant price correction post the COVID-19 outbreak. As highlighted, microfinanciers' asset quality issues tend to be event driven. We therefore expect asset quality issues to peak in FY21E. Consequently, we expect microlenders within our coverage to see a significant recovery in return ratios in FY22/23E. Current valuations for these companies do not fully factor in their ability to deliver superior return ratios.

Company	MCap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)
BANDHAN	440	274	BUY	367
CREDAG	106	720	ADD	797
UJJIVANS	55	32	ADD	40
UJJIVAN	26	213	BUY	356

Darpin Shah

darpin.shah@hdfcsec.com
+91-22-6171-7328

Aakash Dattani

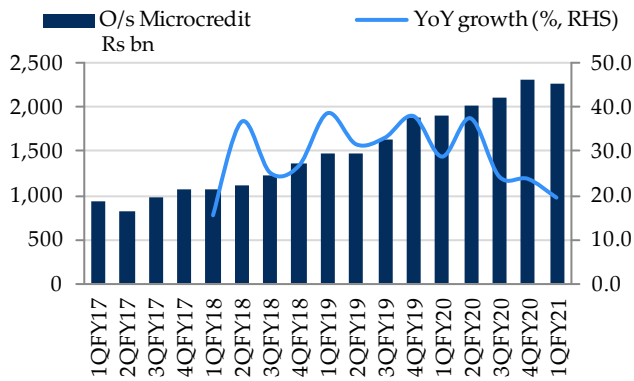
aakash.dattani@hdfcsec.com
+91-22-6171-7337

Punit Bahlani

punit.bahlani@hdfcsec.com
+91-22-6171-7354

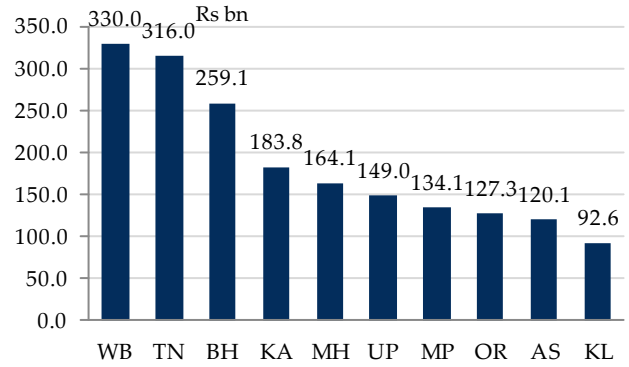
Focus Charts

Exhibit 1: Microcredit growth trends



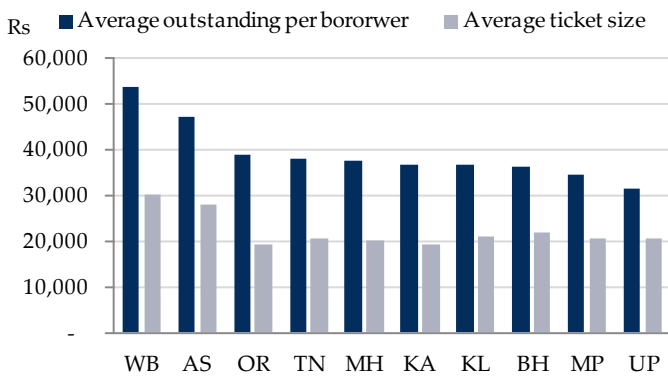
Source: Mfin and HSIE Research

Exhibit 2: State-wise distribution of microcredit



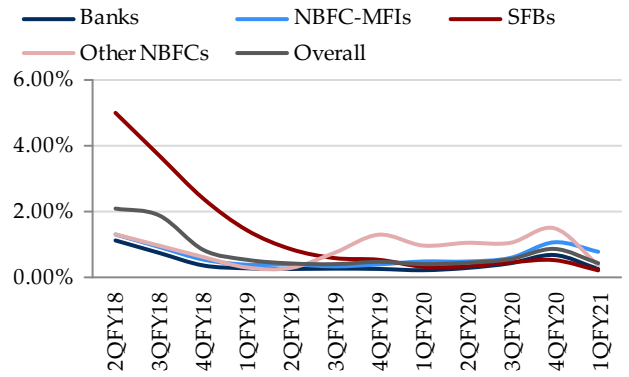
Source: Mfin and HSIE Research

Exhibit 3: Average outstanding per borrower trends



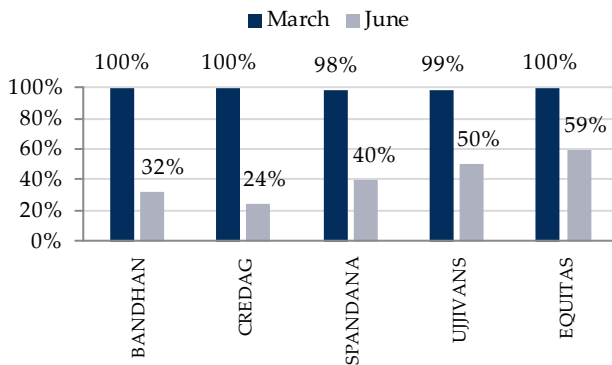
Source: Mfin and HSIE Research

Exhibit 4: GNPA trends



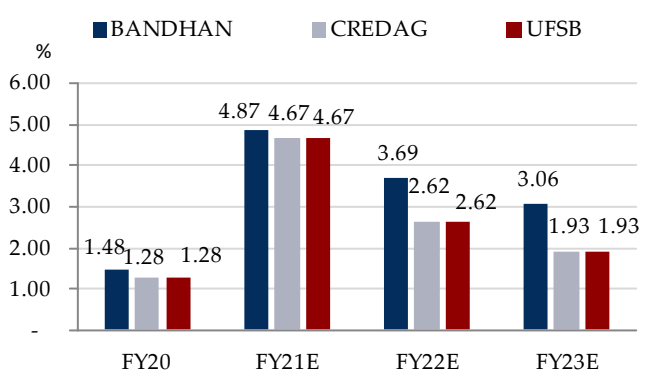
Source: Mfin and HSIE Research

Exhibit 5: Moratorium trends for select microlenders



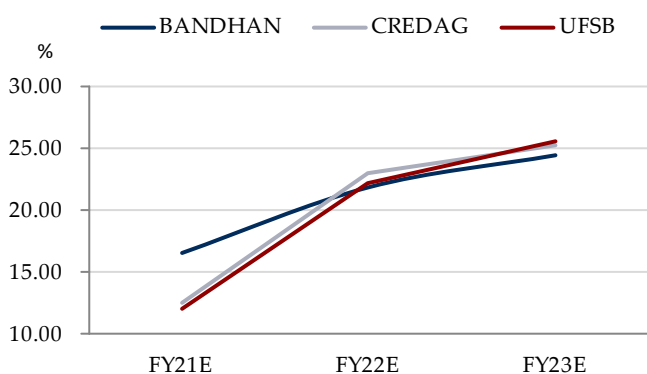
Source: Companies and HSIE Research

Exhibit 6: GNPA estimates for our coverage



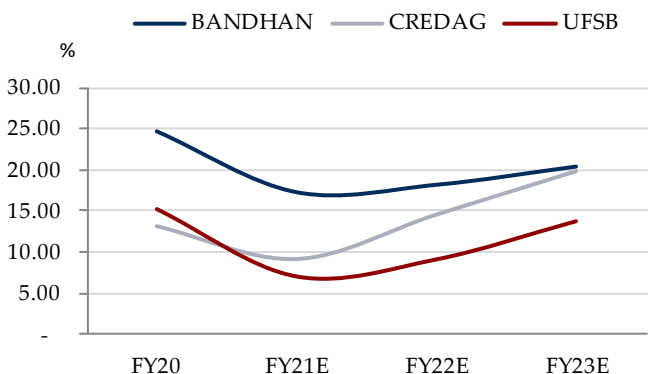
Source: HSIE Research

Exhibit 7: AUM growth estimates for our coverage



Source: HSIE Research

Exhibit 8: RoAE estimates for our coverage



Source: HSIE Research

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JLG model in India- salient features

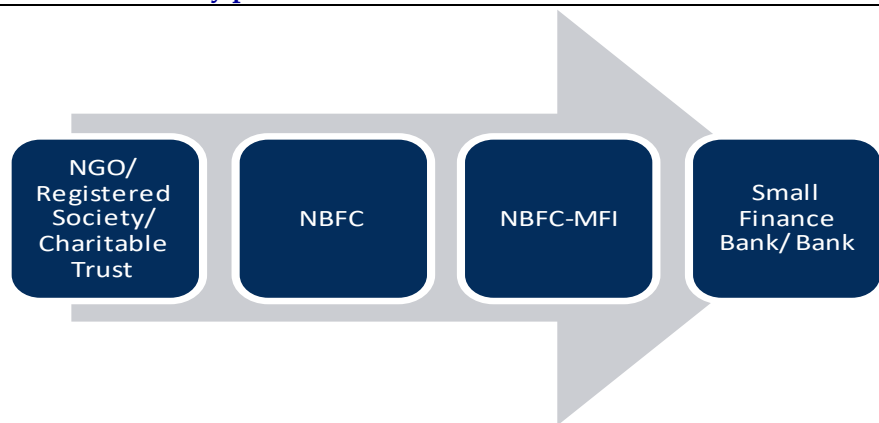
- Borrowers are grouped into clusters to increase accountability
- Groups comprise almost exclusively of women
- Member into the group induction requires consent of the lender and other group members
- Collection frequency (weekly/ fortnightly/ monthly) is determined by the lender and borrowers. Flexibility may exist within the group, but rarely

Incl. lending to SHGs, Mfin estimates the total size of microcredit in India to be in excess of Rs 3tn

Indian microfinance- A short recap...

- The business of microcredit is far from novel. The formalisation and eventual monetisation of the sector picked up only towards the turn of the millennium. Microcredit, in its earliest form, was limited to chit funds and Self-Help Groups (SHGs).
- Grameen Bank’s (Bangladesh) noble-prize winning, women-centric, Joint Lending Group (JLG) model, which entails lending to groups of women (in their individual capacities) is now globally accepted and widely prevalent in India. Although the group’s joint liability is not legally enforceable, the pressure exerted, inter-se the borrowers by social dynamics, creates a joint-liability type of situation. The group may support a laggard borrower, to prevent a default. This would help secure the group’s prospects for receiving a fresh round of loans. An overwhelming majority of the recent growth in microfinance has come from the JLG model, due to preference by both borrowers (faster TAT, and no need to save) and lenders (scalability). Financing of SHGs (Self-Help Groups), pioneered by the NABARD in 1992 is still prevalent.
- A look at the history of several large microfinanciers reveals a typical evolution pattern. Most started as not for profit organisations and later transitioned into NBFC-MFIs. A few evolved further to become small finance banks. BANDHAN is the only one that evolved into a full-fledged bank.

Exhibit 9: Evolutionary profile of microlenders



Source: HSIE Research

Exhibit 10: Evolutionary profile of select microlenders

Entity	Initial name	Initial status	Current status
BANDHAN	Bandhan Konnagar	Registered Society	Universal bank
CRETAG	TMT Trust	Charitable Trust	NBFC-MFI
SPANDANA	Spandana	NGO	NBFC-MFI
e-BHAFIN	Swaya Krishi Sangam	NGO	Merged with IIB
Fusion	Aajeevika	NGO	NBFC-MFI

Source: Company and HSIE Reseaerch

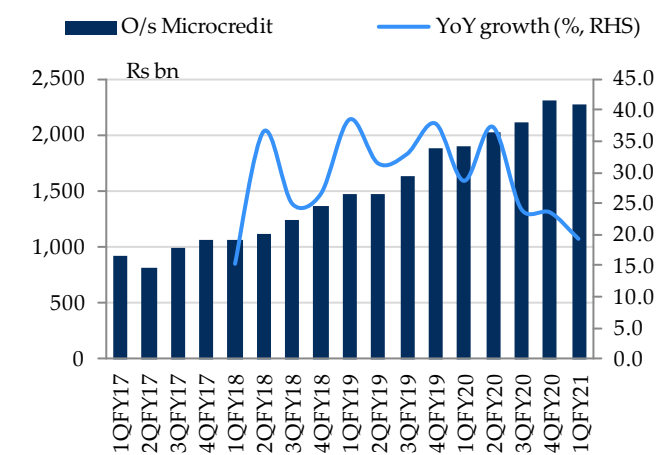
- Even as several microcredit lenders cite financial inclusion and poverty alleviation as important goals, profitability (lofty RoAEs) is much more than a happy outcome. That being said, several studies suggest that microcredit has been successful in achieving its more charitable objectives.

Microfinance sector trends:

Strong growth

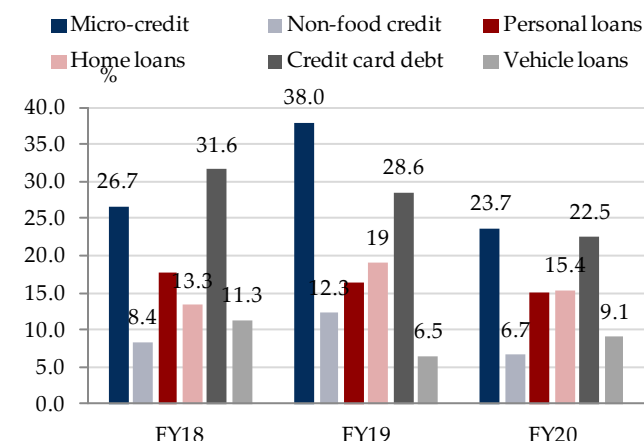
- As of 1QFY21, total outstanding microcredit (not including lending to SHGs) was ~Rs 2.27tn (+19.4% YoY). Over FY18-20, microcredit has seen strong growth at ~29.3% (vs. non-food credit at 9.1% and personal loan growth at 16.4%). However, microcredit growth too, has shown signs of slowing growth in FY20.

Exhibit 11: Microcredit growth trends



Source: Mfin, HSIE Research

Exhibit 12: Growth trends- microcredit vs. other credit segments

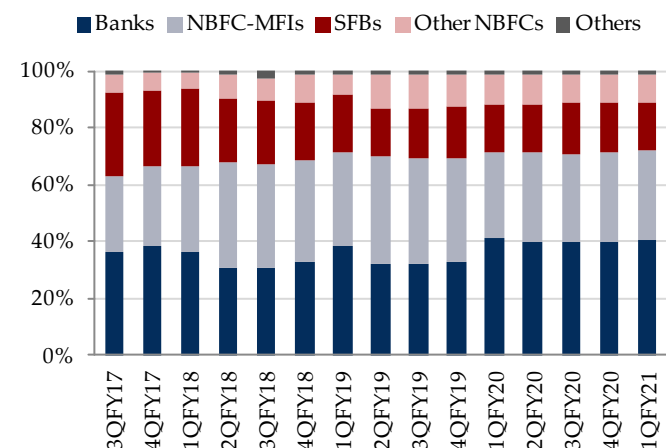


Source: Mfin, RBI, and HSIE Research

Market share trends:

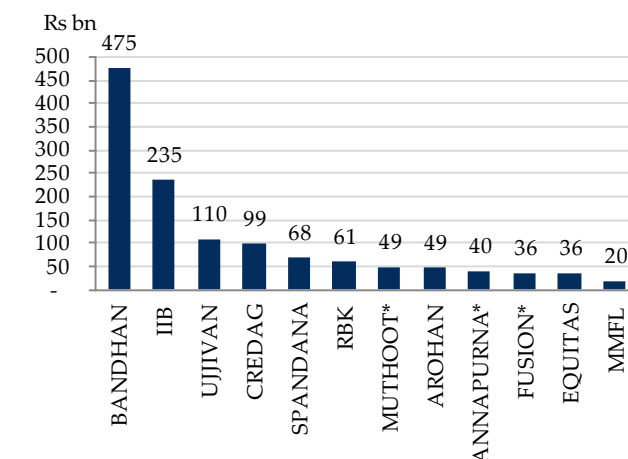
- As of 1QFY21, banks had the highest microcredit market share at 40.7%, followed by NBFC-MFIs at 31.1%. Over time, the market share of NBFC-MFIs appears to have dipped, however, this is on account of the merger of some NBFC-MFIs with banks. SFBs lost significant market share between FY17 and 1HFY19, however, their rate of market share loss has since reduced.

Exhibit 13: Lender-wise growth market share



Source: Mfin, HSIE Research

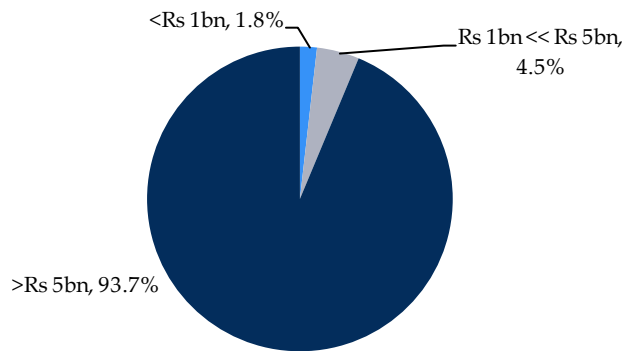
Exhibit 14: Different players' portfolio sizes



Source: Mfin, Companies, and HSIE Research, *indicates as of FY20

- **A small number of large NBFC-MFIs:** Amongst the NBFC-MFIs, a high degree of concentration is visible. As of FY20, the Top 23 NBFC-MFIs with an AUM >Rs 5bn accounted for ~94% of outstanding NBFC-MFI credit.

Exhibit 15: Share of different-sized NBFCs in total NBFC-MFI microcredit

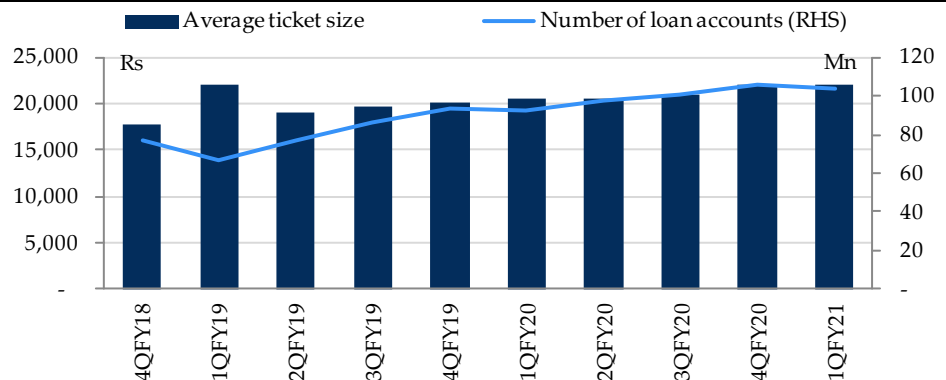


Source: Sa-dhan and HSIE Research

Ticket size and borrower trends:

- In recent years, Mfin data suggests that growth in the number of loan accounts, which stands at 103.7mn (+11.9% YoY) as of 1QFY21 (+17.3% CAGR over FY18-20) has contributed to majority of the growth in outstanding microcredit. Further, the average ticket size of loans for the sector stands at ~Rs 22k. This has grown at a CAGR of 11.4% over the corresponding period.

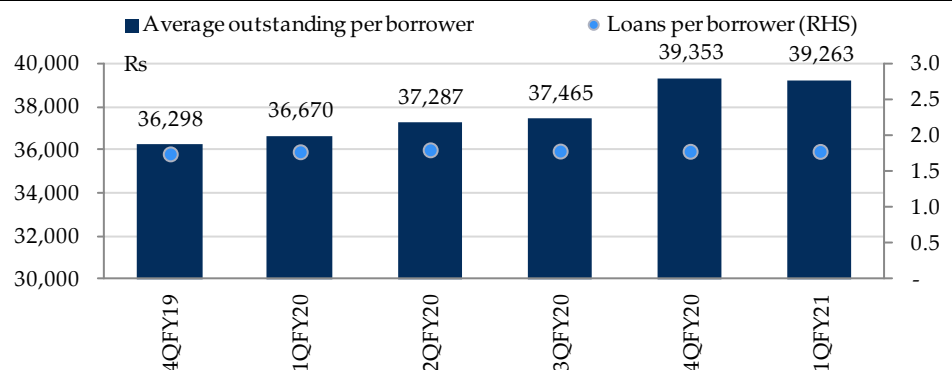
Exhibit 16: Average ticket size and loan account trends



Source: Mfin and HSIE Research

- However, the number of unique borrowers stands at 58mn (+11.5% YoY). This implies that the average outstanding per borrower is Rs 39.3k and the number of loans per active borrower is ~1.8. Interestingly, over the last year, the number of loans per borrower has remained nearly constant.

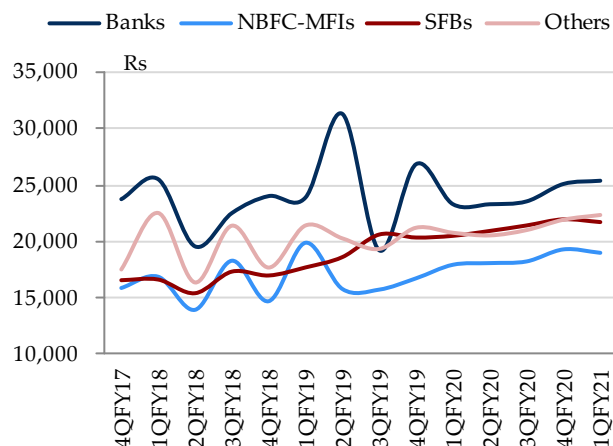
Exhibit 17: Number of unique borrowers and growth in average outstanding per borrower



Source: Mfin and HSIE Research

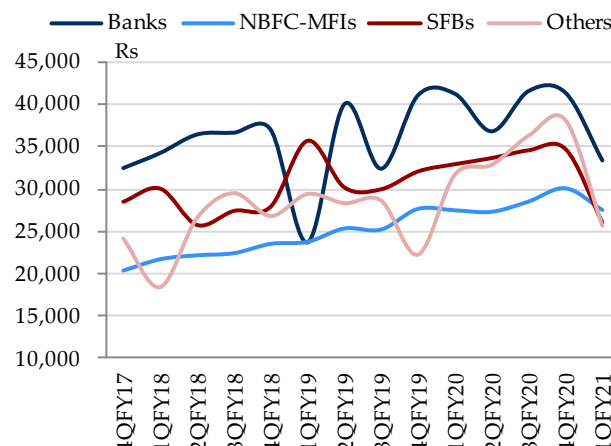
- **Diverse trends across lenders:** Across lender categories, banks had the highest outstanding ticket size, at ~Rs 25.3k (~16% higher than the industry average). However, banks' average ticket size grew by just 4.5% over FY18-20. NBFC-MFIs had an average ticket size of Rs 19.2k (13.9% below the industry average), but this grew at a CAGR of 14.4% over FY18-20. SFBs on the other hand have an average ticket size of Rs 21.7k (in line with the industry average), and their ticket size was almost flat over FY18-20.
- Most players saw a sharp QoQ fall in average disbursal ticket size in 1Q.

Exhibit 18: Lender-wise average outstanding ticket size trends



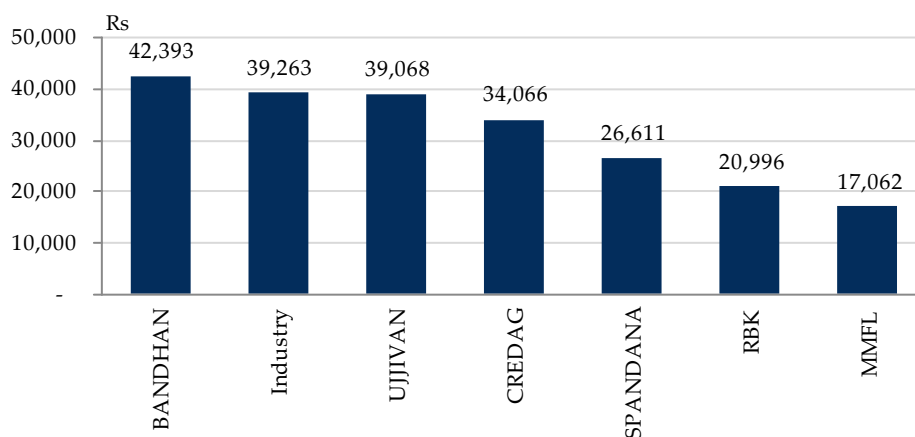
Source: Mfin and HSIE Research

Exhibit 19: Lender-wise average disbursal ticket size trends



Source: Mfin and HSIE Research

Exhibit 20: Average outstanding per borrower across lenders



Source: Companies, Mfin, HSIE Research

Asset quality and factors contributing to underlying risks:

- In the past, microcredit asset quality has been event-driven and highly localised. Past credit events include the AP microfinance crisis, demonetisation and farm loan waiver announcement in certain states, and more recently, upheavals in Assam.
- **Demonetisation impact:** Microborrowers tend to earn, transact and repay loans in cash. As a result, their income and ability to repay was severely impacted during demonetisation. The impact of demonetisation is visible in industry-wide PAR (portfolio at risk) metrics. Demonetisation resulted in a sudden spike in early bucket delinquencies (PAR 1-30), which rose ~7x QoQ to ~10%. However, early bucket delinquencies recovered sharply, falling to 3.7% in 1QFY18 and 1.6%

in 1QFY19. Later bucket delinquencies (PAR 180+) rose and remained relatively sticky. PAR 180+ peaked at 6.7% in 1HFY18 and gradually fell to 4.4% in 1QFY19. Most microfinanciers had to make significant write-offs.

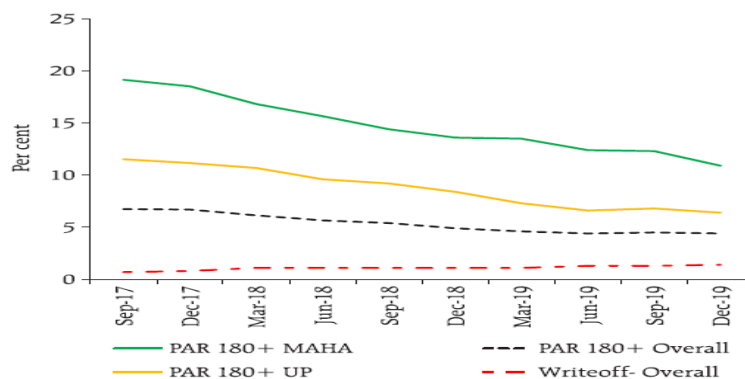
Exhibit 21: Demonetisation effect on PAR



Source: RBI, CRIF Highmark, and HSIE Research

- **Localised credit events:** Numerous local credit events have occurred in the recent past. These include:
 - Socio-political events in UP and MH: While pan India PAR 180+ peaked at 6.7% at the end of 1HFY18, the corresponding delinquency levels in UP and MH were much higher at 11.5% and 19.1% respectively. Subsequently, the delinquencies have decreased but they remain elevated in comparison with industry levels, but write-offs rose significantly.

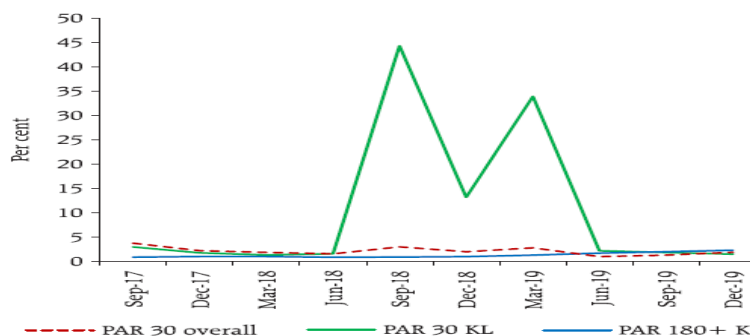
Exhibit 22: PAR trends in UP and MH



Source: RBI, CRIF Highmark, and HSIE Research

- Natural calamities in 2018, 2019 and 2020: The KL floods of 2018, Cyclones Titli and Fani in OR, Cyclone Gaja in TN, and more recently Cyclone Amphan in WB resulted in localised disruptions, however, microlenders have recovered relatively quickly from these events.

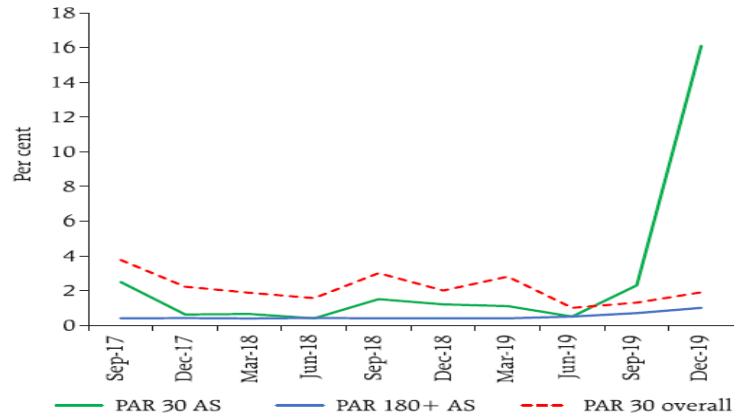
Exhibit 23: PAR trends in KL



Source: RBI, CRIF Highmark, and HSIE Research

- AS microfinance events: A combination of events (economic slowdown in local tea cultivation, allegations of unethical practices against microlenders and protests related to the CAA) resulted in a spike in early bucket delinquencies in AS in 2HFY20. PAR 30 rose to 16% in 3QFY20 (vs. 1.6% for the country as a whole).

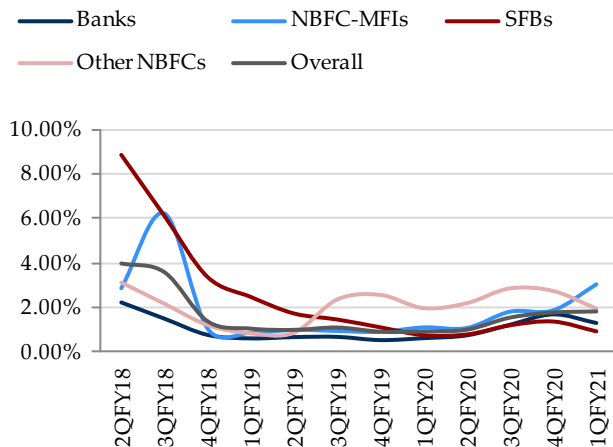
Exhibit 24: PAR trends in AS



Source: RBI, CRIF Highmark, and HSIE Research

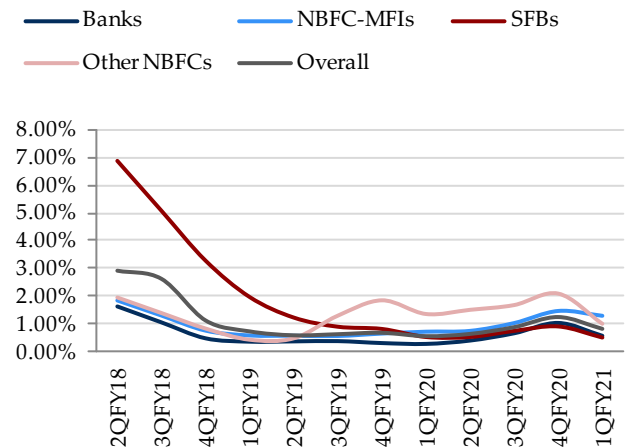
- Since demonetisation, microcredit asset quality trends have been relatively benign, except for sporadic local disruptions. We believe that these trends did not reflect the underlying risks associated with microcredit.

Exhibit 25: Lender-wise 30 dpd trends



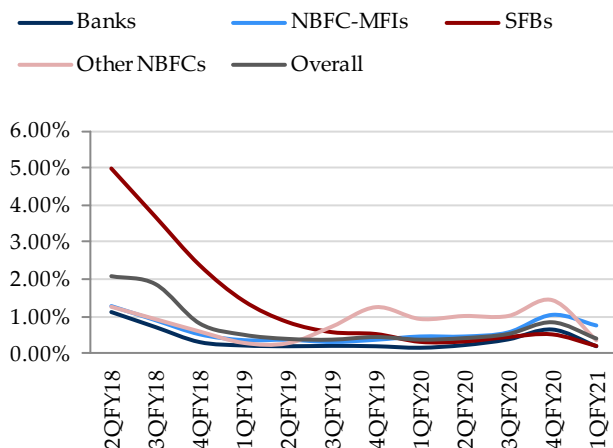
Source: Mfin, and HSIE Research

Exhibit 26: Lender-wise 60 dpd trends



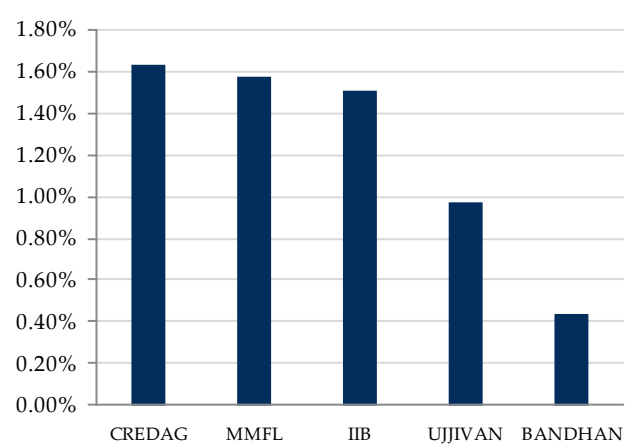
Source: Mfin, and HSIE Research

Exhibit 27: Lender-wise 90 dpd trends



Source: Mfin and HSIE Research

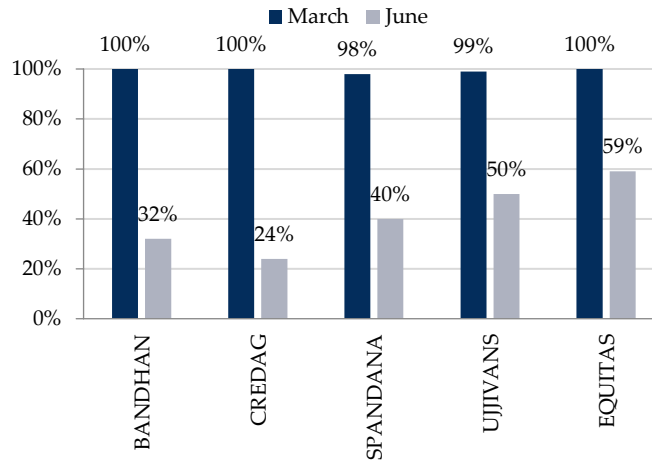
Exhibit 28: Select microlenders' GNPA's



Source: Companies, note: CREDAG classifies accounts which are greater than 60dpd as NPA

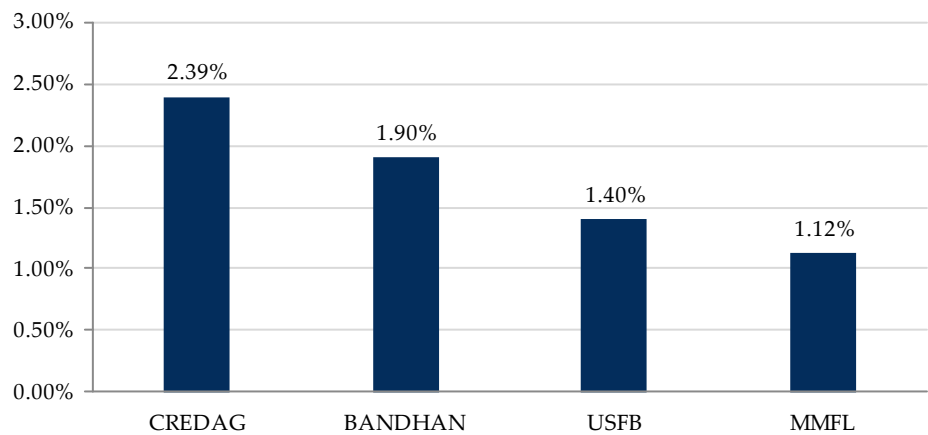
- COVID-19** is set to pose perhaps the largest asset quality challenge for microfinanciers in recent times. Several microlenders reported that close to 100% of the microcredit portfolios were under moratorium at the peak. And even as collection efficiencies have improved, given the vulnerable nature of these borrowers, we believe that asset quality risks will remain elevated.

