

BUY UJJIVAN CMP: 258
Weight- 7%



STOCK DATA

Market Cap(Rs. cr)	3080
IPO Price Band	207-210
Promoter Holding	0%
52 Week H/L	261.05/216.55
Shares outstanding	11.94

KEY FINANCIALS (Rs. in cr where applicable)

Y/E March	2013	2014	2015	H1-16
Net AUM	1126	1617	3219	4080
NII	125	186	281	220
Gross NPA	0.08%	0.07%	0.07%	0.13%
Net NPA	0.08%	0.01%	0.02%	0.04%
Debt/Equity	3.14	4.43	4.24	4.15
CAR	27.27%	22.73%	24.24%	20.57%
ROAE	11.78%	16.92%	13.67%	19.07*
ROAA	2.92%	3.40%	2.50%	3.56%*
NIM	13.76%	13.57%	11.62%	12.04%

*annualised basis

VALUATION: Ujjivan is attractively priced at less than 2x book with ROE of 20% and PE ratio of 19. Ujjivan's AUM is expected to growth 3 times faster than Indian Banks. We see 30% compounding story for next 2-3 years with a 16% stop loss of 216. Accumulate between 240-258.

UJJIVAN FINANCIAL SERVICES

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 Ujjivan financial services has the above traits. Ujjivan is one of the leading MFIs in the country with a pan-India presence serving the under-privileged. The Microfinance Industry is expected to grow at 30%+ rates for next 5 years. 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 companies 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 Andhra Pradesh 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) **Phase 3** – (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 bank licenses.

Why Ujjivan Financial Services?

- A) The opportunity size is massive and companies can increase loan book 4-5x in the next 5 years.
- B) With newly acquired license of Small finance bank the political risk has decreased substantially
- C) Value Mitigation – Unorganized Money Lender to organized Microfinance companies
- D) Diversification – Most Diversified MFI in India with presence in 24 States
- E) Net NPA of 2 Cr. on AUM of 4080 Cr. lower than peers
- F) Large Banks Not interested in providing loans of INR 15000-20000 as collecting cash from small borrowers it's too tedious for the big banks.

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%.

India is highly underpenetrated microfinance market which is the biggest advantage for Ujjivan. Unlike its peers they are geographically largest MFI and well diversified Microfinance Company. 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. (Ujjivan already has its presence in all over India).

Due to factors like under penetration, huge population residing in rural areas with less than 100000 annual income, large unbanked areas, and micro finance industry is expected to grow by leaps and bounds. We believe Ujjivan can easily grow at 30-40% in spite of competition in this sector as the whole industry size (currently 10 billion Dollar) is set to increase.

From 2009 onwards we have seen a spurt in the micro finance companies. Recently 10 companies got a licence of small bank out of them 8 were microfinance companies. According to the RBI norms, as the company crosses the net worth of 500 crores they have to compulsorily get listed. Only two out of these ten companies namely Equitas and Ujjivan has come up with IPOs recently and have got very good response. As more and more IPOs come in this space, the funds raised through this will help the industry as a whole to grow.

About Ujjivan Financial Services

Ujjivan is one of the leading MFIs in the country with a pan-India presence. As of December 31, 2015, the Gross AUM of Ujjivan was INR 4,589cr spread across 24 states and union territories and 209 districts. The company served over **2.77 million active customers** through 470 branches and 7,862 employees.

- The business is primarily based on the **joint liability group lending model** to economically active women.
- The company also offers individual loans and the share of it has been increasing with the management focused on converting group lending customers to individual lending customers.
- Ujjivan is amongst the 10 companies in India to receive in-principle approval from the RBI to set up a small finance bank (SFB) on October 7, 2015.
- Almost 90% of the AUM is towards Joint Liability Group Lending and the balance is towards individual loans.

STRENGTHS

- Ujjivan is the third largest NBFC-MFI in India with Gross AUM aggregating over INR 4,589cr as on 31st Dec 2015 which is well distributed across the country.
- The company is the largest MFI in India in terms of geographical spread with a pan-India presence through the 470 branches across 24 states and union territories and 209 districts in India.
- Going to become a small finance bank
- Joint liability model will ensure low NPAs.
- The company serves over 2.77 million active customers as of December 31, 2015. In addition to constantly assessing the customers' requirements and feedback for the introduction of new products. **The customer retention rates have improved from 73% in Financial Year 2010 to 88% as of December 31, 2015.**

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.

