

SHRIRAM CITY UNION FINANCE

BANKS & FINANCIAL SERVICES

09 MAY 2017

Quarterly Update

BUY

Target Price: Rs 2,420

Asset quality worsens; provisions dent PAT

SCUF reported a weak Q4FY17 marked by sharp deterioration in asset quality and decline in margin, resulting in a significantly lower PAT (Rs 120 mn; down 78% YoY). Headline asset quality deteriorated (224 bps QoQ), as SCUF transitioned to 120dpd GNPA recognition (150dpd earlier). On positive side, AUM grew ~18% YoY to Rs 231 bn, with non-gold portfolio (up ~22% YoY) driving most of the growth.

Management guided for 20-25% YoY AUM growth in FY18. It targets housing finance subsidiary's AUM growth of 50%+ YoY, albeit off a small base. Q4 GNPA's on 90dpd were 9.7% (i.e. 300 bps higher than on 120dpd), hinting at pain in FY18 too. However, we believe PCR will be dropped to ~64% (currently ~73%) to maintain profitability.

CMP : Rs 2,182
Potential Upside : 11%

MARKET DATA

No. of Shares : 66 mn
Free Float : 66%
Market Cap : Rs 144 bn
52-week High / Low : Rs 2,650 / Rs 1,507
Avg. Daily vol. (6mth) : 58,862 shares
Bloomberg Code : SCUF IB Equity
Promoters Holding : 34%
FII / DII : 26% / 6%

Q4FY17 highlights: (1) AUM growth was healthy at ~18% YoY to Rs 231 bn, with non-gold portfolio growing ~22% YoY; (2) Personal loans grew 47% off a small base, while the bread and butter SME book (55% of book) grew 21% YoY. Gold loan AUM (15% of AUM) was flat YoY; (3) Disbursements recovered after a dismal Q3, growing 21% QoQ to Rs 62.5 bn, led by gold loan disbursements (+55% YoY) and Auto/Personal loans (up 33-36% YoY); (4) Provisions rose despite ~14% ppt drop in PCR to 73% and standard asset provisioning was increased from 30 bps to 35 bps as mandated by RBI; (5) Interest reversals from higher GNPA's caused NIM to fall ~140 bps QoQ to 12.5%.

Maintain BUY with rolled-forward TP of Rs 2,420 (11% upside from CMP): We cut our FY18 PAT estimate by 15% to factor in the underperformance. SCUF remains a well-capitalized, high-RoA business, albeit with some near-term concerns on growth and asset quality. We roll forward our multiples to FY19 to arrive at a TP of Rs 2,420 (2.9x FY19E P/ABV). At CMP of Rs 2,182, SCUF trades at 3.1x/2.6x FY18E/19E P/ABV, implying an 11% upside.

Financial summary (Standalone)

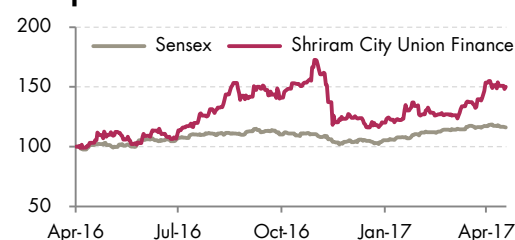
Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs mn)	5,298	5,561	7,194	9,743
EPS (Rs)	80	84	109	148
EPS chg (%)	(5.1)	4.9	29.4	35.4
Book value (Rs)	684	763	854	979
Adj. BV (Rs)	639	700	711	835
PE (x)	27.2	25.9	20.0	14.8
P/ABV (x)	3.4	3.1	3.1	2.6
RoE (%)	12.3	11.7	13.5	15.1
RoA (%)	2.7	2.5	2.7	2.8
Net NPA (%)	1.6	1.8	3.4	2.9

Source: Company, Axis Capital

Key drivers

(%)	Q1'17	Q2'17	Q3'17	Q4'17
AUM growth (YoY)	17	18	19	18
Gross spreads	13.7	14.1	13.9	12.5
GNPA ratio	5.1	5.0	4.5	6.7
Disb. (Rs bn)	53	56	51	62

