

## Ujjivan Small Finance Bank Ltd.

Recommendation	Subscribe		BACKGROUND
<b>Price Band</b>	Rs. 36 – Rs. 37		<p>USFB's (Ujjivan Small Finance Bank's) promoter UFSL (Ujjivan Financial Services Ltd) commenced operations as an NBFC in 2005 with a focus on MFI-JLG loans (joint liability group). In Oct 2015, UFSL received RBI In-Principle Approval to establish an SFB, following which it incorporated USFB as a subsidiary. UFSL, thereafter transferred its business to USFB, which commenced its operations from Feb, 2017. As on Sep 2019, USFB had advances of Rs. 12,780 Cr and a network of 552 branches. The top 4 products of the bank comprise of Group loans (MFI, 70% mix), Micro individual (8% mix), Affordable Housing (9% mix) and MSE (7% mix).</p> <p><b>Details and Objects of the Issue:</b></p> <p>The public issue of USFB consists of fresh issue of Rs. 746 Cr of which Rs. 71 Cr is reserved for shareholders of UFSL. The object of the issue is to comply with RBI's listing mandate of converting to a SFB with three years of start of operations i.e. by Jan 2020.</p> <p><b>Investment Rationale:</b></p> <p>(a) Diversification of product offerings; shift towards secured products            (b) Healthy mobilization of Deposit franchise with focus on increasing retail base            (c) Opex moderation to act as a key catalyst in supporting return ratios            (d) Geographically well diversified portfolio mix            (e) Robust track record of profitable growth with superior asset quality</p> <p><b>Valuation and Recommendation</b></p> <p>The recent acceleration in AUM growth is likely to sustain with USFB now focusing on new secured product offerings like MSE and Affordable Housing over MFI, which have relatively lower yields but also lower cross-cycle credit costs. Replacement of high cost debt with low cost retail deposits combined with a moderation in cost/income is likely to negate the impact of decline in yields as the portfolio mix shifts towards secured products. Credit costs are expected to remain stable and well below 100 bps. We expect H1FY20 ROA/ROE of 2.5%/19.6% to sustain going ahead. <b>USFB is being offered at trailing P/ABV of 2.1x on post diluted basis leaving GOOD scope for appreciation and thus we recommend subscribing to the issue.</b></p>
<b>Bidding Date</b>	Dec 2 – Dec 4, 2019		
<b>Book Running Lead Manager</b>	Kotak, JM, IIFL		
<b>Registrar</b>	Karvy Fintech		
<b>Sector</b>	BFSI		
<b>Minimum Retail Application- Detail at Cut off Price</b>			
Number of Shares	400		
Minimum Application Money	14,800		
Discount to UFSL shareholders	Rs. 2 per share		
<b>Financials (Rs Cr)</b>	<b>FY18</b>	<b>FY19</b>	
Net Interest Income	861	1106	
Pre-Provision Profit	320	309	
PAT	7	199	
<b>Valuations (Post Issue)</b>	<b>At Upper Band</b>		
Market Cap (Rs in Cr)	6394		
EPS*	2.2		
P/E ratio*	17.1		
P/ABV*	2.0x		
RoE (%)*	19.6%		
Note: * = Annualised for H1FY20			
<b>Post Issue Shareholding Pattern</b>			
Promoters	83.3%		
Others	16.7%		
<b>Offer structure for different categories</b>			
QIB (Including Mutual Fund)	75%		
Non-Institutional	15%		
Retail	10%		
Post Issue Equity (Rs. in cr)	1728		
Issue Size (Rs in cr)	746		
Face Value per share (Rs)	10		
<p><b>Jehan Bhadha (+91 22 6273 8174)</b>            Research Analyst            jehankersi.bhadha@nirmalbang.com</p>			
<b>Financial Snapshot</b>	<b>FY18</b>	<b>FY19</b>	<b>H1FY20</b>
Net Interest Income	861	1106	740
YoY growth (%)		29%	46%
Pre Provision Profit	320	309	303
YoY growth (%)		-3%	100%
PAT	7	199	187
YoY growth (%)		2803%	108%
ROA	0.1%	1.7%	2.5%
ROE	0.4%	11.5%	19.6%
P/E @ Rs. 37			17.1x #
P/Adj. BV @ Rs. 37			2.0x *

# Annualised on post issue basis; \* post issue basis

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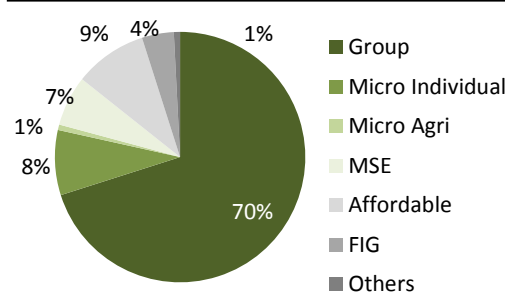
**Business Overview**

USFB’s (Ujjivan Small Finance Bank’s) promoter UFSL (Ujjivan Financial Services Ltd) commenced operations as an NBFC in 2005 with a focus on MFI-JLG loans (joint liability group). In Oct 2015, UFSL received RBI In-Principle Approval to establish an SFB, following which it incorporated USFB (Ujjivan Small Finance Bank Ltd) as a wholly-owned subsidiary. UFSL, thereafter transferred its business undertaking to USFB, which commenced its operations from Feb 1, 2017.