Exhibit 29: Microcredit moratorium trends across lenders



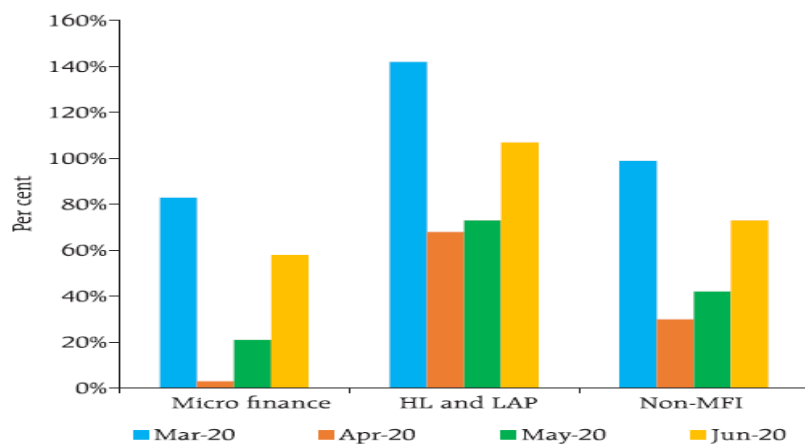
Source: Companies and HSIE Research

Exhibit 30: Ratio of COVID-19 provisions to total advances



Source: Companies, and HSIE Research

Exhibit 31: Month-wise collection efficiency trends of securitised pools



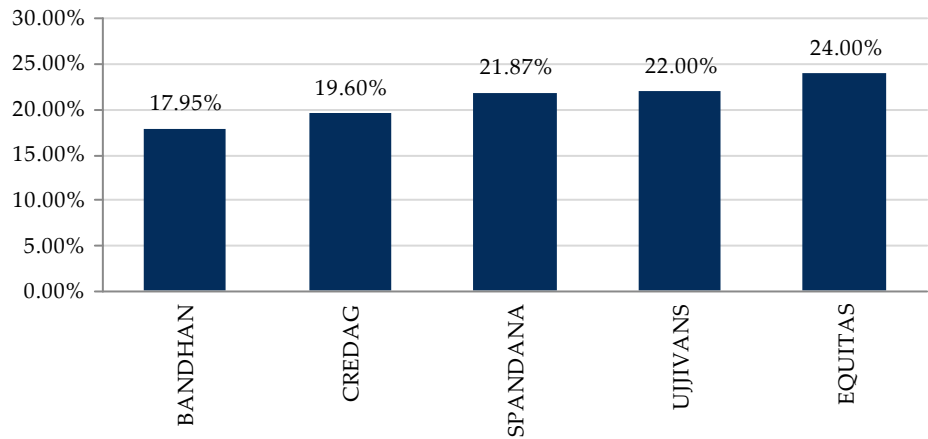
Source: RBI, ICRA, and HSIE Research

- **Factors contributing to underlying risks:** Previous microcredit asset quality trends suggest that the business carries a significant risk, which manifests sporadically. This is on account of:
 - Difficulty in assessing borrowers' incomes: Given the nature of economic activity undertaken by borrowers, assessing their income is difficult due to lack of adequate documentation. This issue becomes more pertinent as borrowers are granted larger loans across cycles, and it can be challenging to assess whether their incomes have increased in tandem. This issue is compounded by the fact that these borrowers are from some of the most economically vulnerable sections of society.
 - Cash collections: Despite the push provided by demonetisation, majority of microloan repayments are collected in cash (~2/3rd). This creates operational challenges, as seen during the lockdown. Several microfinanciers however, continue to encourage borrowers to make digital payments. For example, USFB partnered with Airtel Payments Banks to enable borrowers to make digital repayments.
 - Unsecured nature results in high write-offs. As seen in the case of demonetisation, microlenders had to write-off a significant proportion of their PAR 180+ portfolio.
 - Geographic concentration increases vulnerability to social-political events and natural disasters. Microlenders have thus become increasingly focused on geographical diversification.
 - Rapid growth has raised concerns of borrower over-leveraging: The rapid growth of microcredit has raised concerns of over-leveraging with multiple lenders lending to the same borrower. Our interactions with microborrowers in the past suggest that there is anecdotal evidence to support this.

Interest rates:

- Interest rates charged by most lenders are more than 20%. At present, rates charged, only by NBFC-MFIs are capped by the RBI such that their spreads are limited to 10% in case of large NBFC-MFIs (portfolio > Rs 1bn) and 12% in case of other NBFC-MFIs. Interest rates are to be capped at 2.75x the average base rate of the 5 largest commercial banks.
- Over the years, rates charged by microlenders have seen a slight downtrend in tandem with their CoF.
- Our anecdotal interactions with microborrowers suggest them to be not particularly sensitive to interest rates.

Exhibit 32: Rate of interest charged by various microlenders

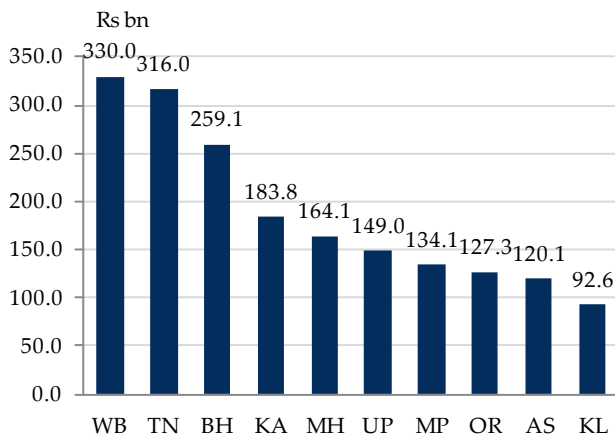


Source: Companies and HSIE Research

Geographical trends

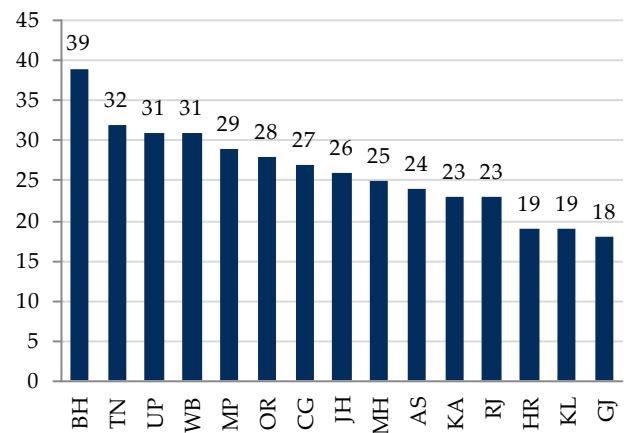
- Microcredit in India is fairly concentrated with the Top 10 states contributing to 82.4% of outstanding credit. The mix has remained fairly constant. Within this, eastern and southern states dominate. WB has the highest market share at 14.5%, closely followed by TN at 13.7%. BH ranked third with an 11.4% market share. Over FY 16-20, eastern states have rapidly gained market share. Southern and eastern states also have the highest number of NBFC-MFIs. BH leads the way with 39, followed by TN at 32 and WB at 31.

Exhibit 33: State-wise portfolio outstanding



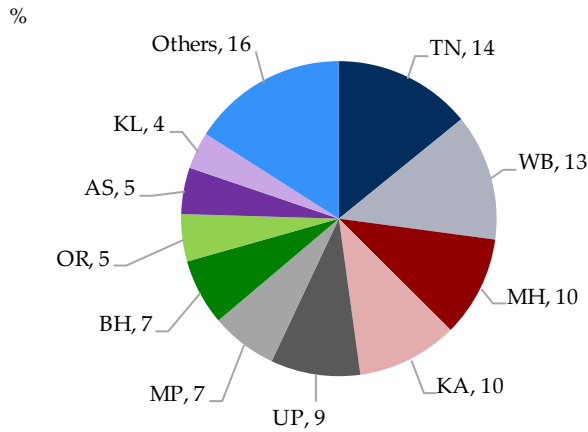
Source: Mfin and HSIE Research

Exhibit 34: State-wise number of NBFC-MFIs

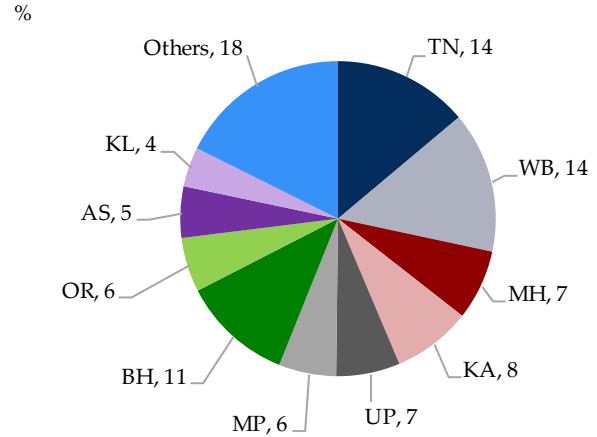


Source: Sa-dhan and HSIE Research

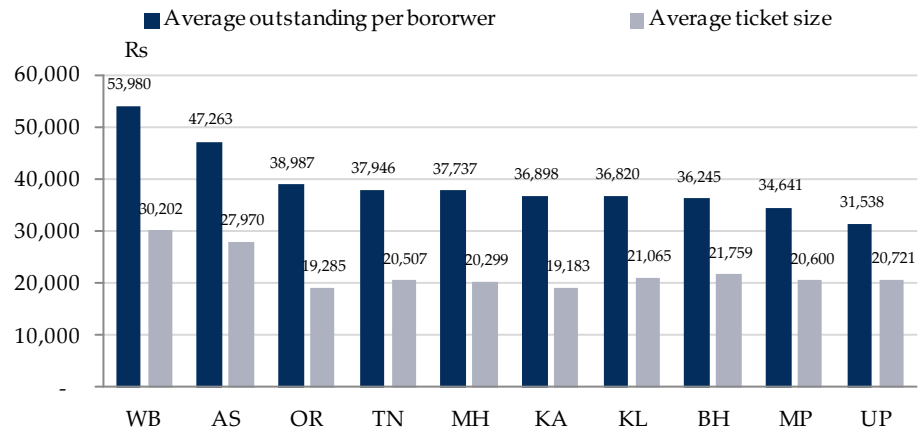
Indian Microfinance: Sector Thematic

Exhibit 35: State-wise distribution of microcredit (FY16)


Source: Mfin and HSIE Research

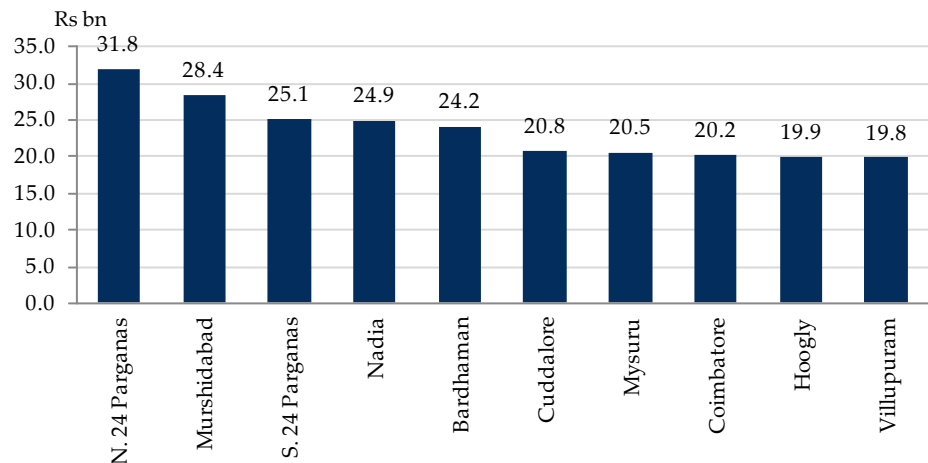
Exhibit 36: State-wise distribution of microcredit (FY20)


Source: Mfin and HSIE Research

Exhibit 37: State-wise average outstanding per borrower


Source: Mfin and HSIE Research

- Ten districts with the largest microcredit portfolios accounted for 10% of outstanding microcredit as of FY20. Of these districts, six were located in WB and four were located in TN.

Exhibit 38: Top ten districts in terms of outstanding microcredit


Source: Sa-dhan and HSIE Research

Industry inflection points and regulations

- Nearly explosive growth of microcredit in AP in the mid-late 2000's and competition from government-backed lending to SHGs made the state the hotbed of microcredit at the time. As a result, borrower indebtedness in the state was much higher than the national average at the time.
- The operations of microlenders in the state were severely restricted as a result of the regulatory crackdown on supposedly coercive collection practices and over-leveraging of borrowers. This culminated into the passage of the AP Microfinance Ordinance, 2010 which was debilitating for microfinanciers in the state.
- The crisis highlighted the concentration risk associated with microcredit and prompted the need for regulating the space. In 2011, the Malegan Committee released its report. Most of the report's recommendations were then incorporated into the RBI's guidelines on NBFC-MFIs.
- It is worth noting that the extant guidelines suffer from a debilitating drawback, as they do not apply to entities other than NBFC-MFIs. Hence banks, SFBs, and other categories of lenders which have a collective market share of 69% are effectively unregulated.
- This creates a regulatory arbitrage that defeats the purpose of these regulations.

RBI's guidelines on NBFC-MFIs

Area	Guidelines
Pricing of loans	Spreads to be capped at 10% for large MFIs (portfolio > Rs 1bn) and 12% for other MFIs Interest rates are to be capped at 2.75x the average base rate of the 5 largest commercial banks. Pricing to include only: -Interest Charge -Processing Fees (max. 1% of the gross loan) -Insurance Premium
Multiple borrowings and indebtedness	Not more than 2 NBFC-MFIs can lend to the same borrower Total borrower indebtedness should not exceed Rs 0.125mn with a cap of Rs 60k in the first cycle.
Loan/borrower characteristics	Annual income of eligible borrowers to not exceed Rs 0.125mn in rural areas and Rs 0.2mn in urban areas Loan tenure for loans in excess of Rs 30k to not exceed 24m, without prepayment penalty. Loans given for income generating purposes should constitute at least 50% of MFIs' loans. Repayment frequency to be either weekly, fortnightly, monthly at the borrower's choice.
Recoveries	To be made only at designated central place. Field staff is allowed to make recovery only if the borrower fails to appear at the central designated place on 2 or more consecutive occasions.

Source: RBI and HSIE Research

Microfinance- the road ahead

- **Growth potential:** Despite the rapid growth seen over the years, we believe microcredit in India offers scope for significant future growth. This growth will be driven by a combination of growth in the borrower base and the average outstanding per borrower. Growth in the near term is likely to be lower on account of COVID-19 related disruptions and will be a function of asset quality outcomes. However, as seen in the past, microcredit growth has rebounded fairly quickly after credit events.
- **Geographical diversification:** At present, 10 states account of more than 80% of outstanding microcredit in the country. Prudent growth is likely to be driven by diversification outside these states (assuming eligible borrowers are evenly distributed).
- **Borrower evolution/ new products:** If microlending were to achieve its more charitable objects successfully, it would result in a significant and permanent increase in borrowers' incomes. This would allow borrowers to avail of larger loans outside the group. Several microlenders offer high vintage borrowers such 'individual' loans. For NBFC-MFIs, growth from these products will be limited, as they can constitute at most 15% of their advances. This limitation does not bind banks and SFBs. Faster growth in this segment will drive industry-wide ticket size metrics.
- These loans are much larger and sometimes secured in nature, and therefore sometimes do not meet the requirements of the RBI's guidelines.
- These products will theoretically allow microlenders to scale up AUMs faster at a lower cost (C-AA). Interest charged (on individual microloans) is at similar to that charged on group loans (we find this surprising).
- **Regulatory arbitrage:** The RBI's guidelines are applicable only to NBFC-MFIs, we believe that this creates a significant regulatory arbitrage. As a result, banks, SFBs and other lenders (~69% m-share) are effectively not bound by these rules. They can potentially lend larger amounts while not complying with indebtedness limits. While the SRO's CoCs do bridge some of these gaps, a revision, if any, in the guidelines by the RBI can close this regulatory arbitrage.
- **Asset Quality:** In the past, microcredit asset quality has been event-driven with highly localized credit events. Recent asset quality trends (pre-COVID-19) have been relatively benign. We believe that these trends do not reflect the underlying risks associate with unsecured lending to bottom-of-the-pyramid borrowers. COVID-19 resulted in a sharp fall in collection efficiency for microfinanciers across the board, and while they have rebounded with the easing of restrictions, we expect a significant rise in delinquencies. Consequently, we build a record rise in GNPA's for most of our coverage companies.

Exhibit 39: Peer set comparison

	MCap (Rs bn)	CMP (Rs)	Rating	TP	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
BANKS																			
AUBANK#	199	655	ADD	724	135	148	175	28.9	29.0	24.6	4.74	4.33	3.66	18.6	14.5	14.8	1.61	1.41	1.47
AXSB#	1,306	427	BUY	565	268	302	352	71.1	14.0	9.9	1.53	1.35	1.15	2.1	9.5	11.4	0.19	0.94	1.21
BANDHAN	440	274	BUY	367	92	103	125	14.6	15.5	12.3	2.97	2.67	2.18	22.9	17.0	18.2	4.08	2.79	2.95
CUBK	101	136	BUY	164	61	65	77	21.1	19.1	13.3	2.23	2.08	1.78	9.4	9.5	12.3	1.00	1.04	1.39
DCBB	25	79	ADD	103	93	94	113	7.3	8.2	6.4	0.85	0.85	0.70	10.3	8.4	9.8	0.91	0.76	0.90
FB	98	49	BUY	64	65	64	75	6.4	8.2	6.3	0.76	0.76	0.66	11.1	8.0	9.6	0.91	0.64	0.75
IIB	414	536	ADD	584	459	511	580	8.4	14.2	9.6	1.17	1.05	0.92	14.7	7.6	9.7	1.51	0.91	1.23
KMB#	2,499	1,264	ADD	1,331	232	287	328	31.8	31.7	27.0	4.27	3.51	2.96	13.9	11.8	11.1	1.78	1.66	1.70
KVB	26	33	REDUCE	35	60	51	63	11.2	8.2	5.7	0.55	0.65	0.53	3.6	4.8	6.7	0.34	0.46	0.61
RBK	102	170	REDUCE	148	185	196	215	17.1	17.8	10.5	0.92	0.87	0.79	5.6	4.5	7.2	0.60	0.53	0.82
SBIN#	1,651	185	BUY	286	175	170	210	4.2	5.7	2.9	0.39	0.41	0.32	6.4	4.6	8.3	0.38	0.27	0.48
UJJIVANS	55	32	ADD	40	17	17	19	15.7	25.2	18.0	1.86	1.88	1.63	15.2	7.0	9.1	2.18	1.07	1.23
NBFCs																			
BAF	1,976	3,293	ADD	3,643	523	571	698	37.5	46.0	28.4	6.29	5.77	4.72	20.2	12.5	17.4	3.65	2.55	3.68
CIFC	206	252	BUY	249	84	93	114	20.9	16.7	14.7	2.99	2.71	2.21	13.8	14.1	14.1	1.63	1.90	2.03
CREDAG	106	720	ADD	797	188	215	249	31.1	39.0	21.1	3.84	3.35	2.89	13.1	9.1	14.5	3.34	2.01	3.12
SHTF	154	609	ADD	861	530	559	718	5.5	8.2	5.8	1.15	1.09	0.85	14.8	9.5	11.7	2.28	1.60	2.13
INDOSTAR	38	280	REDUCE	267	226	245	277	-8.0	29.4	17.5	1.24	1.14	1.01	-11.4	4.5	5.2	-2.96	1.28	1.98
LICHF	141	279	REDUCE	296	294	292	315	5.9	6.7	5.8	0.95	0.96	0.89	13.9	11.0	11.5	1.15	0.94	1.02
REPCO	10	165	ADD	207	233	245	287	3.7	4.4	4.3	0.71	0.67	0.58	16.9	12.3	11.4	2.44	1.90	1.88

Source: HSIE Research, #Adjusted for subsidiaries

Bandhan Bank

Risks more than priced in

BANDHAN is the country's largest (20.9% market share), and (arguably) the most successful microlender. It has had an undoubtedly successful start as a bank, delivering an RoAE of 21.5% over FY16-20, backed by strong deposit traction (~49% CAGR) coupled with granularity, and strong loan growth (~59% CAGR). Eastern and north-eastern states contributed to 55/59/63% of its loan portfolio/deposits/branches. In the near term, asset quality concerns are paramount, even as the moratorium percentage has reduced dramatically. However, BANDHAN's strong PPOP profile and significant COVID-19 related provisions provide comfort.

Current valuations do not reflect BANDHAN's track record, and potential to deliver sustainably high RoAEs. Further, the merger with GRHF will not only support RoAEs but also provide much-needed diversification (away from microcredit and east India). The recent stake sale by the promoters marks the removal of a significant overhang. We initiate coverage with a BUY rating and a target price of Rs 367 (2.65x Sept 22E ABV).

- Deposit franchise and cost control best-in-class:** The bank's deposit franchise, measured by growth, CASA (37.1%) and granularity (58.3% of deposits from retail and small business customers), is surprisingly strong. BANDHAN quickly reined in operating costs, post becoming a bank, unlike most SFBs. Given its focus areas on the asset side and low-cost business model, we believe cost efficiencies are sustainable.
- High RoAE businesses dominate and would drive growth:** Microcredit and mortgages form ~90% of the loan book. These are high RoAE businesses, although with different return profiles. Given the bank's expertise in these and the scope for growth, these businesses will contribute to most of the growth, driving RoAEs, even as we build in higher LLPs.
- Asset quality:** BANDHAN emerged relatively unscathed from major industry credit events. On account of collection challenges faced in Assam, the bank had to write off just 3% of its Assamese portfolio, which is creditable. At its peak, ~71% of the overall portfolio, and almost the entire microcredit portfolio was under moratorium. Collection efficiency has since improved, and ~27% of the microcredit portfolio remains under moratorium. The bank made total COVID-19 related provisions amounting to 1.9% of its portfolio. Given the bank's demonstrable microcredit asset quality track record, we believe that eventual outcomes will not be too worrisome, and its strong PPOP profile can support potential incremental provisioning. We conservatively build in credit costs of 2.4% over FY21-23E.

Financial Summary

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	9,327	24,035	30,322	44,961	63,239	71,233	84,057	105,535
PPOP	4,668	17,929	24,301	37,482	54,466	60,740	69,950	86,304
PAT	2,753	11,120	13,456	19,515	30,237	28,322	35,844	48,208
EPS (Rs)	2.5	10.2	11.3	16.4	18.8	17.6	22.3	29.9
ROAE (%)	14.4	28.6	19.5	19.0	22.9	17.0	18.2	20.4
ROAA (%)	2.69	4.43	3.61	3.87	4.08	2.79	2.95	3.34
ABVPS (Rs)	30.4	40.0	77.2	92.0	91.9	102.6	125.2	151.7
P/ABV (x)	9.01	6.83	3.54	2.97	2.97	2.67	2.18	1.80
P/E (x)	108.8	26.9	24.2	16.7	14.6	15.5	12.3	9.1

Source: Bank and HSIE Research

BUY

CMP (as on 29 Sept 2020)	Rs 274
Target Price	Rs 367
NIFTY	11,222

KEY STOCK DATA

Bloomberg code	BANDHAN IN
No. of Shares (mn)	1,610
MCap (Rs bn) / (\$ mn)	440/5,969
6m avg traded value (Rs mn)	5,981
52 Week high / low	Rs 650/152

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(16.7)	9.6	(45.2)
Relative (%)	(25.3)	(17.7)	(43.0)

SHAREHOLDING PATTERN (%)

	Mar-20	Jun-20
Promoters	61.0	61.0
FIs & Local MFs	13.5	12.3
FPIs	17.5	19.4
Public & Others	8.0	7.3
Pledged Shares	-	-

Source : BSE

Darpin Shah

darpin.shah@hdfcsec.com
+91-22-6171-7328

Aakash Dattani

aakash.dattani@hdfcsec.com
+91-22-6171-7337

Punit Bahlani

punit.bahlani@hdfcsec.com
+91-22-6171-7354

It is noteworthy that BANDHAN emerged largely unscathed from the AP episode due to its absence from the state (allowing it to become a market-leader in terms of portfolio size by a wide margin)

The sizes of individual and group microloans offered by BANDHAN are some of the highest in the industry

WB, BANDHAN's home state, where it is the dominant player, has the highest average outstanding per borrower

The size of the largest microcredit loan offered by BANDHAN is Rs 0.3mn (this is one of the highest in the industry)

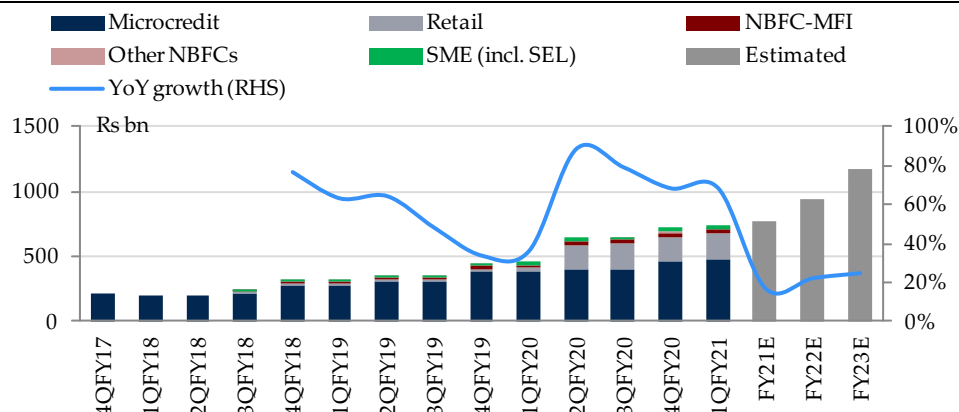
54% of BANDHAN's customers are in the 4th cycle.

50% of BANDHAN's microcredit borrowers are unique to the bank

Loan book trends

- BANDHAN's loan book grew at a CAGR of 53% over FY17-20, aided by strong growth in its microcredit book (CAGR of 31.8%), and more recently aided by the merger with GRHF. We expect BANDHAN to register an overall loan growth of 16.5% in FY21E and 23.1% over FY22-23E.

Exhibit 40: Loan growth trends and estimates

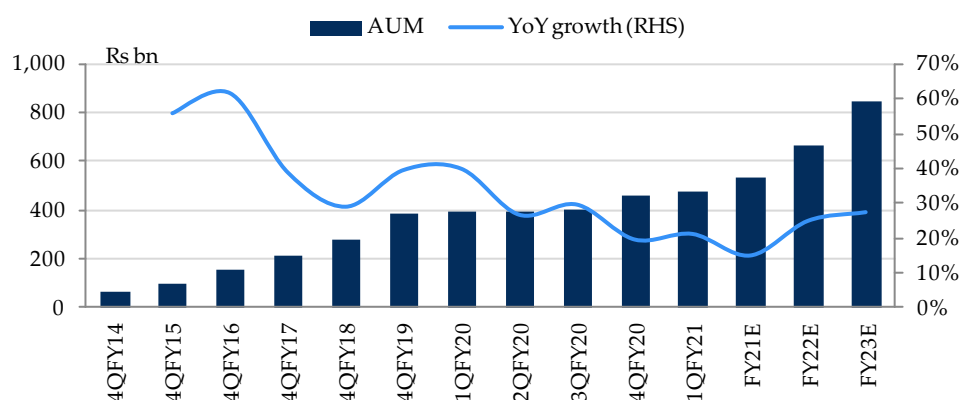


Source: Bank and HSIE Research

Microcredit

- BANDHAN commenced operations as a registered society (a not-for-profit entity), and it was exclusively engaged in microlending until it became a bank. It has the largest microcredit portfolio at Rs 475bn (20.9% m-share), followed by IIB (Rs 234.7bn, 10.3% m-share). Including its exposure to NBFC-MFIs, BANDHAN's total microcredit exposure is ~65% of its loan book.
- Microcredit constitutes the **largest portion of BANDHAN's portfolio**. BANDHAN has a demonstrable track record within this segment, and, unlike most players, it has not faced serious asset quality challenges so far.
- **Microcredit—the driver of overall loan growth:** Microcredit has been the biggest driver of growth. Up until BANDHAN became a bank, microcredit was the sole constituent of its portfolio. Between FY10-FY15, BANDHAN's (e-BFSL) portfolio grew at a ~45% CAGR. Between FY17-19, the bank's loan book grew at ~38% CAGR, with its microcredit book growing at ~34%. However, in FY20, this growth rate slowed to ~20%, given disruptions in Assam in December 2019 and COVID-19 related issues towards the year-end. Given the bank's track record and competitive advantages within the segment, as well as the immense scope for growth, we expect the microcredit portfolio to register 15% growth in FY21E and 26.3% over FY22-23E.

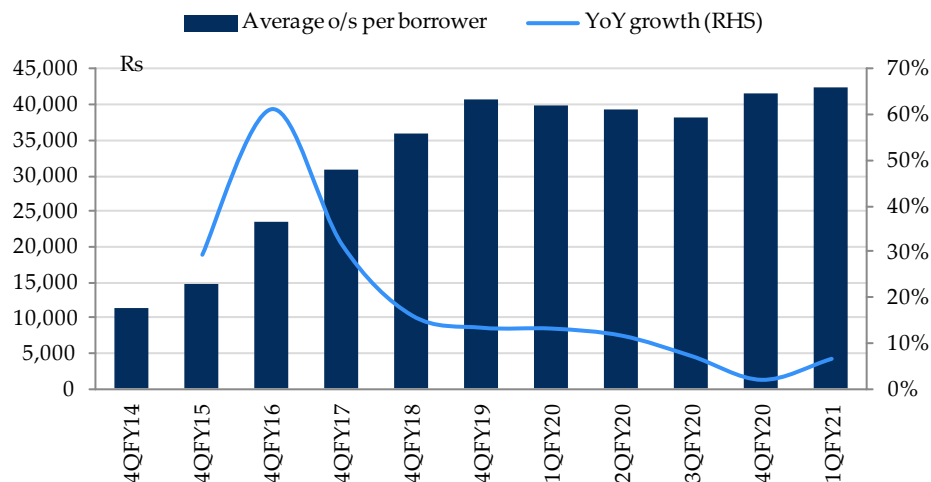
Exhibit 41: Microcredit portfolio trends and outlook



Source: Bank and HSIE Research

- **Growth in average outstanding per borrower:** A closer look at BANDHAN's microcredit growth reveals that the average outstanding per borrower increased sharply by 62% from Rs 23.5k to Rs 38.2k, over FY16-19. While the average outstanding per borrower remained flattish over 9MFY20, it grew to Rs 41.5k in 4QFY20 and further to Rs 42.4k in 1QFY21. BANDHAN's average outstanding per borrower has remained above the industry average (Rs 39.3k as of 1QFY21).

Exhibit 42: Average outstanding per microborrower



Source: Bank and HSIE Research

- BANDHAN's high average outstanding per borrower can be partly explained by high customer vintage (loyalty) as well as a conscious strategic choice. While offering large microcredit loans has a few advantages, such as lowering the C-AA ratio, improving customer loyalty, and enabling faster growth, it increases the risks associated with borrower over-leveraging.

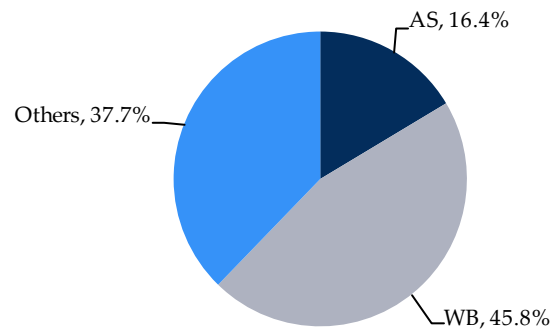
Exhibit 43: Comparison of average outstanding per borrower vs. peers

Company	Rs
BANDHAN	42,393
Industry	39,263
USFB	39,068
CREDAG	34,066
SPANDANA	26,611

Source: Companies, Mfin, and HSIE Research

- **Regional concentration:** Despite BANDHAN being the largest microlender in the country, its microcredit portfolio remains highly concentrated in eastern and north-eastern India, and the pace of geographical diversification has been slow. As of 3QFY20, ~71% of BANDHAN's microcredit book was located in eastern India (WB, AS, BH, OR and JH). Between FY18 and FY20, the share of these states fell by just ~10%. This indicates that these geographies accounted for a significant portion of BANDHAN's growth over the period.