Gross NPA	FY10	FY11	FY12	FY13	FY14	FY15	YTD FY16*
SKSM	NA	5%	42.9%	13.3%	0.6%	0.3%	0.6%
UJJIVAN	1.1%	0.9%	0.9%	0.8%	0.6%	0.9%	0.6%
EQUITAS	1.1%	4.0%	0.6%	0.6%	0.4%	0.5%	0.5%
MFI Industry	0.5%	31.2%	2.0%	0.4%	0.1%	0.1%	0.1%

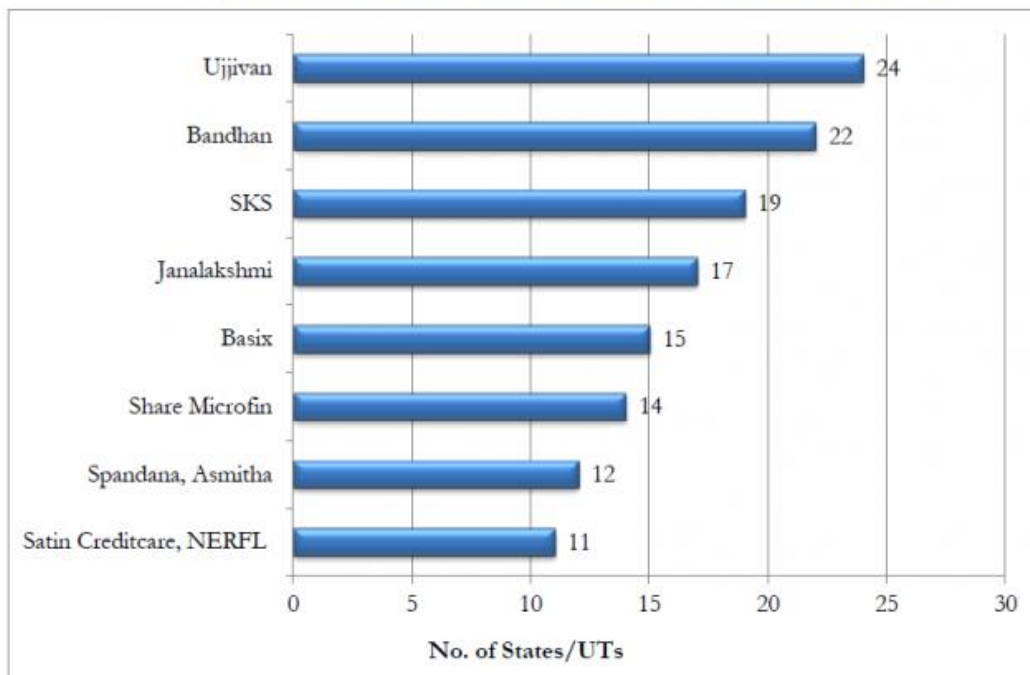
*Note: 9MFY16 for SKSM, 1HFY16 for Ujjivan and 1QFY16 for Equitas MFI; Source: MFIN.

REASONS TO INVEST

Ujjivan- India's Largest MFI by geographical spread

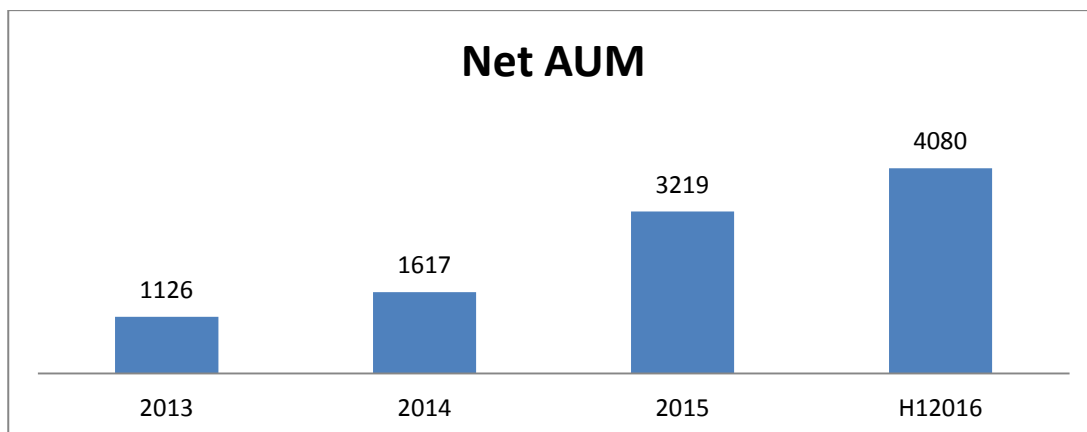
Ujjivan Financial Services has the largest geographical spread with operations across 24 states compared to 22 states for Bandhan Bank and 19 states for SKS Microfinance. More diversification reduces the effect of regional political risk on the business. **Going forward the loan portfolio is expected to grow in non-Andhra Pradesh states, where the micro-credit penetration is low.**