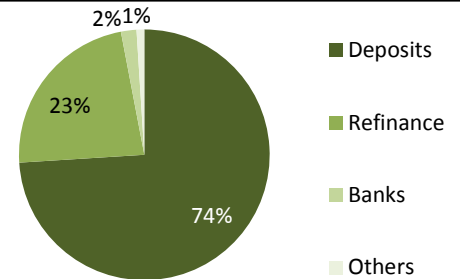
USFB’s asset products comprise: (i) loans to micro banking customers that include group loans (ATS upto Rs. 60,000) and individual loans (ATS of Rs. 0.5-2 Lacs), (ii) agriculture and allied loans, (iii) MSE loans (ATS of Rs. 3-50 lacs), (iv) affordable housing loans (ATS of Rs. 2-35 Lacs), (v) financial institutions group loans (ATS of Rs. 10-25 Cr), (vi) personal loans, and (vii) vehicle loans. On the liability side, USFB offers savings accounts, current accounts and a variety of deposit accounts. In addition, it also provides non-credit offerings comprising ATM-cum-debit cards and distribution of third party insurance products.

Among all the leading SFBs in India, USFB has the most diversified portfolio, spread across 24 states and UTs. As of Sep, 2019, USFB served 49 lac customers and operated from 552 branches that included 141 branches in Unbanked Rural Centres (“URCs”).

**Exhibit 1: Loan Book Mix (Q2FY20)**

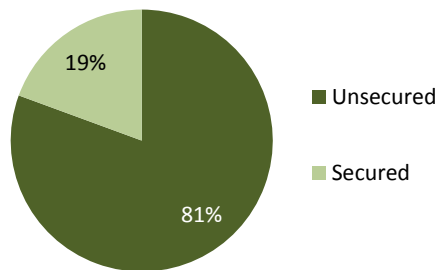


**Exhibit 2: Borrowing Mix (Q2FY20)**

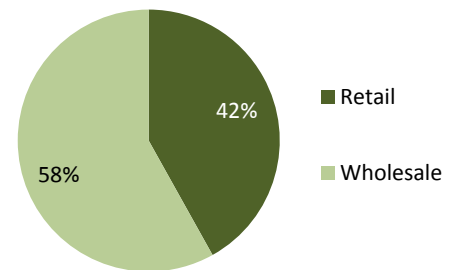


Source: Company, NBRR

**Exhibit 3: Nature of Loan Book**



**Exhibit 4: Deposit Mix (Q2FY20)**



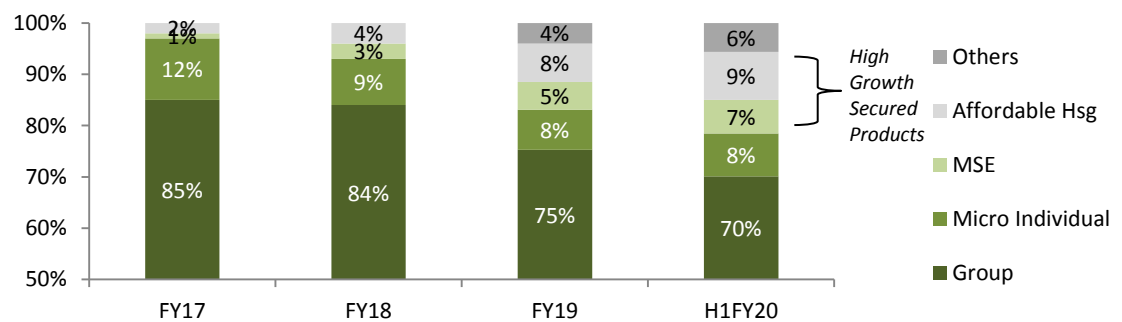
Source: Company, NBRR

**Investment Rationale**

❖ **Diversification of product offerings; shift in favor of secured products**

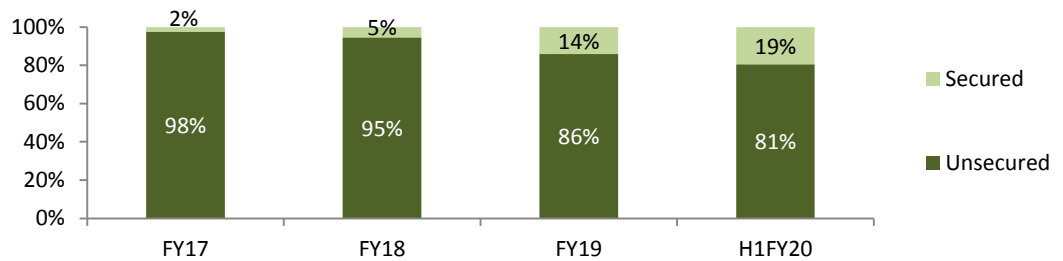
Currently, USFB’s group loan customers with positive repayment track record graduate to becoming individual loan customers. It intends to capitalize on this trend by increasing the penetration of individual loan products, and by innovating and designing need-specific products and services. The bank also offers MSE loans, affordable housing loans, vehicle finance and micro-loans against property to family members of its customers. High growth in MSE and affordable housing shall increase the proportion of secured products, thereby further enhancing the quality of portfolio. USFB intends to increase the ticket size of products, while relying on its established credit assessment procedures & risk management framework to ensure a high quality balanced portfolio.

