

CMP: Rs. 337 Weight: 4%



STOCK DATA-

Market Cap (Rs. Cr)	4100
PAT (FY19)	190
P/E (CMP)	21.4
Promoters Holding (%)	NA
52 week high/low	432/167
Shares outstanding (Cr)	12.11

KEY FINANCIALS – (Rs. in cr)

Y/E March	2016	2017	2018	9M FY- 19
Revenue	1028	1398	1582	1330
PAT	177	208	7	134
NIM (%)	12.3%	12.6%	10.6%	11.5%
GNPA	0.1%	0.2%	3.6%	1.40%
ROE	3.7%	14.1%	0.4%	9.8%
CAR	18.3%	21.0%	23.0%	22.2%

VALUATION

We Expect Ujjivan to Report 40-50% CAGR in Profits for next 12 Quarters as cost to income falls to 60% & ROE Improves to 18-20%. Currently Ujjivan is trading at 2.5x P/B Adjusted for Holding company, we expect 83% Gain in Book Value by March 2021 & expect that it would trade between 2.5-3x P/B on Exit.

20/3/2019

Thesis –At Stallion Asset we have a consistent investment philosophy of buying companies that can:

- 1) **Growth more than 25%**
- 2) **Huge Opportunity Size**
- 3) **High Return on Equity**
- 4) **Smart and Ethical Management**

This is the second time we are buying Ujjivan Financial service in our Portfolio (We First bought it during IPO & sold it after Demonetization). A lot has changed since then in Ujjivan. Ujjivan went through Small Finance bank Conversion, Demonetization, NBFC Crisis & Ofcourse loan waivers in many states. The company has emerged as a winner out of this crisis.

A Bank is Valued on 3 most important parameters

- 1) Ability to raise Capital (Management)
- 2) Growth of the Franchisee
- 3) Most Importantly ROE

Why Ujjivan Financial Service?

- Expect Growth in AUM of more than 30%
- Expect Profit growth of 40-50% for next 12 quarters
- ROE of 18-20% by 2021

We rarely write the risk on the thesis page, but this story is about managing our risks well. The risks we would like to highlight which are very important for this company

- 1) Listing of Small Finance Bank (We are Buying Ujjivan Financial whose the Holding company of SFB)
- 2) Samit Ghosh who has been the face of the company will retire in November 2019.
- 3) Unknown Unknowns!

Evolution – Microfinance + Bank is one of the newest type of Banking we are witnessing. This is not a proven model in India (There are many successful cases of this model globally like in Indonesia & Bangladesh) but what this Virtually guarantees that the since the government can't let a bank go bankrupt as the largest stakeholders are the depositors (A bank is typically leveraged 7x i.e. for every 1 rupees of Equity Money there is 7 rupees of Public deposit money) not the Share Holders the black swan risk which is typically very high in Microfinance has decreased a lot.

Let me Start this report with Bandhan & then continue on to Ujjivan.

Bandhan became a full Service bank in August 2015, Ujjivan ofcourse became a SFB in Feb. - 2017.

Profit (cr)	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019 E
Bandhan	117	188	208	283	438	275	1111	1345	2000
Ujjivan	11.41	0.13	33	58	76	177	208	7	190

In FY2016, the year when it started Bank operations the Profit of Bandhan Bank cracked from 438 Crores in FY2015 to 275 Crores but as we stand today in FY2019 the expected profits for Bandhan Bank in FY2019 is about 2000 (Excluding Gruh), a jump a 4-5x from 2015.

Can Ujjivan do a Repeat of Bandhan Bank?

AUM – Bandhan AUM grew extremely fast even after conversion into a bank, there was some luck involved as well as Bandhan was a bank during demonetization & was allowed to collect old notes. Ujjivan on the other hand witnessed a slowdown & was affected by Demonetization. Ujjivan had to write off 230 crores or around 4% of its FY2017 AUM because of demonetization.

Gross Loan Book (cr)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	9M FY-19
Ujjivan	703	1126	1617	3274	5389	6379	7560	9349
Bandhan		4400	6100	9500	15400	21400	27700	35599

Cost to Income (C/I) – Bandhan transited from MFI to full fledge universal bank in Aug.-15, due to transition their C/I ratio increased from 42.1% in FY-15 to 56.9% in FY-16. Ujjivan is witnessing same situation, Ujjivan transited from MFI to SFB in Feb-17 and their C/I ratio has increased from 53.8% in FY-17 to 67.14% in FY-18 and 75.9% in FY-19. In case of Bandhan Bank, their C/I started declining after one year of transition, as their AUM grew at faster pace. We expect as AUM of Ujjivan financial service grow at rapid pace, their C/I ratio will decline drastically.

