Arihant Capital
Generating Wealth

Company update
17th March 2022

Ujjivan Small Finance Bank Ltd.

CMP: INR 17

Stock Info	
BSE	542904
NSE	UJJIVANSFB
Bloomberg	UJJIVANS IN
Reuters	UJJI.BO
Sector	Banks
Face Value (INR)	10
Equity Capital (INR Cr)	1,928
Mkt Cap (INR Cr)	2,921
52w H/L (INR)	34 / 14

Shareholding Pattern %
(As on Dec, 2021)

Promoters	83.3
FII	0.1
DII	0.8
Public & Others	15.8

Stock Performance (%)	3m	YTD	12m
Ujjivan SFB	-10.6	-9.1	-48.6
Nifty 50	1.8	-0.4	17.5

Financial Snapshot

Rs in cr unless stated	FY20	FY21	9MFY22
AUM	14,153	15,140	16,463
Deposits	10,780	13,136	15,563
NII	1,634	1,729	1,230
PPoP	637	809	373
PAT	350	8	-541
Ratios			
GNPA	1.0	7.1	9.8
NNPA	0.2	2.9	1.7
NIM	10.8	9.5	8.4
RoA	2.2	0.0	-
RoE	13.9	0.3	-
CAR	28.8	26.4	19.1

Source: Company, Arihant Research

Ujjivan Small Finance Bank (Ujjivan SFB) is a mass market focused SFB in India, catering to unserved & underserved segments with focus on digital capabilities, customer-centricity, and financial inclusion, especially in rural areas. Its pan-India presence with no single state contributing >16% of AUM as at Dec'21, coupled with an evolving product portfolio, would enable it to outpace systemic credit growth once the macro turns conducive. Ujjivan's journey towards building secured assets is progressing well and its liability franchise trending better with retail deposits at 53% of total deposits and CASA ratio at 26.5%. We believe the long-term prospects of the bank remain attractive on the back of 1) diversification towards a secured portfolio, 2) ability to manage asset quality post covid disruption and 3) peaking out of the opex cycle 4) credit cost moderation driving ROA expansion and change in management.

Why the stock was underperformer?

Bank has come out with an IPO in Dec'2019 at INR 36-37. Stock has corrected more than 50% from its IPO price due to bank's higher exposure to vulnerable segments (MFI) which was highly impacted by covid pandemic. Hence, credit cost of the bank increased sharply which has led to decrease in stock valuation. Exit of multiple board members and management executives, including Nitin Chugh has also dampened investors sentiment.

How the things are shaping up?

Company has appointed Ittira Davis, as MD & CEO after the exit of Nitin Chugh. Management has given higher credit growth guidance of 15-20%. Also stated that, business momentum has not witnessed any major disruption and monthly collections continue to improve and expects the business momentum to remain strong in Q4FY22E. February month was better in terms of collection efficiency and disbursements. Management is looking to bring down the share of MFI to 50% (From 66.7% currently) as bank is looking to grow Affordable housing, MSE and FIG lending segment.

Business Plan: Bank is working on three key areas for growth under "100-Day Plan" with a primary focus on (a) Rebuilding business volumes, (b) Improving asset quality, and (c) Retaining talent, the management believes that the bank is currently better placed vs H1FY22 at the time of crisis. The bank will look to launch the credit card business in FY23E.

Asset Quality: Due to covid related disruption, GNPA of the bank increased from 1% in FY20 to 9.8% as on Q3FY22. With improving collection and positive trends on the asset quality front, the management expects credit costs to normalise over the next 3-4 quarters. The management has retained its credit cost guidance of ~Rs 1,000 Cr for FY22E. Company carries INR 250 cr of Floating provision. We believe GNPA of the bank to come down to 6% by FY22 end and 1.5-2% by FY23.

Reverse Merger update: The bank has applied to the RBI, SEBI and exchanges for the reverse merger in early Nov'21.The bank will come up with a QIP offering of up to Rs 600 Cr to comply with the minimum public shareholding norms. The reverse merger is expected to be completed within 12-15 months.

We prefer Ujjivan Financial over Ujjivan Small Finance Bank

Currently, the holding company discount is at 43% which is expected to come down on the back of expectation of normalisation in credit cost with reduction in stress, increase in growth, shift from MFI to Non MFI segment and potential reverse merger of Ujjivan Financial with Ujjivan SFB.

Merger ratio: Swap ratio of 115 shares of Ujjivan SFB for every 10 shares of Ujjivan Financials. Merger ratio are favourable for Ujjivan Financials shareholders.