**Exhibit 1: Diversification into MSE, affordable housing & other retail products**



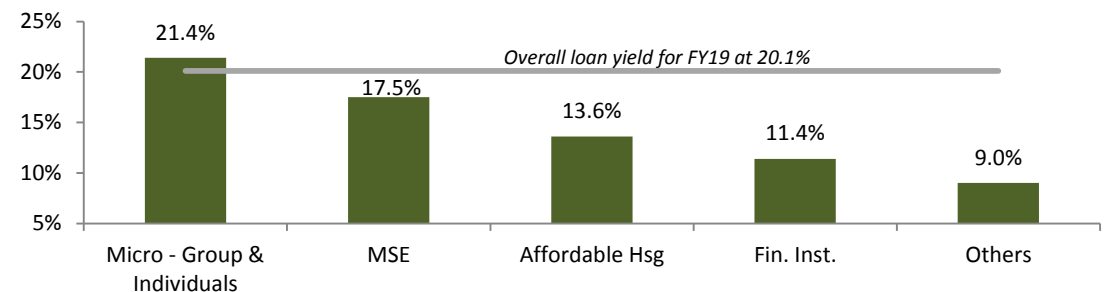
Source: Company, NBRR

**Exhibit 1: Rising share of secured products**



Source: Company, NBRR

**Exhibit 1: Segment-wise yields (FY19)**



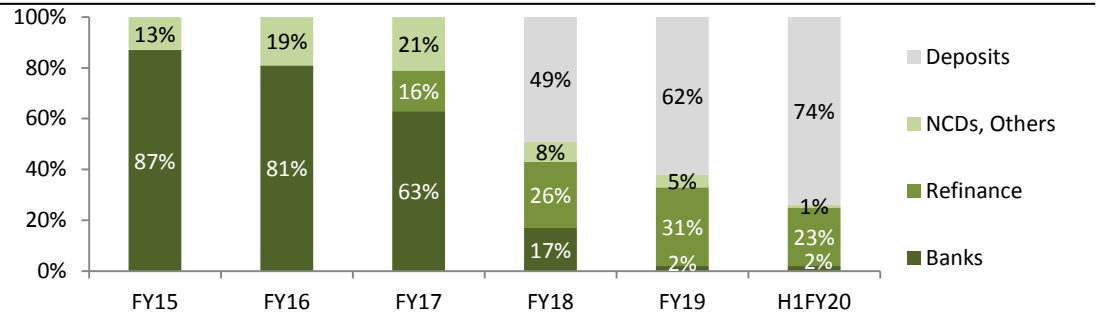
Source: Company, NBRR

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❖ **Healthy mobilization of Deposit franchise with focus on increasing retail base**

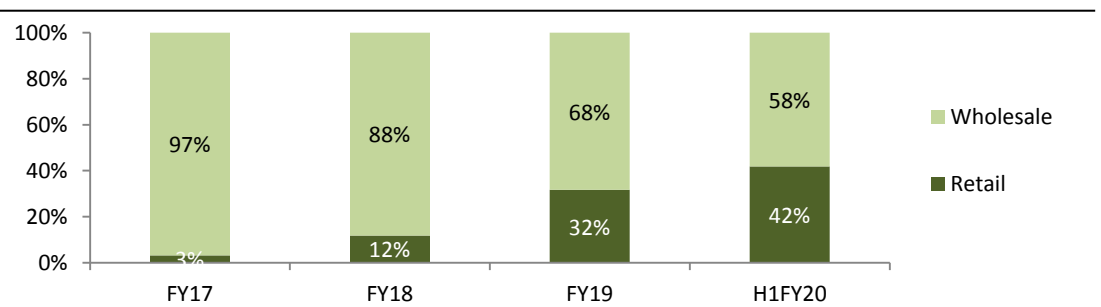
Currently USFB has a strong base of 49 lac customers. It intends to strengthen its liability franchise with a focus on growing its retail deposit base to provide it with a stable, low-cost source of funding. As of Sep 2019, the deposit base of Rs. 10,130 Cr comprises 74% mix of overall borrowings, up from 49% mix as on Sep 2018. Retail deposits out of total deposits were at 42% mix as against 30% mix YoY. As a result, Cost of Funds has been declining. USFB intends to further expand its retail deposit base through measured expansion of its Banking Outlets and offer digital savings and deposit products through internet and mobile banking to acquire new customers. This shift will enable it to access diversified, short term, low cost funds.