Exhibit 44: Geographical split of the microcredit book as of 3QFY20



Source: Bank, State SLBCs, and HSIE Research

Exhibit 45: Share of eastern states in BANDHAN's loan book

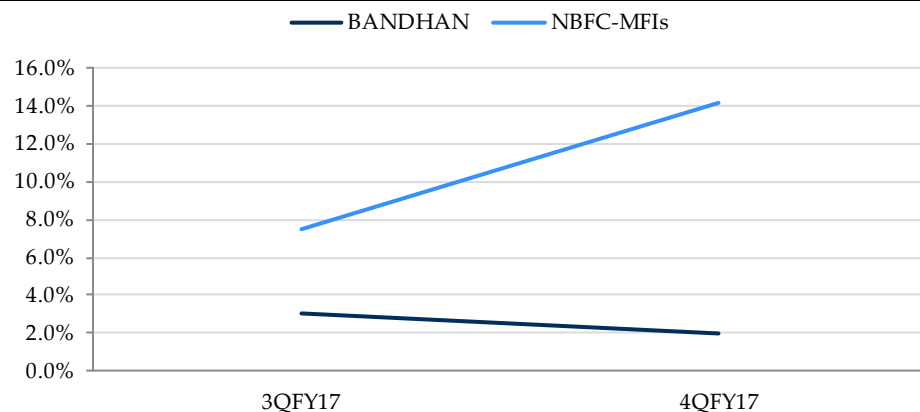
States (Rs bn)	FY16	FY17	FY18	FY19	3QFY20	4QFY20
WB	70.8	92.2	140.7	193.8	204.6	238.8
BH	18.4	26.3	31.6	39.9	43.2	50.8
JH	2.3	3.2	4.7	6.4	7.8	9.1
OD	3.0	3.6	6.5	10.6	11.2	NA
AS	29.2	40.2	53.7	71.8	69.0	NA
Total	123.8	165.5	237.2	322.6	335.9	NA
Total advances	124.4	168.4	297.1	396.4	606.0	666.3
% of Total advances	99.52%	98.30%	79.83%	81.36%	55.42%	NA

Source: Bank, State SLBCs, and HSIE Research

Microcredit: the BANDHAN advantage

- Regulatory arbitrage:** As a bank, BANDHAN is not bound by the RBI directive on microfinance. This potentially allows it to lend without adhering to limits on ticket sizes, indebtedness, income and spreads that are applicable to NBFC-MFIs. The bank already has one of the highest ticket sizes in the industry, as suggested by reported data. It is also one of the few microlenders in the country which has not signed M-fin's and Sa-Dhan's code of conduct. While this does increase risk, it does enable BANDHAN to grow faster (though not prudently, in our opinion).
- Bank advantage:** Microbanking customers contribute to 5.8% of BANDHAN's deposit base. As a full-fledged bank, BANDHAN offers a more attractive proposition for microborrowers over other microlenders. In theory, deposit holding microborrowers are likely to exhibit better credit discipline. As BANDHAN was able to accept specified bank notes during demonetisation, we believe it did not face a significant rise in delinquencies.

Exhibit 46: PAR trends after demonetisation- BANDHAN vs. peers



Source: Bank and HSIE Research

- **Pricing power:** While we believe microborrowers are not very rate sensitive, due to its lower CoF (as a bank), BANDHAN has significant potential pricing power. This may prove to be an advantage in the long run. Further, the bank is not bound by the RBI directive to cap its spreads either, but it has one of the lowest lending rates.

Exhibit 47: Microcredit loan rates offered by BANDHAN and its peers

BANDHAN	17.95%
CREDAG	19.60%
SPANDANA	21.87%
UJJIVANS	22.00%
EQUITAS	24.00%

Source: Companies and HSIE Research

BANDHAN-GRHF merger details:

Announced in Jan-19

Effective date 17-Oct-19

All share deal- Swap Ratio (568 shares of BANDHAN for every 1000 shares of GRHF)

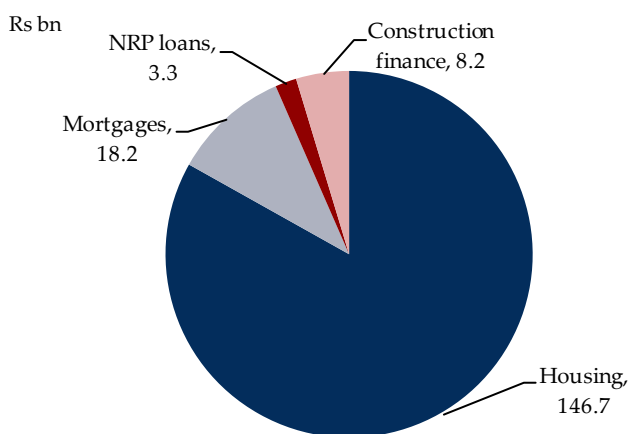
BFHL's holding was reduced by ~20% to ~61% and HDFC acquired ~15% stake in the bank (brought down to 9.9% later)

- **Strong customer franchise (and loyalty):** Historical growth and asset quality metrics suggest that BANDHAN has a strong customer franchise (and consequently high loyalty). We believe that this can be attributed to, customer vintage, the willingness to provide high ticket loans, a strong understanding of customer dynamics in its core geographies, and social/ development work performed by group entities (FIT*, NEFIT#, etc.).

Merger with GRHF reduces concentration risk and provides fresh avenues:

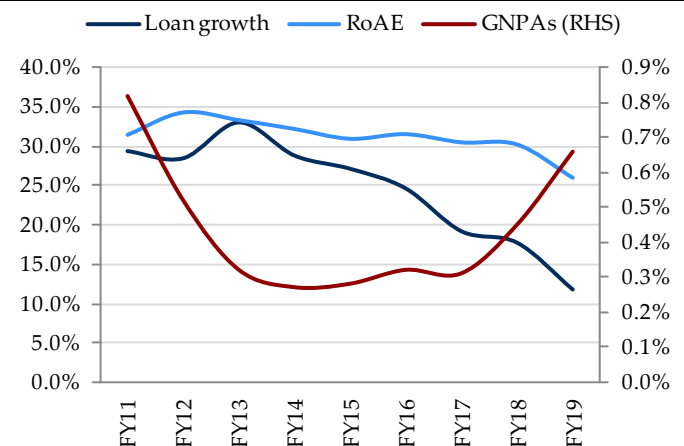
- The merger with GRHF not only helped bring down promoter holding to an extent but also helped BANDHAN diversify instantly on the following fronts: (1) loan book mix (away from microfinance and unsecured lending) and (2) geographical mix (away from eastern India). Further, given that GRHF ran a high RoAE business itself (~31% over FY11-19), BANDHAN's RoAEs are unlikely to be adversely impacted.

Exhibit 48: e-GRHF's portfolio mix as of 1QFY20



Source: Company and HSIE Research

Exhibit 49: e-GRHF's financial metrics



Source: Company and HSIE Research

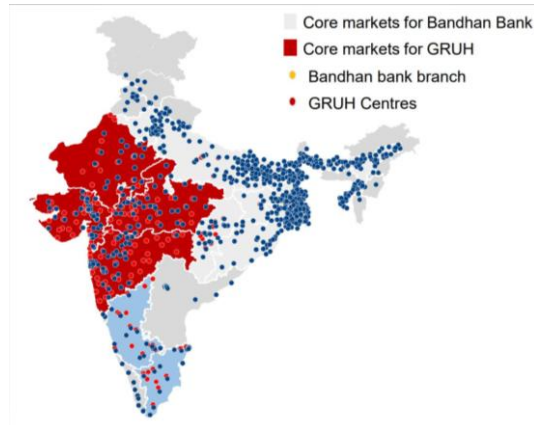
After the recent stake sale by BFHL, its stake in the bank has been reduced further to ~40%

** FIT- Financial Inclusion Trust*

#NEFIT- North-East Financial Inclusion Trust

- GRHF operated through a low-cost network of ~195 branches. At BANDHAN, this business will be carried out through a distinct vertical, using its existing bank branch network. BANDHAN's existing branches will be enabled with GRHF's capabilities. Eventually, GRHF's existing infrastructure and regional expertise can enable BANDHAN to scale up its banking presence in western India.

Exhibit 50: e-GRHF's branch mix as of 3QFY20

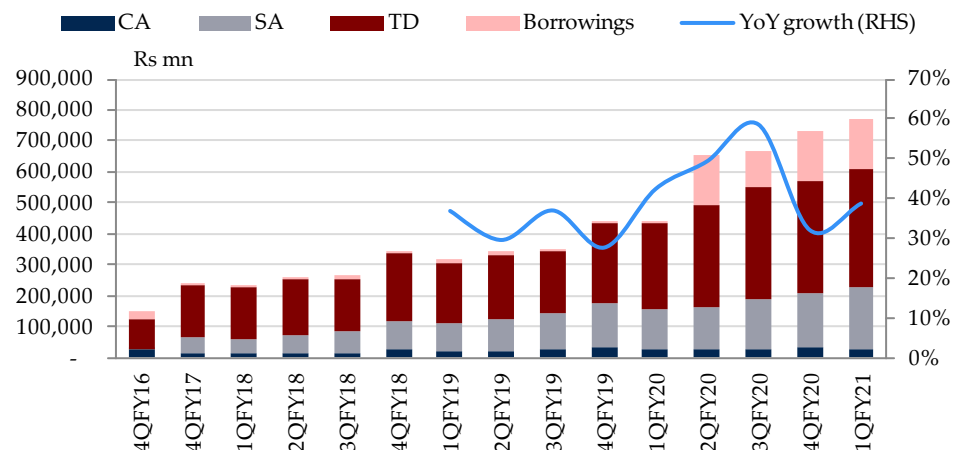


Source: Bank and HSIE Research

(Surprisingly) Strong liability franchise

- BANDHAN's ability to quickly build and maintain a strong liability franchise, as a reasonably young bank, is striking. Over FY17-20, BANDHAN's deposit base has grown at a CAGR of ~49% reaching Rs 606.1bn in 1QFY21.

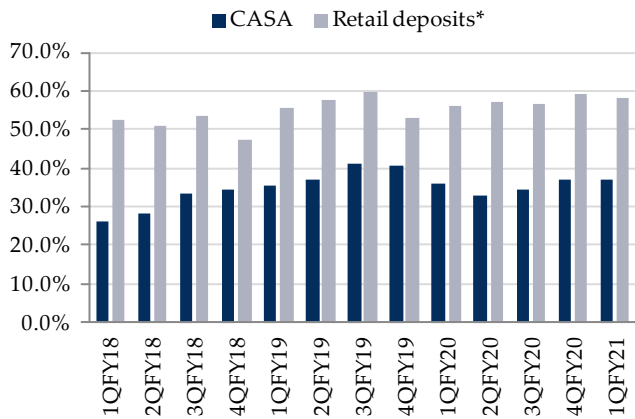
Exhibit 51: BANDHAN's liability profile over time, and YoY deposit growth



Source: Bank and HSIE Research

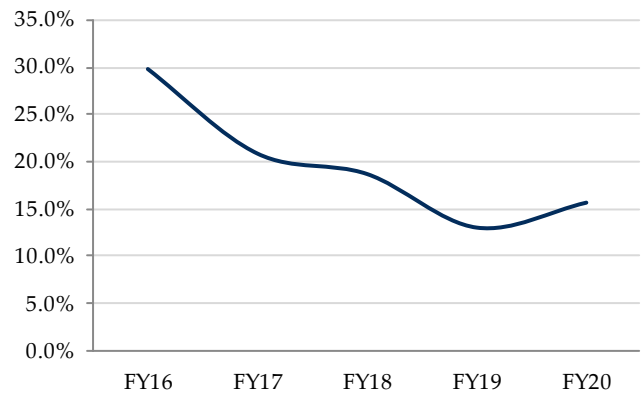
- We find the quick scale-up of BANDHAN's deposit base particularly impressive on account of:
- On the **CASA (37.1%)** and **deposit granularity fronts** (deposits from retail and small business customers constitute ~59% of overall deposits, and top 20 depositors contributed to 15.7% of deposits), BANDHAN stacks up much better than its peers (including some of the PVT sector banks).

Exhibit 52: CASA and retail deposits*



Source: Bank and HSIE Research, *- Deposits from retail and small business customers

Exhibit 53: Contribution of Top 20 depositors



Source: Bank and HSIE Research

Exhibit 54: Deposit parameters- BANDHAN vs. its peers

	CASA	Retail deposits*	Top 20 depositors
AUBANK	14.5%	35.7%	23.4%
BANDHAN	37.1%	58.3%	15.7%
CUBK	24.6%	NA	9.2%
DCBB	21.9%	44%	9.3%
EQUITAS	20.0%	NA	32.7%#
FB	32.0%	86.3%	6.0%
IIB	40.0%	29.7%	24.3%
KVB	33.2%	73.0%	6.10%
RBK	30.1%	30.7%	18.8%

Source: Banks and HSIE Research, *- Deposits from retail and small business customers, #- as of FY19

- Given its NBFC-MFI origins, deposit mobilisation should have theoretically been a challenging task for the bank, as its customer base before the conversion was not deposit-rich. Even now, microbanking customers account for ~5.8% of its deposits.
- BANDHAN's deposit rates are significantly lower than those offered by SFBs but higher than those offered by larger banks (this is on expected lines).

Exhibit 55: SA rates- BANDHAN vs. others

Bank	Up to Rs 0.1mn	Rs 0.1-Rs 1mn	Rs 1-5mn	Rs 5-50mn	Rs 50-100mn	Rs 100mn-1bn	Rs 1bn-2bn	Rs 2bn+
AUBANK	4.00%	5.50%	7.00%	7.00%	6.50%	6.50%	6.50%	6.50%
AXSB	3.00%	3.00%	3.00%	3.50%	3.50%	Repo - 65bp	Repo - 25bp	Repo
BANDHAN	3.00%	6.00%	6.00%	6.55%	7.15%	7.15%	7.15%	7.15%
CUBK	3.50%	3.75%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
DCBB	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
EQUITAS	3.5%	7.00%	7.00%	7.00%	7.25%	7.50%	-	-
FB	Repo-150bps	Repo-150bps	Repo-150bps	Repo-150bps	Repo+10bps	Repo+10bps	Repo+50bps	Repo+50bps
ICICIBC	3.00%	3.00%	3.00%	3.50%	3.50%	3.50%	3.50%	3.50%
IIB	4.00%	5.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
KVB	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
RBK	4.75%	6.00%	6.75%	6.75%	6.75%	6.75%	6.75%	6.75%
USFB	4.00%	5.25%	5.25%	6.25%	6.50%	6.50%	6.50%	6.50%

Source: Banks and HSIE Research

Exhibit 56: TD rates- BANDHAN vs. others

Bank	7-14 d	15-29d	30- 45d	46- 60d	61- 90d	91d - 120d	121d- 185d	6m 1d- 9m	9m 1d- 1yr	1yr 1 d- 2yr	2yr 1 d- 3yr	3yr 1d- 5yr	5yr 1d- 10 yr
AUBANK	3.75%	3.75%	3.75%	4.25%	4.25%	5.00%	5.00%	5.50%	6.50%	6.50%	6.75%	6.50%	6.50%
AXSB	2.50%	2.50%	3.00%	3.25%	3.25%	4.10%	4.10%	4.50%	5.15%	5.15%	5.50%	5.50%	5.50%
BANDHAN	3.00%	3.00%	3.50%	3.50%	3.50%	3.50%	3.50%	5.75%	5.75%	6.00%	6.00%	5.75%	5.75%
CUBK	3.00%	3.25%	3.25%	3.50%	3.50%	3.75%	3.75%	4.00%	5.00%	5.75%	5.75%	5.50%	5.25%
DCBB	4.75%	5.05%	5.05%	5.25%	5.25%	5.75%	5.75%	6.35%	6.35%	6.73%	6.80%	6.85%	6.80%
EQUITAS	3.60%	3.60%	4.10%	4.60%	5.60%	5.85%	5.85%	6.10%	6.60%	7.10%	7.15%	6.75%	6.75%
FB	2.75%	3.00%	3.25%	3.50%	3.75%	3.90%	3.90%	4.00%	4.75%	5.45%	5.50%	5.60%	5.60%
ICICIBC	2.50%	2.50%	2.75%	2.75%	3.00%	3.10%	3.10%	3.60%	3.85%	4.10%	4.60%	4.60%	4.60%
IIB	3.25%	3.25%	3.75%	4.10%	4.30%	4.50%	5.00%	5.40%	6.60%	7.00%	7.00%	6.75%	6.65%
KVB	3.50%	3.75%	3.75%	3.75%	3.75%	4.75%	4.75%	4.75%	5.00%	5.50%	5.50%	5.65%	5.65%
RBK	4.00%	4.50%	4.50%	5.50%	5.50%	5.75%	5.75%	6.25%	6.35%	7.00%	7.00%	6.75%	6.75%
UJJIVANS	3.05%	3.05%	4.05%	4.05%	4.05%	4.80%	4.80%	5.20%	5.20%	6.50%	6.05%	5.80%	5.55%

Source: Banks and HSIE Research

- In the aftermath of the events at YES, BANDHAN's total deposit base grew ~4% QoQ in 4QFY20 and 6.2% QoQ in 1QFY21, while several mid-tier private banks saw muted sequential growth or de-growth over the same period.

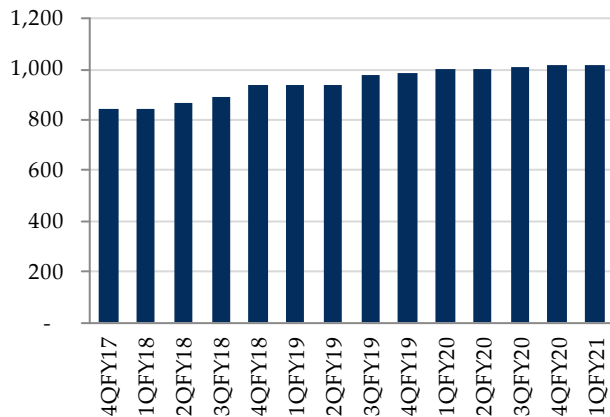
Exhibit 57: QoQ deposit growth- BANDHAN vs. peers

Bank	4QFY20	1QFY21
AUBANK	9.6%	2.2%
AXSB	8.2%	-1.9%
BANDHAN	5.3%	4.9%
CUBK	2.6%	0.5%
DCBB	2.1%	-3.1%
EQUITAS	2.8%	9.3%
FB	5.3%	1.7%
ICICIBC	7.6%	4.0%
IIB	-6.8%	4.6%
KVB	-5.1%	1.7%
RBK	-8.1%	6.8%
UJJIVANS	1.2%	2.6%

Source: Banks and HSIE Research

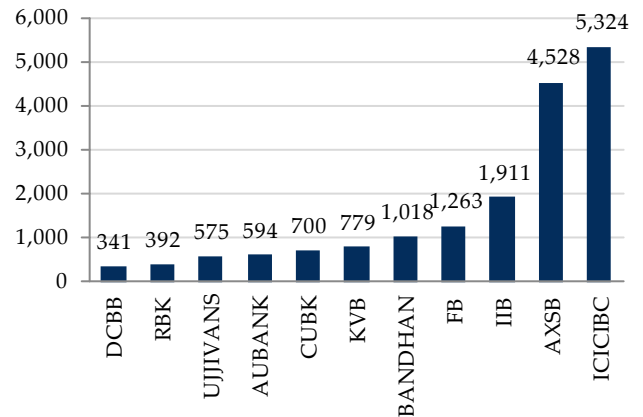
- Swift deposit mobilisation, post-conversion, enabled BANDHAN to sustain high AUM growth and benefit from the fall in CoF, which partly offset the CRR-SLR drag on NIMs.
- **Rapid branch scale-up facilitated strong deposit traction:** Before conversion, BANDHAN operated via DSCs/ Asset Centres to service microborrowers. It commenced banking operations with 501 branches (that accepted liabilities) in FY16 (significantly higher than other SFB converts). In the years that followed, BANDHAN nearly doubled its bank branch count. Given its relatively low deposits per branch (vs. peers), we believe a rapid scale-up in branches helped the bank garner deposits.

Exhibit 58: Branch count over time



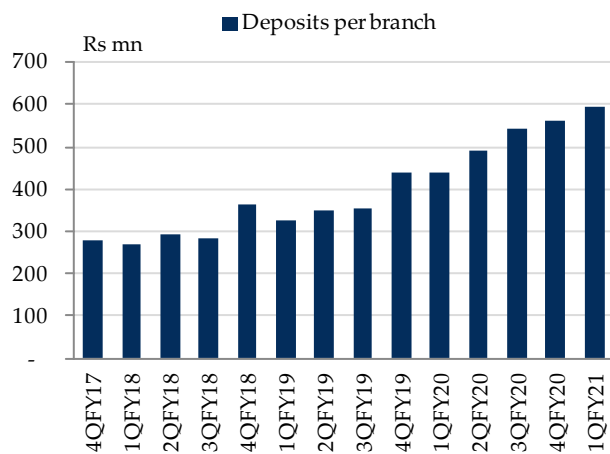
Source: Banks and HSIE Research

Exhibit 59: Branch count- BANDHAN vs. peers



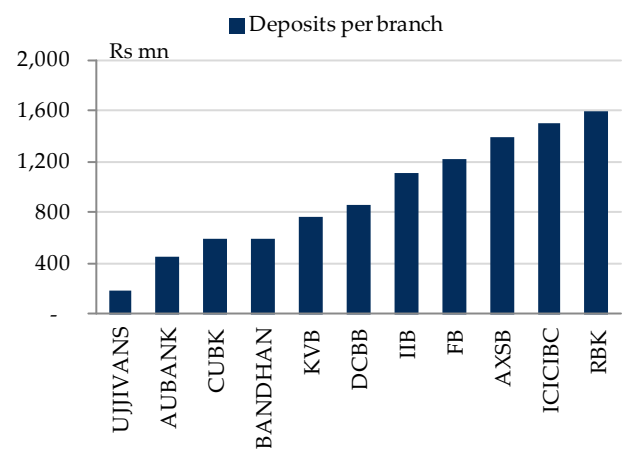
Source: Banks and HSIE Research

Exhibit 60: Trends in deposits/ branch



Source: Banks and HSIE Research

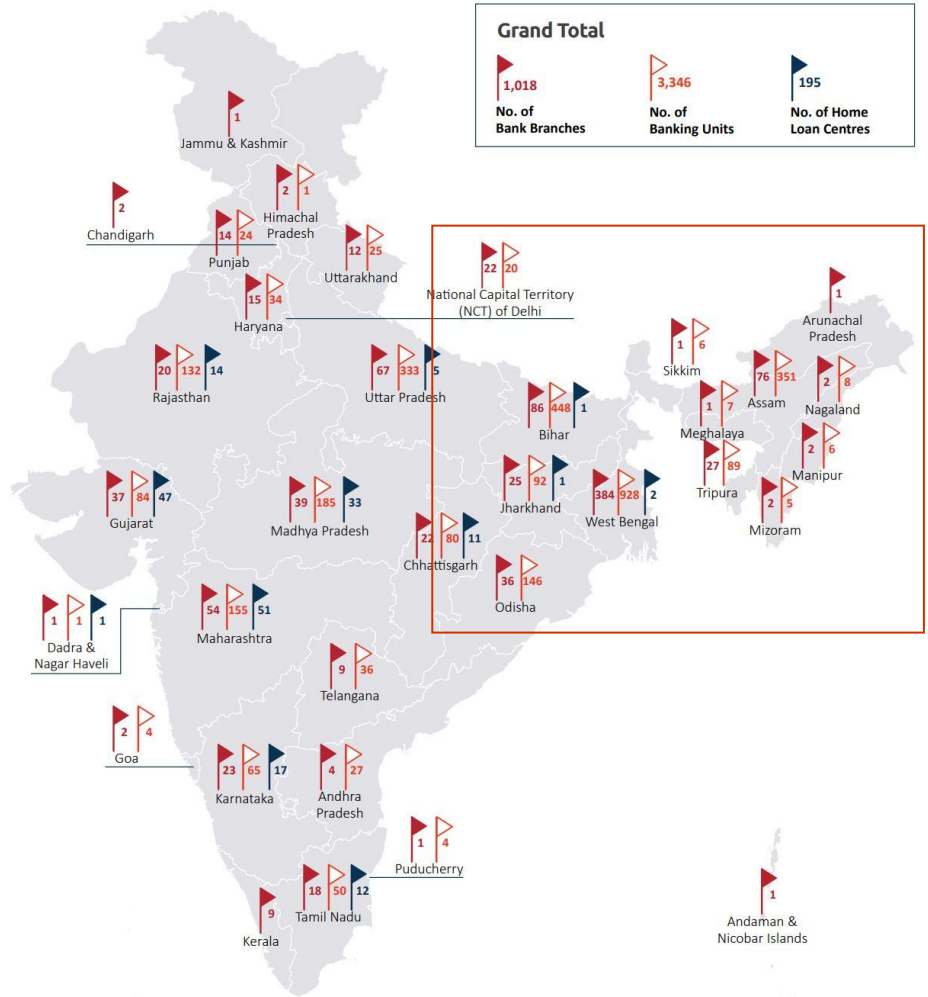
Exhibit 61: Deposits/ branch- BANDHAN vs. peers



Source: Banks and HSIE Research

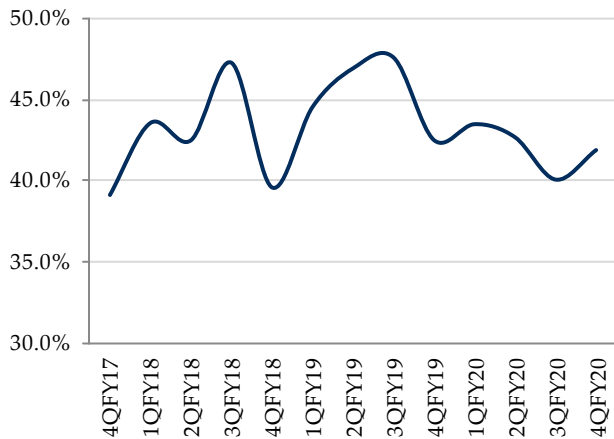
- A **geographical analysis** of BANDHAN's deposits suggests that WB alone contributes to ~40% of BANDHAN's deposits (the state's contribution has not changed much since the bank's inception). Eastern and north-eastern states together contributed to ~59% of BANDHAN's deposits in 4QFY20. In these states, the bank has gained market share, mostly from PSBs. High WB deposit concentration can be explained mainly by the high number of branches that the bank has in the state. BANDHAN's deposits per branch in the state are not significantly higher than its pan-India average deposits per branch.

Exhibit 62: BANDHAN's physical network as of FY20



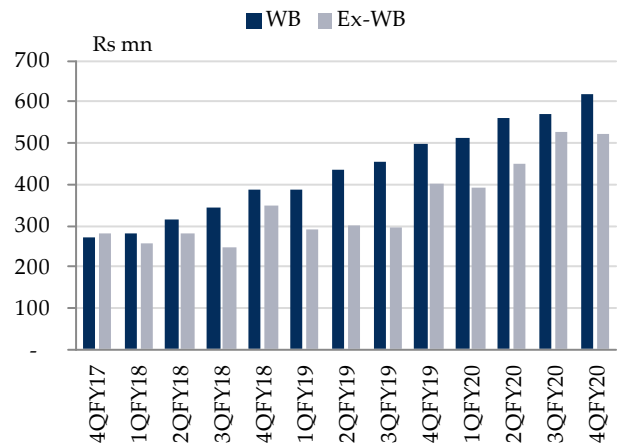
Source: Bank and HSIE Research

Exhibit 63: Share of WB in the bank's deposit base



Source: WB SLBC, Bank, and HSIE Research

Exhibit 64: Average deposits/ branch- Ex-WB vs. WB

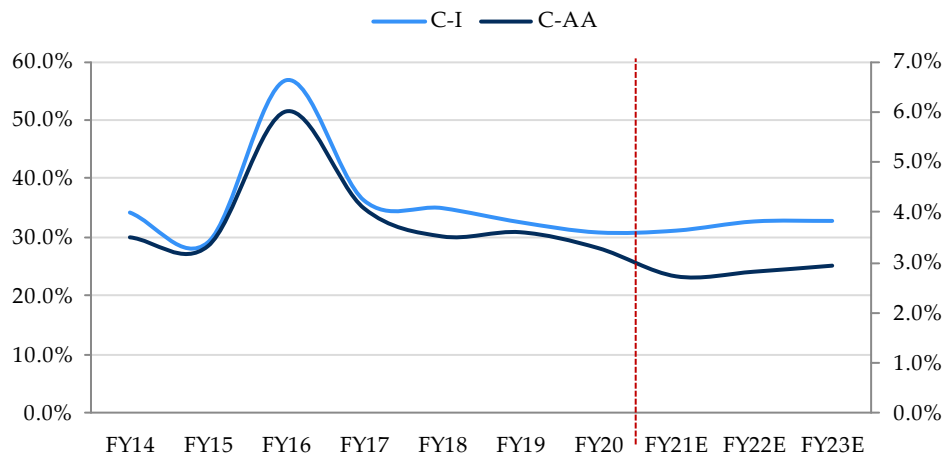


Source: WB SLBC, Bank and HSIE Research

Cost control – best in class, sustainable

- BANDHAN’s operating efficiency is the best in its class. The bank has fared better than its peers in both its pre-bank avatar and as a bank. Post conversion into a bank, it witnessed a characteristic bump-up in costs but managed to rein these in quickly.

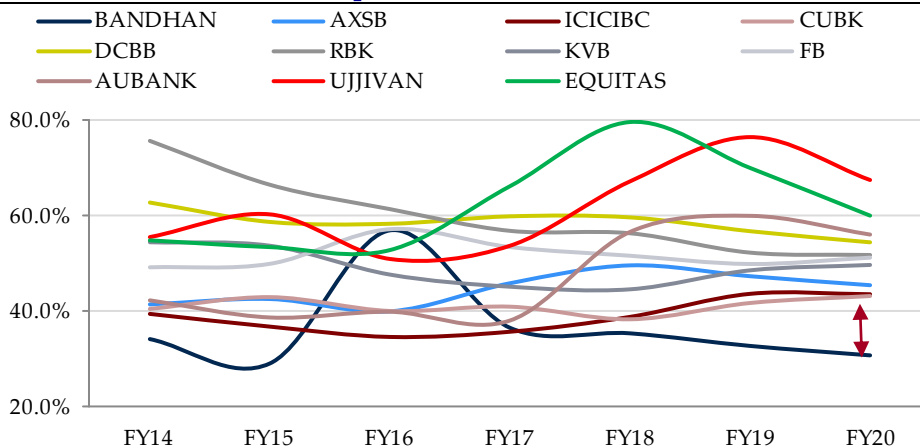
Exhibit 65: C-I and C-AA trends and estimates



Source: Bank and HSIE Research

- BANDHAN reported a C-AA/ C-I ratio of 3.5%/33% over FY18-20. On the C-I front, it outperforms its SFB peers as well as small-medium sized private banks such as CUBK, DCBB, KVB, and RBK, as seen below.

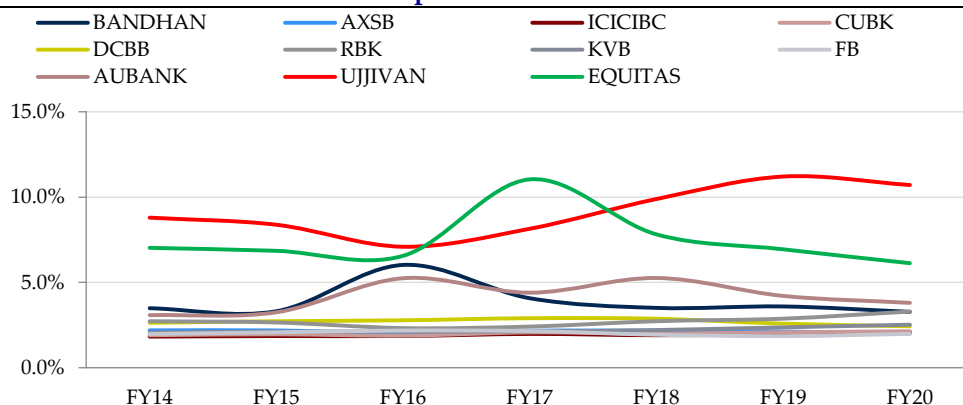
Exhibit 66: C-I: BANDHAN vs. peers



Source: Banks and HSIE Research

- BANDHAN’s C-AA ratio is higher than that of several small-medium private banks, due to the high proportion of microcredit loans in its portfolio, but it is much lower than that of its SFB peers.

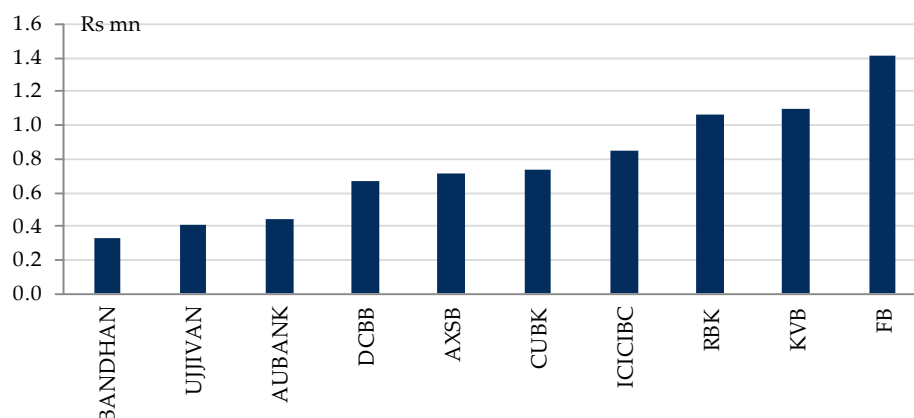
Exhibit 67: C-AA*: BANDHAN vs. peers



Source: Banks and HSIE Research, *Cost-average advances

- A disaggregation of BANDHAN’s operating costs reveals that its average **employee cost per employee** is considerably lower than that of several small-medium sized private banks and SFBs. This could be because the microcredit field staff, who are paid lower rates, constitute a significant proportion of the bank’s employee base. Also, BANDHAN only hires freshers for entry-level positions while internal candidates fill other positions. This helps the bank control costs.

