SATIN CREDITCARE NETWORK LTD.

07/06/2016

BUY SATIN CREDITCARE
CMP: 350 Weight:7%

STOCK DATA

Market Cap(Rs. cr)	1116
EPS(diluted)	19.97
P/E	17.52
P/B	3.84
Promoter's Holding	36.2%
52 week high/low	488/88.50
Shares outstanding	3.19

KEY FINANCIALS(Rs. in crwhere applicable)

Y/E March	2013	2014	2015	2016
AUM (in cr)	580	1056	2141	3271
NII (in cr)	15.5	40.6	59.9	90.6
Gross NPA	0.16%	0.02%	0.02%	0.19%
Net NPA	0.14%	0.02%	0.01%	0.09%
Debt/Equity *	4.2x	6.1x	8.4x	9.3x
CAR	23.4%	15.3%	15.7%	16.8%
ROE	3.8%	11.8%	18.6%	22.1%
ROA	0.7%	1.7%	2%	2.2%
NIM	8.9%	10.5%	9.2%	9.9%
Cost to Income	81.2%	62%	61.5%	61%

*(avg liabilities/avg net worth)

VALUATION:

Satin is trading at 17.5 times FY 2016 earning and having an ROE of 22%. We believe that going forward the company can grow at 40-50% CAGR for the next 3 years with equity dilution of 10-15%.

SATIN CREDITCARE NETWORK

THESIS

At Stallion Asset we normally look for companies that can:

1) Grow at 25% plus for long periods of time (opportunity size)
2) Generate High ROCE
3) Smart and Ethical Management
4) Reasonable valuations

We believe Satin Creditcare Network has the above traits. Satin has a sizeable share in the underpenetrated markets of Northern India. The Microfinance Industry is expected to grow at 30%+ rates for next 5 years. Satin enjoys lower compliances/ regulations, capex requirements as compared to peers like Ujjivan who have just received a small bank licence.We strongly believe that growth is sustainable in this sector for long periods of time.

History -

Microfinance Industry can be divided in 3 phases after RBI gave permission for setting up microfinance in 2000

1) Phase 1 – (2000-2010)-Initial Growth phase where MFI AUM grew at 100% CAGR to INR 163 Billion.
2) Phase 2 – (2010-2012) - Following reports of suicides by some women borrowers; the AP government passed an ordinance in Oct'10 restricting the activities of MFIs in terms of new disbursements and collections. The cause of the borrowers was supported by some political parties, which led to a mass default in AP. Microfinance companies lost 30-40% of

their outstanding portfolio in the sector due to this mass default. Most microfinance companies which had significant exposure to AP went bankrupt after the mass default.

3) Phase3 – (2012-Present) – Revival after Regulation - The microfinance industry stood back on its feet with loan growth of more than 50% CAGR. The RBI announced setting up of small finance banks last year. MFIs were the favourites with the RBI, grabbing 8 of 10 small finance licenses.

Why Satin Creditcare Network ?

1) Opportunity size is massive and companies can increase loan book 4-5x in the next 5 years.

2) Value Mitigation – Unorganized Money Lender to organized Microfinance companies

3) Presence and leadership position in underpenetrated Northern India

4) Diversified Product Portfolio

5) Efforts to Increase head count ensures positive business growth prospects

About Microfinance Business in India

It was in the year 2000, when RBI allowed banks to lend MFI's and treat such lending as priority sector obligations. This ensured sustainable cash flows to micro finance companies as they borrow money from these banks at higher rate (11-12%) and lend it to borrowers at higher rates (24-26%). It received further impetus when banks entered into partnerships with microfinance institutions who acted as agents for disbursements and collections of microfinance loans to individuals. This made the industry a money making business with CAGR growth of +50%.

North India is highly underpenetrated microfinance market which is the biggest advantage for Satin. Micro Finance is well developed in Southern parts of the country where most of the companies are located, but its reach in other locations of the country is very low. (where Satin Creditcare is a big player).

Due to factors like under penetration, huge population residing in rural areas with less than 100,000 annual income, large unbanked areas, micro finance industry is expected to grow by leaps and bounds. We believe Satin Creditcare can easily grow at 40-50% inspite of competition in this sector as the whole industry size (currently 10 billion) is set to increase.

About Satin Creditcare Network

Satin Creditcare Network Limited (SCNL) is one of the largest Microfinance Institutions (MFI) in Northern India, and is the 5th largest MFI in the country. Incorporated in October 1990 as a Non-Banking Finance Company, SCNL started as an individual lending microfinance company. In May 2008, SCNL launched its group lending microfinance business. The business is primarily based on the joint liability group lending model to economically active women. It has presence across 16 states, 431 branches (March 2016).