**Exhibit 5: Robust increase in Deposits mix**



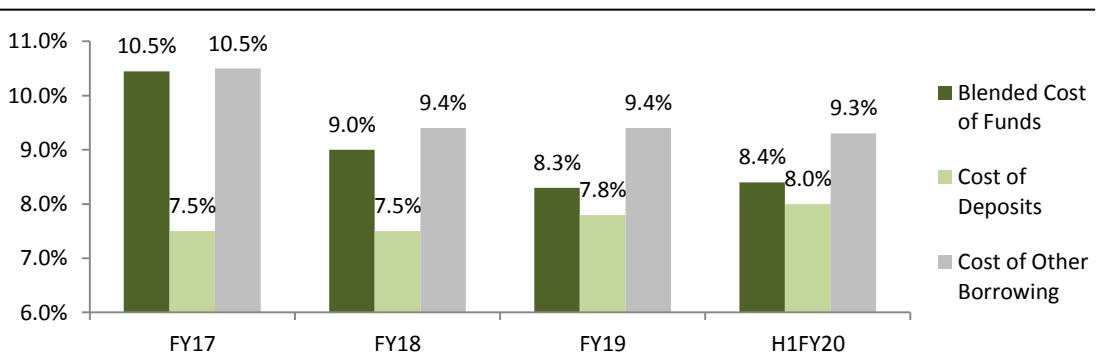
Source: Company, NBRR

**Exhibit 5: Increasing share of Retail mix in Deposits**



Source: Company, NBRR

**Exhibit 5: Cost of Deposits are significantly lower than Cost of Other Borrowings**

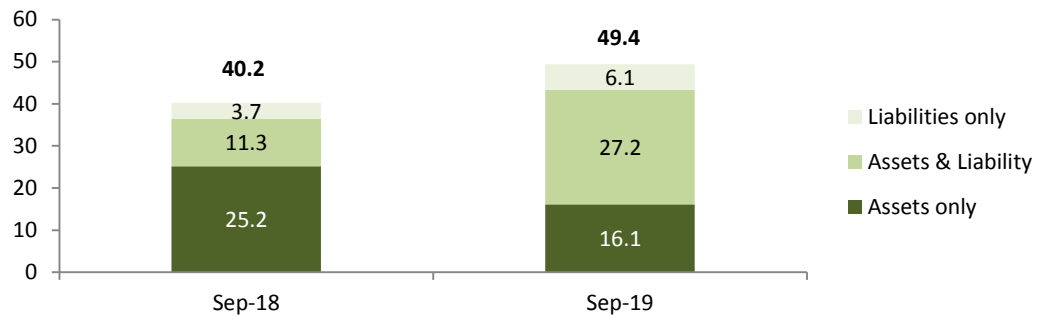


Source: Company, NBRR

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USFB is also converting its existing asset side relationships to liabilities. It plans to cover most of its Micro Banking (MFI & Micro Individual) customers with liability products by the end of FY20.

**Exhibit 5: Tapping Assets side relationships (Customers in Lacs)**

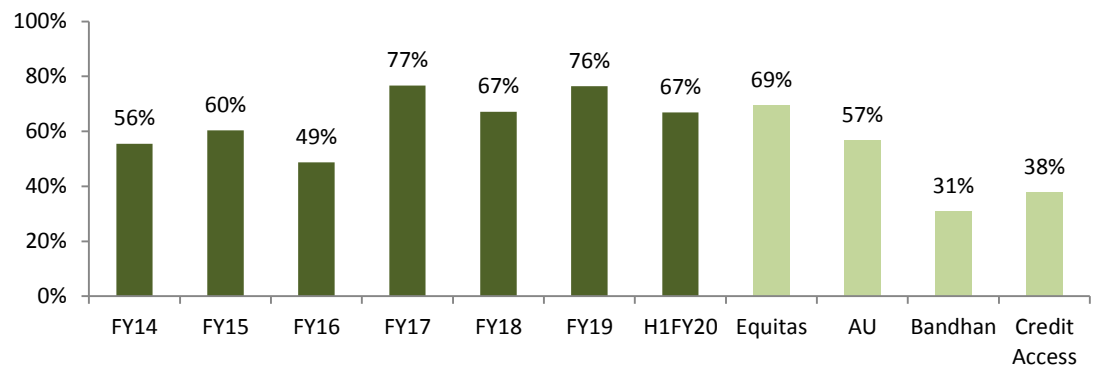


Source: Company, NBRR

❖ **Opex moderation to act as a key catalyst in increasing return ratios**

Although USFB’s ‘high yield, high cost’ business model implies a higher cost/income ratio as compared to a general large scale commercial bank, the costs increased substantially over the FY17-19 period as the bank converted its NBFC outlets into bank branches. Further the bank also introduced several new banking products which required additional staff strength. Thus the cost/income ratio averaged at 73% over FY17-19 period from 49% in FY16. With the SFB conversion phase behind and a sharp pick-up in loan growth, cost/income declined to 67% in H1FY20 from 76% in FY19. This decline is likely to continue in coming years.