Cost to Income	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	9M FY-19
Ujjivan	94.2%	64.1%	55.5%	60.4%	51.0%	53.8%	67.1%	75.9%
Bandhan	45.1%	43.4%	39.7%	42.1%	56.9%	36.3%	35.0%	33.7%

ROE higher than Growth –

Investing in Financials for last many years, I can with conviction tell you that this is the most important point which we would like to elaborate on. There are two types of Lenders

- 1) **Lending Company A** – These companies Grow fast at 30-40% though since a typical lending company makes an ROE of 20%, they typically have to dilute once every 2-3 years, the game works well if you can dilute at Higher P/B multiple again and again as done by Bajaj Finance, HDFC Bank, Yes Bank, IndusInd Bank etc. Typically as long as markets believe in the corporate governance of the Bank, dilution in Indian financials is not a big problem.
- 2) **Lender Company B** – If the ROE of the NBFC is Higher than Growth rates, these are very secular stories as they don't have to dilute at all. Mathematically the companies would give you truck-loads of dividend every year. In theory these companies are similar to Consumer companies with high Free cash flows.

Ujjivan falls in the Type A Company & though the most important thing here is the Valuation at which the Dilution Happens.

20-25% ROE with 40% Growth with outstanding Management = 6-9x Book Value = Bajaj Finance, Bandhan

16-20% ROE with 20% Growth with outstanding Management = 3.5-4.5x Book Value = Kotak & HDFC Bank

10-15% ROE with 20% Growth & decent management = 2-2.5x Book= DCB Bank, City Union Bank

We expect Ujjivan to have a ROE of 18-20% with 30% Growth Rate by FY2021 & decent Management.

Ofcourse you cannot have a 18% ROE and growth at 30% without dilution for long time theoretically, we expect since Ujjivan is just leveraged 5x currently (6-7x Is Normal leverage in Microfinance space), it will have to dilute in the end of FY2021 probably at around 3x Book Value (We have come to 3x Book Using ROE as benchmark & below are our estimates)

	FY2018	FY2019	FY2020	FY2021	FY2021 After Dilution
Equity Value	1760	1950.9	2272	2729	3548
Profit	7	190	322	457	10% Equity at 3x Book

Above Table is our base case forecast of how Ujjivan's Equity book Value will Grow 83% in the next 2 years with 10% Dilution on Equity in FY2021 end. (We will ofcourse be proven wrong here & this is just an estimate for Understanding) whereas Profits will grow from 190 Crores in FY2019 to 450 Crores in FY2021.

ROE of Ujjivan is the Most Important Part of our Thesis & ROE Itself is dependent on 3 Keys Factors

- 1) **Cost of Credit (CASA + Other sources of Borrowing)**
- 2) **Operating Cost (Employee + Admin Cost)**
- 3) **Cost of Lending**

We Believe the ROE of Ujjivan will expand from 10% in FY2019 to 18-20% in FY2021 due to the following Factors.

AUM Growth

Gross Loan Book (cr)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	9M FY-19
Ujjivan	703	1126	1617	3274	5389	6379	7560	9349
Bandhan	3730	4400	6100	9500	15400	21400	27700	35599

The growth in AUM is divided in 3 Parts

- A) Growth In Customers
- B) Growth in Average Ticket Size
- C) Growth In New Products

Growth in New Products

Financials services is a business where once you get the customer, you typically start with selling microfinance & then move on higher ticket loans like MSME Loans & Housing. We will slowly see evolution of Ujjain in selling financial products like Insurance as well but that's in the future. In the table below we have highlighted how the share of housing and MSE segment has gone up in gross loan book from 0.52% of gross loan book in 2015-16 to 12% of gross loan book as on Dec.-18.

	Avg. Ticket Size (000)	2015-16	2016-17	2017-18	9M FY-18
Gross Loan Book (cr)		5389	6379	7560	9349
MFI (group)	2--60	4695	5416	6317	7292
Micro Individual Loan	51--200	666	809	688	748
MSE	200--750	7	56	224	467
Housing Finance	200--500	21	99	323	654
Others		-	-	-	187

The management of Ujjivan has guided that out of the total 30% AUM Growth target, 20% Growth would come from Microfinance whereas other new businesses will contribute 10% of the total growth

Customer Base	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	9M FY-19
Asset Customer (in Lakhs)	10.4	11.04	13	22	30	36	40.7	41.4
Growth in Customer		6.2%	17.8%	69.2%	36.4%	20.0%	13.1%	1.7%
AUM	703	1126	1617	3274	5389	6379	7560	9349
Avg. Ticket Size	8793	12423	18812	19689	19613	19360	20773	22582
Growth in Ticket Size		41.3%	51.4%	4.7%	-0.4%	-1.3%	7.3%	8.7%

*Average ticket size is a calculated number.