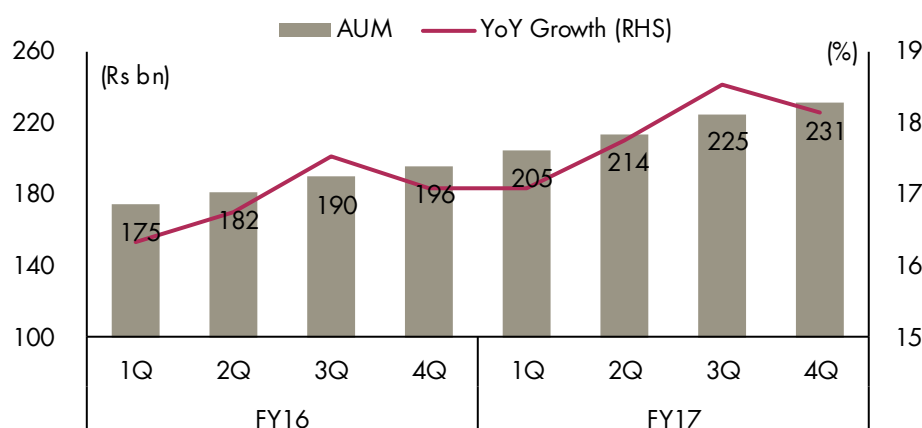
Price performance



Growth outlook and business mix

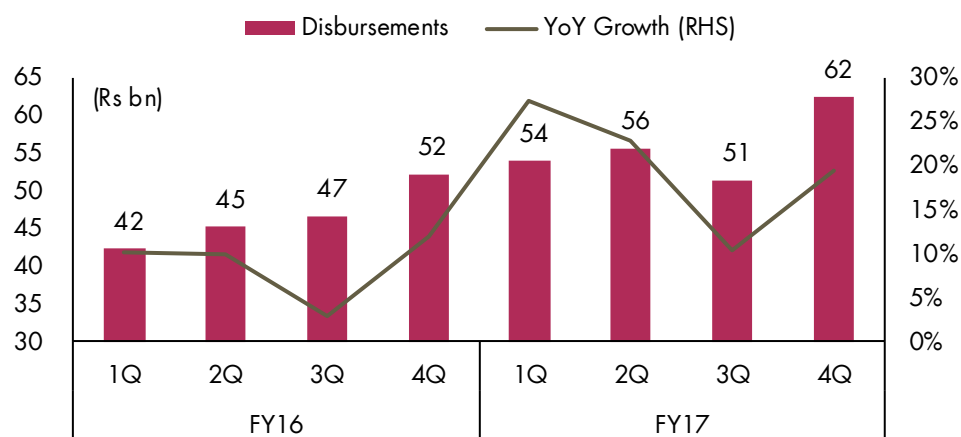
- Management reiterated guidance of 20-25% YoY AUM growth in FY18. It targets housing finance subsidiary's AUM growth of 50%+ YoY, albeit off a small base (Rs 17.8 bn as at end-FY17). Personal loan cross sells are also expected to go up
- SME finance demand is healthy; however, 2W disbursements were down during Q4, as the management withdrew financing from some geographies due to emission norm notification
- Auto loans (new and used cars, tractors) are primarily from core market of Andhra Pradesh/Telangana and Maharashtra
- However, it will refrain from getting into a target populace that is catered to by microfinance companies/ small finance banks, as it is uncomfortable with the risk in the segment
- SCUF reiterated its cautious stance on the gold loan business, as this business remains highly susceptible to poaching from banks. Hence, despite the sharp growth in disbursements, the book was flat on AUM level

Exhibit 1: AUM grew a respectable ~18% YoY on the back of...



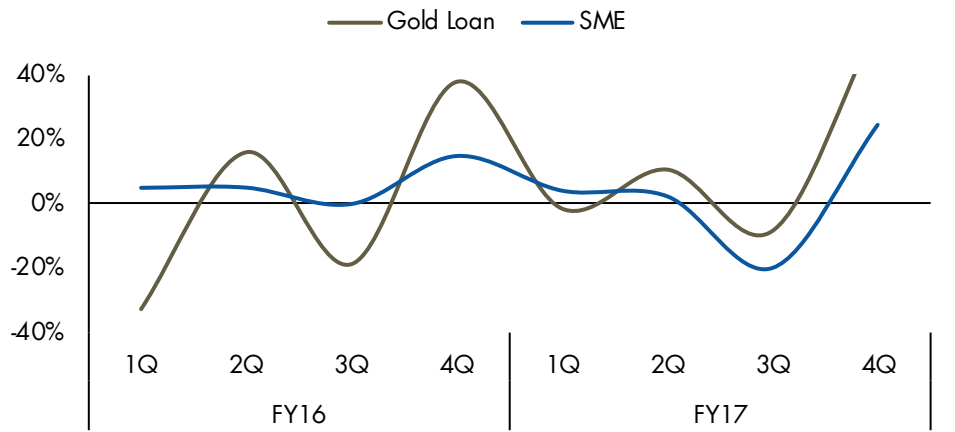
Source: Company, Axis Capital

Exhibit 2: ...steady recovery in disbursements growth as...



