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Ujjivan Small Finance Bank | Industry: BFSI

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Ujjivan is a play on the MFI growth story. So far, it has effectively managed to grow assets with decent asset quality profile. However, going forward trajectory of business model will change with buildup of non-MFI loans and ramp of retail liabilities which shall be an uphill task for the new management in the wake of tough competition in the market space. Also, the bank will have to reduce down the promoter stake further to 40% over the next 2 yrs from levels of 84% post IPO as per RBI guidelines which will be a hangover in the medium term. In this backdrop, in our view, the bank is not likely to trade at higher multiples. Our back of the envelope calculation suggests, the bank is trading at 1.6x FY22e. Given reasonable valuations, we recommend SUBSCRIBE to the issue.

#### About the company

Ujjivan Small Finance Bank (USFB) is majorly into micro-finance lending with asset base of ₹161 bn, 552 banking outlets across 24 states/UTs across 232 districts and 4.9 mn total customers. The IPO is mainly to comply with RBI norms to list within 3 yrs of receiving banking license. USFB is a subsidiary of Ujjivan Financial Services (UFSL) incorporated in 2005, which will dilute their stake in the bank from current 94.4% to 80% post IPO. The promoter stake in the bank has to reduce down further to 40% in next 2 yrs time which shall be a hangover in the medium-term.

#### Key investment arguments

##### MFI growth play

It has 14 years of operating history (while bank is in existence since last ~3 yrs) in lending to micro-finance space. Currently, MFI loans contribute nearly 79% of total loans. Assets, which are at ₹128 bn, have grown at strong CAGR of 32% in last 2.5 yrs from FY17-Q2FY20. Apart from growing at higher rates, it has also tried to diversify the asset mix. It has introduced other loans like MSE loans, housing, vehicle and personal loans and term loans to NBFCs and MFIs. Affordable housing contributes nearly 9.5% of total loans and MSE 6.5%. Geography-wise, south has 35% share, east 29%, north 20% and west 16%.

SFB license were issued to nearly 10 NBFCs of which Ujjivan is one of the players. Currently, AU SFB is the only one listed player in SFB while other having sizeable reach are Equitas Holdings, Janalakshmi, ESAF Micro-Finance, Disha Microfinance. Micro-finance is a high margin, high ROE business only if costs are controlled. There are few successful players having strong profitability matrix. Ujjivan SFB draws ROE of 19.6% and ROA of 2.5% (H1FY20). In our view, future profitability would be driven by how successful it is in building non-MFI loans and retail deposit franchise while keeping costs in check.

##### Post banking license, liabilities are at initial stage of growth, lot more needs to done

In last 3 yrs, deposits have reached a size of ₹101.3 bn, of this retail deposits are at ₹42.5 bn i.e. 42% of total deposits spread across 3.3 mn customers. While CASA is at 12%, CA 2.1% and SA 9.8% as on Q2FY20. Crucial is buildup of retail deposits which is meager at ₹42.5 bn while non-retail deposits are high at 58%. Also, concentration of top 20 depositors is high at 35% of total deposits. One of the reason for low accretion of retail deposits is sourcing of the same done from micro-banking customers which have lower savings. The bank will have to re-engineer the strategy for fast buildup of deposits to focus more on urban & semi-urban location. In our view, successful buildup of the retail liabilities will be tough task for the bank given the steep competition in the market.

##### Management change underway

Founding promoter & CEO of the company Mr.Samit Ghosh will be retiring from the bank in November 2019. Mr.Nitin Chugh, current President, will be taking over as MD&CEO with effect from 1st December 2019. His previous assignment has been with HDFC Bank, Standard Chartered Bank, HCL Hewlett Packard. At this crucial juncture where the business model is going through a significant change, management change is disappointing. Achieving right strategies and delivering on high expectations will be an uphill task for the new management.