- 63% of its total loan portfolio outstanding is given out for Agri-allied activities followed by 29% for service and trade purposes and 8% for production.
- Product Portfolio – Details

	MFI	Product Financing – Solar Lamp	MSME(1)
Start Date	**May 2008**	**Oct 2015**	**Apr 2016**
Ticket Size	₹15,000 – ₹50,000	Less than ₹4,000	₹1.0 – ₹10.0 Lakh
Avg. Ticket Size (Mar'16)	~ ₹24,000	Less than ₹4,000	~ ₹7.0 Lakh
Tenure	12 - 24 months	Up to 12 months	24 – 60 months
Frequency of Collection	Bi-Weekly / Monthly	Bi-Weekly / Monthly	Monthly
No. of States	16		
No. of Clients	1.85		
Interest Rate range %	~ 22 - 26%	~ 22 - 23%	~ 23%

(1) MSME: Micro, Small & Medium Enterprises

STRENGHTS

- Satin Creditcare is the largest MFI in North India and 5th largest in the country with gross AUM of Rs 3271 cr. as on 31st March, 2016.
- In last 4 years its AUM and PAT has grown at a CAGR of 78% and 145% respectively. Higher than its peers.
- Probably the only MFI player in the country whose portfolio grew by 36% in FY11 when the industry was going through crisis.
- Presently Joint Liability group (JLP) accounts for more than 98% of the total loan portfolio as on March 2016.
- Current customer base has grown to 1.85 mn – grown 4x over FY13-FY16.
- First and second time borrowers form 80% of the gross loan portfolio and volume, hence higher ticket size additions from the current clientele can be expected.
- An added advantage for Satin is that unlike Ujjivan (who has got a small bank licence) the company will not have to comply with many stringent RBI rules like maintenance of reserve ratios.

Game Changer for Micro-finance has been Joint Liability Group lending as loans are not made to an individual but liability sharing among 5 people. This ensures that the borrower pays and in case the borrower doesn't pay, no group member will ever receive loans from any microfinance company. There is a lot of social pressure to these ladies to not default as it will spoil relations with other liability sharing members who are normally their cousins or in-laws. 95% of all microfinance loans in India are given to Women which mainly include priority lending in rural areas.

REASONS TO INVEST

Largest MFI in North India

Going forward the loan portfolio is expected to grow in non-Andhra Pradesh states, where the micro-credit penetration is low. Satin Credit care has got strong market presence in 16 states in North and Central India where the Micro-Finance penetration is the lowest.

Top States with Highest MFI Client Concentration (Mar 2016)

Region	MFI Clients (Lakh)	Population (Crore)	Households (Crore)	Penetration %
Tamil Nadu	56.5	7.8	1.56	36.3%
Karnataka	38.2	6.6	1.32	28.9%
Odisha	21.4	4.4	0.89	24.1%
Kerela	12.2	3.4	0.68	18.0%
Madhya Pradesh	28.1	8.0	1.60	17.5%
Maharashtra	37.1	12.1	2.43	15.3%
West Bengal	21.9	9.5	1.90	11.5%
Punjab	5.6	3.0	0.59	9.5%
Gujarat	12.3	6.6	1.33	9.3%
Haryana	4.9	2.8	0.56	8.8%
Bihar	19.3	11.7	2.33	8.3%
Uttar Pradesh	31.3	21.6	4.31	7.3%
Rajasthan	7.5	7.5	1.50	5.0%

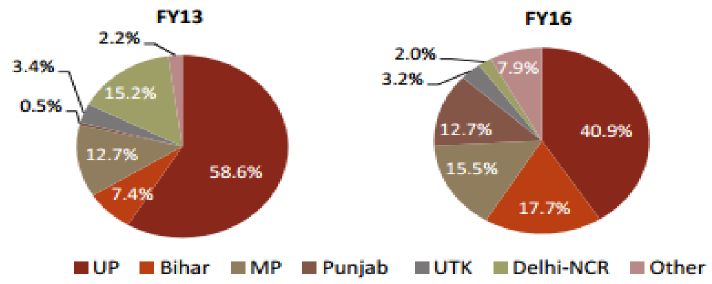
Satin's States of Operation

Source: MFI Clients - Micrometer, MFIN; Population - http://www.indiaonlinepages.com/