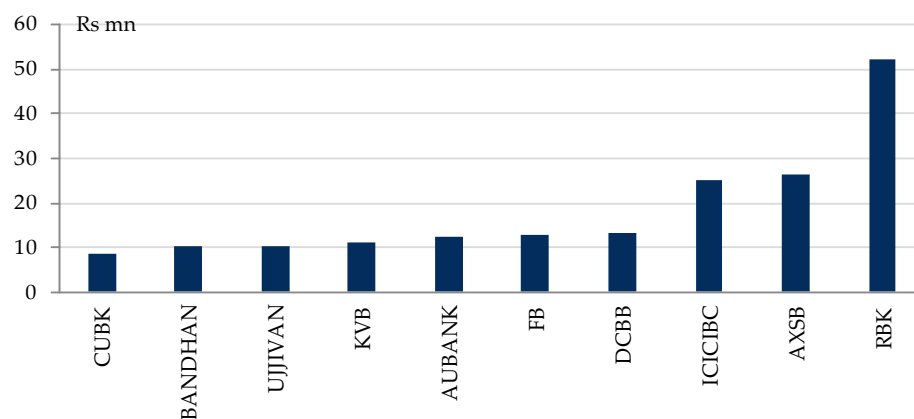
Exhibit 68: Employee cost per employee- BANDHAN vs. peers



Source: Banks and HSIE Research

- BANDHAN’s average other operating costs per branch, including doorstep service centres (DSCs), are also much lower than those of its peers. This can be because its physical footprint comprises a large proportion of DSCs.

Exhibit 69: Other operating expenditure per branch- BANDHAN vs. peers



Source: Banks and HSIE Research

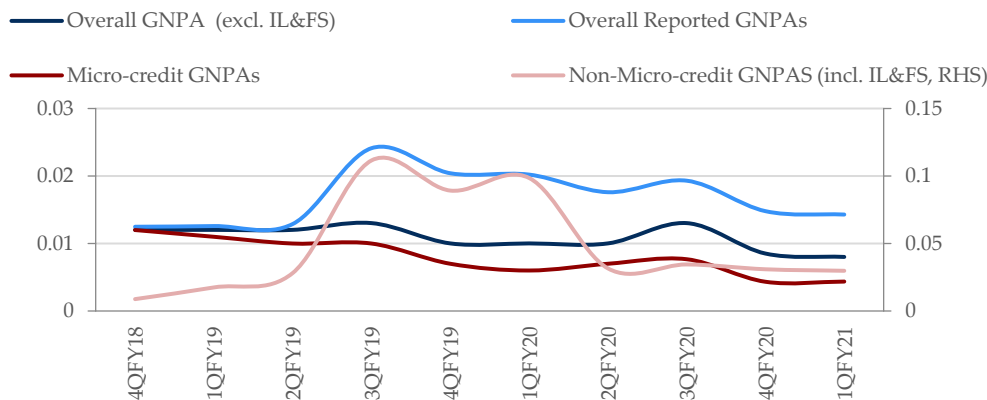
- We expect BANDHAN's current cost-metrics to sustain/ improve slightly, and we hence build a C-I/ C-AA ratio of 32.2/2.8% over FY21-23E. Our stance is premised on the following:
- Microcredit and affordable housing are likely to be the main drivers of loan growth at the bank. BANDHAN has successfully grown its microcredit portfolio so far while keeping costs under control. e-GRHF too followed a cost-efficient business model. Therefore, we believe BANDHAN can further scale up both verticals while controlling costs.
- While BANDHAN is unlikely to scale up its retail portfolio significantly (ex-microcredit and affordable housing), it is important to note that its vast existing branch network is capable of supporting any scale-up (retail loans per branch excluding microcredit and affordable housing is one of the lowest).

Asset quality trend and outlook

- For an extended period (FY14-20), BANDHAN has fared better than most microfinanciers on the asset quality front. Microcredit GNPA's did not exceed 1% between FY14-20. The bank has not faced significant asset quality events, and it emerged mostly unscathed from credit events that impacted most microlenders, such as the AP microcredit crisis (2010) and demonetisation (2016).

In FY19, BANDHAN saw an increase in GNPA's owing to its ~Rs 3.8bn exposure to IL&FS. Asset quality trends, ex-IL&FS are neither erratic nor alarming

Exhibit 70: Segment-wise GNPA trends



Source: Bank and HSIE Research

Exhibit 71: Microcredit GNPA's: BANDHAN vs. peers

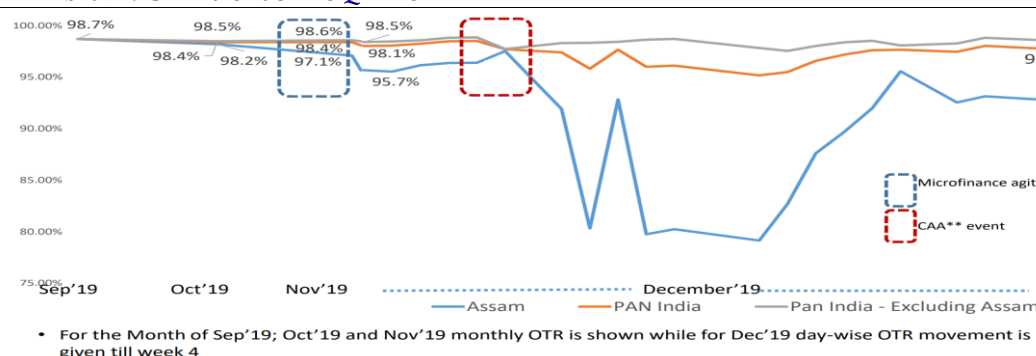
Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20	1QFY21
BANDHAN	0.09%	0.05%	0.15%	0.51%	1.20%	0.70%	0.43%	0.44%
CREDAG	0.01%	0.04%	0.08%	0.08%	0.82%	0.61%	1.57%	1.63%
UJJIVAN	0.07%	0.07%	0.15%	0.28%	3.76%	0.93%	0.97%	0.97%
AROHAN	0.37%	0.29%	0.36%	0.32%	1.22%	0.57%	1.83%	N/A
ASIRVAD	0.02%	0.03%	0.10%	4.47%	2.33%	0.48%	1.83%	N/A
FUSION	0.00%	0.00%	0.26%	0.37%	3.25%	1.55%	1.12%	N/A
MMFL	0.31%	0.17%	0.22%	0.49%	0.49%	0.81%	1.60%	1.58%
MHTT	0.00%	0.00%	0.04%	0.15%	2.49%	1.47%	N/A	N/A

Source: Companies and HSIE Research

Assam challenges - losses controlled but risks remain

- However, the bank did face collection challenges in Assam on account allegations of unethical practices resulting in protests by borrowers, and civil unrest in late 2019.
- At the time, Assam accounted for ~16% of BANDHAN's microcredit portfolio, and the bank had a ~56% market share in the state. Its on-time repayment rate (OTR) in Assam fell from ~99% in September 2019 to ~80%, and no new loans were disbursed in the state.

Exhibit 72: OTR trends in 3QFY20



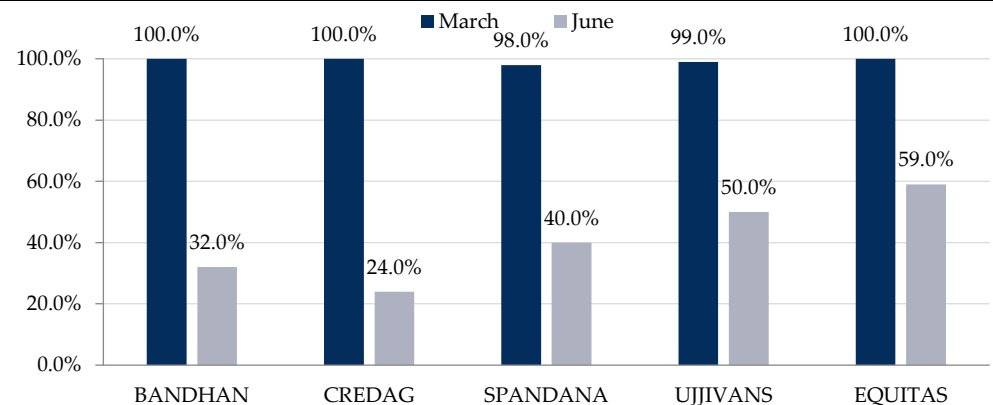
Source: Bank and HSIE Research

- Of the bank's total PAR 30 at the time (~Rs 5.6bn), ~28% was attributable to its portfolio in Assam.
- The banks' overall microcredit GNPA's rose 7bps QoQ to 72bps in 3QFY20. We believe that the bank emerged relatively unscathed, on account of the following:
- OTR quickly recovered to ~94% by the end of December 2019 and remained at similar levels in 4QFY20.
- In 3QFY20, BANDHAN's GNPA in Assam was just 3.1% (vs. 6.2% for the industry). In 3QFY20, the bank provided ~Rs 2bn against its exposure in the state and wrote off ~Rs 1.98bn in 4QFY20. This implies that eventual losses related to the events were just ~Rs 2bn (~3% of its Assamese portfolio), much lower than what several microfinanciers have experienced in past credit events.
- However, the challenges faced by BANDHAN in Assam, yet again, bring to the fore, the risks associated with microcredit. Being east-heavy has shielded the bank's microcredit portfolio so far, but it also makes the bank very susceptible to concentration/ event risks.

Moratorium trends:

- At its peak, ~71% of BANDHAN's portfolio (and ~100% of microloans) was under moratorium (similar trends were witnessed at other microlenders too).
- As of 1QFY21, ~27% of the bank's portfolio and ~32% of microloans were under moratorium. On this front, BANDHAN has fared better than several of its competitors, particularly the other SFBs.

Exhibit 73: Microcredit moratorium trends- BANDHAN vs. other microlenders



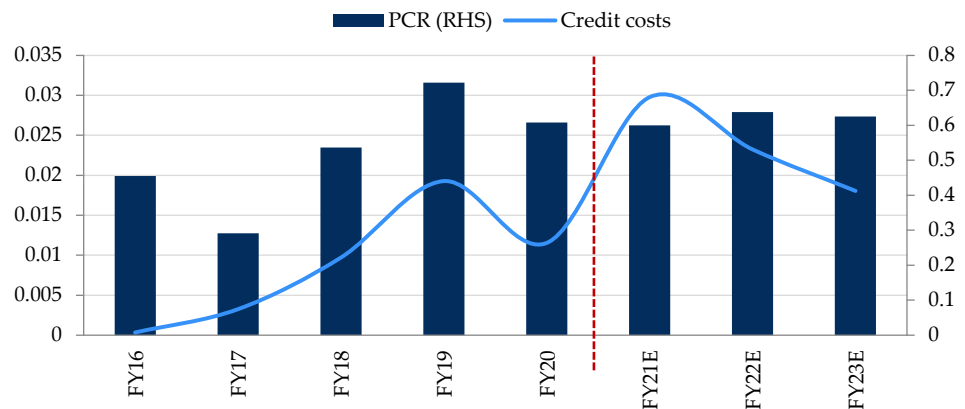
Source: Bank, HSIE Research

- Media articles suggest that collection efficiency has improved further since, reaching 80% in August. The management expects this figure to reach 90% by October and normalise by December.
- Despite (1) BANDHAN's strong asset quality track record, and (2) a significant reduction in its proportion of loans under moratorium seen, and better performance relative to peers, we expect the GNPA's to rise to an all-time high of 4.9% in FY21E, and fall gradually to 3.1% in FY23E.
- Microborrowers' meagre incomes and low savings would have made them more vulnerable to financial stress. Further, we believe that pre-COVID-19 stress levels did not fully reflect the inherently risky nature of microlending at the time (without factoring in the impact of COVID-19).

Provisioning:

- Over FY16-20, BANDHAN's non-tax provisions have averaged ~1% of average assets (credit costs of 88bps), spiking in FY19 (IL&FS related provisions- Rs 3.8bn, ~1% of loan at the time) and FY20 (Assam- Rs 2bn, 0.26% of loans and COVID-19 related provisions- Rs 6.9bn).

Exhibit 74: Credit cost and PCR trends and outlook



Source: Bank and HSIE Research

- In 1QFY21, BANDHAN made Rs 7.5bn of COVID-19 related provisions, taking the total stock of such provisions to Rs 14.4bn (1.9% of overall loans, and ~3% of microcredit). Further, the bank maintains 1% provisions on standard assets.
- BANDHAN's ratio of COVID-19 related provisions to total loans (~1.9%) is lower than that of other microfinanciers', on account of their differences in the portfolio mix.
- We conservatively build non-tax provisions of 2.2/1.8/1.5% of average assets over FY21/22/23E.

How do we value BANDHAN?

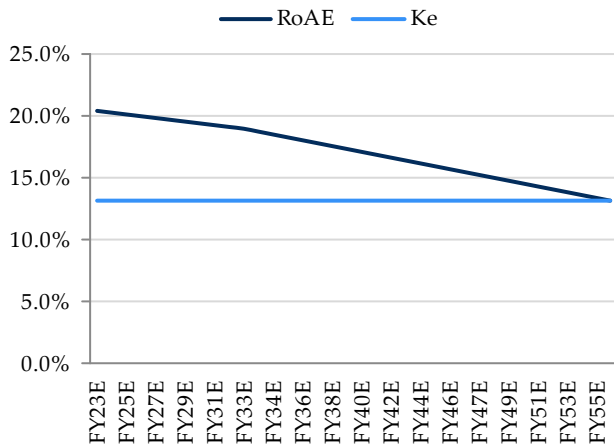
- Based on our RI model, we assign a target multiple of 2.65x Sept-22E ABV.

Exhibit 75: RoAE vs. Ke estimates

Rf	6.00%
Rm	5.00%
Beta	1.45
Ke	13.26%

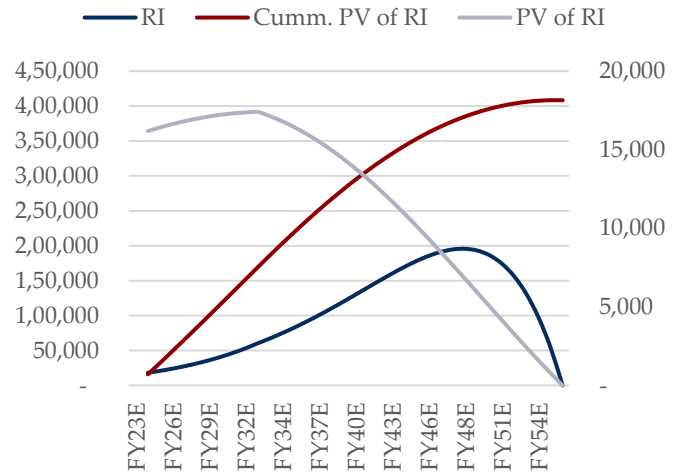
Source: HSIE Research

Exhibit 76: RoAE vs. Ke estimates



Source: HSIE Research

Exhibit 77: RI accumulation



Source: HSIE Research

Our assigned multiple reflects the following aspects of BANDHAN's business:

- As a bank, BANDHAN's RoAEs have averaged 21.5% between FY16-20 and its CRAR averaged ~29%. Over this period, its portfolio microcredit loans constituted 87.3% of the bank's portfolio. Given the bank's relatively low leverage over the period, we believe its core microcredit business has the potential to deliver higher RoAEs. That said, unlike most microfinanciers, BANDHAN has not witnessed a major credit event. Before its merger with BANDHAN, e-GRHF's RoAE averaged ~31% over FY11-19. We thus believe that BANDHAN can sustainably deliver an RoAE of ~18%.
- Microcredit has several inherent risks, given the vulnerable segments to which it lends. Further, BANDHAN's microcredit portfolio is highly concentrated in East and North East India, where it is the dominant player, and its average outstanding per borrower is one of the highest in the industry. This creates an additional concentration risk. As a result, we assign a higher risk premium while valuing BANDHAN.

Risks

- **Worse-than-expected outcomes related to COVID-19:** We expect BANDHAN to register a sharp YoY rise in GNPA's and a sharp slowdown in growth, followed by a sustained recovery on these parameters in FY22/23E. Given that significant uncertainty regarding the economic and asset quality outcomes still prevails, worse-than-expected outcomes would pose a downside risk to our estimates. We have attempted to capture the impact of such outcomes on our estimates and valuations in our scenario analyses.
- **Faster-than-expected growth in non-core segments:** In our estimates, we expect BANDHAN's core segments of microcredit, and now affordable housing, to contribute to most of the incremental growth in the near term, given the significant scope for growth. Both these segments are high RoAE segments. While the decision to grow other retail products faster may reduce concentration risk, it would entail a significant scale-up in operating expenditure which would hurt return ratios.
- **Regulatory risk:** At present, banks are not covered by the RBI's directive on microfinance. This had created a regulatory arbitrage, as highlighted earlier. The extension of the framework to include banks could limit BANDHAN's ability to grow its microcredit portfolio.

Downside scenario analyses

- Our base case estimates for BANDHAN factor in (1) a significant reduction in loan growth in FY21E, followed by a significant recovery (albeit lower than previous trends), and (2) a record rise in GNPA's followed by a gradual reduction therein. However, given the continuing uncertainty around the spread of the virus and the resultant economic fallout, we believe that the risks to our estimates lie mostly to the downside. We have attempted to evaluate the impact of (1) more-than-expected stress, and (2) slower-than-expected in growth on our estimates.
- Under our worst-case scenario, GNPA's in FY21/22E could be 42.4/37.5% higher than our base case estimates.
- We build loan growth of 9.3% in FY21E under our worst-case scenario, but we still see a significant recovery to 15.8% in FY22E and 19.4% in FY23E.
- FY21/22/23E earnings could be 28.0/40.4/41.6% lower than our base case estimates under our worst-case scenario.
- RoAEs for FY21/22/23E fall to 12.6/11.7/13.7% under our worst-case scenario and our assigned multiple would fall to 2.2x. Given BANDHAN's strong PPOP profile, it reports fairly decent RoAEs even under our worst-case scenario.

Exhibit 78: Scenario analyses results

Particulars	Base Case			Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	37,797	34,912	35,973	47,411	40,994	37,789	50,650	44,565	41,975	53,822	47,991	45,924
GNPA (%)	4.87	3.69	3.06	6.39	4.69	3.56	6.89	5.19	4.06	7.39	5.69	4.56
AUM growth (YoY, %)	16.48	21.80	24.39	11.35	17.81	21.44	10.33	16.81	20.40	9.31	15.81	19.41
NII (Rs mn)	71,233	84,057	105,535	68,617	76,145	91,627	68,093	74,326	88,244	67,570	72,642	85,065
PPOP (Rs mn)	60,740	69,950	86,304	57,957	61,664	71,795	57,400	59,764	68,267	56,843	58,000	64,947
Provisions (Rs mn)	22,724	21,837	21,595	26,709	25,782	23,295	28,099	27,570	25,268	29,457	29,300	27,144
Provisions (%)	2.98	2.32	1.80	3.66	3.01	2.20	3.89	3.29	2.47	4.11	3.56	2.74
PAT	28,322	35,844	48,208	23,280	26,732	36,132	21,830	23,985	32,034	20,403	21,382	28,164
ABV Rs	103	125	152	96	116	137	94	112	131	92	109	126
RoAA (%)	2.79	2.95	3.34	2.30	2.22	2.54	2.16	2.00	2.26	2.02	1.78	2.00
RoAE (%)	17.05	18.17	20.43	14.23	14.22	16.66	13.40	12.95	15.18	12.58	11.72	13.72
Assigned multiple		2.7			2.5			2.4			2.2	
TP		367			291			267			245	

Source: HSIE Research

Exhibit 79: Scenario analyses results

Change in (vs. base case)	Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	25.44%	17.42%	5.05%	34.01%	27.65%	16.68%	42.40%	37.46%	27.66%
GNPA (%)	+150bps	+100bps	+50bps	+200bps	+150bps	+100bps	+250bps	+200bps	+150bps
AUM growth (YoY, %)	-500bps	-400bps	-300bps	-600bps	-500bps	-400bps	-700bps	-600bps	-500bps
NII (Rs mn)	-3.67%	-9.41%	-13.18%	-4.41%	-11.58%	-16.38%	-5.14%	-13.58%	-19.40%
PPOP (Rs mn)	-4.58%	-11.85%	-16.81%	-5.50%	-14.56%	-20.90%	-6.42%	-17.08%	-24.75%
Provisions (Rs mn)	17.54%	18.07%	7.87%	23.65%	26.25%	17.01%	29.63%	34.17%	25.69%
Provisions (%)	+69bps	+69bps	+39bps	+91bps	+96bps	+66bps	+114bps	+124bps	+94bps
PAT	-17.80%	-25.42%	-25.05%	-22.92%	-33.09%	-33.55%	-27.96%	-40.35%	-41.58%
ABV Rs	-6.25%	-7.45%	-9.64%	-8.21%	-10.24%	-13.54%	-10.13%	-12.90%	-17.25%
RoAA (%)	-49bps	-73bps	-80bps	-63bps	-96bps	-108bps	-77bps	-117bps	-135bps
RoAE (%)	-282bps	-394bps	-377bps	-365bps	-522bps	-524bps	-447bps	-645bps	-671bps
Assigned multiple		2.5			2.4			2.2	
TP		-20.8%			-27.2%			-33.2%	
Upside		6.2%			-2.6%			-10.6%	

Source: HSIE Research

Financials

Income statement

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Interest earned	15,813	39,087	48,023	66,441	108,855	125,160	147,632	179,781
Interest expended	6,485	15,052	17,701	21,480	45,616	53,927	63,575	74,246
Net interest income	9,327	24,035	30,322	44,961	63,239	71,233	84,057	105,535
Non-interest income	1,500	4,114	7,062	10,630	15,492	16,969	19,888	22,891
<i>Fee income</i>	1,454	3,204	4,045	5,990	7,995	8,537	10,871	13,522
<i>Treasury income</i>	21	217	463	378	1,134	1,750	2,000	2,000
Total income	10,827	28,149	37,384	55,591	78,731	88,202	103,945	128,426
Total operating expenditure	6,159	10,220	13,083	18,110	24,265	27,461	33,995	42,123
Employee costs	3,251	5,456	6,880	10,087	13,670	15,353	19,094	24,019
PPOP	4,668	17,929	24,301	37,482	54,466	60,740	69,950	86,304
Non-tax provisions	533	884	3,742	7,351	13,932	22,724	21,837	21,595
Prov. for NPAs (incl. std prov.)	533	802	3,331	7,598	13,922	22,574	21,687	21,445
PBT	4,135	17,045	20,559	30,131	40,534	38,016	48,113	64,709
Tax expenses	1,383	5,925	7,103	10,616	10,297	9,694	12,269	16,501
PAT	2,753	11,120	13,456	19,515	30,237	28,322	35,844	48,208

Statement of assets and liabilities

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Sources of funds								
Share capital	10,951	10,951	11,928	11,931	16,102	16,102	16,102	16,102
Reserves	22,394	33,513	81,891	100,087	135,852	164,174	198,226	241,613
Shareholder's funds	33,345	44,465	93,819	112,017	151,955	180,277	214,329	257,716
Savings deposits	23,711	53,847	92,094	140,080	177,270	221,587	274,768	335,217
Current deposits	2,346	14,526	24,145	36,097	33,015	34,665	38,132	41,945
Term deposits	94,831	163,913	222,451	256,139	360,530	468,690	585,862	732,327
Total deposits	120,887	232,287	338,690	432,316	570,815	724,942	898,762	1,109,490
Borrowings	30,516	10,289	2,850	5,214	163,792	171,981	163,382	156,847
Other liabilities & provisions	14,408	15,320	7,741	14,870	30,617	35,209	39,434	44,166
Total liabilities	199,157	302,361	443,101	564,417	917,178	1,112,410	1,315,907	1,568,219
Application of funds								
Cash and cash equivalents	31,734	73,650	55,106	58,027	83,529	129,785	125,195	102,925
Investments	37,580	55,165	83,719	100,375	153,518	188,883	224,057	264,318
G-Secs	37,578	55,182	77,734	92,094	146,509	181,236	215,703	255,183
Advances	124,375	168,391	297,130	396,434	666,299	776,082	945,276	1,175,853
Fixed assets	2,372	2,518	2,381	3,312	3,688	3,964	4,262	4,581
Other assets	3,095	2,637	4,764	6,270	10,144	13,694	17,118	20,542
Total assets	199,157	302,361	443,101	564,417	917,178	1,112,410	1,315,907	1,568,219

Source: Bank, HSIE Research

Key ratios

(Rs mn)	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E	FY23E
Valuation ratios								
EPS	2.5	10.2	11.3	16.4	18.8	17.6	22.3	29.9
Earnings Growth (%)	N/A	304.0	21.0	45.0	54.9	(6.3)	26.6	34.5
BVPS (ex reval.)	30.4	40.6	78.7	93.9	94.4	112.0	133.1	160.0
ABVPS (ex reval. & 100% cover)	30.4	40.0	77.2	92.0	91.9	102.6	125.2	151.7
RoAA (%)	2.69	4.43	3.61	3.87	4.08	2.79	2.95	3.34
RoAE (%)	14.4	28.6	19.5	19.0	22.9	17.0	18.2	20.4
P/E (x)	108.8	26.9	24.2	16.7	14.6	15.5	12.3	9.1
P/ABV (x)	9.01	6.83	3.54	2.97	2.97	2.67	2.18	1.80
P/PPOP (x)	64.2	16.7	13.4	8.7	8.1	7.3	6.3	5.1
Dividend yield (%)	-	-	0.4	1.1	-	-	0.4	1.1
Profitability ratios (%)								
Yield on advances	20.6%	21.3%	16.4%	16.5%	15.3%	15.0%	14.8%	14.7%
Yield on investment	7.0%	9.2%	7.1%	6.7%	6.5%	6.5%	6.5%	6.5%
Cost of deposits	3.7%	7.3%	5.9%	5.4%	6.5%	6.3%	6.2%	6.1%
Core spread	17.0%	14.0%	10.5%	11.1%	8.9%	8.8%	8.6%	8.6%
NIM	9.8%	11.4%	9.4%	9.7%	8.2%	7.8%	7.7%	7.9%
Operating efficiency								
Cost/avg. asset ratio	6.0	4.1	3.5	3.6	3.3	2.7	2.8	2.9
Cost-income ratio (excl. treasury)	57.0	36.6	35.4	32.8	31.3	31.8	33.3	33.3
Balance sheet structure ratios (%)								
Loan growth	NA	35.4	76.5	33.4	68.1	16.5	21.8	24.4
Deposit growth	NA	92.2	45.8	27.6	32.0	27.0	24.0	23.4
C/D ratio	102.9	72.5	87.7	91.7	116.7	107.1	105.2	106.0
Equity/ (%)	16.7	14.7	21.2	19.8	16.6	16.2	16.3	16.4
Equity/loans	26.8	26.4	31.6	28.3	22.8	23.2	22.7	21.9
CASA	21.6	29.4	34.3	40.8	36.8	35.3	34.8	34.0
Total Capital Adequacy Ratio (CAR)	29.0	26.4	31.5	29.2	27.4	24.7	24.2	23.5
Tier I CAR	26.7	24.8	30.3	27.9	25.2	22.7	22.5	22.0
Asset quality								
Gross NPLs (Rs mn)	188	863	3,731	8,196	9,928	37,797	34,912	35,973
Net NPLs (Rs mn)	102	612	1,729	2,283	3,894	15,114	12,649	13,495
Gross NPLs (%)	0.15	0.51	1.25	2.04	1.48	4.87	3.69	3.06
Net NPLs (%)	0.08	0.36	0.58	0.58	0.58	1.95	1.34	1.15
Slippages (%)	1.0	1.9	2.6	2.0	2.2	5.0	3.2	2.8
Coverage ratio (%)	45.5	29.1	53.7	72.1	60.8	60.0	63.8	62.5
LLP (%)	0.03	0.33	0.97	1.93	1.15	2.98	2.32	1.80
RoAA Tree (%)								
Net interest income	9.13%	9.58%	8.14%	8.93%	8.54%	7.02%	6.92%	7.32%
Non-interest income	1.47%	1.64%	1.89%	2.11%	2.09%	1.67%	1.64%	1.59%
Treasury income	1.42%	1.28%	1.09%	1.19%	1.08%	0.84%	0.90%	0.94%
Operating cost	6.03%	4.08%	3.51%	3.59%	3.28%	2.71%	2.80%	2.92%
Non-tax provisions	0.52%	0.35%	1.00%	1.46%	1.88%	2.24%	1.80%	1.50%
Provisions for NPAs	0.52%	0.32%	0.89%	1.51%	1.88%	2.22%	1.79%	1.49%
Tax expenses	1.35%	2.36%	1.91%	2.11%	1.39%	0.96%	1.01%	1.14%
RoAA	2.69%	4.43%	3.61%	3.87%	4.08%	2.79%	2.95%	3.34%
Leverage (x)	5.97	6.80	4.72	5.04	6.04	6.17	6.14	6.09
RoAE	16.1%	30.2%	17.0%	19.5%	24.6%	17.2%	18.1%	20.3%

Source: Bank and HSIE Research

CreditAccess Grameen

Best amongst peers

CreditAccess Grameen (CREDAG) is the flagship company of Credit Access Asia. In 2020, CREDAG acquired 76.2% stake in Madura Microfinance Limited (MMFL), making it the largest NBFC-MFI with a portfolio of ~Rs 120bn (5.3% m-share). Whilst registering strong portfolio growth (~48% CAGR over FY16-20), the company has geographically diversified and maintained a tight leash on asset quality. This has allowed CREDAG to deliver an RoAE of ~17%. Like most lending institutions, it is likely to see a rise in stress and slowdown in portfolio growth owing to COVID-19 related disruptions. While we expect the company to see a record rise in NPAs, we believe its long-term prospects remain intact on account of (1) its track record, (2) focus on portfolio diversification (further aided by the acquisition of MMFL), (3) strong balance sheet, ability to access funds, and (4) significant scope for profitable growth. We initiate coverage with an ADD rating (price target of Rs 797 (2.9x Sept-22E ABV)).

- Asset quality:** CREDAG emerged relatively unscathed from industry events such as the AP crisis and demonetisation. Over FY16-20, GNPA's averaged <1%. ~18% of CREDAG's portfolio and ~13% of MMFL's portfolio were under moratorium as of August. While we believe that asset quality risks remain elevated in the near term and we expect GNPA's to peak at 4.7% in FY21E, given CREDAG's creditable track record and focus on geographical diversification, we do not foresee major long-term asset quality concerns.
- Funding and capital position:** Having a CRAR of 23.7%, almost entirely composed of Tier I and a diversified borrowing base, CREDAG is well-placed on both these fronts. The company's ability to raise sufficient funds from a variety of sources to fund strong portfolio growth bears testament to this. Further, its strong parentage has/ will allow the company to raise funds from overseas with relative ease. Given that short-tenure microcredit loans constitute a majority of CREDAG's portfolio, the company has significant surpluses in near term buckets. While the company is looking to raise equity capital, we have not incorporated this into our estimates.
- High RoAE potential:** While microfinanciers' spreads are capped, they are significantly higher than most lenders'. Even if one adjusts for high operating expenditure and loan losses, across cycles, select microfinanciers such as CREDAG can deliver superior return ratios. Over FY16-20, CREDAG's RoAE was ~17%. We expect return ratios to fall significantly in FY21E, and recovery sharply. CREDAG has the potential to deliver superior RoAEs. We expect CREDAG to deliver an RoAE of 14.4% over FY21-23E.

Financial Summary

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	1,982	3,852	5,060	8,016	10,534	15,509	18,156	22,441
PPOP	1,436	2,329	3,148	5,726	6,989	10,969	12,273	15,315
PAT	832	803	2,125	3,218	3,355	2,706	5,017	8,141
EPS (Rs)	11.4	9.4	16.5	22.4	23.2	18.4	34.2	55.5
EPS growth (%)	70.8	-17.9	76.5	35.5	3.3	-20.4	85.4	62.3
RoAE (%)	19.9	15.0	20.7	16.9	13.1	9.1	14.5	19.8
RoAA (%)	3.67	2.61	5.03	5.16	3.34	2.01	3.12	4.08
ABVPS (Rs)	63.0	71.5	111.9	164.8	187.7	214.7	248.9	304.4
P/ABV (x)	11.42	10.06	6.43	4.37	3.84	3.35	2.89	2.37
P/E (x)	63.1	76.8	43.5	32.1	31.1	39.0	21.1	13.0

Source: Company, HSIE Research

ADD

CMP (as on 29 Sept 2020)	Rs 720
Target Price	Rs 797
NIFTY	11,222

KEY STOCK DATA

Bloomberg code	CREDAG IN
No. of Shares (mn)	144
MCap (Rs bn) / (\$ mn)	104/1,405
6m avg traded value (Rs mn)	77
52 Week high / low	Rs 1,001/305

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	39.1	92.6	12.5
Relative (%)	30.5	65.2	14.6

SHAREHOLDING PATTERN (%)

	Mar-20	Jun-20
Promoters	79.9	79.9
FIs & Local MFs	9.9	9.6
FPIs	5.6	6.2
Public & Others	4.6	4.3

Pledged Shares

Source : BSE

Darpan Shah

darpan.shah@hdfcsec.com
+91-22-6171-7328

Aakash Dattani

aakash.dattani@hdfcsec.com
+91-22-6171-7337

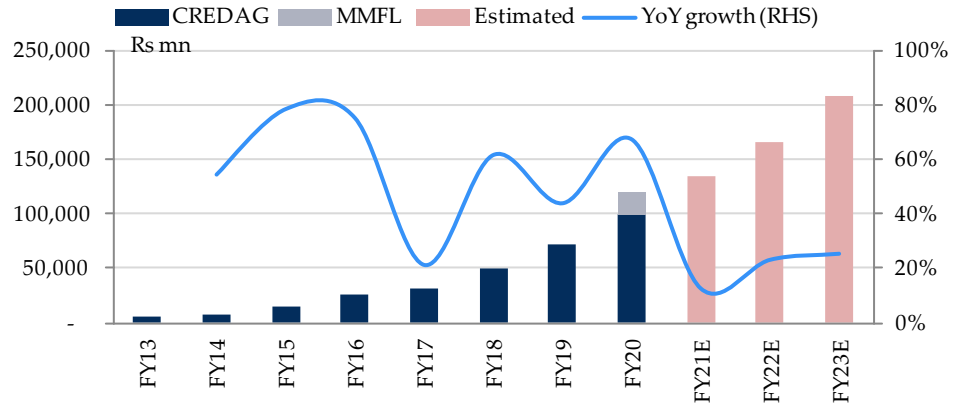
Punit Bahlani

punit.bahlani@hdfcsec.com
+91-22-6171-7354

Portfolio growth trends

- CREDAG is the largest NBFC-MFI in India and has registered strong portfolio growth in the last few years (~54% over FY16-20, incl. MMFL, ~48% excl. MMFL), and this has been faster than the industry.