| IPO Details             |              |
|-------------------------|--------------|
| Rating                  | SUBSCRIBE    |
| IPO Price (₹/share)     | 36-37        |
| M Cap post issue (₹ mn) | 66,587       |
| Issue Opens             | Dec 2, 2019  |
| Issue closes            | Dec 4, 2019  |
| IPO Share listing       | Dec 12, 2019 |

| Key Data                              |        |
|---------------------------------------|--------|
| Price Band (₹ /share)                 | 36-37  |
| No. of Shares to be issued (mn)       | 203    |
| Issue Size (₹ mn)                     | 7,500  |
| Fresh issue size (₹ mn)               | 7,500  |
| Capital before pre-IPO placement (mn) | 15,255 |
| Pre-IPO Eq. Capital (mn)              | 15,969 |
| Post-IPO Eq. Capital (mn)             | 17,997 |
| Dilution (%)                          | 12.7   |
| FV (₹)                                | 10.0   |

| Share Reservation (%) |    |
|-----------------------|----|
| QIB                   | 75 |
| Non-institutional     | 15 |
| Retail                | 10 |

| Issue Managers |  |
|----------------|--|
| BRLMs          | Kotak Mahindra Capital, IIFL Securities, JM Financial. |
| Registrar      | Karvy Fintech  |
| Listing        | BSE, NSE   |

| Financials     |       |        |        |
|----------------|-------|--------|--------|
| (₹ mn)         | FY18  | FY19   | H1FY20 |
| NII            | 8,610 | 11,064 | 7,404  |
| PAT            | 69    | 1,992  | 1,871  |
| y-o-y (%)      | -     | 2,803  | 108    |
| EPS (₹)        | 0.0   | 1.4    | 1.3    |
| BV (x)         | 10.0  | 11.2   | 12.8   |
| ABV (x)        | 9.7   | 11.1   | 12.5   |
| P/ABV (x)      | 3.8   | 3.3    | 3.0    |
| Gross NPAs (%) | 3.8   | 0.9    | 0.9    |
| Net NPAs (%)   | 0.7   | 0.3    | 0.3    |
| CET 1 (%)      | 19.3  | 16.2   | 16.2   |
| Total CAR (%)  | 23.0  | 18.9   | 18.8   |

### Hangover to bring down promoter stake further to 40% in next 2 yrs from 80%

Ujjivan Small Finance Bank's (USFB) IPO is mainly to comply with RBI norms to list within 3 yrs of receiving banking license. USFB is a subsidiary of Ujjivan Financial Services (UFSL) incorporated in 2005, which will dilute their stake in the bank from current 94.4% to 80% post IPO. The promoter stake in the bank has to reduce down further to 40% in next 2 yrs time which shall be a hangover in the near-term.

### Valuations

Ujjivan is a play on the MFI growth story. So far, it has effectively managed to grow the assets with decent asset quality profile. However going forward, trajectory of business model will change with buildup of non-MFI loans and ramp of retail liabilities which shall be an uphill task for the new management in the wake of tough competition in the market space. Also, the bank will have to reduce down the promoter stake further to 40% over the next 2 yrs from levels of 84% post IPO as per RBI guidelines which will be a hangover in the medium term. In this backdrop, in our view, the bank is not likely to trade at higher multiples. Our back of the envelope calculation suggests, the bank is trading at 1.6x FY22e. Given reasonable valuations, we recommend **SUBSCRIBE** to the issue.

| Valuations         | FY17    | FY18  | FY19  | H1FY19 | H1FY20 |
|--------------------|---------|-------|-------|--------|--------|
| EPS (₹)            | 0.0     | 0.0   | 1.4   | 0.6    | 1.3    |
| BV (x)             | 10.0    | 10.0  | 11.2  | 10.7   | 12.8   |
| ABV (x)            | 10.0    | 9.7   | 11.1  | 10.5   | 12.5   |
| No. of shares (mn) | 1,440   | 1,440 | 1,440 | 1,440  | 1,440  |
| FV of shares (₹)   | 10.0    | 10.0  | 10.0  | 10.0   | 10.0   |
| P/E (x)            | 152,232 | 776.4 | 26.7  | 59.1   | 28.5   |
| P/BV (x)           | 3.7     | 3.7   | 3.3   | 3.5    | 2.9    |
| P/ABV (x)          | 3.7     | 3.8   | 3.3   | 3.5    | 3.0    |
| Price (₹)          | 37      | 37    | 37    | 37     | 37     |