**Exhibit 15: Cost/Income ratio to further decline**



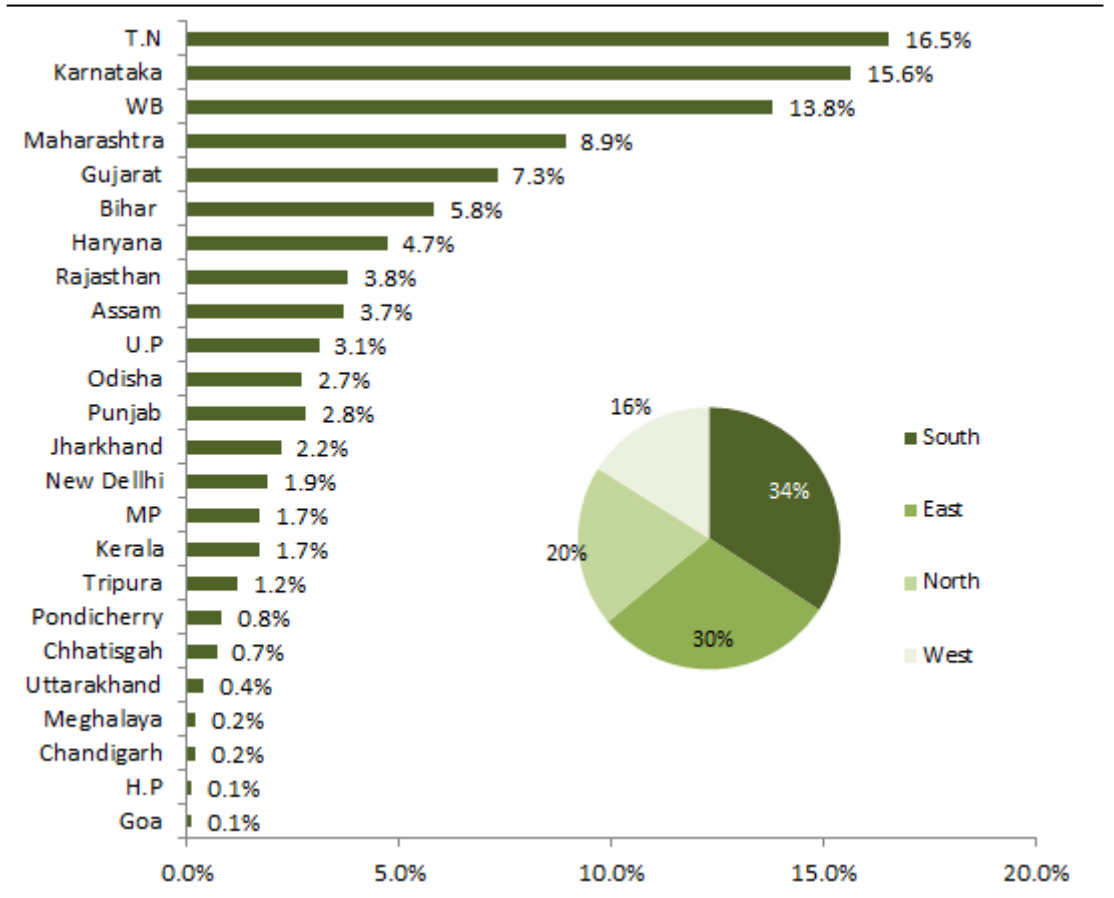
Source: Company, NBRR (Q2FY20 figures for Equitas, AU, Bandhan, Credit Access)

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❖ **Geographically well diversified portfolio mix**

USFB has a highly diversified portfolio with no state accounting for more than 17% of overall portfolio. Diversified operations allow the bank to derisk its business by mitigating political and state-specific risks. USFB has a larger footprint in the southern & eastern regions. As of Sep, 2019 USFB was present in 24 states and union territories encompassing 232 districts via 552 branches. Urban, semi-urban and rural areas account for 65%, 30% and 5% respectively of the AUM.

**Exhibit 5: State / Region wise portfolio mix**



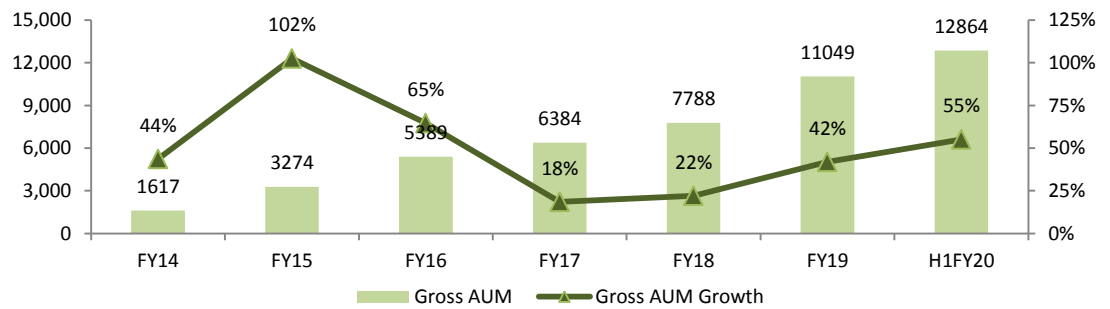
Source: Company, NBRR

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❖ **Robust track record of profitable growth with superior asset quality**