We expect 10% Growth in Average ticket size in Microfinance & 10% Growth in Customer addition.

Cost/Income Ratio

Ujjivan's Cost to Income jumped from 51% in FY2016 to 76% in FY2019, ofcourse this is just because of a transition from Microfinance Company to a Bank. Just like Bandhan we expect that cost to income would come down to 60% by FY2021.

Cost to Income	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	9M FY-19
Ujjivan	94.2%	64.1%	55.5%	60.4%	51.0%	53.8%	67.1%	75.9%
Bandhan	45.1%	43.4%	39.7%	42.1%	56.9%	36.3%	35.0%	33.7%

Let's discuss what led to sharp rise in C/I for bank.

- a) As per RBI guidelines, Ujjivan had to convert all its branches from distribution centres to full fledged banking branch. In order to setup new bank, bank had to do some upfront expense like hiring new employees for branches, giving them training, branch setup cost like furniture and fixtures etc. That led to increase in their C/I ratio.

Ujjivan (Cr)	2015-16	2016-17	2017-18	9M FY-19
Employee Exp.	196.65	271.6	366.4	373.7
(%) of Net Revenue	19.1%	19.4%	23.2%	25.9%
Admin Exp.	102.17	173.8	246.3	287.7
(%) of Net Revenue	9.9%	12.4%	15.6%	20.0%
Total Operating Cost of Revenue	299	445.4	612.7	661.4
% Operating Cost of Revenue	29%	31.8%	38.8%	45.9%

	2015-16	2016-17	2017-18	9M FY-18
Branch	469	470	475	522
Banking Outlets		15	187	464
Employees	8049	10167	11242	14305

Operating expenses for Ujjivan have grown from 29% of Revenue to 46% of revenue as they have converted 464 centres into full banking branches, bank will have to convert only 49 centres in FY-20 all required employees are hired, all set-up cost is done. The management has guided that Q3FY2019 was the top in terms of cost to income. Typically branch banking is not profitable business from first day of branch open & it takes 2 years for any new bank branch to break even. The total employee count has gone up from 8049 in FY-16 to 14305 as on 9M FY-18.

CASA Ratio

Ujjivan has CASA ratio of 10.4% compared to 3.7% same time last year & we at Stallion have no way to predict if Ujjivan can scale up its CASA or no. Bandhan, AU & Equitas have done a fantastic job in raising CASA. Ofcourse AU & Equitas used high Interest rates to get CASA, a strategy which was first started by Kotak bank & then followed by Yes Bank. Typically larger banks like HDFC & ICICI have CASA at cheap cost but since banking is a low differentiation model, the only way these new banks can lure customers is by offering higher CASA.

Borrowing Profile	Mar'17	Jun'17	Sep'17	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18
Term Loan from Banks	63%	55%	39%	25%	16%	12%	5%	2%
Refinance	15%	18%	21%	24%	26%	31%	39%	34%
Deposits	3%	6%	20%	35%	49%	49%	49%	58%
NCDs	12%	9%	9%	9%	8%	8%	6%	1%
Others	7%	12%	10%	8%	NA	NA	8%	5%
Avg. Cost of borrowing+Deposits	10.4%	9.8%	9.7%	9.3%	9.0%	8.6%	8.5%	8.5%

Ofcourse the biggest upside in being a bank is lower cost of fund & Ujjivan has reduced cost by 200 Bps in last 2 years. They have repaid high cost bank borrowing & replaced it with fixed deposits by offering higher rates.

(mn)	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18
Asset Customer Base	39.9	40.7	40.3	40.3	41.4
Deposit Customers	2.6	3.8	6	10.2	15.3
New to Bank Deposit Customers	0.5	0.9	1.2	1.7	2.3

Deposit customers and new customers are growing at faster rate for bank. Deposits customers are those customers which have taken loan from Ujjivan and have opened bank account with Ujjivan. Banks forces customers who are taking loan from them should open bank account with them because bank can also track financial position of customer. At present around 37% of customers who have taken loan from bank have opened CASA account with bank, bank expect this number will grow in coming future.

CASA Ratio	2015-16	2016-17	2017-18	9M FY-19
Ujjivan	NA	NA	3.70%	10.40%
Bandhan	21.55%	29.43%	34.32%	41.10%
Cost of Borrowing				
Ujjivan	NA	10.40%	9.00%	8.50%
Bandhan	9.05%	7.64%	6.90%	6.40%

We can see from table above, as CASA ratio of Bandhan Bank increased, their cost of borrowing declined from 9.05% in FY-16 to 6.4% as on Dec.-18, we can see decline in cost of borrowing from 10.4% in FY17 to 8.50% as on Dec-18, we expect as their CASA ratio improves further their cost of borrowing will come down further.