## Financials

| Profit & Loss                                  |               |                |                 |                 |                 |
|--|---------------|----------------|-----------------|-----------------|-----------------|
| (₹ mn)   | FY17          | FY18           | FY19            | H1FY19          | H1FY20          |
| Interest income                                | 2,170         | 14,679         | 18,316          | 8,333           | 12,597          |
| Interest Expenses                              | 1,094         | 6,069          | 7,252           | 3,270           | 5,193           |
| <b>NII</b>                                     | <b>1,077</b>  | <b>8,610</b>   | <b>11,064</b>   | <b>5,063</b>    | <b>7,404</b>    |
| Other Income                                   | 69            | 1,115          | 2,060           | 911             | 1,752           |
| <b>Total Income</b>                            | <b>1,145</b>  | <b>9,725</b>   | <b>13,124</b>   | <b>5,975</b>    | <b>9,156</b>    |
| Operating Expenses                             | 1,092         | 6,529          | 10,034          | 4,459           | 6,130           |
| <b>Operating Income</b>                        | <b>53</b>     | <b>3,196</b>   | <b>3,090</b>    | <b>1,516</b>    | <b>3,026</b>    |
| Provisions and Contingencies                   | 44            | 3,108          | 406             | 212             | 436             |
| PBT  | 9             | 88             | 2,684           | 1,304           | 2,590           |
| Tax Expense                                    | 9             | 20             | 692             | 402             | 719             |
| <b>Profit for the year</b>                     | <b>0</b>      | <b>69</b>      | <b>1,992</b>    | <b>901</b>      | <b>1,871</b>    |
| <i>Growth (%)</i>                              |               | <i>19508.6</i> | <i>2802.8</i>   |                 | <i>107.6</i>    |
| EPS  | 0.0           | 0.0            | 1.4             | 0.6             | 1.3             |
| FV   | 10            | 10             | 10              | 10              | 10              |
| No. of Shares                                  | 1,440         | 1,440          | 1,440           | 1,440           | 1,440           |
| Balance Sheet                                  |               |                |                 |                 |                 |
| (₹ mn)   | FY17          | FY18           | FY19            | H1FY19          | H1FY20          |
| <b>LIABILITIES</b>                             |               |                |                 |                 |                 |
| <b>Share Capital</b>                           | <b>16,400</b> | <b>16,400</b>  | <b>16,400</b>   | <b>16,400</b>   | <b>16,400</b>   |
| of which - Equity Capital                      | 14,400        | 14,400         | 14,400          | 14,400          | 14,400          |
| of which - Preference Capital                  | 2,000         | 2,000          | 2,000           | 2,000           | 2,000           |
| Share application money pending allotment      |               |                |                 |                 | 359             |
| ESoPs and purchase outstanding                 |               |                |                 |                 | 107             |
| Reserves & Surplus                             | 0             | 69             | 1,796           | 970             | 3,534           |
| <b>Shareholder Funds</b>                       | <b>16,401</b> | <b>16,469</b>  | <b>18,196</b>   | <b>17,371</b>   | <b>20,401</b>   |
| Deposits                                       | 2,064         | 37,725         | 73,794          | 41,881          | 1,01,298        |
| Borrowings                                     | 62,914        | 38,528         | 41,661          | 41,869          | 34,702          |
| Current Liabilities                            | 2,980         | 2,006          | 3,771           | 2,717           | 4,678           |
| <b>TOTAL LIABILITIES</b>                       | <b>84,359</b> | <b>94,729</b>  | <b>1,37,422</b> | <b>1,03,837</b> | <b>1,61,079</b> |
| <b>ASSETS</b>                                  |               |                |                 |                 |                 |
| Cash & Bank Balances                           | 2,609         | 2,496          | 4,465           | 1,960           | 4,873           |
| Bal. with banks & money at call & short notice | 5,019         | 2,452          | 6,480           | 3,412           | 2,221           |
| Investments                                    | 14,467        | 12,325         | 15,266          | 13,303          | 20,184          |
| Loans & Advances                               | 58,610        | 73,362         | 1,05,525        | 80,387          | 1,27,804        |
| Fixed Assets                                   | 1,398         | 1,983          | 2,845           | 2,521           | 2,962           |
| Other Assets                                   | 2,256         | 2,110          | 2,842           | 2,254           | 3,036           |
| <b>TOTAL ASSETS</b>                            | <b>84,359</b> | <b>94,729</b>  | <b>1,37,422</b> | <b>1,03,838</b> | <b>1,61,079</b> |