Top 10 MFIs Operating in Number of Indian States/Union Territories



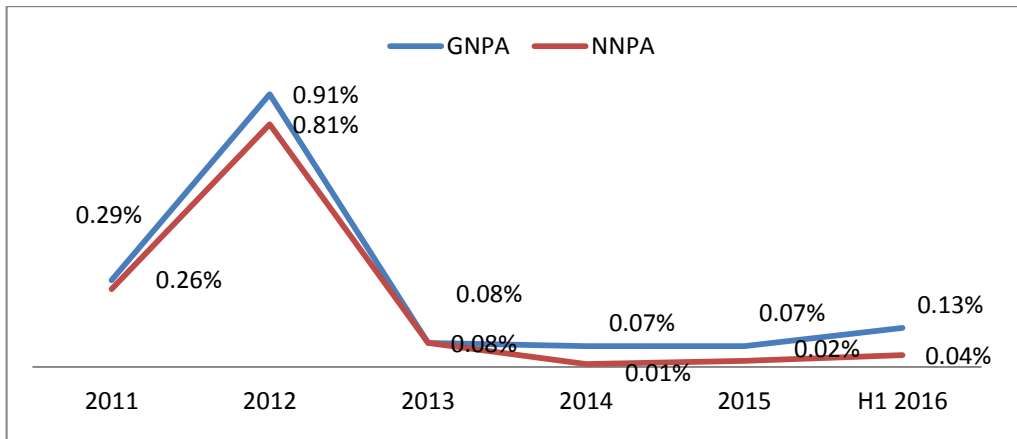
Robust AUM growth

Ujjivan's AUM has compounded at 71% CAGR from INR 1126cr in FY13 to INR 3274cr in FY15.



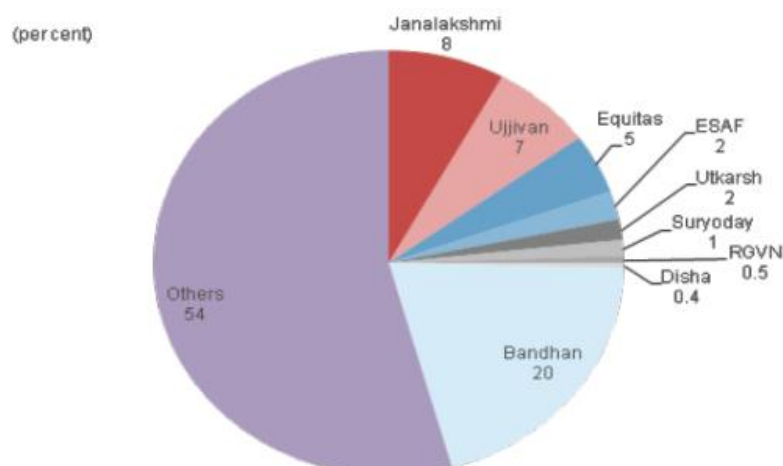
Improving Asset Quality

Ujjivan 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.



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.



Note: Shares are calculated on the basis of AUMs as of March 2015

ESAF: Evangelical Society Action Forum

Source: MFIN, CRISIL Research

Strong Return Ratios

	H1-2016	2015	2014	2013
ROAE	19.07%*	13.67%	16.92%	11.78%
ROAA	3.56%*	2.50%	3.40%	2.92%

*Annualized basis

KEY RISKS – PLEASE UNDERSTAND THIS PART PROPERLY

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.”**

- The proposed SFB will come with more stringent rules, and more capital requirement for developing the required infrastructure and technology.
- The company has no experience in managing the liability side of the book. The cost will definitely accelerate as the company opens branches on better location (shift from 1st-2nd floor to the ground floor), employee cost etc. A Large portion of this cost will be re-covered by lower cost of borrowing but the cost will front ended and returns back-ended.
- Recently 10 NBFCs have got the permission for small bank, thus making the industry more competitive. We can expect a decline in NIMs as the company does not have any kind of competitive advantage.
- Another major risk which we fore see, is the political risk. **Since the company is in the business of priority sector lending, huge political interference is present.** This might hamper the smooth functioning of the business. Moreover, each state has their own governmental and political issues and Ujjivan is present in most of the states if not all.
- Ujjivan will have to dilute equity to grow its AUM every 2-3 years.