Source: Company, Axis Capital

Exhibit 3: ...Gold loan & SME finance disbursements recover...

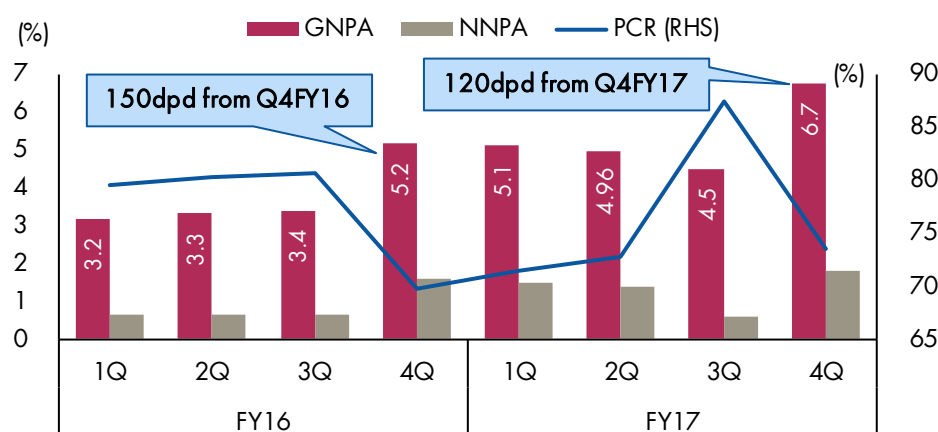


Source: Company, Axis Capital

Asset quality, GST impact and pilot-testing ARC sales

- ◆ GNPA's on 90dpd basis were at 9.72% (a few bps higher than last quarter) and on 150dpd basis were ~6.16% (reported figures on 120dpd at 6.73%)
- ◆ Management attributed the sharp 224 bps rise in 120-dpd GNPA(%) to:
 - a lingering impact of demonetization (RBI dispensation availed in the last quarter, not available in Q4) and
 - impact of movement to 120 dpd NPA recognition norms (150dpd in Q3)
- ◆ **On RBI dispensation:** ~Rs 2 bn worth of loans were not recognized as GNPA's in Q3, of which ~Rs 1.2 bn have been recovered and the rest have been recognized as GNPA's in Q4FY17
- ◆ Provision coverage would be dropped to ~60% (from ~73% currently) in FY18, as SCUF transitions to 90dpd NPA recognition
- ◆ SCUF stated that asset quality in non-core northern and western markets is robust and infact better than that in the core markets
- ◆ **On GST,** SCUF stated that most of its customers are unaware and unprepared (as regards compliance, rates applicable etc.) and have not been able to assess the impact of GST on their business. SCUF plans to set up an internal task force with external consultants to help its customers transition to GST
- ◆ **On asset sales to ARCs,** the management is running pilot test to figure out feasibility of this route to resolve/ recover from sticky accounts

Exhibit 4: Asset quality deteriorated sharply on transition to 120 dpd

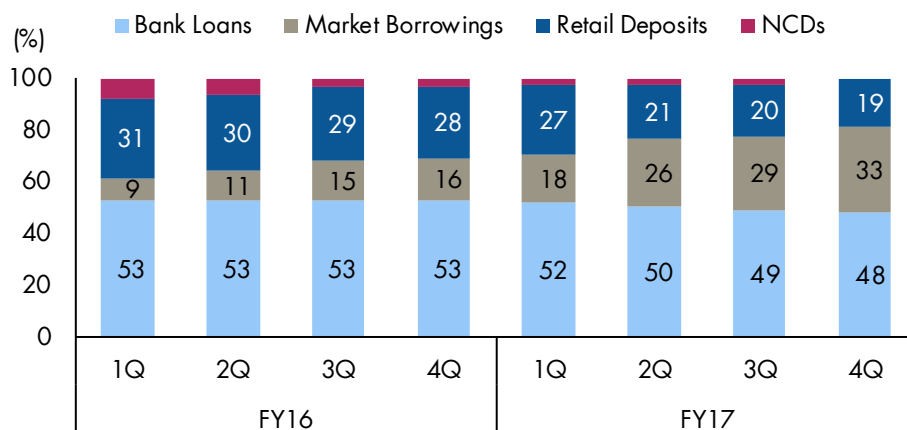


Source: Company, Axis Capital

Margin expected to decline ahead

- Higher GNPA's led to interest reversals of Rs 560 mn during Q4. We believe the same could recur once SCUF migrates to 90dpd in FY18. SCUF expects a total of ~50 bps compression in NIM in FY18
- It is also looking to get into urban markets, where yield and NIM would be lower because of significantly higher competition