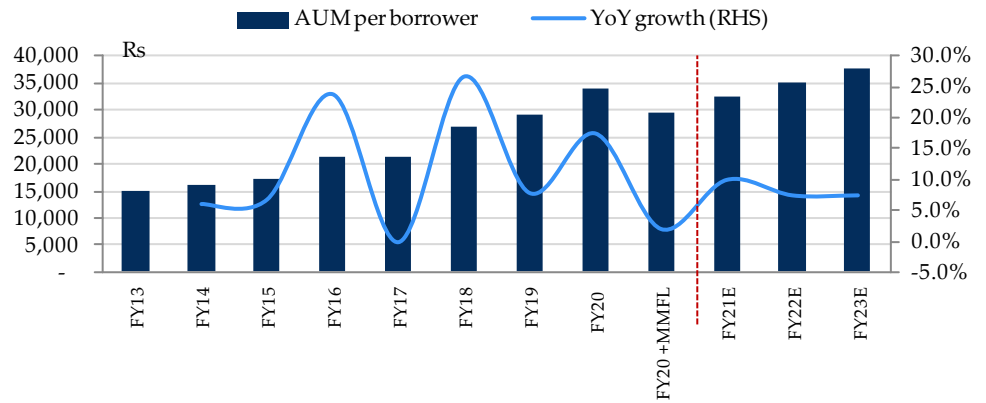
Exhibit 80: Portfolio trends and outlook



Source: Company and HSIE Research

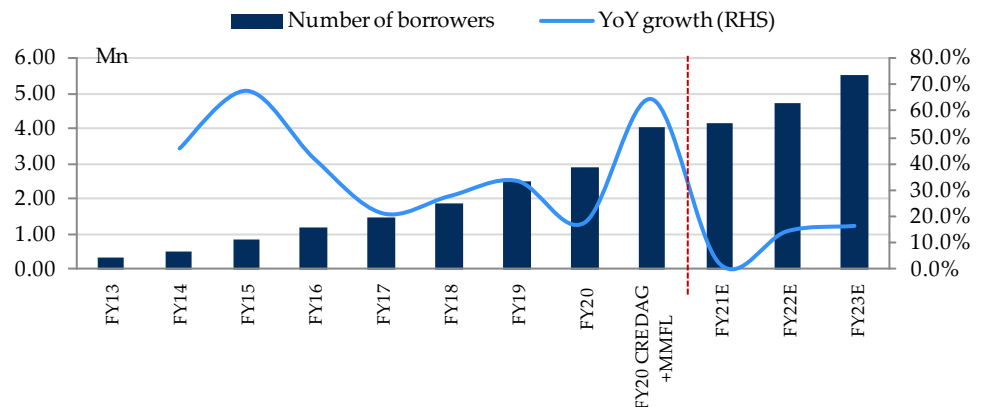
- Growth in the number of borrowers and average outstanding per borrower:** Growth in the number of borrowers accounted for a majority of the portfolio growth at CREDAAG. Between FY16-20, CREDAAG's borrower base grew at a CAGR of 28.3%, reaching 2.91mn (excl. MMFL), while its average outstanding per borrower grew at a CAGR of 15.2%, reaching ~Rs 34k (excl. MMFL) over the same period.

Exhibit 81: Average outstanding per borrower- trends and outlook



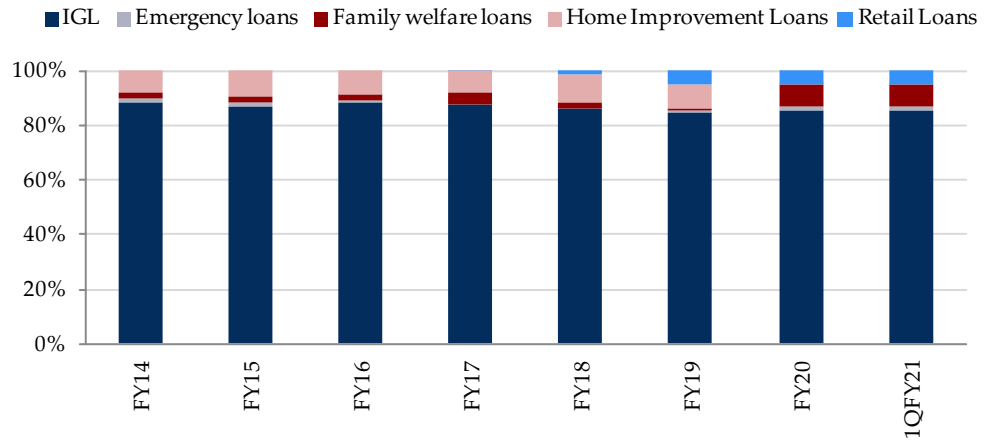
Source: Company and HSIE Research

Exhibit 82: Number of borrowers- trends and outlook



Source: Company and HSIE Research

- Income-generating loans (IGL) dominate, and retail finance growth is prudent:** IGL 'group' microfinance loans are the mainstay of CREDAG's product portfolio, accounting for 85.5% of loans as of 1QFY21 (~39% CAGR over FY16-20). In FY17, CREDAG began to offer individual retail loans (5.1% of total loans) of a higher ticket size to its borrowers. Existing microborrowers, who have been within the group set-up for at least 3 years and have a satisfactory repayment record, are eligible for these loans. Further, the current borrower base of these loans (~74k) is a fraction of the group borrowers that have a vintage over three years (~0.93mn)- an indicator that these loans are not being offered recklessly- a positive.

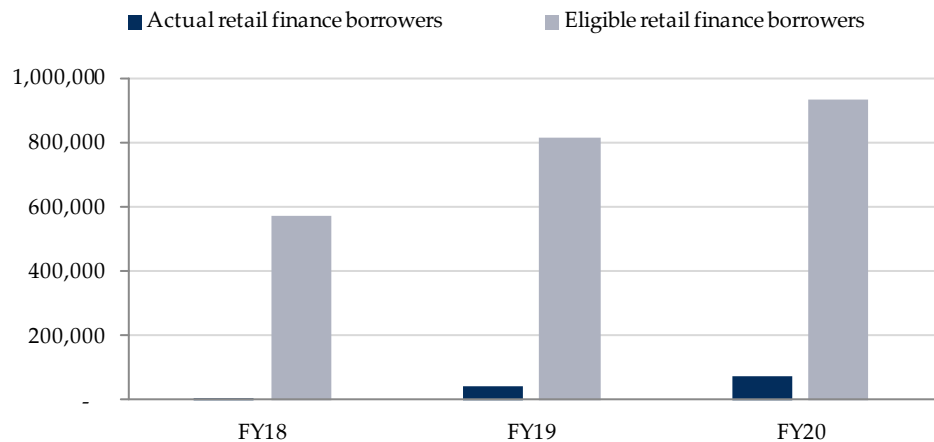
Exhibit 83: Loan book mix over the years


Source: Company and HSIE Research

Exhibit 84: Average outstanding per borrower (product-wise)

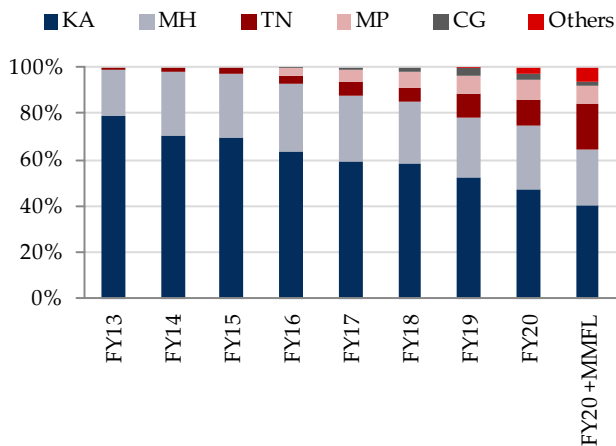
Particulars (Rs)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21
IGL	18,700	17,900	17,300	20,800	20,900	20,500	21,400	22,200	21,900
Home improvement	8,200	7,400	5,000	2,900	7,600	7,200	4,800	3,000	2,700
Family welfare	10,500	10,000	9,600	9,100	8,200	7,500	8,000	8,800	8,800
Emergency	600	600	600	700	600	600	600	600	600
Retail loans	77,100	76,500	73,500	77,200	73,400	70,600	67,600	66,500	65,800

Source: Company and HSIE Research

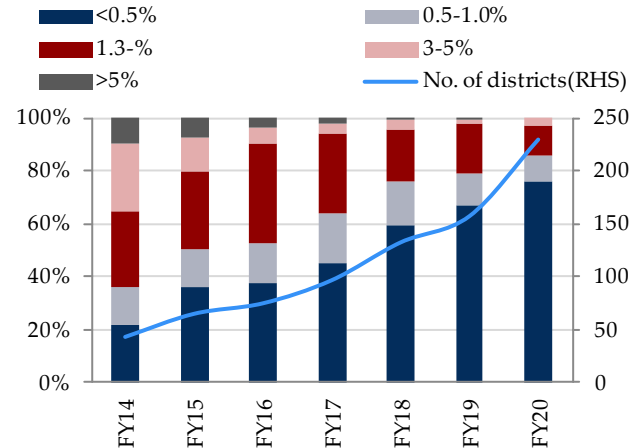
Exhibit 85: Eligible retail finance borrowers vs. actual retail finance borrowers


Source: Company and HSIE Research

- Growth led by geographical expansion:** High regional portfolio concentration has proved to be detrimental for microlenders in the past. Cognisant of this issue, CREDAG has followed a strategy of contiguous geographical expansion. After having achieved a sufficient degree of penetration within a district (typically takes 3 years), CREDAG expands into adjacent districts. The inherent benefits of this strategy include (1) familiarity with the demographic profile of the new district, and (2) lower costs. In 2QFY20, CREDAG forayed into Gujarat, Rajasthan, UP and Bihar. It expanded from 238 branches across 64 districts and 3 states in FY15 to 929 branches across 230 districts in 13 states. The share of KA (in portfolio terms) has reduced from ~68% in FY15 to ~53% in FY19 and 47.5% in FY20 (ex-MMFL). The contribution of the Top 10 districts to AUMs is 29% vs. 63% in FY15.

Exhibit 86: District-wise concentration metrics


Source: Company and HSIE Research

Exhibit 87: District-wise concentration metrics


Source: Company and HSIE Research

Growth drivers:

- Acquisition of MMFL:** Madura Microfinance Limited is an NBFC-MFI based out of TN. The company earlier operated as the Micro Credit Foundation of India and was founded by the promoters of the erstwhile Bank of Madura. In 2019, CREDAG announced plans to acquire MMFL for a total consideration of Rs 8.75bn. As of FY20, CREDAG held 76.2% in the company and is likely to acquire the remainder by way of a share swap. We have incorporated this in our FY21E estimates.

Exhibit 88: Financial snapshot of MMFL

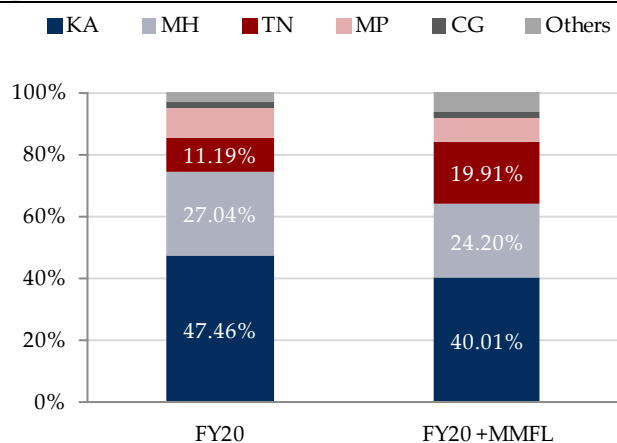
Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20
AUM (Rs mn)	2,300	3,686	5,531	8,230	11,840	19,570	21,000
Number of borrowers (mn)	0.21	0.33	0.41	0.52	0.69	0.96	1.22
Outstanding per borrower (Rs)	11,165	11,183	13,565	15,977	17,196	20,455	17,284
RoAA (%)	4.17	4.32	3.55	3.76	3.62	5.03	4.20
RoAE (%)	15.18	18.33	18.92	21.10	18.95	28.71	22.07
GNPA (%)	NA	NA	NA	0.49	0.51	0.92	1.63

Source: Company and HSIE Research

- The acquisition will result in an improvement in CREDAG's concentration metrics. For example, the contribution of KA to CREDAG's portfolio (ex-MMFL) was 47.5%; however, it reduces to 40% for the merged entity. The contribution of the Top 10 districts to total AUM falls from 29% to 24%. The average outstanding per borrower for the combined entity is lower (Rs ~29.6k).

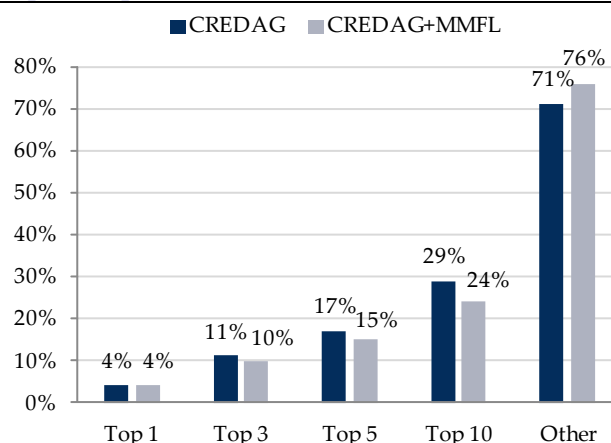
CreditAccess Grameen: Initiating Coverage

Exhibit 89: Geographical portfolio split pre- & post-acquisition



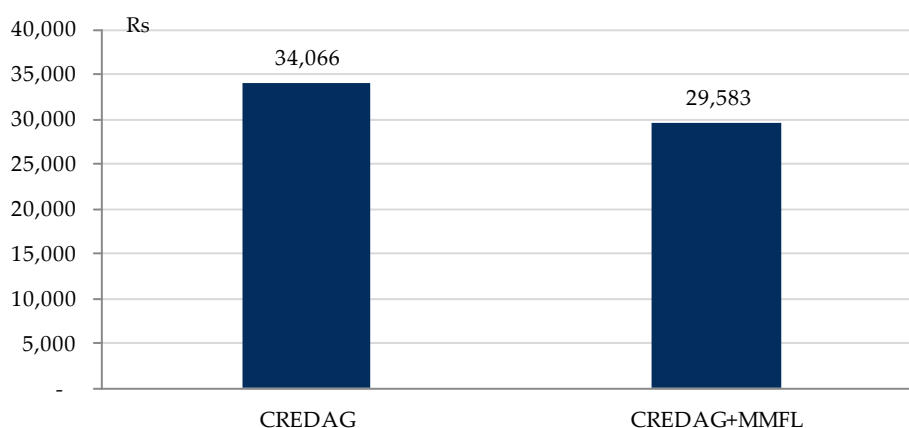
Source: Company and HSIE Research

Exhibit 90: Contribution of Top 1/3/5/10 districts pre- & post-acquisition



Source: Company and HSIE Research

Exhibit 91: Average outstanding per borrower comparison



Source: Company, HSIE Research

- The acquisition of MMFL will allow CREDAG to grow in the following ways (1) larger physical infrastructure will result in higher outreach potential, (2) CREDAG can offer its wider range of products including retail loans to MMFL's borrowers, resulting in an increase in the average outstanding per borrower for MMFL's borrower base.
- **Growth in average outstanding per borrower:** Given high (and rising) borrower retention rates, natural graduation of existing borrowers across cycles will contribute to AUM growth, driving an increase in the average outstanding per borrower. In fact, the acquisition of MMFL's customers, who have lower average outstanding balances, increases scope for a prudent increase in the overall AUM per borrower, as explained earlier.
- Retail loans constitute 5.1% of CREDAG's AUM (excl. MMFL) and the number of retail borrowers are a fraction of the eligible microcredit borrower base. With high retention rates and graduation of borrowers across cycles, the eventual pool of borrowers (0.93mn at present) eligible for these loans is likely to trend upwards, driving growth. This will also drive an increase in the average outstanding per borrower. However, the secured nature of some of these products would imply that their share cannot exceed 15% of advances (RBI mandate).
- We expect the average outstanding per borrower for the combined entity to grow by 7.5% over FY21-23E reaching ~Rs 37.6k.

- Geographical and branch expansion to drive growth in borrower base:** Together, CREDAG and MMFL have 1,388 branches covering 248 districts, in 14 states. In FY20, CREDAG expanded into several new states such as GJ, RJ, UP and BH. We expect CREDAG to register a ~11% growth in the number of borrowers to ~55mn over FY21-23E.
- Consequently, we expect CREDAG to register an AUM CAGR of ~20% over FY21-23E.

Exhibit 92: CREDAG's product offering

Loan Type	Product	Max. ticket size (Rs)	Avg. o/s (Rs)	Max.tenure (m)	Yield	% of AUM
Group	IGL	80,000	21,900	30	19.6%	85.5%
	Home improvement	50,000	8,800	48	19.6%	7.80%
	Family welfare	15,000	2,700	12	19.6%	1.50%
	Emergency	1,000	600	3	19.6%	0.10%
Individual	Vikas	5,00,000		60	21.0%	
	Udyog	1,50,000	66,300	24	22.0%	5.10%
	Savaari	70,000		24	22.0%	
	Suvidha	1,50,000		6	20.0%	

Source: Company and HSIE Research

Exhibit 93: MMFL's product offering

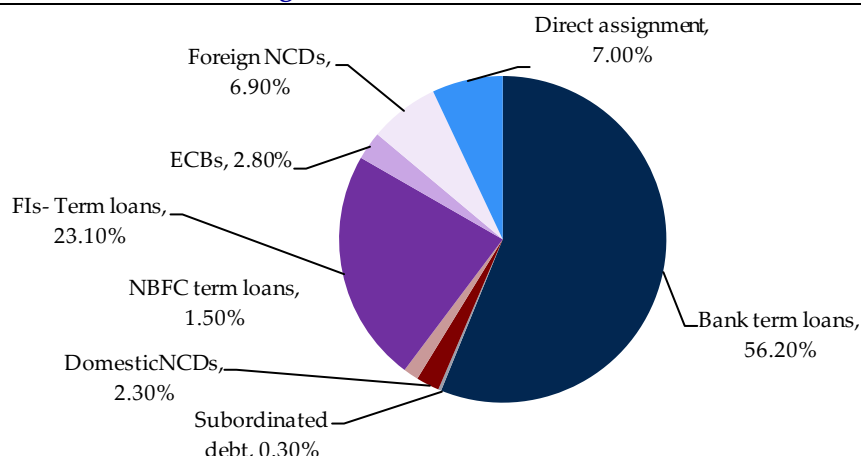
Loan Type	Product	Max. ticket (Rs)	Max. tenure (m)	Yield
Group	Entry Level	33,000	30	
Group	Activity Term Loan	65,000	30	21.30%
Individual	Certified Activity Loan	15,000	20	
Individual	Business Development Loan	15,000	24	

Source: Company and HSIE Research

Funds aplenty so far, aided by strong parentage; Comfortable ALM profile

- CREDAG has been comfortably placed on the borrowings' front. Its borrowings have grown at 51.7% CAGR over FY16-20. The company's borrowing mix is well-diversified. Bank's constitute the largest source of borrowings at 56.2%, followed by borrowings from financial institutions at 23.1%.

Exhibit 94: CREDAG's borrowing mix



Source: Company and HSIE Research

Exhibit 95: CRAR trends

Particulars	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21
CRAR	28.9%	27.8%	40.4%	41.2%	35.7%	34.6%	34.2%	32.4%	23.6%	23.7%

Source: Company, HSIE Research

- CREDAG is looking to raise equity capital (up to Rs 1bn as per the enabling resolution). This will help the company comply with promoter holding requirements. However, we have not factored this into our estimates.
- CREDAG's **strong parentage** should strengthen the company's ability to raise both debt and equity capital locally and especially globally. At present, **Credit Access Asia (CAA)** holds 79.9% in CreditAccess Grameen Limited and operates in 3 countries (India, Vietnam, and the Philippines). CAA has a diverse shareholder base, with several marquee investors such as Olympus Capital and the Asian Development Bank. CREDAAG is the flagship company of CAA, with CREDAAG accounting for ~2.9mn of CAA's total customer base of ~3mn across nations. Interestingly, back in 2007, CAA had invested in EQUITAS.

Exhibit 96: Snapshot of CAA's Asia Operations (FY19)

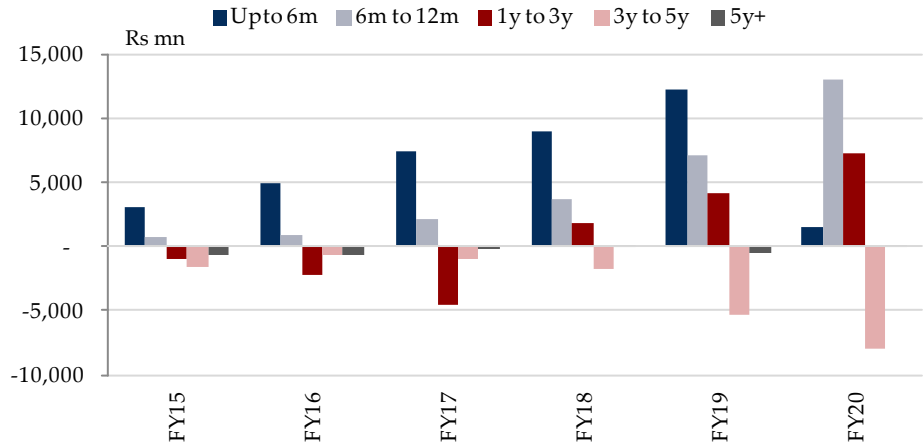
Particulars	CREDAG	CA Indonesia	CA Philippines	CAA
Portfolio (Rs bn)	79.19	4.44	2.50	86.13
YoY growth	49%	60%	61%	49.9%
Customers	2.47	0.349	0.201	3.02
Average outstanding per customer (Rs)	32,078	12,728	12,470	28,552
RoAE	16.5%	12.1%	10.2%	12.7%
CRAR	32.1%	19.2%	21.6%	N/A
GNPA	0.9%	3.0%	3.3%	1.1%
NNPA	0.0%	0.0%	0.0%	0.0%
Credit costs	4.1%	1.4%	3.7%	N/A

Source: Company and HSIE Research

CreditAccess Grameen: Initiating Coverage

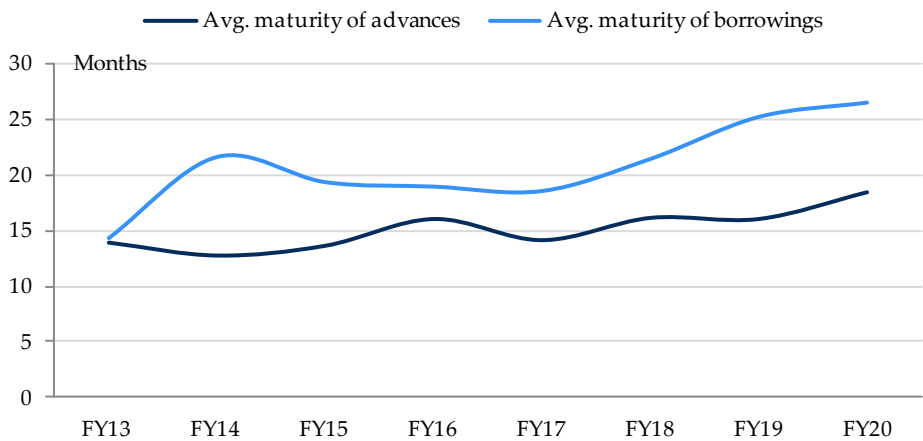
- Given the short maturity of microcredit loans which constitute a majority of the company's portfolio, CREDAG reported large surpluses (the difference between advances and borrowings maturing) in near term buckets (up to 6 months and between 6 and 12 months). In FY20, however, CREDAG saw a sharp fall in the surplus within the bucket up to 6 months. This can be on account of the moratorium. Nevertheless, the company's overall ALM profile remained healthy.
- The impact of an increase in the proportion of retail finance loans which are slightly longer in tenure (relative to group microcredit loans) can also be seen. The company saw a deficit in the 1-3-year bucket until FY17. It has since seen rising surpluses within this bucket.

Exhibit 97: Liquidity profile (difference between advances and borrowings)



Source: Company, HSIE Research

Exhibit 98: Average maturity of advances and borrowings

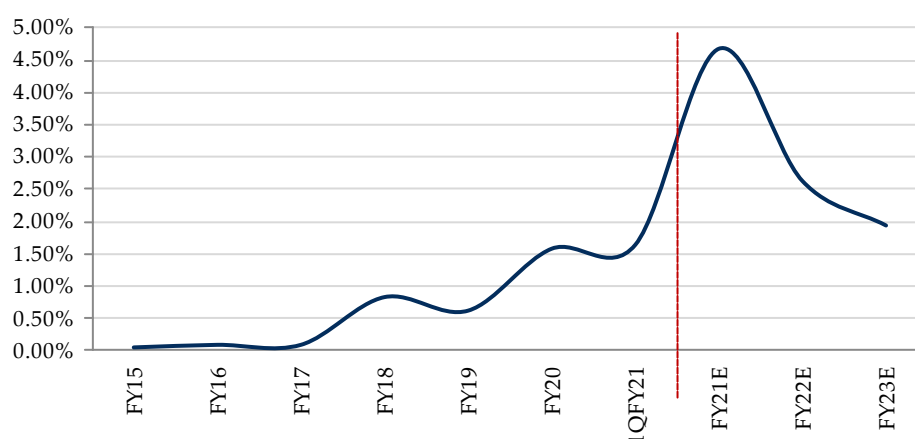


Source: Company, HSIE Research

COVID-19 to impact asset quality, but collection trends heartening

- In recent times, CREDAG's asset quality trends have not been worrisome. GNPA's have averaged <1% over FY18-20 (1.63% at present). It did see a slight rise in GNPA's in 3QFY20 (+33bps QoQ) as floods in 2QFY20 resulted in portfolio quality deterioration in certain districts of MH and KA. Another NBFC-MFI, SPANDANA, has also faced issues in these geographies.

Exhibit 99: GNPA trends



Source: Company and HSIE Research

- Events which severely impacted the asset quality of several of CREDAG's peers (AP crisis and demonetisation) have had a limited impact on the company's asset quality. CREDAG's recognition policy is more conservative than that of its peers. The company classifies accounts which are more than 60 days past due as Stage III/ GNPA. Given the inherently risky nature of microcredit, conservative recognition policies are welcome, and they insulate the balance sheet.

Exhibit 100: Microcredit GNPA trends- CREDAG vs. peers

Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20	1QFY21
BANDHAN	0.09%	0.05%	0.15%	0.51%	1.20%	0.70%	0.43%	0.44%
CREDAG	0.01%	0.04%	0.08%	0.08%	0.82%	0.61%	1.57%	1.63%
UJJIVAN	0.07%	0.07%	0.15%	0.28%	3.76%	0.93%	0.97%	0.97%
AROHAN	0.37%	0.29%	0.36%	0.32%	1.22%	0.57%	1.83%	N/A
ASIRVAD	0.02%	0.03%	0.10%	4.47%	2.33%	0.48%	1.83%	N/A
FUSION	0.00%	0.00%	0.26%	0.37%	3.25%	1.55%	1.12%	N/A
MMFL	0.31%	0.17%	0.22%	0.49%	0.49%	0.81%	1.60%	1.58%
MTHT	0.00%	0.00%	0.04%	0.15%	2.49%	1.47%	N/A	N/A

Source: Companies and HSIE Research

Exhibit 101: CREDAG's recognition and provisioning policy

	RBI Norms		IND-AS		CAGL Policy		MMFL Policy	
Asset Classification	Standard Assets	0-90 days	Stage I	0-30 days	0-15 days		0-30 days	
	Sub-Standard Assets	91-180 days	Stage II	31-90 days	16-60 days		31-90 days	
	Loss Assets	>180 days	Stage III	>90 days	>60 days		>90 days	

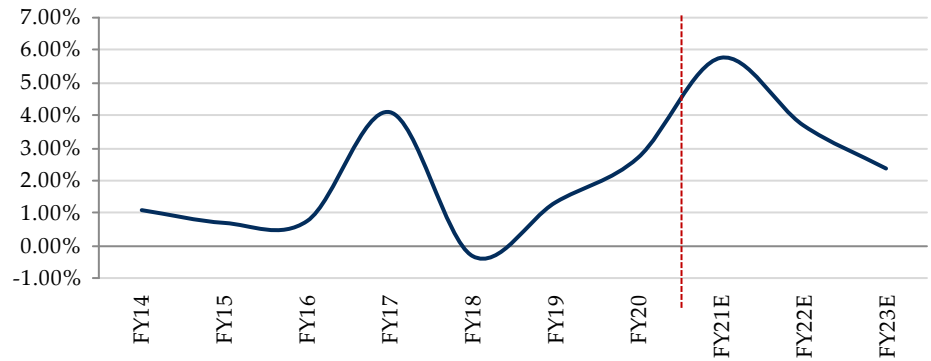
	RBI Norms	IND-AS	CAGL Policy		MMFL Policy		
Provisioning Norms	Higher value among the following: • 1% of on-book Loan Assets; or • [50% of aggregate overdue loan installments in respect of Sub-Standard Loan Assets; and • 100% of aggregate overdue loan installments in respect of Loss Loan Assets]	ECL Methodology	Provisioning	Write-offs	Provisioning	Write-offs	
			Stage I	4.42%* of EAD (Q1 FY21)	>270 days	3.18%* of EAD (Q1 FY21)	>180 days
			Stage II				
			Stage III				

* CAGL – 2.04% ECL + 2.39% additional provisions to account for COVID-19 impact in FY21. * MMFL – 2.06% ECL + 1.12% additional provisions to account for COVID-19 impact in FY21

Source: Companies and HSIE Research

- Further, CREDAG maintains close to 100% coverage on GNPA's/ Stage III assets. Such conservatism again is desirable on account of the unsecured nature of such loans.

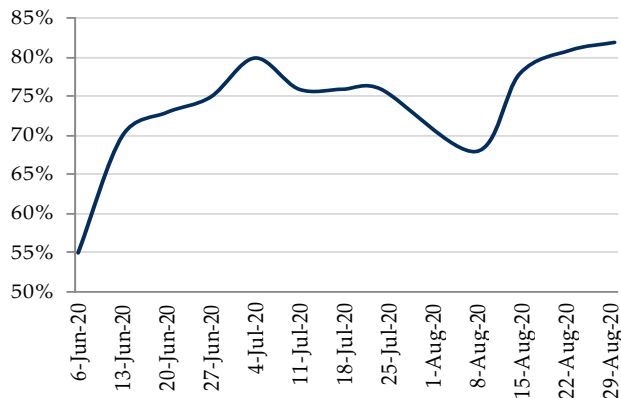
Exhibit 102: Credit cost trends and outlook



Source: Company and HSIE Research

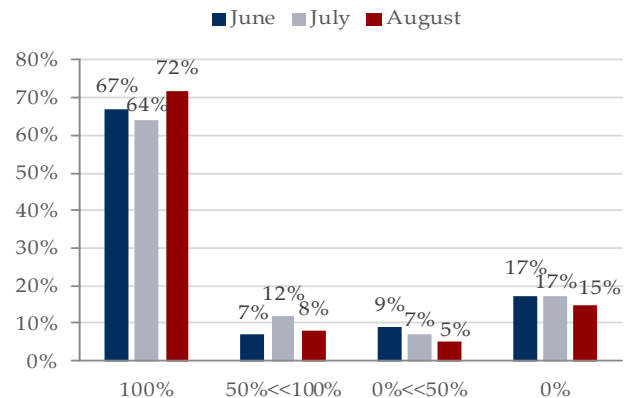
- Moratorium and collections trends:** Like most microlenders, at the start of the lockdown, CREDAG reported that 100% of its portfolio was under moratorium. However, the pace of reduction in the proportion of loans under moratorium/ improvement in collection efficiency has been better than that of its peers. As of August 2020, 18% of its portfolio was under moratorium, and 15% of its borrowers had not made a single payment. MMFL's performance on this front has been less impressive.