Valuation: On FY24E P/BV (Bloomberg consensus), Ujjivan SFB is trading at discount of 31% over its closest peers Equitas SFB. Equitas SFB FY24E P/BV: 1.3x and Ujjivan SFB FY24E P/BV: 0.9x

Holding company discount pre and post merger announcement

i. Holdco discount prior to merger announcement (1 year prior)

IN Cr.	Prior to merger announcement	
	Ujjivan	Equitas
SFB Mcap	5,505	6,266
Holding Company stake in SFB	83.3%	81.9%
Value for Holding Company	4,587	5,137
Holding Company Mcap	2,749	2,926
Holdco Discount	**-40%**	**-43%**

Note: Share price or Mcap are as on 18th March 2021.

ii. Holdco discount post merger announcement (As per merger ratio)

IN Cr.	Post merger announcement (as on 21-3-22)	
	Ujjivan	Equitas
SFB share price	17	53
Holding Company share price	112	108
Merger ratio (Holding:SFB)	10:115	10:226
Holding company value per share as per merger ratio	196	120
Holdco Discount as per merger ratio	-43%	-10%

Source: Arihant Research, Company Filings

SFBs gaining credit market share at accelerated rate

India's Small Finance Banks (SFBs) have carved a niche in small-ticket lending (~8% of systemic credit) in a short span of 4 years. They command 6% market share in small loans and incremental market share of >20% pre-covid. Further, SFBs are improving their rural market share at an accelerated pace. Its market share in small loans remains as high as 6% vs 1% total credit market share as at Dec'20. In a short span of 4 years in SFB operations, deposit market share of SFBs increased to 1% with incremental market share remaining higher at 3%. End-to-end digital onboarding process, customised product offerings and relatively higher interest rates helped them gain share from incumbents at an accelerated pace. Fast-evolving liability franchise would ensure sustainable source of funds at competitive rates and would further strengthen SFBs' position in the lending space.

Considering the government thrust on financial inclusion, there is an huge untapped lending opportunity and SFBs' experience in underwriting loans based on unstructured data, SFB's will dominate the small-ticket lending space going ahead.

Within SFBs, industry leaders (e.g. AU, Equitas, and Ujjivan) are likely to lead the growth given their deep distribution networks, competitive rates on the back of lower cost of funds as compared to other SFBs, and wide range of products to cater to changing customer needs.

Asset strategy – Gradually focuses on formal segment

Bank is likely to diversify its portfolio into non-mfi segment. Bank is looking to realign its AUM mix with Micro and non-microbanking shares at 50%-50% over the medium to longer term from currently 67%-33% respectively. Affordable housing and MSE segments to remain key non-microbanking growth drivers in the medium term with focus on the formal segment. Bank has improved its internal processes by way of digitisation and the focus on productivity resulted in all-time higher quarterly disbursement in Q3FY22.

To expand its target market and shift product mix to bring in a better quality of book, it plans to deal with more formal segments rather than only the informal and the semiformal. Bank is expanding its reach via scale-up of existing channels & addition of new channels through Fintech, payments bank, money mitra outlets. Bank has launched product called micro LAP which is currently available in selected branch and targeting to scale it up by Q1FY23.

Evolution of Ujjivan Small Finance Bank

Ujjivan SFB commenced its operations as a NBFC in 2005 with the aim of providing a full range of financial services. It mainly funded the joint liability group lending model by providing collateral free, small ticket-size loans to economically active women. Ujjivan SFB was amongst the 10 awardees of a banking license and commenced SFB operations in Feb’17 respectively as a SFB.

Recent change in regulation by RBI have a positive impact for MFI industry

Recently, RBI released the much awaited final guidelines for the microfinance
industry.

Key changes as per the master directions are towards (a) Definition of Microfinance loan, (b) Qualifying assets criteria, (c) Pricing of loans (d) Net Owned Fund (NOF) requirement, (e) Assessment of Household Income, (f) Limit on repayment obligations of a Household, (g) Conduct towards Microfinance Borrowers.

These final regulations, are positive for the microfinance sector, especially NBFC-MFIs given the removal of pricing differential. Further, the increase in annual household income limit criteria to INR 300K to qualify for a microfinance loan bodes well for the sector. We have seen a gradual MoM improvement in collection efficiency and rising trends in disbursals, which points towards normalization for the sector.

Microfinance loan pricing now stands changed against the earlier regulation
whereby maximum interest charged can be lower of cost of funds plus a margin cap of 10% for MFIs with loan portfolio of Rs1bn or above and 12% for others. All regulated entities are now required to have a board approved policy regarding the pricing of the microfinance loan which shall consist of the following detail.

Arihant Research Desk

Email: research@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park Building No. 10, 1st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880	Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199

Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	SMS: 'Arihant' to 56677	www.arihantcapital.com	research@arihantcapital.com

Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800Fax. 022-42254880