KEY RISKS – PLEASE UNDERSTAND THIS PART PROPERLY

- 1) **Dilution of Stake:** Ujjivan Small Finance Bank is wholly owned subsidiary of Ujjivan Financial service limited. As per RBI guidelines, Ujjivan SFB has to get listed by Jan.-20 and promoter has to reduce its stake to 40% by 2022, there is no clarification how this will be done, management is in discussion with RBI to work out some solution. At present there is no final decision from management.

Equitas Holding Ltd is facing the same problem they have has decided to demerge 47% stake of the Bank.

We expect Ujjivan Financial services to Demerge 60% of Bank business & remain 40% of the Business would carry a 50% holding company discount. We assign a 20-25% Discount to Ujjivan Financial because of this & we are buying Ujjivan at 5000 Crores Market Cap & at 2.5x P/B instead of 4000 Crore current market cap.

- 2) **Political Risk:**

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 ex 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.”**

We can't qualify risk here; there can be a unknown unknown here anytime!

- 3) **Key Man Risk** – Last year Sudha Suresh, MD & CEO of Ujjivan Financial Service resigned from company. As per RBI guidelines Samit Ghosh, MD of Ujjivan Bank has to retire by Nov.-19. Markets gives valuations to Financials based on the Banker, we look forward to see the new banker & his strategy.

Valuations & Conclusion: We Expect Ujjivan to Report 40-50% CAGR in Profits for next 12 Quarters as cost to income falls to 60% & ROE Improves to 18-20%.

	FY2018	FY2019	FY2020	FY2021	FY2021 After Dilution
Equity Value	1760	1950.9	2272	2729	3548
Profit	7	190	322	457	10% Equity at 3x Book

Currently Ujjivan is trading at 2.5x Adjusted for Holding company P/B, we expected a 83% Gain in Book Value by March 2021 & expect a that it would trade at between 2.5-3x Exit P/B.

I am always worried on Unknown Unknowns in Microfinance business, I love them as a business model but our eyes have to be 3 Things 1) RISK 2) RISK 3) RISK

Disclosures and Disclaimer for Research Report

This Report is published by Amit Jeswani, Proprietor of Stallion Asset (hereinafter referred to as "Stallion Asset") for private circulation. Stallion Asset has registration for Research Analyst under SEBI (Research Analyst) Regulations, 2014. Stallion Asset or its associates has not been debarred / suspended by SEBI or any other regulatory authority for accessing / dealing in securities Market. Stallion Asset or analyst or his relatives do not hold any financial interest in the subject company. Associates may have such interest in its ordinary course of business as a distinct and independent body. Stallion Asset or its associates or Analyst do not have any conflict or material conflict of interest at the time of publication of the research report with the company covered by Analyst. Stallion Asset or its associates / analyst has not received any compensation / managed or co-managed public offering of securities of the company covered by Analyst during the past twelve months. Stallion Asset or its associates has not received any compensation or other benefits from the company covered by Analyst or third party in connection with the research report. Analyst has not served as an officer, director or employee of subject company and Stallion Asset / analyst has not been engaged in market making activity of the subject company. Analyst or his relatives do not hold beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of this research report. Analyst has exercised due diligence in checking correctness of details and opinion expressed herein is unbiased. This report is meant for personal informational purposes and is not be construed as a solicitation or financial advice or an offer to buy or sell any securities or related financial instruments. While utmost care has been taken in preparing this report, we claim no responsibility for its accuracy. Recipients should not regard the report as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without any notice and this report is not under any obligation to update or keep current the information contained herein. Past performance is not necessarily indicative of future results. This report accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this report. Each recipient of this document should make such investigations as they deem necessary to arrive at an independent evaluation of an investment in the securities of the companies referred to in this document (including the merits and risks involved), and should consult their own advisors to determine the merits and risks of such an investment. The information in this document has been printed on the basis of publicly available information, internal data and other reliable sources believed to be true, but we do not represent that it is accurate or complete and it should not be relied on as such, as this document is for general guidance only. Stallion Asset or any of its affiliates/ group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. Stallion Asset has not independently verified all the information contained within this document. Accordingly, we cannot testify, nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this document. While Stallion Asset endeavours to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Neither Stallion Asset nor its directors, employees or affiliates shall be liable for any loss or damage that may arise from or in connection with the use of this information.

Analyst Name: Amit Jeswani; Tel No: +91-9167090883; Email ID: info@stallionasset.com