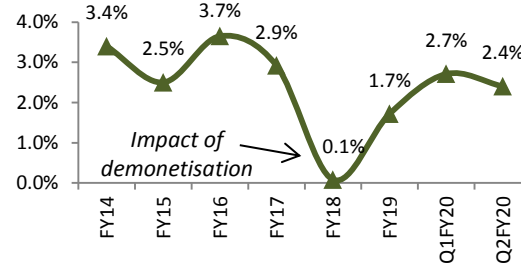
Combining the performance of erstwhile UFSL (NBFC) and USFB (post conversion to SFB) we note that the company grew its Gross AUM at a strong 46% CAGR over FY14-H1FY20. ROA/ROE averaged at 3.2%/16.3% over FY4-16 before sliding lower during FY17 & FY18 owing to (i) conversion from NBFC to bank branches which led to an increase in opex, and (ii) demonetization which led to higher credit costs. Asset quality has been impressive except for the impact of demonetization during FY17 & FY18.

**Exhibit 1: Gross AUM & Growth**

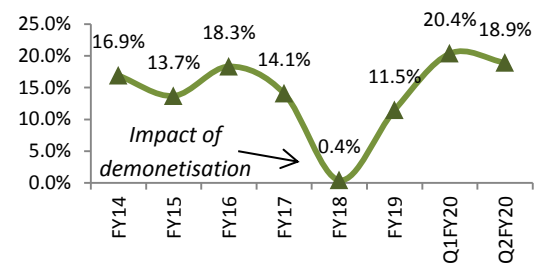


Source: Company, NBRR

**Exhibit 3: ROA**

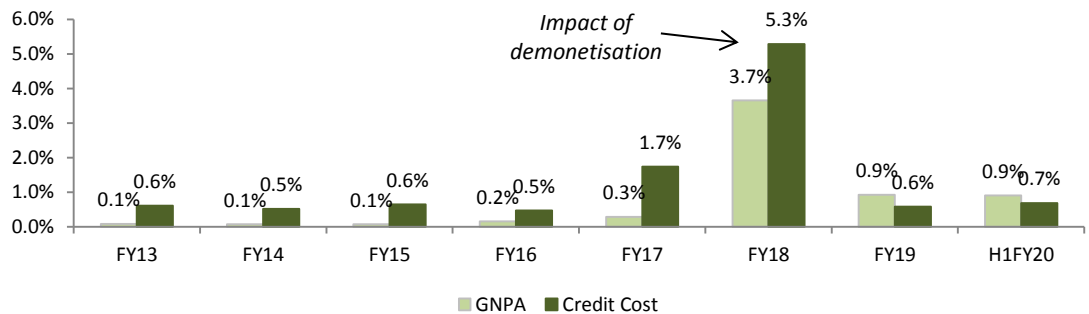


**Exhibit 4: ROE**



Source: Company, NBRR

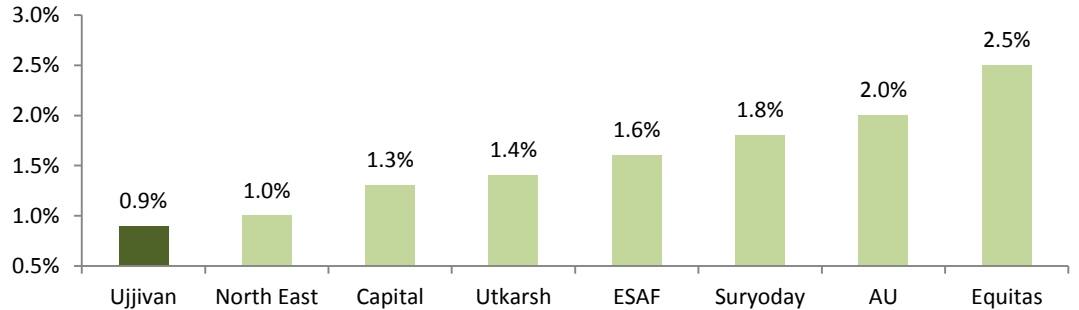
**Exhibit 1: GNPA & Credit Cost**



Source: Company, NBRR

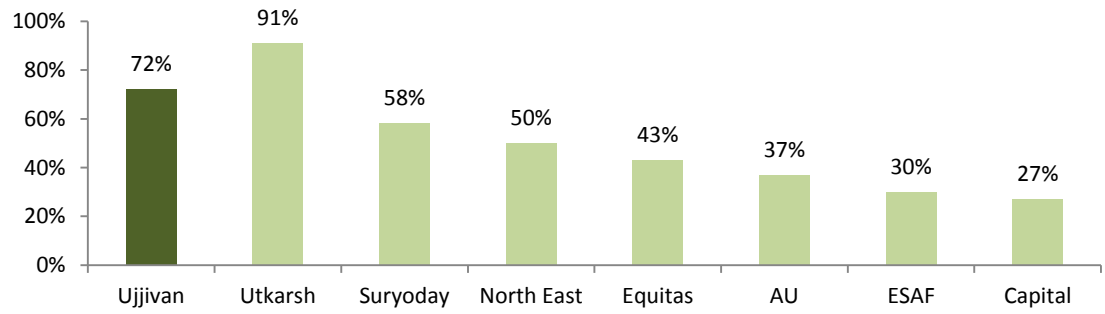
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**Exhibit 1: GNPA (FY19): The best amongst SFBs**