Financials – Lets Understand 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%.

Please see the table below.

Ujjivan has been lending at average rate of 23% and borrowing at an average rate of 11% for the last 3.5 years. The Average Net Interest spread has been 12% over the last 3.5 years. Out of the 12% earned 7% goes into NPA provisions and Operating Expenses. The company then earns about 5% of AUM as pretax profit. This is roughly how the business works.

Year	2011	2012	2013	2014	2015	2016 H1
Lending Rates (%)	26.64	20.33	22.74	23.73	22.78	22.73
Cost of Funds (%)	13.36	10.96	10.11	10.53	11.31	12.03
Spread	13.28	9.37	12.63	13.2	11.47	10.7
Average AUM (cr)	497.9	658.1	908.5	1371.6	2417	3649
Opex as %of AUM	17.53	13.82	10.75	8.84	8.54	7.86
Gross NPA (cr)	1.8	6.3	0.9	1.1	2.3	5.1

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 or a 1000 rupee note for the loan manager). The operating expenses can move higher for next 1 year as the company start its small bank operations and starts accepting deposits.

Technical Analysis – Among our wealth creating study of last 25 years in all market, we understand that sectors that create largest wealth are the ones where there are many IPO's coming up. IPO's that create the largest wealth is created in sectors that are hot though you have to be careful. For Example- In US, 3 years prior to the dot com bubble, there were more than 80% of IPO's in technology space. 81% of all IPO's in 1999 were in technology space, 89% of all IPO's in 2000 were in Technology space. In India Between 2006-2008 most IPO's were there in Real Estate, Commodity and Infrastructure; those stocks went up 2-5 times in those two years. We believe microfinance can become the next hot sector with many other Small banks and microfinance companies getting listed. On the downside history has show that the low of the IPO the greatest support and normally is not breached hence we believe that 216 can be a great stop loss for Ujjivan i.e. our downside risk is 16% and upside unlimited.

PEER COMPARISON

These are the listed Microfinance players. We believe Ujjivan's ROE may fluctuate between 15-20% for the next 5 years with 30%+ CAGR Growth in AUM.

	Gross AUM(cr)*	Market Cap	Profit(2016)*	PE	ROE(2016)
Ujjivan	4589	3060	160**	19	20
Equitas	6125	4883	167	29	13
SKS	7677	8041	302	27	25
Satin	2538	898	54**	17	19

*Dec 2015 ** Estimated

CONCLUSION

- We believe that Ujjivan can grow at 30% plus rates for long periods of time. There are always risks in fast growing companies, though the biggest risk in Microfinance stems from political risk.
- Once Ujjivan starts its banking operations we need to see how the cost structure changes. Private Sector banks trade at 5x Book with 1/3 of expected growth of microfinance companies. There may be re-rating going forward in valuations as its trading at 1.8 times P/B.
- The company is backed by strong institutions and extremely strong management.

(a) The top 10 Shareholders as on the date of filing of this Draft Red Herring Prospectus are as follows:

Sr. No.	Name of the Shareholder	No. of Equity Shares	Percentage (%)
1.	CDC Group Plc.	10,932,696	12.69
2.	Alena Private Limited	10,790,943	12.53
3.	International Finance Corporation	10,202,406	11.84
4.	NewQuest Asia Investments II Limited	8,199,522	9.52
5.	Elevar Equity Mauritius	6,355,684	7.38
6.	Sarva Capital LLC	5,870,426	6.82
7.	Women's World Banking Capital Partners, L.P.	5,406,628	6.28
8.	Bajaj Holdings & Investment Limited	5,124,702	5.95
9.	Sequoia Capital India Investments III	4,201,276	4.88
10.	India Financial Inclusion Fund	3,508,772	4.07
	Total	70,593,055	81.96

- Ujjivan is priced lower than its peers Equitas and SKS microfinance. We love companies that are growing fast, ethical management and we can buy them a reasonable price. We intend to hold this stock for the next 2-3 years and compound money for our clients at higher rates with a stop loss of 216.

Disclosure - Amit Jeswani & Family have no positions.

Analyst Disclosures: Positions held – Yes – Juhi Shah

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