Exhibit 103: CREDAG's collection efficiency trends



Source: Company and HSIE Research

Exhibit 104: CREDAG's moratorium trends

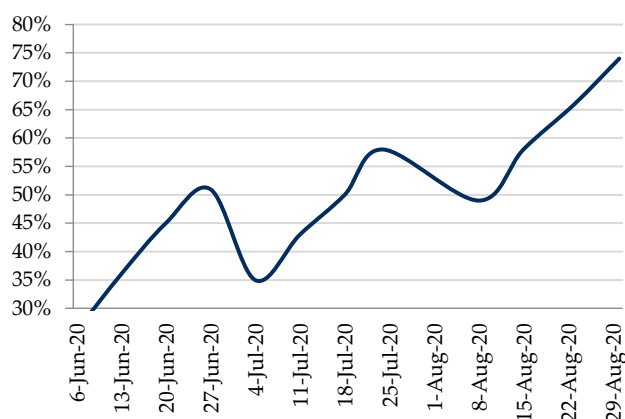


Source: Company and HSIE Research, indicates % of customers paying certain % of instalment

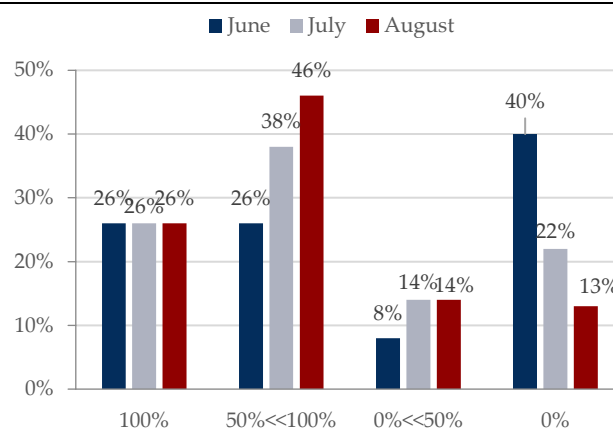
Exhibit 105: CREDAG's geographical collection efficiency

Particulars	June	July	August
KA	78%	78%	86%
MH	62%	65%	72%
TN	75%	79%	86%
MP	81%	88%	88%
Others	86%	87%	87%

Source: Company and HSIE Research

Exhibit 106: MMFL's collection efficiency trends


Source: Company and HSIE Research

Exhibit 107: MMFL's moratorium trends


Source: Company and HSIE Research, indicates % of customers paying certain % of instalment

Exhibit 108: MMFL's geographical collection efficiency

Particulars	June	July	August
TN	54%	66%	77%
MH	45%	56%	72%
OD	43%	43%	63%
BH	66%	75%	71%
Others	60%	68%	74%

Source: Company, HSIE Research

- CREDAG can see a significant rise in stress in the near-term, and we expect GNPA's and credit costs to reach 4.7% and ~5.8% respectively in FY21E.** However, we are sanguine with regards to the company's long-term prospects from an asset quality point of view on account of the following:
- Geographical diversification:** Whilst growing its portfolio, CREDAG has constantly diversified, with a reduction in state and district concentration metrics. The acquisition of MMFL has helped the company diversify further.
- High retention rates—high-quality sourcing:** High customer retention rates reflect a high proportion of borrowers qualifying for repeat loans and a good repayment track record. Such borrowers also tend to be more loyal, and the incidence of loans from multiple lenders amongst these borrowers is likely to be lower too. Retention rates have trended upwards from 77% in FY13 to 85% in FY20.
- Customer-focussed, flexible, high touch model:**
- The company has integrated its diverse product offering with social awareness programmes. For example, CREDAG has offered 1.95mn education loans and 1.1mn sanitation loans to date.

Exhibit 109: Details of beneficiaries under social outreach programmes

Particulars	Year of introduction	Cumulative number of beneficiaries
Customer awareness drive- Jagruti	2011	2,696,271
Education loans	2012	1,953,295
Sanitation loans	2010	1,109,037
Safe water connections	2010	308,465
Home renovation	2013	853,469

Source: Company and HSIE Research

- CREDAG's tele-calling team regularly contacts customers to understand customer awareness levels on various parameters and obtain feedback on various aspects of their experience with the company. While the sample size may be small, the results appear promising.

Exhibit 110: Summary of awareness call responses

Awareness %	FY19	FY20
Insurance details	99	99
Loan products	97	100
Branch details	97	100
Loan passbook	98	99
Bank accounts	96	98
Credit bureau	96	94
Interest and fees	94	97
Complaint box	87	87
Toll free redressal	88	91
Sample size (number)	22,660	31,310

Source: Company and HSIE Research

Exhibit 111: Summary of feedback call responses

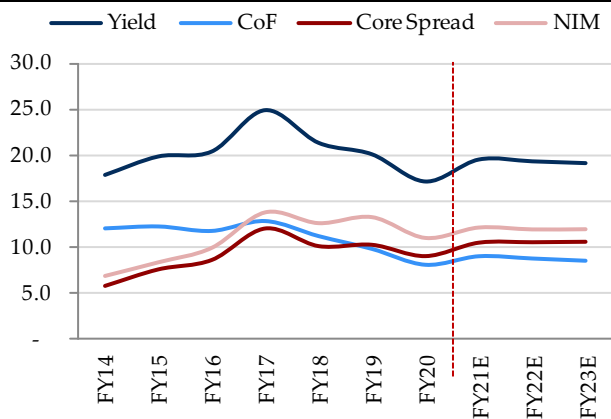
Particulars (%)	FY19			FY20		
	Happy	Satisfactory	Unhappy	Happy	Satisfactory	Unhappy
Staff behaviour	96	4		100		
Loan amount	93	5	2	99	1	
TAT	95	5		99	1	
Disbursement process	94	5	1	99	1	
Tenure	96	4		99	1	
Installment	94	4	2	98	1	1
Kendra meeting	96	4		100		

Source: Company and HSIE Research

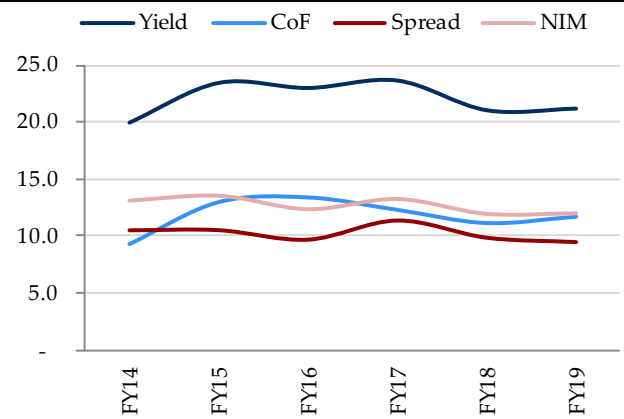
- CREDAG has been accredited for its responsible lending practices by several bodies. (1) It has been graded 'M1C1' by CRISIL under the Comprehensive MFI Grading system. According to CRISIL, this signifies the 'highest-capacity' of the institution to manage its operations in a sustainable manner; (2) CREDAAG has also been rated $\Sigma\alpha$ with a positive outlook by MCRII; (3) Under the Smart Campaign, CREDAAG has taken adequate care to implement Client Protection Principles.
- Even though borrowers are allowed to repay either at weekly/ fortnightly/ monthly intervals, they must attend weekly meetings. This ensures a high degree of cohesion within the group and allows greater connect between the loan officer and the borrower.
- We believe that these factors would contribute to higher customer loyalty and in turn, better asset quality.

Strong margin profile and operating efficiencies to support return ratios

- Despite the regulatory cap, microcredit remains a high spread/ margin business. We believe that this is only partly explained by underlying risk. Over FY14-16, CREDAG's spreads (average 7.3%) were much below the regulatory limit of 10%. Spreads have since exceeded the 10% mark on occasion, but the company has complied, as such compliance is measured on an incremental basis. More recently, spreads have averaged 9.8% over FY18-20.
- CREDAG's rates on group microloans are slightly lower than the average for NBFC-MFIs but in line with some of the larger microfinanciers. Interestingly, rates on larger individual loans offered are higher than those on group microloans, despite being offered to customers with a good repayment track record and the secured nature of such loans. This could be a result of such loans not falling within the ambit of the RBI directive on microloans.
- MMFL's yields and CoF are slightly higher than those of CREDAG and its spreads too, are just within the regulatory limit.
- We expect CREDAG's spreads to remain stable or expand slightly. This is premised on the following (1) rates charged are mainly in line with the industry, (2) any change in the cost of funds will have to be transmitted to borrowers on an incremental basis, and the term of such micro and (3) microborrowers are not too sensitive to pricing, they place considerably greater focus on the quantum of loans, and (4) the rising proportion of retail finance loans for which the rates charged are higher than those charged on group microfinance loans. We expect spreads and NIMs of 10.5/12.1% over FY21-23E.
- Any change in the regulatory limit on NBFC-MFIs' spreads can post a threat to our estimates.

Exhibit 112: Margin profile (CREDAG)


Source: Company, HSIE Research

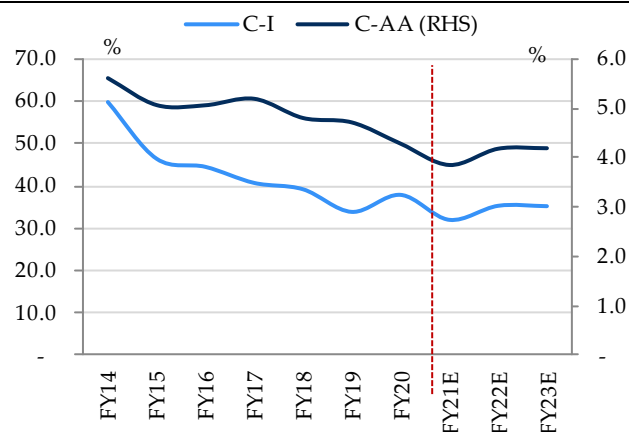
Exhibit 113: Margin profile (MMFL)


Source: Company, HSIE Research

- CREDAG added 753 branches and 9,261 employees over FY14 to FY20 (net, not incl. MMFL). However, it has seen a steady improvement in its C-AA ratio over the period (135bps) to ~4.3%. This appears to be the result of economies of scale. Productivity, as measured by AUM per branch (Rs 106.5mn) and per employee (Rs 9.1mn) have steadily increased over the period. We believe that improving customer retention ratios and loan ticket sizes have driven this improvement.

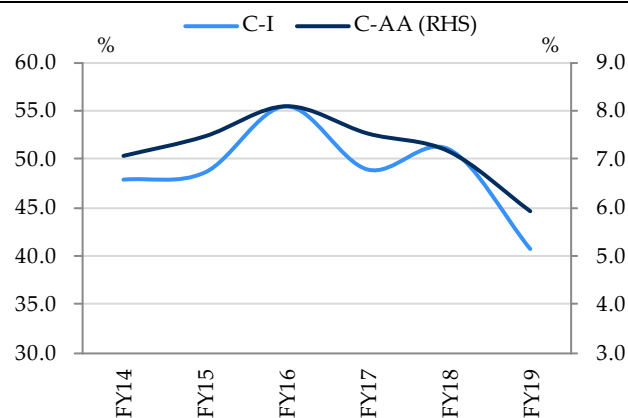
CreditAccess Grameen: Initiating Coverage

Exhibit 114: CREDAAG's C-I and C-AA ratios



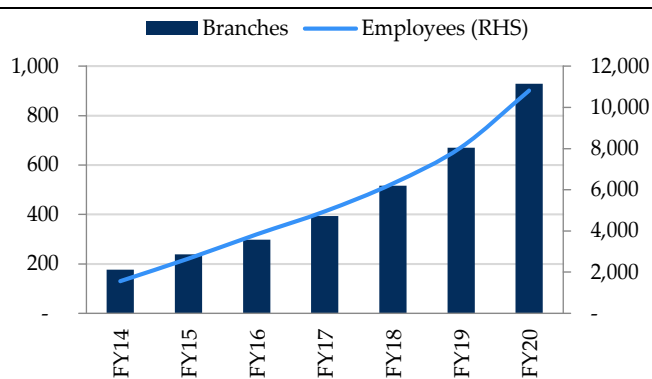
Source: Company and HSIE Research

Exhibit 115: MMFL's C-I and C-AA ratios



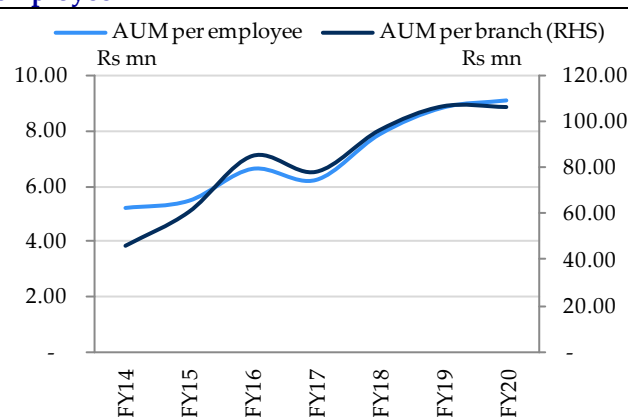
Source: Company and HSIE Research

Exhibit 116: CREDAAG's Branch and employee count



Source: Company and HSIE Research

Exhibit 117: CREDAAG's AUM per branch and employee



Source: Company and HSIE Research

- Therefore, even as costs per branch and employee have increased over the corresponding period, productivity gains have resulted in an improvement in operating efficiency.
- Near-term improvement in cost ratios is likely to be hindered by the acquisition of MMFL whose business model is different from CREDAAG's in the following ways:
 - Borrower meeting frequency is lower; in the event this is increased/ streamlined, it could result in a bump in costs.
 - Borrowers also visit MMFL's branches more often than CREDAAG's borrowers visit theirs. Adoption of CREDAAG's policies could increase costs.
- We expect CREDAAG to report C-I and C-AA ratios of 34.2% and 4.1% over FY20-22E.

How do we value CREDAG?

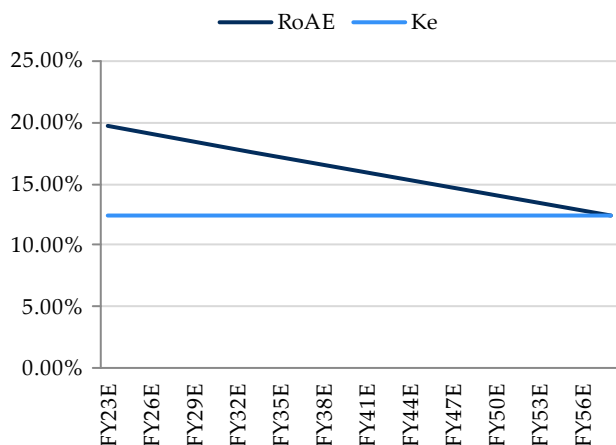
- Based on our RI model, we assign a target multiple of 2.9x Sept-22E ABV.

Exhibit 118: RI Model assumptions

Rf	6.00%
Rm	5.00%
Beta	1.30
Ke	12.50%

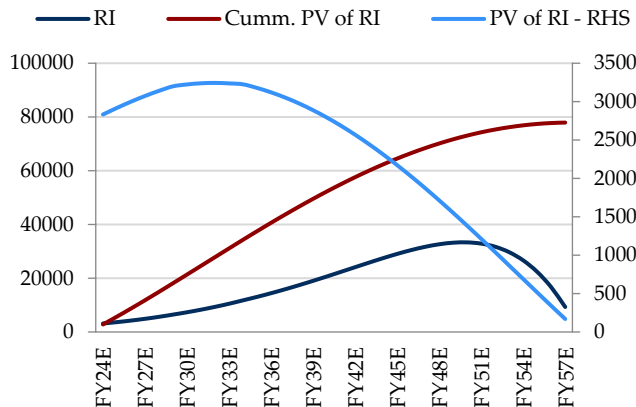
Source: HSIE Research

Exhibit 119: RoAE Estimates vs. Ke



Source: HSIE Research

Exhibit 120: RI accumulation



Source: HSIE Research

Our assigned multiple reflects the following parameters:

- High return ratios:** Even as microfinanciers' spreads are capped, they are significantly higher than most lenders'. Even if one adjusts for high operating expenditure and loan losses, across cycles, select microfinanciers such as CREDAG can deliver superior return ratios. Over FY16-20, CREDAG's RoAE was ~17%. We expect return ratios to fall significantly in FY21E, followed by a sharp recovery. CREDAG has the potential to deliver superior RoAEs in the long term.
- Inherent risks:** CREDAG's portfolio is almost entirely composed of microcredit, which is an inherently risky business. The company's several virtues such as (1) low average outstanding per borrower, (2) sustained geographical diversification of exposure and reduction of concentration risks, and (3) no major asset quality events until date do not completely eliminate the inherent risks associated with microlending. Microlenders, therefore, warrant a higher Ke due to a higher risk premium.

Risks

- Worse-than-expected outcomes due to COVID-19:** We expect CREDAG to register a sharp YoY rise in GNPA's and a sharp slowdown in growth, followed by a sustained recovery on these parameters in FY22/23E. Given that significant uncertainty regarding the economic and asset quality outcomes still prevails, worse-than-expected outcomes would pose a downside risk to our estimates. We have attempted to capture the impact of such outcomes on our estimates and valuations in our scenario analyses.
- Regulatory risk:** As an NBFC-MFI, CREDAG is bound by the RBI directive on microcredit. Any unfavourable regulatory changes such as a reduction in spreads, reduction in indebtedness limits or loan sizes, and capital requirements could adversely impact CREDAG's growth prospects and return ratios.

Downside scenario analyses

- Our base case estimates for CREDAG factor in (1) a significant reduction in loan growth in FY21E followed by a significant recovery and (2) a record rise in GNPA's followed by a gradual reduction therein. However, given the continuing uncertainty around the spread of the virus and the resultant economic fallout, we believe that the risks to our estimates lie mostly to the downside. We have attempted to evaluate the impact of (1) more-than-expected stress, and (2) slower-than-expected growth than in our estimates.
- Under our worst-case scenario, GNPA's in FY21/22E could be 33.9/37.4% higher than our base case estimates.
- We build loan growth of 7.5% in FY21E under our worst-case scenario, but we still see a significant recovery to 19.0% in FY22E and further to 20.8% in FY23E.
- FY21/22/23E earnings could be 67.5/46.8/32.7% lower than our base case estimates under our worst-case scenario. The sharp fall in earnings is a result of high expected PCR, in line with CREDAG's historical provisioning policy.
- RoAEs for FY21/22/23E fall to 2.9/8.6/15.2% under our worst-case scenario and our assigned multiple would fall to 2.3x.

Exhibit 121: Our scenario analyses assumptions

Particulars	Scenario 1			Scenario 2			Scenario 3		
Increase in GNPA%	1.0%	0.5%	0.0%	1.5%	1.0%	0.5%	2.0%	1.5%	1.0%
Decrease in AUM growth %	-3.0%	-2.0%	-1.0%	-4.0%	-3.0%	-2.0%	-5.0%	-4.0%	-3.0%

Source: HSIE Research

Exhibit 122: Scenario analyses results

Particulars	Base Case			Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	6,630	5,049	4,891	7,741	5,600	4,614	8,318	6,281	5,454	8,882	6,935	6,237
GNPA (%)	4.92	3.04	2.38	5.92	3.54	2.38	6.42	4.04	2.88	6.92	4.54	3.38
AUM growth (YoY, %)	12.5	23.0	23.8	9.5	21.0	22.5	8.5	20.0	21.8	7.5	19.0	20.8
NII (Rs mn)	15,509	18,225	22,498	15,261	17,511	21,336	15,188	17,273	20,897	15,115	17,035	20,438
PPOP (Rs mn)	11,108	12,848	15,989	10,895	12,260	15,018	10,820	11,956	14,553	10,789	11,760	14,068
Provisions (Rs mn)	7,631	6,053	5,184	8,631	6,885	5,321	9,150	7,513	6,081	9,658	8,122	6,800
Provisions (%)	5.99	4.03	2.79	6.88	4.77	3.02	7.33	5.27	3.53	7.78	5.78	4.03
PAT	2,590	5,062	8,050	1,687	4,005	7,224	1,244	3,310	6,312	843	2,710	5,415
ABV Rs	214	248	303	208	235	284	205	227	270	202	221	257
RoAA (%)	1.92	3.20	4.18	1.27	2.63	3.96	0.94	2.21	3.54	0.64	1.84	3.12
RoAE (%)	8.73	14.65	19.59	5.77	12.09	18.65	4.29	10.24	17.00	2.93	8.57	15.17
Assigned multiple		2.93			2.8			2.6			2.3	
TP		797			706			623			547	

Source: Company and HSIE Research

Exhibit 123: Scenario analyses results

Change in (vs. base case)	Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	16.76%	10.93%	-5.65%	25.46%	24.41%	11.51%	33.97%	37.35%	27.52%
GNPA (%)	+100bps	+50bps	-	+150bps	+100bps	+50bps	+200bps	+150bps	+100bps
AUM growth (YoY, %)	-300bps	-200bps	-100bps	-400bps	-300bps	-200bps	-500bps	-400bps	-300bps
NII (Rs mn)	-1.60%	-3.92%	-5.17%	-2.07%	-5.23%	-7.12%	-2.54%	-6.53%	-9.16%
PPOP (Rs mn)	-1.92%	-4.58%	-6.08%	-2.60%	-6.94%	-8.98%	-2.87%	-8.47%	-12.01%
Provisions (Rs mn)	13.10%	13.73%	2.65%	19.90%	24.12%	17.31%	26.57%	34.18%	31.17%
Provisions (%)	+89bps	+74bps	+23bps	+135bps	+125bps	+74bps	+179bps	+175bps	+124bps
PAT	-34.88%	-20.89%	-10.26%	-51.98%	-34.61%	-21.60%	-67.47%	-46.47%	-32.73%
ABV Rs	-2.88%	-5.38%	-6.26%	-4.29%	-8.50%	-10.87%	-5.57%	-11.25%	-15.14%
RoAA (%)	-65bps	-57bps	-22bps	-98bps	-99bps	-64bps	-128bps	-136bps	-106bps
RoAE (%)	-296bps	-256bps	-93bps	-444bps	-441bps	-259bps	-580bps	-608bps	-441bps
Assigned multiple		2.8			2.6			2.3	
TP		-11.4%			-21.8%			-31.4%	
Upside		-1.0%			-13.5%			-24.0%	

Source: Company and HSIE Research

Financials

Income statement

(Rs mn)	FY16	FY17	FY18	FY19	FY20 (CL)	FY21E	FY22E	FY23E
Interest earned	4,065	7,017	8,597	12,183	16,334	24,717	29,020	35,776
Interest expended	2,082	3,165	3,537	4,168	5,800	9,208	10,864	13,335
Net interest income	1,982	3,852	5,060	8,016	10,534	15,509	18,156	22,441
Other income	602	75	118	650	721	637	827	1,214
Total income	2,585	3,927	5,179	8,666	11,255	16,146	18,983	23,655
Total operating expenditure	1,149	1,598	2,031	2,940	4,266	5,177	6,710	8,340
PPOP	1,436	2,329	3,148	5,726	6,989	10,969	12,273	15,315
Provisions & contingencies	140	1,086	-134	749	2,373	7,337	5,539	4,388
PBT	1,295	1,243	3,282	4,977	4,616	3,632	6,734	10,927
Tax expenses	463	440	1,157	1,760	1,261	926	1,717	2,786
PAT	832	803	2,125	3,218	3,355	2,706	5,017	8,141
Minority interest	-	-	-	-	19	-	-	-
PAT (excl. minority interest)	832	803	2,125	3,218	3,336	2,706	5,017	8,141

Source: Bank, HSIE Research

Statement of assets and liabilities

(Rs mn)	FY16	FY17	FY18	FY19	FY20 (CL)	FY21E	FY22E	FY23E
Sources of funds								
Share capital	730	857	1,284	1,436	1,440	1,467	1,467	1,467
Reserves	3,869	5,273	13,091	22,215	25,902	30,664	35,680	43,821
Net worth	4,599	6,130	14,375	23,651	27,342	32,131	37,147	45,288
Minority interest					1,090	-	-	-
Borrowings	22,333	26,852	36,235	48,666	95,397	109,231	137,674	172,446
Other liabilities	1,148	399	526	1,257	2,068	2,481	2,863	3,303
Total liabilities	28,080	33,381	51,136	73,574	125,896	143,843	177,684	221,038
Application of funds								
Advances	24,754	28,401	48,955	66,028	110,989	124,864	153,586	192,376
Goodwill on consolidation/ amalgamation				-	3,176	4,669	4,669	4,669
Cash and cash equivalents	2,549	3,770	1,431	6,156	7,176	8,830	13,446	17,082
Fixed assets	113	146	172	271	2,618	2,748	2,886	3,030
Other assets	663	1,065	578	1,119	1,937	2,731	3,098	3,880
Total assets	28,080	33,381	51,136	73,574	125,896	143,843	177,684	221,038

Source: Bank, HSIE Research

Key ratios

	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Valuation ratios								
EPS (Rs)	11.4	9.4	16.5	22.4	23.2	18.4	34.2	55.5
Earnings growth (%)	70.8	(17.9)	76.5	35.5	3.3	(20.4)	85.4	62.3
BVPS (Rs)	63.0	71.5	111.9	164.8	189.9	219.0	253.2	308.7
Adj. BVPS (Rs)	63.0	71.5	111.9	164.8	187.7	214.7	248.9	304.4
RoAA (%)	3.7	2.6	5.0	5.2	3.3	2.0	3.1	4.1
RoAE (%)	19.9	15.0	20.7	16.9	13.1	9.1	14.5	19.8
P/E (x)	61.2	74.5	42.2	31.1	30.1	37.8	20.4	12.6
P/ABV (x)	11.4	10.1	6.4	4.4	3.8	3.4	2.9	2.4
P/PPOP (x)	36.6	26.5	29.4	18.1	14.8	9.6	8.6	6.9
Profitability (%)								
Yield on advances	20.39	25.00	21.36	20.08	17.05	19.40	19.30	19.15
Cost of funds	11.82	12.92	11.24	9.82	8.05	9.00	8.80	8.60
Core spread	8.58	12.08	10.12	10.26	9.00	10.40	10.50	10.55
NIM	9.95	13.72	12.57	13.21	11.00	12.17	12.07	12.01
Operating efficiency (%)								
Cost/avg. asset ratio	5.07	5.20	4.81	4.71	4.28	3.84	4.17	4.18
Cost-income ratio	44.5	40.7	39.2	33.9	37.9	32.1	35.3	35.3
Balance sheet structure ratios (%)								
Loan growth	82.9	14.7	72.4	34.9	68.1	12.5	23.0	25.3
Borrowing growth	73.1	20.2	34.9	34.3	96.0	14.5	26.0	25.3
Equity/assets	16.4	18.4	28.1	32.1	21.7	22.3	20.9	20.5
Equity/loans	18.6	21.6	29.4	35.8	24.6	25.7	24.2	23.5
Total capital adequacy ratio (CAR)	21.5	29.7	29.6	35.3	23.6	24.3	22.4	21.6
Tier I CAR	17.6	20.2	28.2	34.4	22.3	23.0	21.3	20.7
Asset quality								
Gross NPLs (Rs mn)	19.7	25.7	374.1	492.4	1,421.0	6,302.9	4,347.0	4,000.4
Net NPLs (Rs mn)	-	-	16.2	108.9	343.5	313.1	305.5	340.2
Gross NPLs (%)	0.08	0.08	0.82	0.61	1.28	4.67	2.62	1.93
Net NPLs (%)	-	-	0.03	0.16	0.31	0.23	0.18	0.16
Coverage ratio (%)	100	100	96	78	76	95	93	91
Provision/avg. loans (%)	0.73	4.09	- 0.35	1.30	2.68	5.76	3.68	2.35
RoAE tree								
Net interest income	8.74%	12.54%	11.97%	12.86%	10.56%	11.50%	11.29%	11.26%
Non-interest income	2.66%	0.24%	0.28%	1.04%	0.72%	0.47%	0.51%	0.61%
Operating cost	5.07%	5.20%	4.81%	4.71%	4.28%	3.84%	4.17%	4.18%
Provisions	0.62%	3.53%	-0.32%	1.20%	2.38%	5.44%	3.45%	2.20%
Tax expense	2.04%	1.43%	2.74%	2.82%	1.26%	0.69%	1.07%	1.40%
ROAA	3.67%	2.61%	5.03%	5.16%	3.34%	2.01%	3.12%	4.08%
Leverage (x)	5.42	5.73	4.12	3.28	3.91	4.54	4.64	4.84
RoAE	19.91%	14.97%	20.72%	16.92%	13.08%	9.10%	14.48%	19.75%

Source: Company and HSIE Research

Ujjivan Small Finance Bank & Ujjivan Financial Services

Watch for corporate actions

Ujjivan Small Finance Bank (USFB) is a microlender with an urban focus (65% of loans in metro and urban areas, unlike peers). It has a microcredit book of Rs 109.7bn (~76% of its loans). USFB's geographical diversification, asset quality (GNPAs at ~1%), and capital adequacy are inspiring. However, it has struggled on the opelev (C-I at 67.4% in FY20) and deposit granularity (albeit improving gradually) fronts. Corporate actions and regulatory compliance will be focal points for investors in the medium term. Ujjivan Financial Services (UJJIVAN) is required to reduce its stake in USFB. Eventually, the management intends to reverse merge UJJIVAN into USFB (but this has not been permitted by the RBI for now). Investors should prefer UJJIVAN over USFB, given the steep discount. We initiate coverage on UJJIVAN with a BUY (target price of Rs 356, 25% holding company discount) and on USFB with an ADD (TP of Rs 40, 1.9x Sept-22E ABV).

- Regulatory and corporate action overhang:** UJJIVAN is required to reduce its stake in USFB to 40% by February 2022. This can be achieved in the following ways: (1) USFB acquires another entity; (2) UJJIVAN sells a part of its stake in USFB; or (3) USFB raises fresh capital. The management is keen on reverse merging the two entities (regardless of its ability to help with bringing down promoter holding). Under various scenarios, the shareholders of UJJIVAN are better placed than those of USFB. The holding company discount is substantial, and the shareholders of UJJIVAN stand to gain, especially if the reverse merger goes through.
- Deposit traction improving, but it is work-in-progress:** USFB's deposit franchise is still work-in-progress, as indicated by its low CASA (~14%) and deposit concentration metrics (Top 20 depositors at ~29%). Unlike several small and medium-sized private banks, USFB did not see deposit outflows post the events at YES - this is creditable. However, building a strong granular deposit franchise will be an uphill task for the bank.
- Diversification:** USFB's loan book is fairly well-diversified, across 24 states, with no state contributing to more than 16% of its loan book. This is advantageous, given microcredit's historical vulnerability to event and concentration risks. Between FY17 and 1QFY21, USFB has also diversified away from microcredit (~76% of loans at present, vs. ~98% in FY17).
- High RoAE potential:** In the near-term elevated credit costs will impact RoAEs, but we expect a recovery to 13.7% in FY23E. Given the predominance of microcredit in USFB's loan mix and the company's low leverage, there is significant scope for further RoAE expansion.

Financial summary

(Rs mn)	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	8,610	11,064	16,336	19,036	21,628	26,676
PPOP	3,196	3,090	6,372	7,610	9,360	11,333
PAT	69	1,992	3,499	2,181	3,057	5,174
EPS (Rs)	N/A	1.4	2.0	1.3	1.8	3.0
EPS growth (%)	N/A	N/A	46.4	(37.7)	40.2	69.2
RoAE (%)	0.1	13.0	15.2	7.0	9.1	13.7
RoAA (%)	0.5	1.72	2.18	1.07	1.23	1.72
ABVPS (Rs)	9.7	11.1	17.1	16.9	19.5	22.5
P/ABV (x)	3.3	2.9	1.9	1.9	1.6	1.4
P/E (x)	667.3	23.0	15.7	25.2	18.0	10.6

Source: Bank and HSIE Research

Ujjivan Small Finance

ADD

CMP (as on 29 Sept 2020)	Rs 32
Target Price	Rs 40

KEY STOCK DATA

Bloomberg code	UJJIVANS IN
No. of Shares (mn)	1,728
MCap (Rs bn) / (\$ mn)	55/745
6m avg traded value (Rs mn)	68
52 Week high / low	Rs 63/23

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	7.1	10.6	-
Relative (%)	(1.5)	(16.8)	-

Ujjivan Financial Services

BUY

CMP (as on 29 Sept 2020)	Rs 213
Target Price	Rs 356

KEY STOCK DATA

Bloomberg code	UJJIVAN IN
No. of Shares (mn)	122
MCap (Rs bn) / (\$ mn)	26/351
6m avg traded value (Rs mn)	1,077
52 Week high / low	Rs 416/125

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(4.7)	25.7	(32.3)
Relative (%)	(13.3)	(1.6)	(30.1)

Darpin Shah

darpin.shah@hdfcsec.com
+91-22-6171-7328

Aakash Dattani

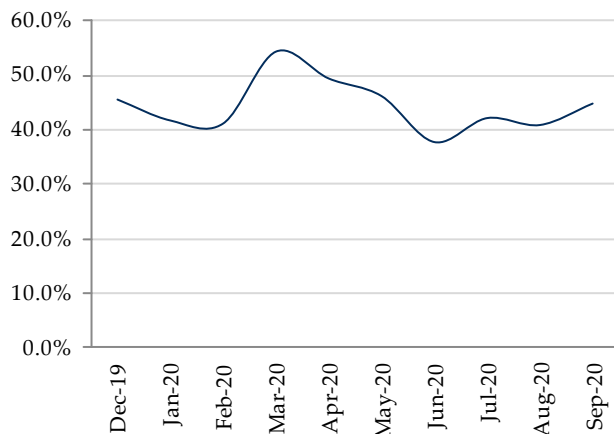
aakash.dattani@hdfcsec.com
+91-22-6171-7337

Punit Bahlani

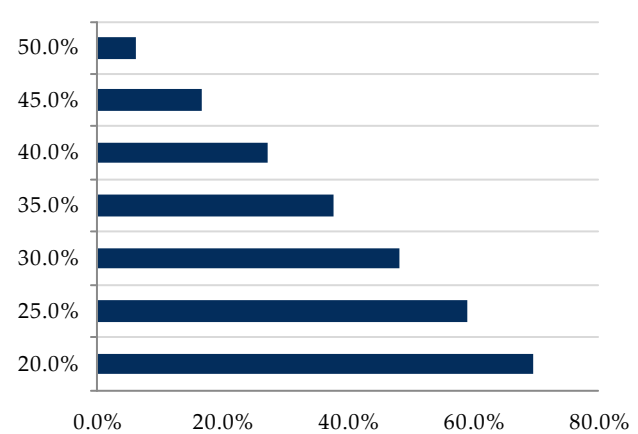
punit.bahlani@hdfcsec.com
+91-22-6171-7354

Brief corporate history and holding company/ listing conundrum

- Ujjivan Financial Services Private Limited was incorporated in 2004. In 2005, the company received an NBFC license from the RBI and, in 2013, it became an NBFC-MFI.
- In 2015, UJJIVAN was one of the ten entities to receive an in-principal approval from the RBI to set up an SFB. USFB commenced operations in February 2017.
- The existing business of UJJIVAN was transferred to the SFB via a slump sale in 2017. In turn, UJJIVAN acquired complete control of the SFB. UJJIVAN was the sole shareholder of USFB, and it had no other business.
- Immediately before listing in May 2016, UJJIVAN was mostly foreign-held (50%+). UJJIVAN's IPO provided an exit to several existing foreign holders.
- To comply with the RBI guidelines on SFBs, USFB was required to ensure the following: (1) promoter holding in the bank had to be at least 40%, and it was to be brought down to 40% within five years (February 2022), 30% within 10 years and 26% within 12 years of the date of commencement of operations (February 2017); (2) foreign shareholding was to be limited to 74%; and (3) USFB had to list itself within three years of achieving a net worth of Rs 3bn.
- It was a Catch-22 situation. UJJIVAN would be the promoter of the SFB; however, it was mostly foreign-held. The initial IPO helped satisfy condition (2). USFB was founded with a net worth in excess of Rs 3bn.
- UJJIVAN's management was hopeful that the RBI would allow it to reverse-merge into USFB. This would have helped satisfy condition (3) but would have resulted in promoter shareholding dropping to 'nil'. Herein lay the catch— the RBI did not permit this method of ensuring compliance.
- USFB was finally listed in December 2019, satisfying (3) and the promoters' holding was reduced to ~83%. UJJIVAN has to reduce its stake in USFB to 40% by February 2022. Commentary indicated that the management is still hopeful for the reverse merger and is negotiating with the regulator to relax the promoter holding criteria.
- UJJIVAN has the following options to meet the promoter holding criteria (a) sale of shares by the UJJIVAN in USFB (capital gains would be taxed in the hands of the UJJIVAN and if it chooses to transfer the proceeds to its shareholders as dividend, (b) inorganic growth, (c) a fundraise or, (d) reverse merger if permitted by the RBI. The last option would be the most desirable for shareholders of the UJJIVAN as the holding company discount would be effectively eliminated.
- Option (a) is not quite desirable for the shareholders of UJJIVAN, given the tax implications.
- Option (c) seems unlikely in the near term. Given the current hold-co discount, shareholders of UJJIVAN stand to gain, especially if the reverse merger goes through. UJJIVAN therefore serves as a better investment proposition than USFB.
- **Current valuations imply a 43% holding company discount, which is unwarranted. Subsequently, we initiate with a BUY rating on UJJIVAN and ADD on USFB.**

Exhibit 124: Historical implied holding company discount


Source: Exchanges and HSIE Research

Exhibit 125: Upside at different levels of holding company discount


Source: HSIE Research

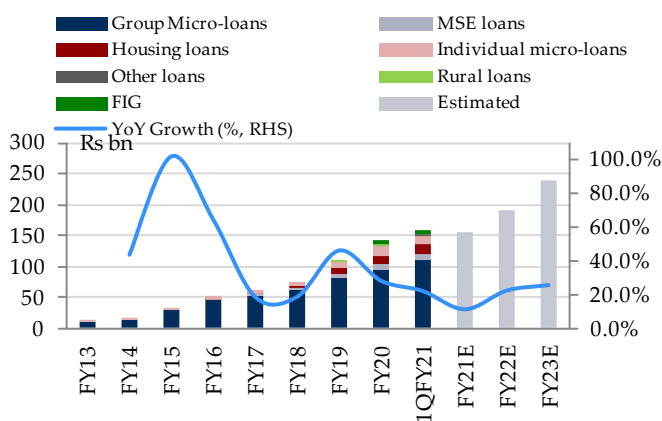
Product diversification and higher ticket sizes drive growth

- Overall portfolio growth trends:** Between FY16-20, the company registered an AUM CAGR of ~35%, with its portfolio reaching Rs 141.5bn in FY20. In its early years, before becoming an SFB, the company's portfolio grew much faster (~64.8% YoY over FY13-17).
- Post conversion into an SFB, the company saw loan growth slow significantly over FY17 and FY18 (average growth of ~18.5%). This was led by slower growth in the microcredit portfolio as a result of demonetisation. FY19 saw an upswing in growth (46%) which sustained into 9MFY20 (45.7% YoY AUM growth), led by strong growth in non-microcredit segments (the small base aided this).
- However, portfolio traction has since slowed (28/3.9% YoY/QoQ in 4QFY20 and 21.9/1.5% YoY/QoQ in 1QFY21). This can be attributed to issues faced by the company in Assam relating to its microcredit portfolio and COVID-19 related disruptions.
- Microcredit portfolio trends:** Over FY13-20, the company's microcredit portfolio has grown at a CAGR of ~41%, slower than its overall portfolio, as the bank gradually diversified away from microlending.
- Over FY13-16, the microcredit portfolio grew at a CAGR of ~70%. Growth in this segment later slowed to 19.2% over FY17-20, and further to ~14% in 1QFY21. However, microcredit continues to constitute an overwhelming majority of the company's portfolio (76.4% of loans).
- Group lending trends:** Trends in group loans have been similar to those in overall microloans, given that they constitute ~86.5% of total microloans. YoY growth averaged ~64.8% between FY13-16 and ~18.9% over FY17-20. In 1QFY21, growth in group microcredit loans further dipped to just 9.8% YoY.
- Individual microcredit trends:** USFB, like many microfinanciers, offers both individual and group microcredit loans. Individual loans, however, constitute just 10.3% of AUMs (and 13.5% of overall microcredit book). Growth in the individual microcredit portfolio has been more volatile than that in group microcredit loans- strong growth over FY13-16 on a small base was followed by considerable moderation in growth in FY17 (~21.4% YoY) and de-growth (-13.9%

YoY) in FY18. Growth re-accelerated in FY19 (+23.1% YoY) and FY20 (+68.7% YoY). Average ticket sizes in this segment (~Rs 102k) are fairly high.