Source: Company, NBRR

**Exhibit 1: PCR (FY19): Amongst the top quartile within SFBs**



Source: Company, NBRR



**Key Risks and Concerns**

❖ **High exposure to Unsecured segments poses a risk**

Although the overall mix of unsecured portfolio is declining, it still constitutes 81% of the AUM and is mainly focused towards the bottom of the pyramid borrowers and thus poses a high risk in the eventuality of a severe economic slowdown. Any state or region specific political interference/event or natural calamities like floods and droughts could also impact the collection efficiency of USFB.

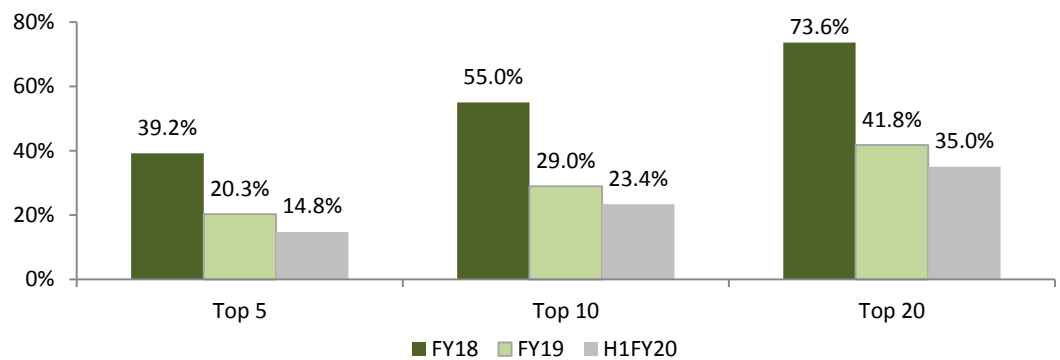
❖ **Non-compliance with RBI observations may have an adverse impact on USFB in future**

During an inspection conducted during January and February 2019, for the financial year FY18, RBI had made certain observations regarding business and operations in relation to (i) the lack of a system to tag PSL advances, miscategorising of PSL advances, and earning of processing fees on PSL loans; (ii) lack of a rating methodology to assess borrowers; (iii) high proportion of bulk deposits, and concentration of deposits in top 20 depositors; (iv) liability products being offered from certain Asset Centres without RBI approval; (v) lack of a fraud management system, weak customer grievances redressal mechanism and deficiencies in AML and KYC protocols; (vi) the lack of an independent compliance department. USFB has responded to such observations and addressed them, and for certain observations has provided a timeline by which they would be resolved.

❖ **High concentration of deposits**

Top 20 depositors constitute 35% of the total deposits which exposes the bank to future funding risks. Although their concentration is consistently declining.

**Exhibit 15: Cost/Income ratio to further decline**



Source: Company, NBRR (Q2FY20 figures for Equitas, AU, Bandhan, Credit Access)

### Valuation and Recommendation

The recent acceleration in AUM growth is likely to sustain with USFB now focusing on new secured product offerings like MSE and Affordable Housing over MFI, which have relatively lower yields but also lower cross-cycle credit costs. Replacement of high cost debt with low cost retail deposits combined with a moderation in cost/income is likely to negate the impact of decline in yields as the portfolio mix shifts towards secured products. Credit costs are expected to remain stable and well below 100 bps. We expect H1FY20 ROA/ROE of 2.5%/19.6% to sustain going ahead. **USFB is being offered at trailing P/ABV of 2.1x on post diluted basis leaving GOOD scope for appreciation and thus we recommend subscribing to the issue.**

#### Exhibit 17: Peer Comparison

	Equitas SFB *	AU SFB	Bandhan Bank #	Credit Access	Avg.	Ujjivan SFB
<b>As on Q2FY19</b>						
Loan Book (Rs cr)	13,269	27,876	64,186	7,905	28,309	12,780
Tier 1	20.5%	14.9%	23.0%	32.8%	22.8%	18.2%
NIM	8.8%	5.3%	8.2%	12.3%	8.7%	10.6%
Cost/Income	69%	57%	31%	38%	49%	67%
GNPA	2.8%	2.0%	1.0%	0.5%	1.6%	0.9%
NNPA	1.7%	1.1%	0.6%	0.0%	1.1%	0.3%
Loan CAGR FY17-Q2FY20	28%	46%	25%	46%	36%	37%
ROA FY19	1.5%	1.5%	3.9%	5.0%	3.0%	1.7%
ROA H1FY20	1.3%	1.7%	4.8%	4.8%	3.2%	2.5%
ROE FY19	9.1%	14.1%	19.0%	16.3%	14.6%	11.5%
ROE H1FY20	9.0%	17.5%	28.3%	16.0%	17.7%	19.6%
P/BV as on Q2FY20	3.2	6.8	6.2	4.6	5.2	2.1
P/ABV as on Q2FY20	3.5	7.4	6.4	4.6	5.5	2.1