Reducing Geographic concentration

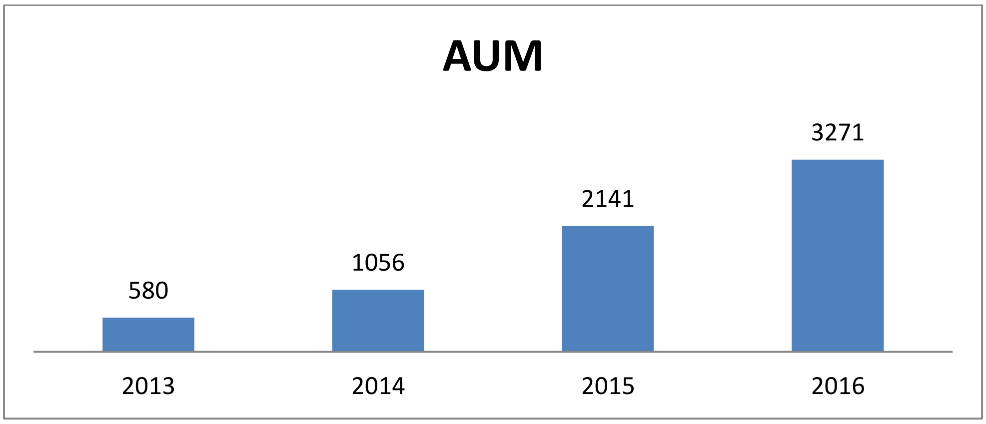
Historically, Microfinance companies are associated with a lot of political interference and hence concentration of loan portfolio in a particular state (more than 50% from Bihar and U.P.) increases the political risks for the company. In last three years company has managed to reduce its concentration in U.P. (Largest contributor to the loan portfolio) and going forward they are also planning to add southern states in its portfolio.

Gross Loan Portfolio – Reducing Geographic concentration



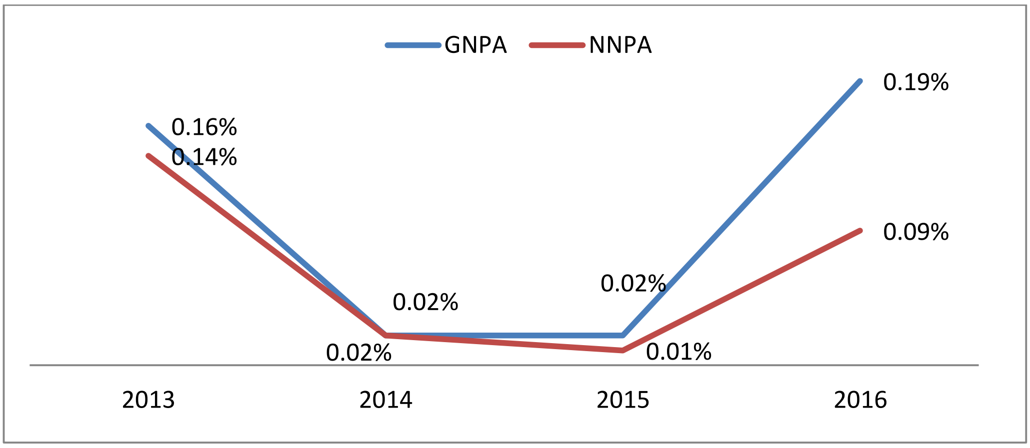
Robust AUM growth (including Managed Portfolio)

Satin's AUM has compounded at 78% CAGR from INR 580cr in FY13 to INR 3271cr in FY16.



Improved Asset Quality

Satin has one of the best asset qualities as compared to its peers.The company's Joint Liability model helps the company to maintain its asset quality. In Joint liability model, the company gives a loan to 4-5 people together. So if one defaults the others are liable for the said amount and the company can collect it from them.

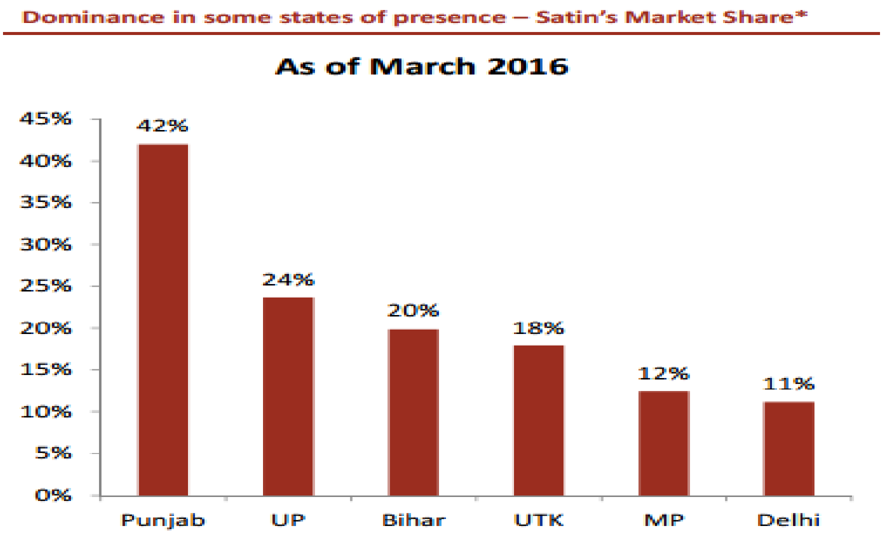


Operational efficiency better than its peers

	Gross Loan per branch	Opex/Average AUM
Satin	**7.6 CR**	**6.7%**
SKS	6.4 CR	7.1%-GLP
Equitas	8.3 CR	7.10%
Ujjivan	8.7 CR	7.5%

Sizable market share in some states -

Company is the market leader in few North Indian states.