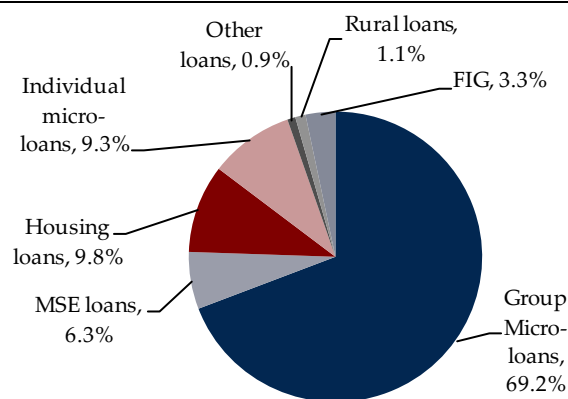
- Recent ticket size trends:** In the case of both group and individual microcredit loans, an increase in ticket sizes has contributed to most of the growth over FY17-FY20. YoY growth in group microloan ticket sizes averaged 14.4% between FY17-FY20 and that in individual microloans averaged 15.2%. Further in 1QFY21, the average ticket size for group microloans grew by 10% QoQ to Rs 39k and for individual microloans grew by 4% QoQ to Rs 102k. Even non-microcredit loans have seen a considerable increase in ticket sizes. E.g. MSE loan ticket sizes have almost doubled to Rs 1.5mn since 3QFY19.
- Other segments:** Over FY17-20, the company’s non-microcredit portfolio has grown at multifold to constitute ~24% of total loans (vs. a mere 2.4% in FY17). In 1QFY21, the non-microcredit portfolio grew 56% YoY.
- Within this portfolio, affordable housing (10.8% of total AUM) and MSE (7.0% of AUM) have reported CAGRs of 149/159% over FY17-20 vs. overall AUM CAGR of 30%. Given the relatively smaller base, we expect these portfolios to grow at a much faster rate. The company has also ventured into other high-yielding segments such as personal loans and vehicle loans in select geographies.
- We like the company’s geographical diversification strategy (with no state contributing more than 16% of AUMs), but we are slightly wary of the fast growth in ticket sizes across non-micro segments and high group and individual microloan ticket sizes.
- We expect the company to report an AUM CAGR of 19.9% over FY20-23E, with a 19% CAGR in case of microcredit. We expect microloans to constitute ~75% of USFB’s portfolio by FY23E. The management guides for achieving a 50-50 micro-non-micro loan mix in the medium term.

Exhibit 126: AUM trends and outlook



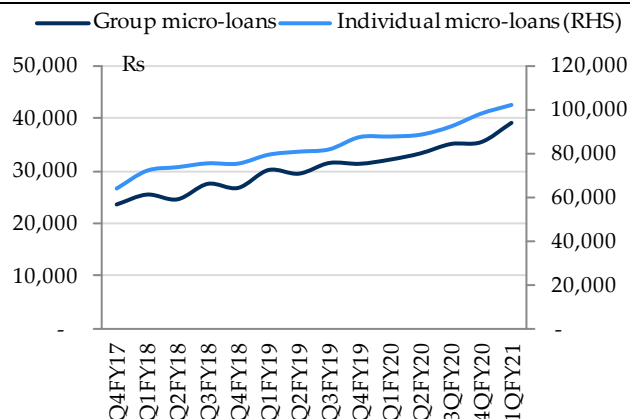
Source: Bank and HSIE Research

Exhibit 127: AUM mix



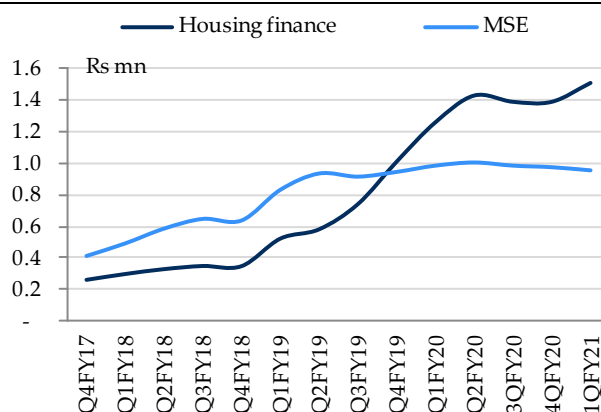
Source: Bank and HSIE Research

Exhibit 128: Microloan ticket size trends



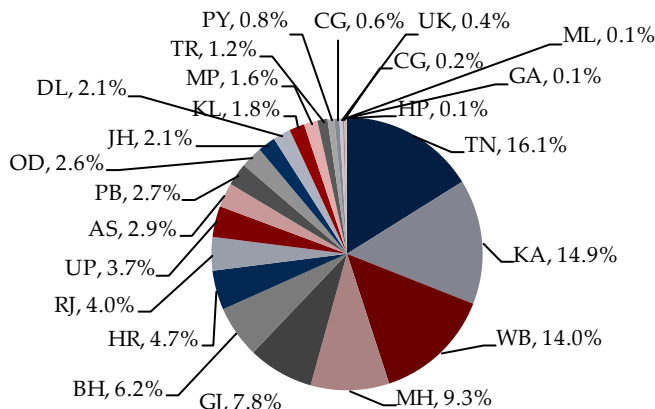
Source: Bank and HSIE Research

Exhibit 129: Non-microloan ticket size trends



Source: Bank and HSIE Research

Exhibit 130: Geographical split of the portfolio

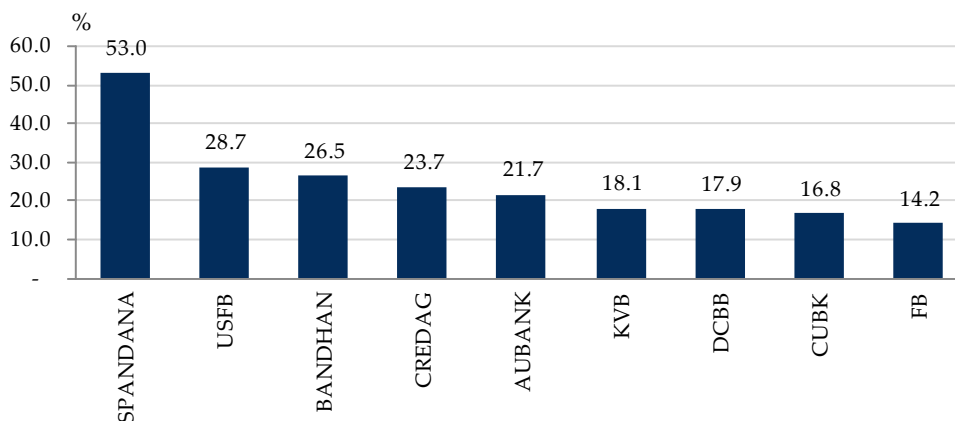


Source: Bank and HSIE Research

Comfortable capital position

- Having raised funds in FY20 at the time of its IPO, USFB is one of the best-placed SFBs on this front, with a CRAR of 28.7% (of which 27.9% is Tier I). The bank can, therefore, absorb significant credit losses (under our worst-case scenario, we expect its CRAR to fall to 17.4% in FY23E) and capture any resilient credit growth.

Exhibit 131: CRAR- USFB vs. peers

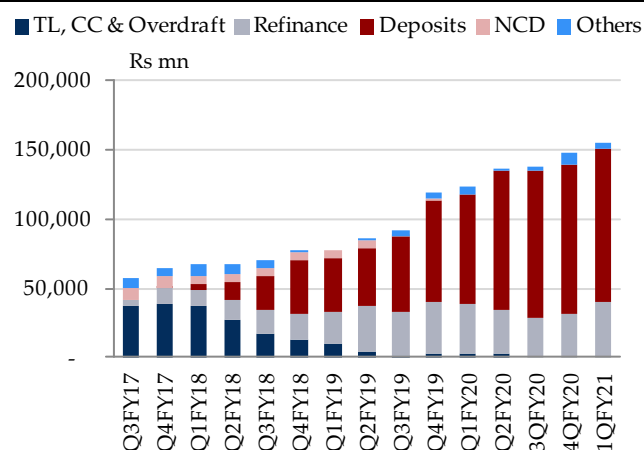


Source: Bank and HSIE Research

Fledgling deposit franchise

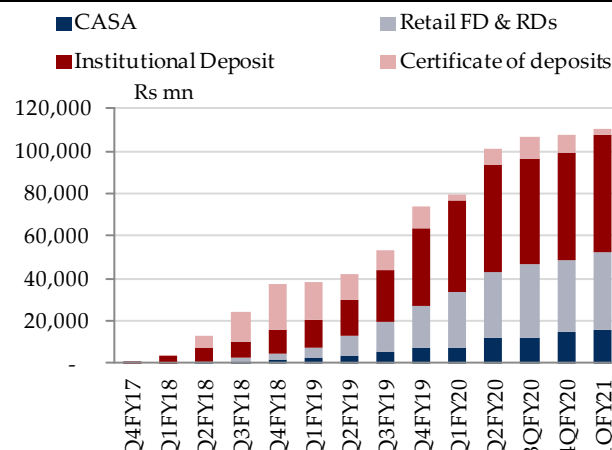
- USFB's deposit base grew from Rs 1.06bn in FY17 to Rs 110.6bn in 1QFY21, and its CD ratio has dipped from 195% in FY18 to 128.9% in 1QFY21. Its incremental CD ratio was even lower at ~75%. Despite strong deposit growth, we believe USFB's liability franchise is still work-in-progress. Our stance is premised on:
- High deposit concentration:** Initial deposit growth at USFB, like at most new banks, was mostly driven by bulk deposits. Deposit concentration, measured by the contribution of the top-20 depositors, has fallen from 73.6% in FY18 to 41.8% in FY19 and further to ~29% in FY20. Nevertheless, it remains high.
- Low retail and CASA deposits, but scope for improvement exists:** USFB's CASA ratio improved from 6.3% in 1QFY19 to ~14% in 1QFY21. This figure is comparable with AUBANK's CASA ratio (~14%) but is lower than EQUITAS' (~20%) and several small and medium-sized private banks'. USFB's share of retail deposits has increased from 13.9% in 1QFY19 to 45% in 1QFY21 (does not appear to be as defined under LCR disclosures). Relatively slow CASA and retail deposit traction can be attributed to the following:
 - No major rate differential:** As a relatively new bank and an SFB that too, USFB has a natural disadvantage in acquiring retail deposits (particularly CASA). A differential rate offering could have helped here. However, USFB's SA rates are surprisingly low and are lower than those/ at par with those offered by some larger full-fledged banks. On the SA front, while the bank's deposit base is predominantly located in metro and urban areas, the bank is focused on smaller deposit ticket sizes, as it targets the mass segment rather than the affluent segment. Its TD rates, on the other hand, are not too different from those offered by peers (SFBs and small- to medium-sized private sector banks).
 - Urban focus:** USFB has rapidly scaled up its branch network; it now has 575 branches, and its branch network rivals that even of some smaller full-fledged banks. 84% of the bank's deposits came from metro and urban locations. While these geographies are deposit rich, they are highly competitive and larger banks will have a more significant advantage here.

Exhibit 132: Liability profile evolution



Source: Bank and HSIE Research

Exhibit 133: Deposit profile evolution



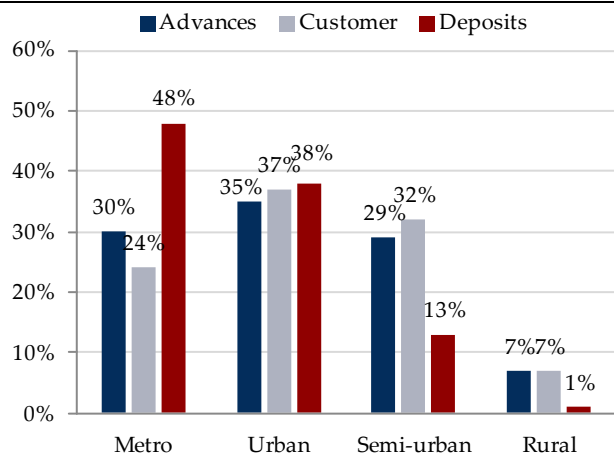
Source: Bank and HSIE Research

Exhibit 134: Deposit concentration metrics

Particulars	FY17	FY18	FY19	1HFY20	FY20
Top 5 depositors	96.72%	39.18%	20.27%	14.81%	N/A
Top 10 depositors	97.96%	54.98%	29.02%	23.43%	N/A
Top 20 depositors	98.32%	73.59%	41.84%	34.99%	29.04%

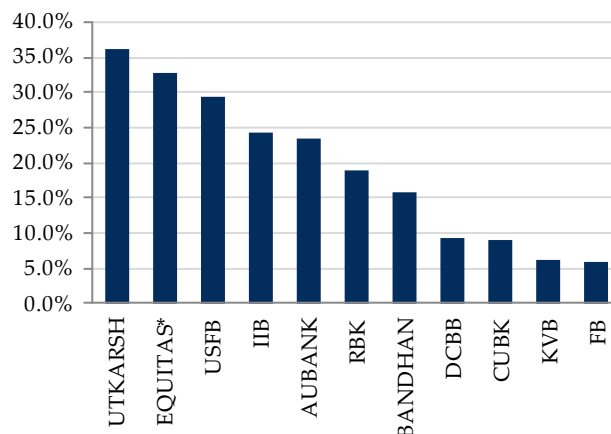
Source: Bank and HSIE Research

Exhibit 135: Geographical spread of deposits, branches, and advances



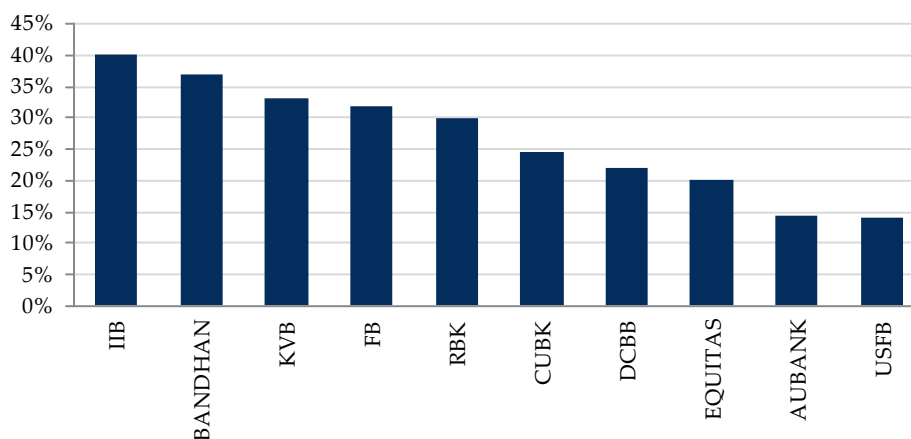
Source: Bank and HSIE Research

Exhibit 136: Comparison of deposit concentration (share of top 20 depositors)



Source: Bank and HSIE Research

Exhibit 137: CASA- USFB vs. peers



Source: Bank and HSIE Research

Exhibit 138: SA rates- USFB vs. others

Bank	Upto Rs 0.1mn	Rs 0.1-Rs 1mn	Rs 1-5mn	Rs 5-50mn	Rs 50-100mn	Rs 100mn-1bn	Rs 1bn-2bn	Rs 2bn+
AUBANK	4.00%	5.50%	7.00%	7.00%	6.50%	6.50%	6.50%	6.50%
AXSB	3.00%	3.00%	3.00%	3.50%	3.50%	Repo - 65bp	Repo - 25bp	Repo
BANDHAN	3.00%	6.00%	6.00%	6.55%	7.15%	7.15%	7.15%	7.15%
CUBK	3.50%	3.75%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
DCBB	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
EQUITAS	3.5%	7.00%	7.00%	7.00%	7.25%	7.50%	-	-
FB	Repo-150bps	Repo-150bps	Repo-150bps	Repo-150bps	Repo+10bps	Repo+10bps	Repo+50bps	Repo+50bps
ICICIBC	3.00%	3.00%	3.00%	3.50%	3.50%	3.50%	3.50%	3.50%
IIB	4.00%	5.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
KVB	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
RBK	4.75%	6.00%	6.75%	6.75%	6.75%	6.75%	6.75%	6.75%
USFB	4.00%	5.25%	5.25%	6.25%	6.50%	6.50%	6.50%	6.50%

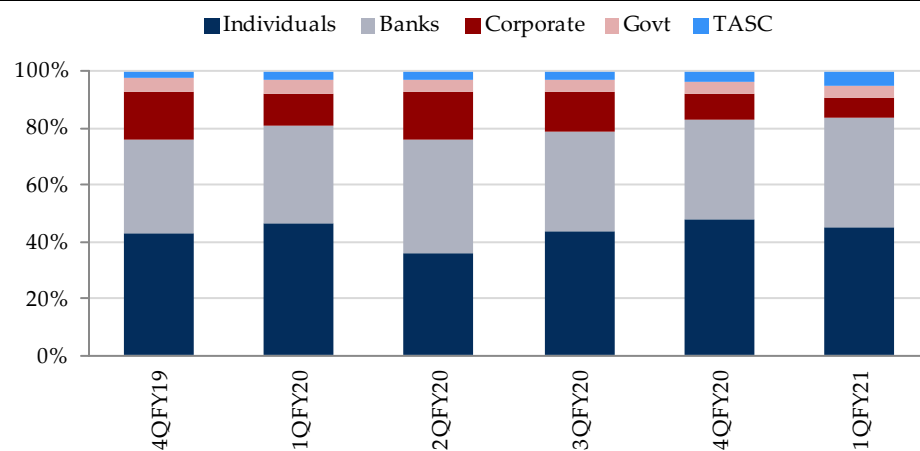
Source: Bank and HSIE Research

Exhibit 139: TD rates- USFB vs. others

Bank	7-14 d	15-29d	30- 45d	46- 60d	61- 90d	91d - 120d	121d- 185d	6m 1d- 9m	9m 1d- 1yr	1yr 1 d- 2yr	2yr 1 d- 3yr	3yr 1d- 5yr	5yr 1d- 10 yr
AUBANK	3.75%	3.75%	3.75%	4.25%	4.25%	5.00%	5.00%	5.50%	6.50%	6.50%	6.75%	6.50%	6.50%
AXSB	2.50%	2.50%	3.00%	3.25%	3.25%	4.10%	4.10%	4.50%	5.15%	5.15%	5.50%	5.50%	5.50%
BANDHAN	3.00%	3.00%	3.50%	3.50%	3.50%	3.50%	3.50%	5.75%	5.75%	6.00%	6.00%	5.75%	5.75%
CUBK	3.00%	3.25%	3.25%	3.50%	3.50%	3.75%	3.75%	4.00%	5.00%	5.75%	5.75%	5.50%	5.25%
DCBB	4.75%	5.05%	5.05%	5.25%	5.25%	5.75%	5.75%	6.35%	6.35%	6.73%	6.80%	6.85%	6.80%
EQUITAS	3.60%	3.60%	4.10%	4.60%	5.60%	5.85%	5.85%	6.10%	6.60%	7.10%	7.15%	6.75%	6.75%
FB	2.75%	3.00%	3.25%	3.50%	3.75%	3.90%	3.90%	4.00%	4.75%	5.45%	5.50%	5.60%	5.60%
ICICIBC	2.50%	2.50%	2.75%	2.75%	3.00%	3.10%	3.10%	3.60%	3.85%	4.10%	4.60%	4.60%	4.60%
IIB	3.25%	3.25%	3.75%	4.10%	4.30%	4.50%	5.00%	5.40%	6.60%	7.00%	7.00%	6.75%	6.65%
KVB	3.50%	3.75%	3.75%	3.75%	3.75%	4.75%	4.75%	4.75%	5.00%	5.50%	5.50%	5.65%	5.65%
RBK	4.00%	4.50%	4.50%	5.50%	5.50%	5.75%	5.75%	6.25%	6.35%	7.00%	7.00%	6.75%	6.75%
USFB	3.05%	3.05%	4.05%	4.05%	4.05%	4.80%	4.80%	5.20%	5.20%	6.50%	6.05%	5.80%	5.55%

Source: Bank and HSIE Research

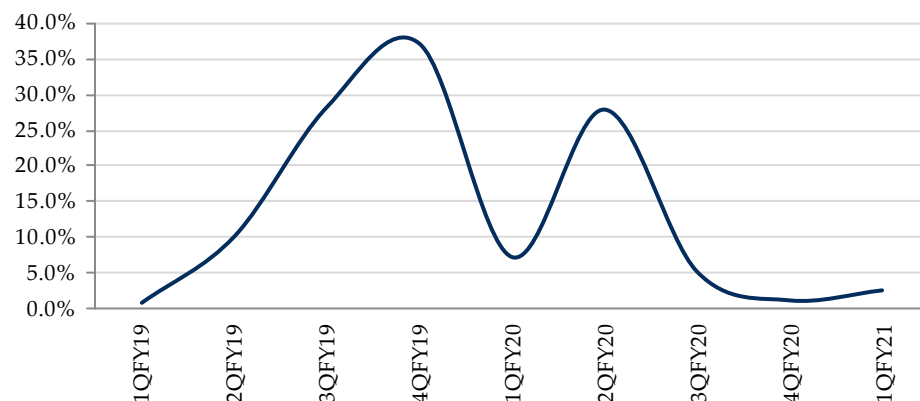
Exhibit 140: Trends in segment-wise deposits



Source: Bank and HSIE Research

- Deposit trends post Yes Bank:** The events at YES adversely impacted several small- and mid-sized private sector banks, particularly IIB and RBK, which saw significant deposit outflows in 4QFY20. While USFB's deposit growth rate slowed to 46/1.2% YoY/QoQ in 4QFY20 and further to 40/2.6% in 1QFY21 (vs. 110%+ YoY earlier), it did not witness a fall in its deposit base. We believe this is creditable. Nevertheless, building a granular deposit base will be an uphill task and progress front will be keenly watched.

Exhibit 141: Recent QoQ deposit growth trends

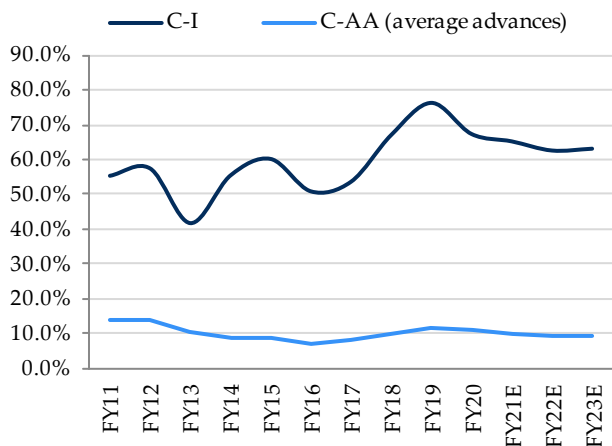


Source: Bank and HSIE Research

Operating (In)efficiency

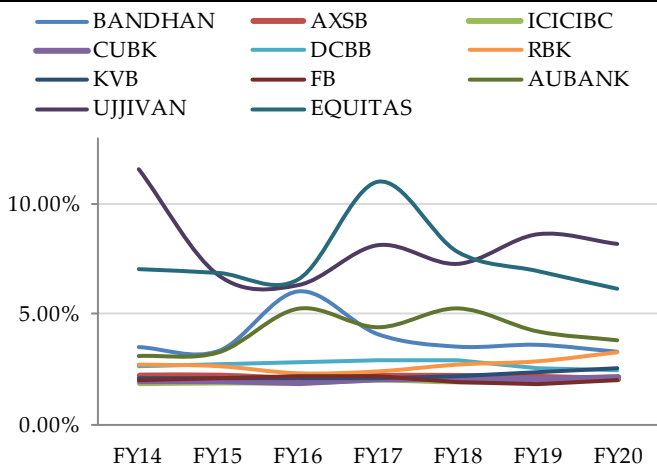
- Like most SFB converts, USFB saw a characteristic bump-up in operating costs post-conversion. However, its operating expenses were high, even before conversion when compared with those of some of its NBFC-MFI contemporaries. UJJIVAN's C-I averaged ~54% between FY11-16 & C-AA averaged 11%. Between FY16-20, USFB's C-I averaged 71% and C-AA averaged 6.4%. More recently, in 4QFY20 and 1QFY21, the bank's C-I was 64.6% and 55.9%. A significant part of this fall can be attributed to lower business volumes on account of COVID-19 related disruptions.
- Higher costs at USFB also point to lower branch productivity (when compared on a business/ branch basis vs. banks such as DCBB, CUBK, FB and AUBANK), which may be partly explained by the recent scale-up in branches. Average costs per employee and per branch are lower than/ in line with peers'.
- The management guides for a rapid improvement in efficiency metrics post FY20 (500bps annual reduction). Improvement in operating efficiencies is likely to be the biggest RoAE driver at USFB. Diversification away from microcredit may facilitate this; however, continued branch addition will have an offsetting impact.
- We model a slight improvement in efficiency ratios (C-I of 63.7% over FY21-23E) as we believe economies of scale will slowly but eventually manifest at the bank. Further, cost control has been a significant challenge and a time-consuming process for several banks, some much larger than USFB.

Exhibit 142: C-I & C-AA trends



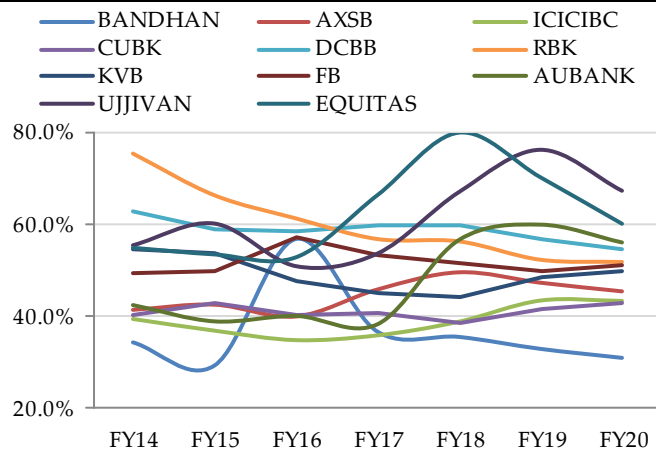
Source: Bank and HSIE Research

Exhibit 144: C-AA ratio- USFB vs. peers



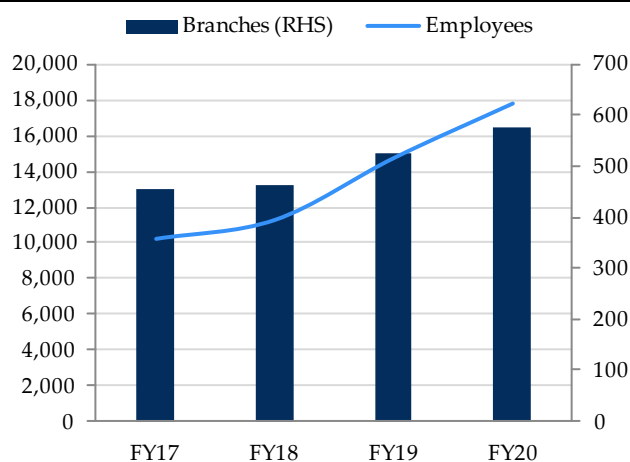
Source: Banks and HSIE Research, C-AA: Cost-Average Assets

Exhibit 143: C-I- USFB vs. peers

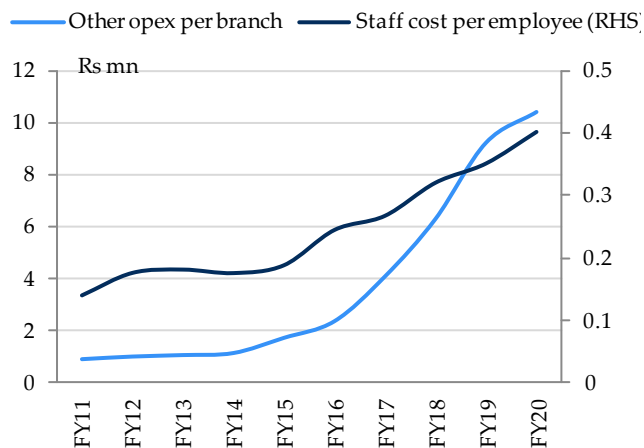


Source: Banks and HSIE Research

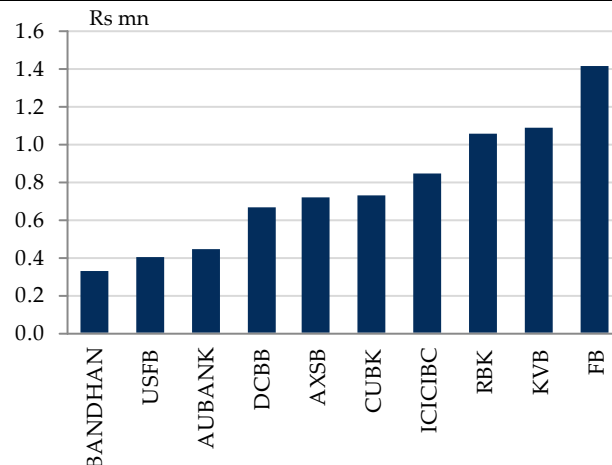
Exhibit 145: Branch and employee count



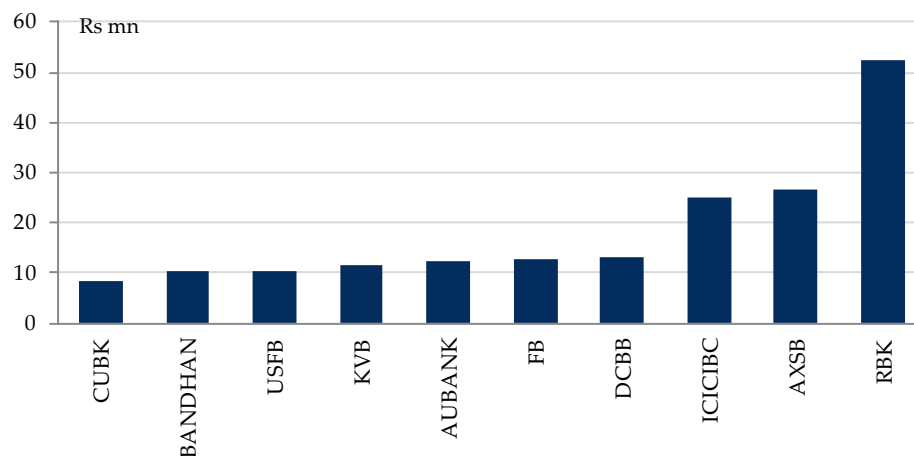
Source: Bank and HSIE Research

Exhibit 146: Other opex per branch and employee cost per employee trends

Source: Bank and HSIE Research

Exhibit 147: Employee cost per employee- USFB vs. peers

Source: Banks and HSIE Research

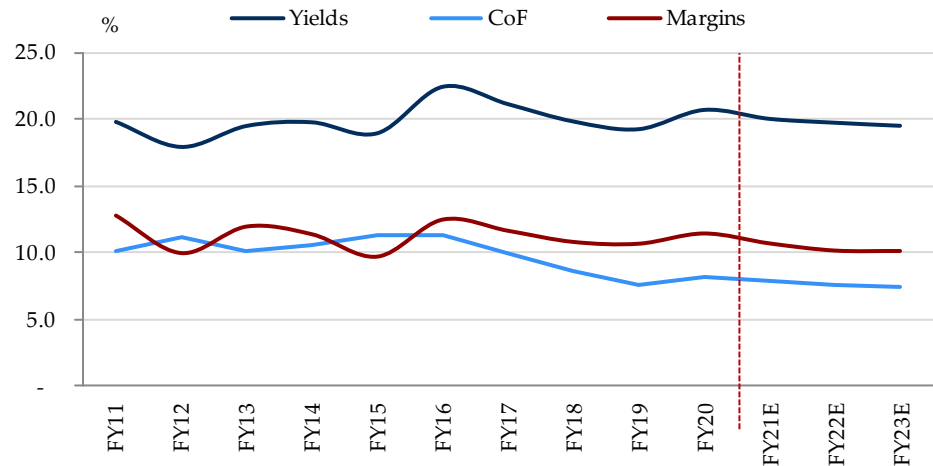
Exhibit 148: Other operating expenditure per employee- USFB vs. peers

Source: Banks and HSIE Research

NIM outlook

- UJJIVAN's/ USFB's yields have averaged ~20% over FY11-FY20, with little variation, ranging from ~18% in FY12 to ~22.5% in FY16. High yields have been a consequence of the high proportion of microcredit loans. Further, the yields on the microcredit book have been stable at ~21% over the last ~12 quarters.
- Post conversion into a bank, USFB has seen a sustained decline in its CoF, as it began to replace its borrowings with relatively low-cost deposits and refinance. The company's CoF has fallen by over 250bps since it became a bank.
- Consequently, the company's NIMs have dipped only slightly post becoming a bank.
- We expect NIMs to compress slightly, and average 10.4% over FY21-23E (vs. 11.3% over FY11-20). Even as the proportion of relatively low yielding non-microcredit loans rises, the effect of this will be partly offset by a further fall in the bank's CoF.