Source: Company, LKP Research

| <b>Ratios</b>                 |             |             |             |               |               |
|-------------------------------|-------------|-------------|-------------|---------------|---------------|
| <b>Growth Rates (%)</b>       | <b>FY17</b> | <b>FY18</b> | <b>FY19</b> | <b>H1FY19</b> | <b>H1FY20</b> |
| Loans                         | -           | 25.2        | 43.8        | -23.8         | 59.0          |
| Investments                   | -           | -14.8       | 23.9        | -12.9         | 51.7          |
| Total assets                  | -           | 12.3        | 45.1        | -24.4         | 55.1          |
| NII                           | -           | 699.8       | 28.5        | -54.2         | 46.2          |
| Total Income                  | -           | 749.2       | 34.9        | -54.5         | 53.2          |
| Operating Income              | -           | 5,901       | -3.3        | -50.9         | 99.6          |
| PAT                           | -           | 19,509      | 2,803       | -54.8         | 107.6         |
| <b>Other important ratios</b> | <b>FY17</b> | <b>FY18</b> | <b>FY19</b> | <b>H1FY19</b> | <b>H1FY20</b> |
| NII/Total Income              | 94.0        | 88.5        | 84.3        | 84.7          | 80.9          |
| Other Income / Total Income   | 6.0         | 11.5        | 15.7        | 15.3          | 19.1          |
| Cost/Income Ratio             | 95.3        | 67.1        | 76.5        | 74.6          | 66.9          |
| Total assets yield (%)        | -           | 17.1        | 16.5        | -             | 19.8          |
| Cost of funds (%)             | -           | 8.6         | 7.6         | -             | 9.5           |
| Margins (%)                   | -           | 10.1        | 10.0        | -             | 11.7          |
| Avg. ROE (%)                  | -           | 0.5         | 13.0        | -             | 11.1          |
| Avg. ROA (%)                  | -           | 0.1         | 1.7         | -             | 1.4           |
| Gross NPAs (₹)                | 164         | 2,759       | 979         | 1,539         | 1,094         |
| Net NPAs (₹)                  | 18          | 509         | 275         | 234           | 425           |
| Provisions (₹)                | 146         | 2,250       | 703         | 1,305         | 669           |
| Gross NPAs (%)                | 0.3         | 3.8         | 0.9         | 1.9           | 0.9           |
| Net NPAs (%)                  | 0.0         | 0.7         | 0.3         | 0.3           | 0.3           |
| Provisions (%)                | 0.2         | 3.1         | 0.7         | 1.6           | 0.5           |
| CET 1                         | 17.6        | 19.3        | 16.2        | 20.2          | 16.2          |
| Tier I Capital                | 20.4        | 22.3        | 18.4        | 23.1          | 18.2          |
| Tier II Capital               | 0.7         | 0.7         | 0.6         | 0.7           | 0.7           |
| Total Capital                 | 21.1        | 23.0        | 18.9        | 23.8          | 18.8          |
| <b>Valuations</b>             | <b>FY17</b> | <b>FY18</b> | <b>FY19</b> | <b>H1FY19</b> | <b>H1FY20</b> |
| EPS (₹)                       | 0.0         | 0.0         | 1.4         | 0.6           | 1.3           |
| BV                            | 10.0        | 10.0        | 11.2        | 10.7          | 12.8          |
| ABV                           | 10.0        | 9.7         | 11.1        | 10.5          | 12.5          |
| No. of shares                 | 1,440       | 1,440       | 1,440       | 1,440         | 1,440         |
| FV of shares (₹)              | 10.0        | 10.0        | 10.0        | 10.0          | 10.0          |
| P/E (x)                       | 1,52,232    | 776         | 26.7        | 59.1          | 28.5          |
| P/BV (x)                      | 3.7         | 3.7         | 3.3         | 3.5           | 2.9           |
| P/ABV (x)                     | 3.7         | 3.8         | 3.3         | 3.5           | 3.0           |

Source: Company, LKP Research

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