Exhibit 5: Share of market borrowings rising (9% in Q1FY16 to 33% in Q4FY17)

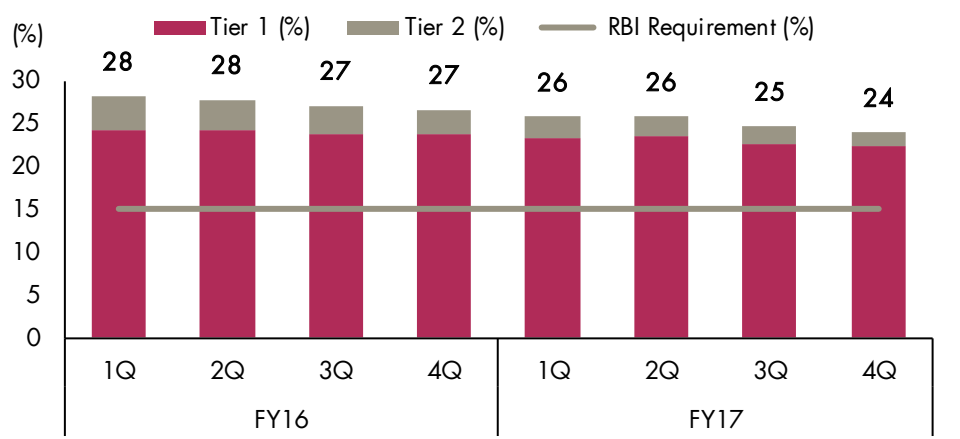


Source: Company, Axis Capital

Housing Finance subsidiary – Down in the doldrums

- Provisions and write-offs were higher (up 2.5x QoQ) due to higher GNPA's at 5.3% (including portfolio sold to ARCIL)
- Construction/builder finance and loans of ticket size above Rs 3 mn have been completely stopped since past couple of quarters
- AUM (Rs 17.8 bn in FY17) was down ~3% QoQ due to ~35% drop in retail disbursements (again attributed to demonetization), higher-than-expected prepayments of ~7%, and sale of ~Rs 500 mn of loans to ARCIL

Exhibit 6: Capital position remains strong – SCUF may either pursue aggressive organic + inorganic growth, or reward shareholders with higher dividend payouts