Exhibit 149: Yield, CoF and NIM trends and outlook



Source: Bank and HSIE Research

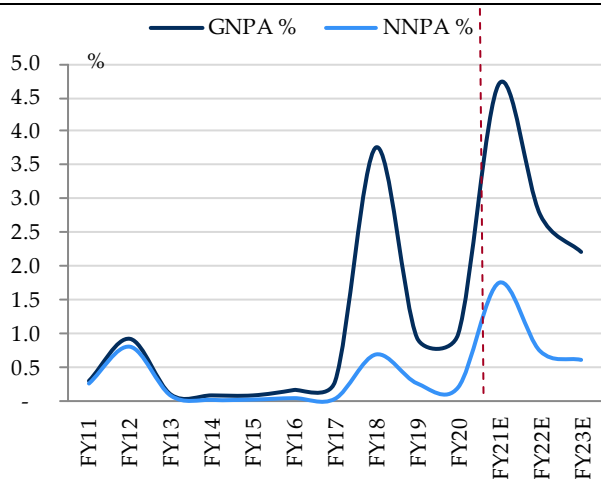
Asset quality and moratorium trends

- Historical GNPA trends:** Between FY11-17, UJJIVAN's/USFB GNPA's ranged between 7-28bps with annualised credit costs ranging between 4bps and 1%. In FY18, its GNPA's rose to 3.76%, and credit costs hit 5.86% (after demonetisation). USFB has not witnessed any major asset quality events except for demonetisation. Asset quality trends have since been benign, and high write-offs contributed to the sharp pull-back in GNPA's, which are ~1% at present (albeit cushioned by the standstill classification benefit). USFB's microcredit NPAs are in line with its SFB peers (10bps for USFB vs. 22bps for SFBs). NPA trends in the other business segment are also benign with Housing NPAs at 30bps and MSE at 1.1% as on 1QFY20.
- Early bucket delinquencies:** In 3QFY20, USFB's PAR 0 rose from 1.6% to 2.1%, as a result of a rise in stress in its Assamese microcredit portfolio (3.3% of AUMs of which ~half was in troubled districts located in Upper AS). Other microlenders, such as BANDHAN, faced issues here too and made higher provisions for the same. USFB's PAR 0, since then, has trended down (-30bps since 3Q) and currently stands at 1.8%. However, here too, current figures are impacted by the standstill classification benefit.
- USFB's microcredit book is relatively well-diversified with no state constituting more than ~16% of its AUMs. However, it does have high exposure to certain states such as TN (16.1%), KA (14.9%) and WB (14%). These states also happen to have some of the largest outstanding microcredit portfolios. With continued lockdowns in these regions, the performance of microcredit in these large states will be keenly watched, and it could heavily influence USFB's asset quality.

Moratorium trends

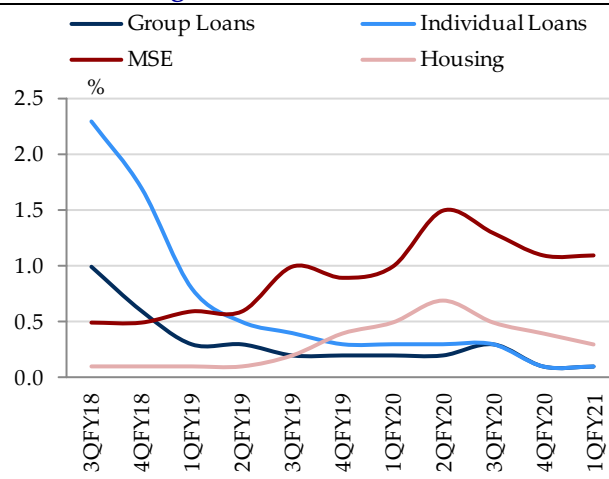
- At its peak, 90% of the company’s portfolio was under moratorium (98% of microloans were under moratorium). The proportion of loans under moratorium have since reduced to 50% (47% of microloans). Collection efficiency (measured as the ratio collections during the period against dues for the period) has improved from 5% in April, to ~16% in May to ~54% in June and 59% July. Collection efficiency for June/July adjusted for collection of previous dues would have been 59/64%. The company reported that the difference in repayment behaviour between urban/metro and rural borrowers has begun to reduce. The repayment rate for the former category is 58.5% while it is 65% for the latter.
- The high touch nature of microcredit meant that collections in this business were impacted to a greater extent on account of COVID-19 related disruptions. To combat this problem, the company set up alternate channels for collection. It has tied up with Airtel Payments Bank for its outlets serve as collection points for the USFB. It is witnessing good traction on this front, and its collection from digital sources has increased from 16% to 37% in May.
- As per the management, ~50%+ of the microcredit borrowers are engaged in the provision of essential services such as groceries, dairy, etc. Amongst the other businesses (MSE and Housing), a large proportion of the borrowers opted for the moratorium to preserve liquidity and not on account of difficulties in income generation.
- We expect USFB to see a broad-based rise in NPAs (across its portfolio), and we build GNPA’s of 4.7% in FY21E.

Exhibit 150: GNPA trends and outlook



Source: Bank and HSIE Research

Exhibit 151: Segment-wise GNPA's

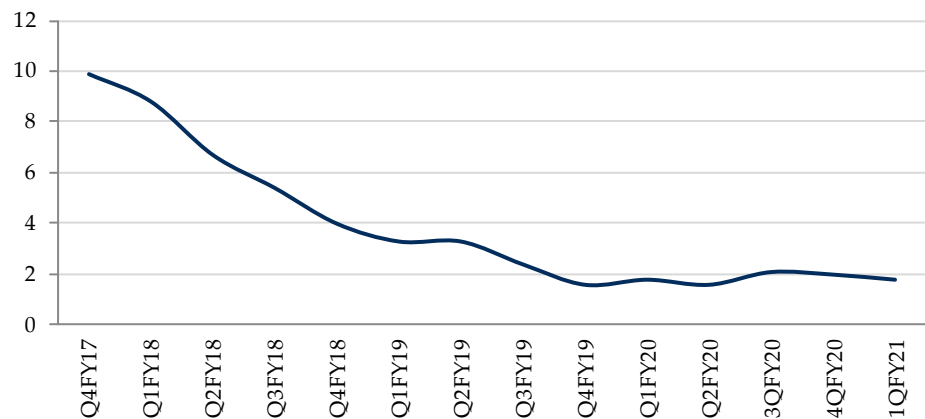


Source: Bank and HSIE Research

Exhibit 152: Microcredit GNPA- USFB vs. peers

Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20	1QFY21
BANDHAN	0.09%	0.05%	0.15%	0.51%	1.20%	0.70%	0.43%	0.44%
CRETAG	0.01%	0.04%	0.08%	0.08%	0.82%	0.61%	1.57%	1.63%
UJJIVAN	0.07%	0.07%	0.15%	0.28%	3.76%	0.93%	0.97%	0.97%
AROHAN	0.37%	0.29%	0.36%	0.32%	1.22%	0.57%	1.83%	N/A
ASIRVAD	0.02%	0.03%	0.10%	4.47%	2.33%	0.48%	1.83%	N/A
FUSION	0.00%	0.00%	0.26%	0.37%	3.25%	1.55%	1.12%	N/A
MMFL	0.31%	0.17%	0.22%	0.49%	0.49%	0.81%	1.60%	1.58%
MTHT	0.00%	0.00%	0.04%	0.15%	2.49%	1.47%	N/A	N/A

Source: Bank and HSIE Research

Exhibit 153: PAR 0 trends

Source: Bank and HSIE Research

Exhibit 154: Segment-wise moratorium trends

Segment	April	May	June
	% moratorium		
Microcredit	99	85	50
MSE loans	70	74	46
Affordable housing	70	67	46
Personal loans	60	61	65
Vehicle loans	99	79	35
FIG		21	1
Others		1	1
Overall	90	80	47

Source: Bank and HSIE Research

Exhibit 155: Segment-wise collection efficiency

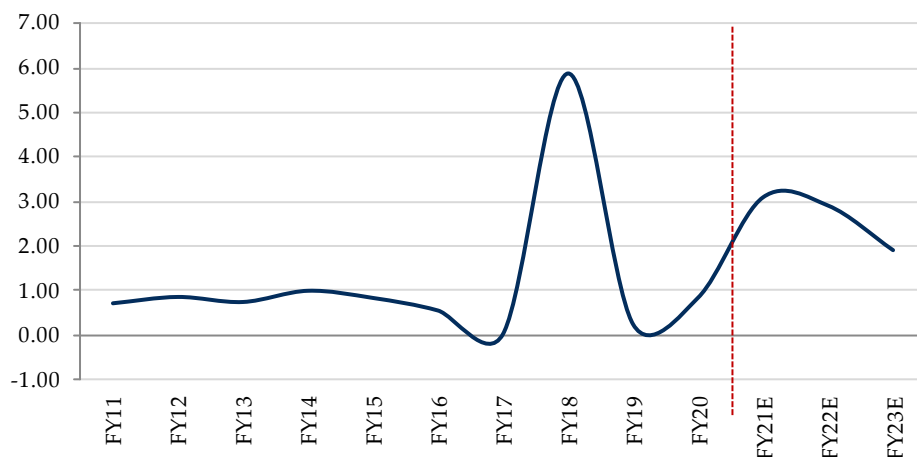
Segment	March	April	May	June	July
	% collection efficiency				
Microcredit	93	2	14	53	58
MSE loans	82	19	17	46	47
Affordable housing	94	32	33	52	68
Personal loans	91	44	38	62	60
Vehicle loans	95	33	23	67	78
FIG	100	77	67	86	97
Overall	93	5	16	54	59

Source: Bank and HSIE Research

Provisioning trends

- Over FY16-20, USFBs non-tax provisions have averaged ~1.09% of average assets (credit costs of 1.45bps), spiking in FY18 (demon impact - Rs 3.1bn, 3.47% of loans).
- In 1QFY21, USFB created additional Covid-19 related provisions of Rs 1.29bn, taking the total stock of such provisions to Rs 2bn (1.4% of loans).
- We conservatively build credit costs of 3.1/2.9/1.9% of average assets over FY21/22/23E.

Exhibit 156: Credit cost trends and outlook



Source: Bank and HSIE Research

How do we value USFB and UJJIVAN?

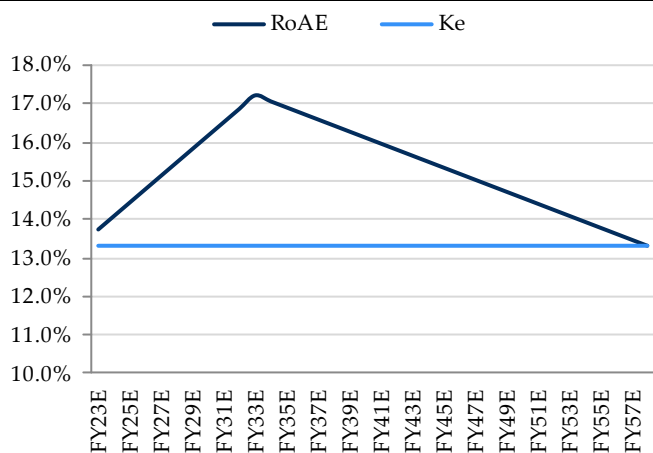
- Based on our RI model, we assign a target multiple of 1.9x Sept-22E ABV.

Exhibit 157: RI Model assumptions

Rf	6.00%
Rm	5.00%
Beta	1.46
Ke	13.30%

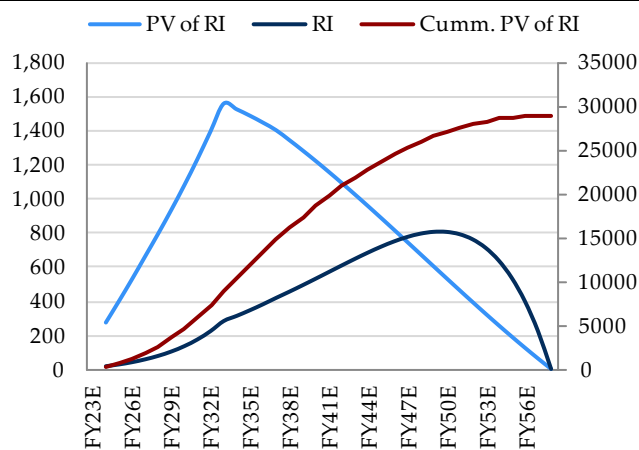
Source: Bank and HSIE Research

Exhibit 158: RoAE vs. Ke estimates



Source: HSIE Research

Exhibit 159: RI accumulation



Source: HSIE Research

Our assigned multiple reflects the following parameters:

- **Scope for improvement in return ratios:** In the recent past, while USFB's margin profile has been strong, the sharp rise in operating expenditure post-conversion into a bank has limited the improvement in return ratios. We expect RoAEs to fall significantly in FY21E to 7.0% as credit costs are likely to increase sharply. Post FY21E, we expect a reduction in credit costs and a gradual improvement in operating efficiency to drive RoAE improvement. Further improvements in operating efficiency will drive RoAE expansion in the long run.
- **Inherent risks:** At present, microcredit constitutes ~76% of USFB's portfolio consists of microcredit, which is an inherently risky business. We expect microcredit to remain the largest component of the bank's portfolio, even as the share of other loan segments is likely to rise. Consequently, we do not expect the bank's RoAEs to average >17% across cycles in the long run.
- **Valuing UJJIVAN:** While valuing UJJIVAN, we assign a 25% holding company discount to its stake in USFB. At present, UJJIVAN holds an 83.3% stake in USFB and is required to reduce its stake to 40% by February 2022. UJJIVAN has various options to reduce its stake. Even if one assumes that UJJIVAN sells its stake (43.3%) in USFB and distributes the proceeds to its shareholders (the most unattractive alternative from its shareholders' perspective) after paying capital gains tax and applying a 25% discount to its remaining stake, the implied holding company discount is not justified. Further, the value of what its residual stake (40%) would be in USFB at CMP, is equal to ~87% of its market capitalisation. We thus believe that the implied holding company discount is excessive.

Risks

- **Worse-than-expected outcomes related to COVID-19:** We expect USFB to register a sharp YoY rise in GNPA's and a sharp slowdown in growth, followed by a sustained recovery on these parameters in FY22/23E. Given that significant uncertainty regarding the economic and asset quality outcomes still prevails, worse-than-expected outcomes would pose a downside risk to our estimates. We have attempted to capture the impact of such outcomes on our estimates and valuations in our scenario analyses.
- **Regulatory risk:** At present, SFBs are not covered by the RBI's directive on microfinance. This had created a regulatory arbitrage, as highlighted earlier. The extension of the framework to include banks could limit USFB's spreads and its ability to grow its microcredit portfolio.
- **Inability to improve operating efficiency:** We expect an improvement in operating efficiency to be the most significant driver of RoAE improvement. However, the bank has struggled on this front, and several other banks have too. The bank's inability to rein in operating costs will limit its scope for RoAE improvement.
- **Inability to quickly scale up its granular deposit base:** As highlighted earlier, USFB's deposit franchise is relatively nascent, and it has a low CASA % and high deposit concentration. The bank would need to grow its deposit base in a granular fashion to prudently fund its growth. Its inability to do so would limit its ability to fund its portfolio growth prudently.

- **Unsuitable/ expensive acquisition:** In its quest to comply with the SFB norms on promoter holding, USFB may be forced to acquire a business that is not a good fit.

Downside scenario analyses

- Our base case estimates for USFB factor in (1) a significant reduction in loan growth in FY21E, followed by a significant recovery, and (2) a significant rise in GNPA's followed by a gradual reduction therein. However, given the continuing uncertainty around the spread of the virus and the resultant economic fallout, we believe that the risks to our estimates lie mostly to the downside. We have attempted to evaluate the impact of (1) higher than expected stress, and (2) slower than expected in growth in our estimates.
- Under our worst-case scenario, GNPA's in FY21/22E could be 43.5/53.5% higher than our base case estimates.
- We build loan growth of 4.9% in FY21E under our worst-case scenario, but we still see a significant recovery to 16.2% in FY22E and further to 20.5% in FY23E.
- Under our worst-case scenario, we expect USFB's earnings to dip by 88% (from our base case estimates) in FY21E, and we expect it to post losses in FY22/23E. The drag on expected earnings stems from a significant fall in expected NII (vs. our base case estimates- -4.6/-12.7/-18.6% lower) due to slower loan growth. Further, high operating expenditure, relatively low operating efficiency (average C-AA of 6.8% over FY21-23E vs. 6.6% under our base case) and rise in provisions (4.1% LLPs over FY21-23E vs. 2.6% under our base case).

Exhibit 160: Our scenario analyses assumptions

Particulars	Scenario 1			Scenario 2			Scenario 3		
Increase in GNPA%	1.50%	1.0%	0.5%	2.0%	1.5%	1.0%	2.5%	1.0%	1.5%
Decrease in AUM growth %	-4.0%	-3.0%	-2.0%	-5.0%	-4.0%	-3.0%	-6.0%	-5.0%	-4.0%

Source: Company and HSIE Research

Exhibit 161: Scenario analyses results

Particulars	Base Case			Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	7,399	5,305	5,319	9,408	6,790	6,046	9,976	7,422	6,798	10,617	8,145	7,652
GNPA (%)	4.71	2.76	2.21	6.21	3.76	2.71	6.71	4.26	3.21	7.21	4.76	3.71
AUM growth (YoY, %)	11.9	22.2	25.5	7.9	19.2	23.5	5.9	17.2	21.5	4.9	16.2	20.5
NII (Rs mn)	19,036	21,628	26,676	18,533	20,105	24,055	18,281	19,289	22,482	18,155	18,884	21,713
PPOP (Rs mn)	7,610	9,360	11,333	7,075	7,734	8,528	6,808	6,862	6,845	6,674	6,430	6,021
Provisions (Rs mn)	4,683	5,256	4,388	5,709	6,625	5,218	5,993	7,087	5,734	6,323	7,624	6,337
Provisions (%)	3.09	2.91	1.91	3.88	3.90	2.48	4.12	4.31	2.87	4.38	4.71	3.27
PAT	2,181	3,057	5,174	1,018	826	2,465	607	-168	828	262	-889	-235
ABV Rs	17	19	22	16	17	19	15	16	17	15	15	15
RoAA (%)	1.07	1.23	1.72	0.50	0.34	0.84	0.30	-0.07	0.29	0.13	-0.37	-0.08
RoAE (%)	7.04	9.10	13.72	3.35	2.64	7.48	2.01	-0.55	2.69	0.87	-2.99	-0.81
Assigned multiple		2.0			1.6			1.3			1.1	
TP		40			27			20			16	

Source: Company and HSIE Research

Exhibit 162: Scenario analyses results

Change in (vs. base case)	Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPA (Rs mn)	27.16%	28.00%	13.67%	34.83%	39.92%	27.81%	43.50%	53.54%	43.87%
GNPA (%)	+150bps	+100bps	+50bps	+200bps	+150bps	+100bps	+250bps	+200bps	+150bps
AUM growth (YoY, %)	-400bps	-300bps	-200bps	-500bps	-400bps	-300bps	-600bps	-500bps	-400bps
NII (Rs mn)	-2.65%	-7.04%	-9.83%	-3.97%	-10.82%	-15.72%	-4.63%	-12.69%	-18.61%
PPOP (Rs mn)	-7.03%	-17.37%	-24.75%	-10.54%	-26.69%	-39.60%	-12.30%	-31.30%	-46.87%
Provisions (Rs mn)	21.93%	26.05%	18.92%	27.99%	34.85%	30.66%	35.03%	45.06%	44.40%
Provisions (%)	+78bps	+99bps	+57bps	+103bps	+140bps	+96bps	+128bps	+180bps	+135bps
PAT	-53.34%	-72.98%	-52.35%	-72.17%	-105.49%	-84.00%	-88.00%	-129.09%	-104.54%
ABV Rs	-7.23%	-11.90%	-16.15%	-9.56%	-16.97%	-24.96%	-11.78%	-21.16%	-31.56%
RoAA (%)	-57bps	-89bps	-88bps	-77bps	-130bps	-143bps	-94bps	-150bps	-180bps
RoAE (%)	-370bps	-645bps	-624bps	-503bps	-966bps	-1103bps	-617bps	-1210bps	-1453bps
Assigned multiple	2.8			2.7			2.5		
TP	-32.50%			-50.00%			-60.00%		
Upside	-15.6%			-37.5%			-50%		

Source: Company and HSIE Research

Financials

Income statement

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E	FY23E
Interest earned	14,679	18,316	27,036	32,036	37,338	45,770
Interest expended	6,069	7,252	10,700	13,000	15,710	19,095
Net interest income	8,610	11,064	16,336	19,036	21,628	26,676
Non-interest Income	1,115	2,060	3,222	2,887	3,419	4,088
Fee income (CEB)	792	1,395	2,127	1,643	2,095	2,707
Total income	9,725	13,124	19,558	21,923	25,047	30,764
Total operating expenditure	6,529	10,034	13,186	14,313	15,687	19,431
Employee expenses	3,604	5,188	7,185	7,738	8,325	10,443
PPOP	3,196	3,090	6,372	7,610	9,360	11,333
Non-tax provisions	3,108	406	1,710	4,683	5,256	4,388
Prov. For NPAs (incl. std. asset prov.)	3,869	232	1,045	4,604	5,081	4,143
PBT	88	2,684	4,662	2,927	4,104	6,944
Tax expenses	20	692	1,163	746	1,047	1,771
PAT	69	1,992	3,499	2,181	3,057	5,174

Statement of assets and liabilities

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E	FY23E
Sources of funds						
Preference share capital	2,000	2,000	2,000	2,000	2,000	2,000
Equity share capital	14,400	14,400	17,282	17,282	17,282	17,282
Reserves & surplus	69	1,796	12,595	14,776	17,833	23,007
Shareholders' funds	14,469	16,196	29,877	32,058	35,116	40,289
<i>Savings deposits</i>	1,285	7,035	12,310	15,387	20,004	27,005
<i>Current deposits</i>	102	806	2,284	3,427	4,455	5,568
<i>Term deposits</i>	36,338	65,953	93,210	121,174	157,526	196,907
Total deposits	37,725	73,794	107,805	139,988	181,984	229,480
Borrowings	38,528	41,661	39,533	44,006	48,010	53,038
Other liabilities & provisions	2,006	3,771	4,898	5,142	5,400	5,670
Total liabilities	94,729	137,422	184,112	223,194	272,509	330,477
Application of funds						
Cash & cash equivalents	4,948	10,945	13,433	26,046	31,492	30,917
Investments	12,325	15,266	23,961	32,897	40,946	49,338
Advances	73,362	105,525	140,436	157,164	192,038	241,080
Fixed assets	1,983	2,845	3,005	3,155	3,313	3,478
Other assets	2,110	2,842	3,277	3,932	4,719	5,662
Total assets	94,729	137,422	184,112	223,194	272,509	330,477

Source: Bank, HSIE Research

Key Ratios

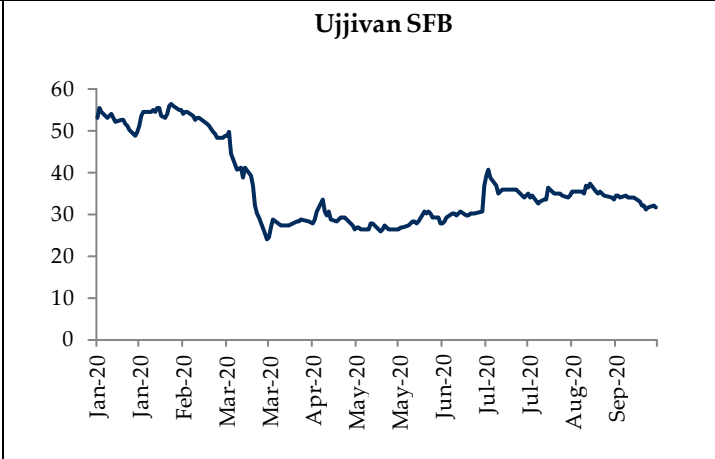
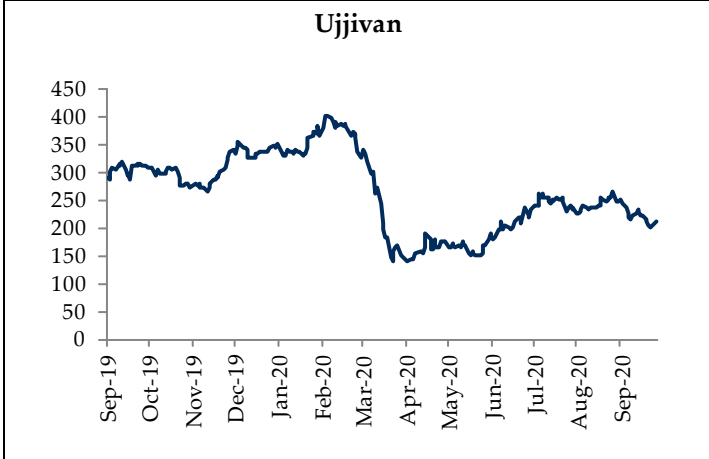
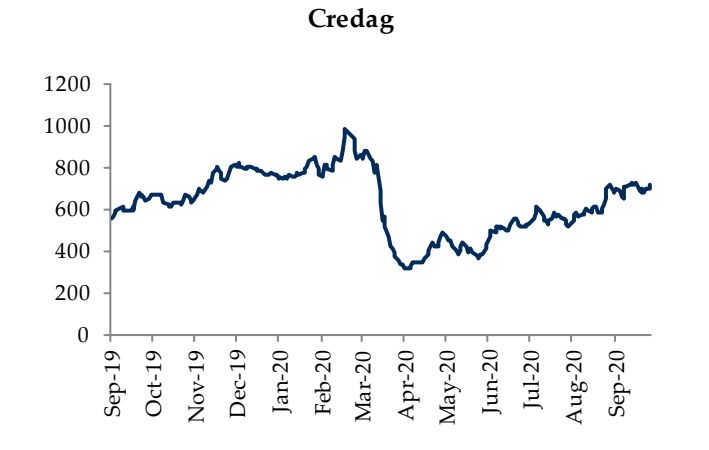
	FY18	FY19	FY20E	FY21E	FY22E	FY23E
Valuation ratios						
EPS (Rs)	0.0	1.4	2.0	1.3	1.8	3.0
Earnings growth (%)	19,505.7	2,803.2	75.6	(37.7)	40.2	69.2
BVPS (Rs)	10.0	11.2	17.3	18.5	20.3	23.3
ABVPS (Rs)	9.7	11.1	17.1	16.9	19.5	22.5
DPS (Rs)	-	-	-	-	-	-
RoAA (%)	0.08	1.72	2.18	1.07	1.23	1.72
RoAE (%)	0.48	12.99	15.19	7.04	9.10	13.72
P/E (x)	667.34	22.99	15.71	25.20	17.98	10.62
P/ABV (x)	3.28	2.88	1.86	1.88	1.63	1.42
P/PPOP (x)	14.33	14.82	8.62	7.22	5.87	4.85
Dividend yield (%)	-	-	-	-	-	-
Profitability (%)						
Yield on advances	18.83	18.58	20.25	20.02	19.80	19.57
Yield on investment	6.89	6.75	7.07	6.90	6.80	6.70
Cost of deposits	5.57	6.40	8.06	7.80	7.53	7.39
Core spread	10.23	11.01	12.11	12.17	12.21	12.12
NIM	10.85	10.72	11.46	10.74	10.23	10.19
Operating efficiency (%)						
Cost/avg. asset ratio	7.3	8.6	8.2	7.0	6.3	6.4
Cost-income ratio	67.1	76.5	67.4	65.3	62.6	63.2
Balance sheet structure						
Loan Growth (%)	25.2	43.8	33.1	11.9	22.2	25.5
Deposit Growth (%)	N/A	95.6	46.1	29.9	30.0	26.1
C/D Ratio (%)	13.1	14.8	12.5	18.6	17.3	13.5
Equity/Assets (%)	15.3	11.8	16.2	14.4	12.9	12.2
Equity/Advances (%)	19.7	15.3	21.3	20.4	18.3	16.7
CASA (%)	3.7	10.6	13.5	13.4	13.4	14.2
Capital Adequacy Ratio (CAR, %)	23.0	18.9	28.8	25.8	23.4	22.2
W/w Tier I CAR (%)	19.3	16.2	26.2	24.8	22.2	21.0
Asset quality						
Gross NPLs (Rs mn)	2,759	979	1,371	7,399	5,305	5,319
Net NPLs (Rs mn)	509	275	275	2,778	1,429	1,477
Gross NPLs (%)	3.8	0.9	1.0	4.7	2.8	2.2
Net NPLs (%)	0.7	0.3	0.2	1.8	0.7	0.6
Slippage (%)	8.4	0.9	1.2	5.0	3.3	2.8
Coverage Ratio (%)	81.5	71.8	80.0	62.5	73.1	72.2
Provision/Avg. Loans (%)	5.9	0.3	0.8	3.1	2.9	1.9
RoAE Tree (%)						
Net interest income	9.62	9.53	10.16	9.35	8.73	8.85
Other income	1.24	1.77	2.00	1.42	1.38	1.36
Operating cost	7.29	8.64	8.20	7.03	6.33	6.44
Non-tax provisions	3.47	0.35	1.06	2.30	2.12	1.46
Tax expense	0.02	0.60	0.72	0.37	0.42	0.59
RoAA	0.08	1.72	2.18	1.07	1.23	1.72
Leverage	6.2	7.6	7.0	6.6	7.4	8.0
RoAE	0.48	12.99	15.19	7.04	9.10	13.72

Source: Bank, HSIE Research

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: >10% Downside return potential

1Yr Price Movement



Thematic reports by HSIE



Cement: WHRS – A key cog in the flywheel



Autos: Where are we on “S” curve?



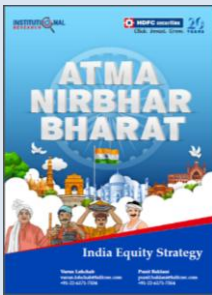
FMCG: Defensive businesses but not valuations



Autos: A changed landscape



Banks: Double whammy for some



India Equity Strategy: Atma Nirbhar Bharat



Indian IT: Demand recovery in sight



Life Insurance: Recovery may be swift with protection driving margins



Retail: Whole flywheel is broken?



Appliances: Looming beyond near-term disruption



Pharma: Chronic therapy – A portfolio prescription



Indian Gas: Looking beyond the pandemic



India Equity Strategy: Quarterly flipbook



Real Estate: Ripe for consumption



Indian IT: expanding centre of gravity



Indian Chemical: Evolution to revolution!



Life Insurance: ULIP vs. MF



Infrastructure: On the road to re-rating



Cement: Spotting the sweet spot



Pharma: Cardiac: the heartbeat of domestic market

Indian Microfinance: Sector Thematic

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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Institutional Equities

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,

Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

Board: +91-22-6171-7330 www.hdfcsec.com