(Source: Company Data, Nirmal Bang Research)

Note: \* Equitas P/B is derived assuming Holding co is trading at a 55% discount post listing of SFB

Note: # Bandhan AUM CAGR includes that of Gruh's AUM before acquisition

## Ujjivan Small Finance Bank Ltd.

### Financials

P&L (Rs. Crs)	FY18	FY19	H1FY19	H1FY20	#H1FY20 Ann	Bal. Sheet (Rs. Crs)	FY18	FY19	H1FY20
Interest earned	1,468	1,832	833	1,260	2,519	Equity capital	1,440	1,440	1,440
Interest expended	607	725	327	519	1,039	Prof. Sh Cap	200	200	200
<b>NII</b>	<b>861</b>	<b>1,106</b>	<b>506</b>	<b>740</b>	<b>1,481</b>	Reserves & surplus	7	180	400
Non interest income	111	206	91	175	350	Net worth	1,647	1,820	2,040
<b>Total income</b>	<b>972</b>	<b>1,312</b>	<b>597</b>	<b>916</b>	<b>1,831</b>	Deposits	3,773	7,379	10,130
<i>Growth</i>		35%		53%	40%	(of which CASA)	138	785	1,203
Operating expenses	653	1,003	446	613	1,226	Borrowings	3,853	4,166	3,470
<i>Growth</i>		54%		37%	22%	Other liab and prov	201	377	468
Staff costs	360	519	233	337	674	Total liabilities	7,826	11,923	14,068
Other Op Exp	292	485	213	276	552	<b>Total liab and equity</b>	<b>9,473</b>	<b>13,742</b>	<b>16,108</b>
<b>Profit before prov</b>	<b>320</b>	<b>309</b>	<b>152</b>	<b>303</b>	<b>605</b>	Cash and bank bal	245	648	222
<i>Growth</i>		-3%		100%	96%	Bal. with RBI	250	446	487
Provisions	311	41	21	44	87	Investments	1,232	1,527	2,018
<i>Growth</i>	-87%	-87%		105%	115%	Net Advances	7,336	10,552	12,780
Profit before tax	9	268	130	259	518	<i>Growth</i>	25%	44%	59%
Taxes	2	69	40	72	144	Other assets	409	569	600
<b>Net profit</b>	<b>7</b>	<b>199</b>	<b>90</b>	<b>187</b>	<b>374</b>	<b>Total assets</b>	<b>9,473</b>	<b>13,742</b>	<b>16,108</b>
<i>Growth</i>				108%	88%				

Key Ratios	FY18	FY19	H1FY19	H1FY20	#H1FY20 Ann	Asset Quality	FY18	FY19	H1FY20
Yield on Advances	19.7%	20.1%	19.8%	19.9%	19.9%	GNPA	276	98	109
Yield on Tot Assets	17.7%	17.0%	18.0%	18.2%	18.2%	GNPA ratio	3.7%	0.9%	0.9%
Cost of Borrowings	9.0%	8.3%	8.3%	8.4%	8.4%	NNPA	51	28	43
Spread	10.65%	11.77%	11.50%	11.50%	11.50%	NNPA ratio	0.7%	0.3%	0.3%
NIM	10.31%	10.93%	10.88%	10.64%	10.64%	PCR (Reported)	82%	72%	61%
						Credit Cost	4.2%	0.4%	0.6%

Per Share Data	FY18	FY19	H1FY19	H1FY20	#H1FY20 Ann	Balance Sheet Ratios	FY18	FY19	H1FY20
EPS	0.0	1.4	0.6	1.1	2.2	Deposit / Tot. Borrow	49.5%	63.9%	74.5%
BVPS	11.4	12.6	12.1	17.9	18.8	CASA	3.7%	10.6%	11.9%
Adjusted BVPS	11.1	12.4	11.9	17.6	18.5	Tier - 1	22.3%	18.4%	18.2%

Valuation Ratios	FY18	FY19	H1FY19	H1FY20	#H1FY20 Ann	Profitability Ratios	FY18	FY19	H1FY20
P/E	776.3	26.7			17.1	Cost / Income Ratio	67.1%	76.5%	66.9%
P/BV *	3.2	2.9	3.1	2.1	2.0	ROE	0.4%	11.5%	19.6%
P/ABV *	3.3	3.0	3.1	2.1	2.0	ROA	0.08%	1.72%	2.51%

Source: Company data, NBRR

# = H1FY20 Annualised figures

\* = P/B & P/ABV as on H1FY20 are on post diluted basis

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