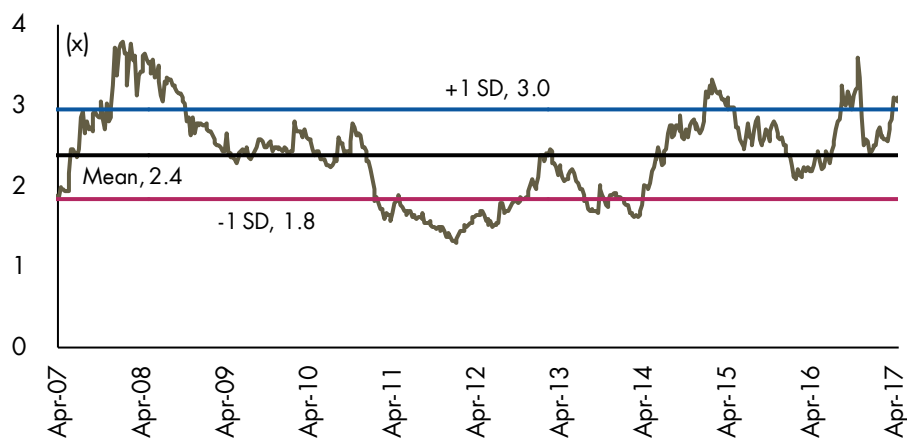


Source: Company, Axis Capital

Exhibit 7: Results update

(Rs. mn)	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	Mar-18E	Mar-17	% Chg
Interest earned	11,072	9,757	13	11,557	(4)	52,276	44,316	18
Interest expended	3,937	3,534	11	3,933	0	18,487	15,344	20
Net interest income	7,134	6,223	15	7,624	(6)	33,788	28,972	17
Other income	5	163	(97)	6	(18)	28	29	(3)
Total income	11,076	9,920	12	11,563	(4)	52,304	44,345	18
Total net income	7,139	6,386	12	7,630	(6)	33,816	29,001	17
Staff expenses	1,389	1,528	(9)	1,394	(0)	6,163	5,503	12
Other operating expenses	1,427	1,433	(0)	1,583	(10)	6,745	5,857	15
Operating profit	4,324	3,425	26	4,653	(7)	20,908	17,642	19
Provision & Contingencies	4,118	2,561	61	2,242	84	9,925	9,105	9
Provision for tax	86	309	(72)	835	(90)	3,789	2,976	27
Reported profit	120	555	(78)	1,577	(92)	7,194	5,561	29
Asset quality (%)								
Gross NPAs (Rs.)	15,367	9,801	57	9,929	55	25,889	15,367	68
Gross NPA %	6.7	5.2	158 bps	4.5	224 bps	9.4	6.7	272 bps
Net NPAs (Rs.)	4,099	2,970	38	1,252	227	9,385	4,099	129
Net NPA %	1.8	1.6	23 bps	0.6	122 bps	3.4	1.8	163 bps
Provisioning	73.4	69.7	369 bps	87.3	(1,390) bps	63.8	73.3	(958) bps
Business growth								
Disbursements	62,447	52,226	19.6	51,462	21.3	268,267	223,556	20.0
AUM	231,320	195,758	18.2	225,439	2.6	276,862	231,320	19.7

Source: Company, Axis Capital

Exhibit 8: 10 years P/ABV movement


Source: Bloomberg, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	38.3	44.3	52.3	62.1
Interest expended	(13.8)	(15.3)	(18.5)	(20.9)
Net interest income	24.5	29.0	33.8	41.1
Non interest income	0.2	-	-	-
Net income	24.7	29.0	33.8	41.2
Operating expenses	(10.5)	(11.4)	(12.9)	(15.7)
Staff expenses	(5.1)	(5.5)	(6.2)	(7.3)
Other operating expenses	(5.4)	(5.9)	(6.7)	(8.4)
Operating profit	14.2	17.6	20.9	25.5
Provisions & contingencies	(6.2)	(9.1)	(9.9)	(10.6)
Pre-tax profit	8.1	8.5	11.0	14.9
Tax expense	(2.8)	(3.0)	(3.8)	(5.1)
Profit after tax	5.3	5.6	7.2	9.7
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	5.3	5.6	7.2	9.7

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	208.5	245.4	293.6	345.7
Cash & Balances with RBI	6.4	6.4	8.3	9.7
Investments	7.9	7.1	7.9	8.6
Advances	191.4	229.6	275.1	324.7
Fixed assets	0.8	0.8	0.7	0.6
Other assets	1.6	1.0	1.2	1.3
Total liabilities	208.5	245.4	293.6	345.7
Equity capital	0.7	0.7	0.7	0.7
Preference capital	-	-	-	-
Reserves & surplus	44.5	49.6	55.6	63.9
Networth	45.1	50.3	56.3	64.6
Borrowings	144.1	170.4	207.4	245.6
Deposits	-	-	-	-
Other liabilities & prov.	19.3	24.7	29.9	35.4

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs)	80	84	109	148
BV (Rs)	684	763	854	979
Adj. BV (Rs)	639	700	711	835
DPS (Rs)	15	15	18	22
Dividend payout (%)	19	18	16	15
Yields & Margins (%)				
Yield on advances	22.0	21.1	20.7	19.1
Cost of funds	10.3	9.8	9.8	8.5
Net interest margin	13.5	13.4	13.0	12.3
Asset quality (%)				
Gross NPAs	5.1	6.7	9.4	8.8
Net NPAs	1.6	1.8	3.4	2.9
Credit cost	3.5	4.3	4.7	3.8
Provisioning coverage	69.7	73.3	63.8	66.8
Capital (%)				
Tier-I	23.4	22.3	21.3	19.7
CAR	26.1	23.9	23.9	22.1
Efficiency (%)				
ROA	2.7	2.5	2.7	2.8
ROE	12.3	11.7	13.5	15.1
Cost to income	42	39	38	38
CASA	-	-	-	-
Effective tax rate	34	35	35	35
Growth (%)				
Net interest income	14	18	17	22
Fee income	-	-	-	-
Operating expenses	15	8	14	21
Profit after tax	(5)	5	29	35
Advances	22	20	20	18
Deposits	-	-	-	-
Total assets	16	18	20	18

Source: Company, Axis Capital

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