Huge Opportunity Size

The eight MFIs cumulatively accounted for about 26% of assets managed by the industry as of 2014-15. As they exit the industry, after metamorphosing into SFBs along with Bandhan (which converted into a universal bank and accounted for 20% of March 2015 AUM), the industry size will halve.

Strong Return Ratios

	2016	2015	2014	2013
ROE	22.1%	18.6%	11.8%	3.8%
ROA	2.2%	2%	1.7%	0.7%

Company has got better ROE as compared to its listed peer Ujjivan.

Strong relationship with lenders

Inspite of not getting a small bank licence, raising funds is not going to be difficult for the company as they have strong backup of Marquee PE investors and a very good relationship with their lenders. They have an active relationship with 73 banks and financial institutions.

PE Investors of the company include **SBI-FMO, MV Mauritius, Shore Cap, NMI and DMP.**

PEER COMPARISION

Let's compare Satin with its listed peers. Satin can grow at 40-50% on the back of raising new capital and expanding tonew geographies.As compared to its peers, Satin is fairly valued promising a higher growth potential.

FY2016 (in cr)	Gross AUM	Market Cap	Net Profit	P/E	ROE (%)
Ujjivan	5389	4200	177	24x	18
Equitas	6125	5851	167	35x	13
SKS	7677	8653	303	29x	25
Satin	3271	1244	57	22x	22

*prices as on 7/6/2016

Understanding the Business

Microfinance is an easy business to understand. There is cost of capital and there is yield from capital, the difference between the two is my gross profit. Then I have cost to pay for people who default on their obligation and other operating cost like employee cost, rents etc.
For the Last 5 years Microfinance industry has been lending at 22-24% per year and borrowing at 11-13% per year. The difference of cost of borrowing and lending Income is broadly 10-13%.

In the microfinance business the maximum you can give a first time lender is 15,000 and once he pays the money in 1 year then the company can increase limits to 30,000 so as the customer becomes older the operating expenses per customer decreases (it takes the same time to collect a 500 rupee note ora 1000 rupee note for the loan manager). Since 80% of total gross loan portfolio and volume comprise of first time and second time borrowers, as they will become eligible for higher ticket size loans, the loan portfolio shall increase considerably.

KEY RISKS – PLEASE READ THIS CAREFULLY

Micro-finance targets the weakest section of the society and it's really not fair for them to make ROE's of more than 20%. When I write this one of my analyst says that's it not fair for life saving drug companies to have 30%+ ROE's but all these Pharma companies have it. We do understand that the world is not fair but while making assumptions, we believe that if microfinance companies start making a lot of money (25%+ ROE), that's the day you got to be really cautious because that will definitely bring in political interference. The RBI is not in favour of excessive profit making and wants a balance of social impact and profits. This is substantiated through one of the many speeches the RBI governor made on this topic –**"My sense is that you cannot, in good conscience, make a fortune at the bottom of the pyramid. Make reasonable profits, But if you start making a fortune, it does start Raising social anxiety about how the fortune is being made."**

- Satin enjoys high lending rates than peers (24-26%) but this may not be sustainable after initial growth spurt as the industry is getting competitive with no product differentiation.
- Satin Credicare had also applied for a small bank licence but like SKS microfinance, they couldn't receive the permission for the same. Management is eyeing a universal bank licence in next few years which is going to be very difficult for the company as that may involve incurring of expenses and divergence of focus from the business activities.
- Another major risk which we foresee, is the political risk. Since the company is in the business of priorty sector lending, huge political interference is present. This might hamper the smooth functioning of the business.
- In the current financial year the company is planning to the raise 5000 crores through debt and equity. Due to the nature of the business, the company will need to borrow funds in order to grow but raising equity shall dilute the share of the shareholders.

CONCLUSION

Satin is trading at lower valuations than its listed peers and hence an attractive investment at 17.52x.The company has good credit quality and no added regulations which it would otherwise have as a small bank. It is also planning to add 2000 employees this year to take the head count to 5000 employees (i.e. rise of 67%). This shows that management is very optimistic about its future growth. Management has given a guidance of GLP to reach 5000 cr and PAT to grow at more than 70% in FY 2017.

Disclosure: Amit Jeswani & Family have no positions

Analyst Disclosures: No positions

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