AXIS DIRECT

UJJIVAN FINANCIAL SERVICES

BANKS & FINANCIAL SERVICES

4 MAY 2017 Quarterly Update

BUY

Target Price: Rs 470

Transient pain in FY18; story intact

PAT declined 65% YoY in Q4FY17, higher than our estimate, due to lower provisions. Headline GNPAs (0.3%) hide the underlying weakness in the asset quality (GNPAs of ~3.7% without RBI dispensation and 0-day PAR at ~9.9%). Improvement in cumulative collection efficiency(96.7%) is slow but steady (drought in some southern states, demonetization and influence of local groups).

Ujjivan may have to take some write-offs (~3% of loans), but these are transitory issues and will not inflict permanent fracture to microfinance business models. Pain will be sharp, but transient. We maintain our constructive stance on the Indian financial inclusion theme, for which Ujjivan is a pure-play. Any myopic reaction could provide excellent entry opportunity into Ujjivan's structural growth story.

CMP	: Rs 382
Potential Upside	: 23%

MARKET DATA

No. of Shares	: 120 mn
Free Float	: 100%
Market Cap	: Rs 46 bn
52-week High / Low	: Rs 547 / Rs 217
Avg. Daily vol. (6mth)	: 1.3 mn shares
Bloomberg Code	: UJJIVAN IB Equity
Promoters Holding	: 0%
FII / DII	: 18% / 13%

Q4FY17 key highlights:(1) Management stated there are ~41k accounts (Rs 0.7 bn) where no recoveries have occurred since November; (2) ~53% of defaulting customers have repaid atleast 1 instalment showing their willingness to pay; (3) Ujjivan has re-organized its JLG model to make non-defaulting group members liable only for the first 3 instalments due after a default. This ensures good quality borrowers remain with the company and defaultersare weeded out; (4) It used to acquire ~100 k clients/ month in FY17, but plans to curb client growth in FY18, relying instead of cross sells to existing clients; achieving ~20% loan growth for FY18(targets to grow MSE/housing to ~50% mix over 5 years).

Maintain BUY with revised TP of Rs470 (23% upside from CMP): We do not foresee any significant change in Ujjivan's transition plans on account of this turmoil. Disbursements, however, may moderate. We prefer Ujjivan amongst SFBs given its better risk management practices (predictive avoidance of stressed areas like Vidarbha, Sagar etc.), stronger client relationships, undeterred focus on financial inclusion and robust capital position (ability to grow even after some haircuts).We cut earnings for FY17-19 by 27% to factor in potential write-offs and cautious growth and, value Ujjivan at 2.7x FY19E P/ABV of Rs 172 to arrive at a TP of Rs 470. At CMP, Ujjivan trades at 2.5x/2.2x FY18/19E P/ABV.

Financial summary (Standalone)

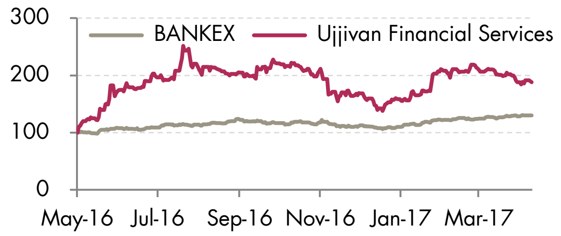
Y/E March	FY16	FY17	FY18E	FY19E
PAT(Rs mn)	1,772	2,077	1,157	2,455
EPS (Rs)	18	17	10	21
EPS chg (%)	99.0	(0.7)	(44.3)	112.2
Book value (Rs)	118	147	156	175
Adj. BV (Rs)	118	147	155	172
PE (x)	21.8	21.9	39.4	18.6
P/ABV (x)	3.2	2.6	2.5	2.2
RoE (%)	18.3	14.1	6.4	12.5
RoA (%)	3.7	2.9	1.3	2.2
Net NPA (%)	0.0	0.0	0.3	0.5

Source: Company, Axis Capital

Key drivers

(%)	Q2FY17	Q3FY17	Q4FY17
Loan Growth	59	44	18
Disb. Growth	80.7	0.9	(32.7)
GNPA	0.17	0.25	0.28

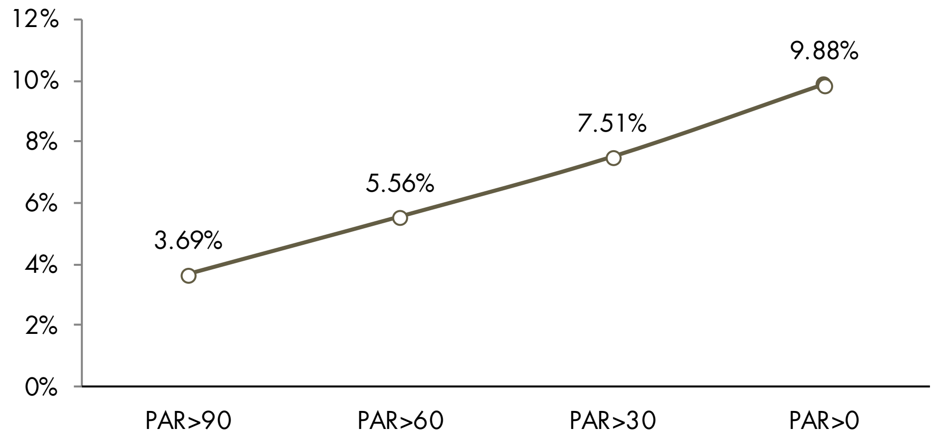
Price performance



What has changed in our FY18 estimates?

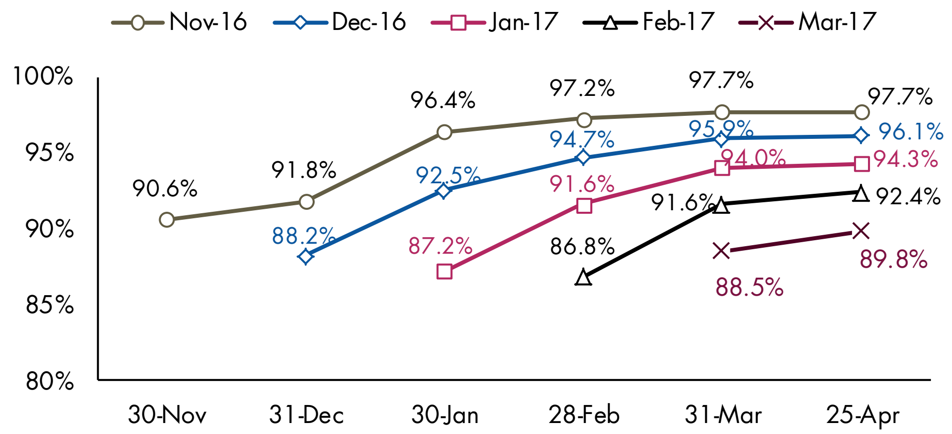
- Some one-time write-offs now seem to materialize (we estimate ~3% of loans may not be recoverable, translating to ~Rs 1.8 bn)
- Ujjivan has already taken additional provisions of ~Rs 650mn over the past two quarters (~Rs 570 mn in Q3 and ~Rs 72 mn in Q4), which may be used while writing these loans off
- This implies net additional provisions of Rs 1.2 bn in FY18, leading to a cut in our PAT estimate by ~27% to Rs 1.2 bn (vs. Rs. 1.6 bn earlier)
- Upside risk: Any improvement in drought conditions or abatement of local influence may provide some cushion/ recovery
- Downside risk: A weak monsoon and contagion effect from debt waivers pose additional risk to earnings

Exhibit 1: *PAR as on 31st march 2017



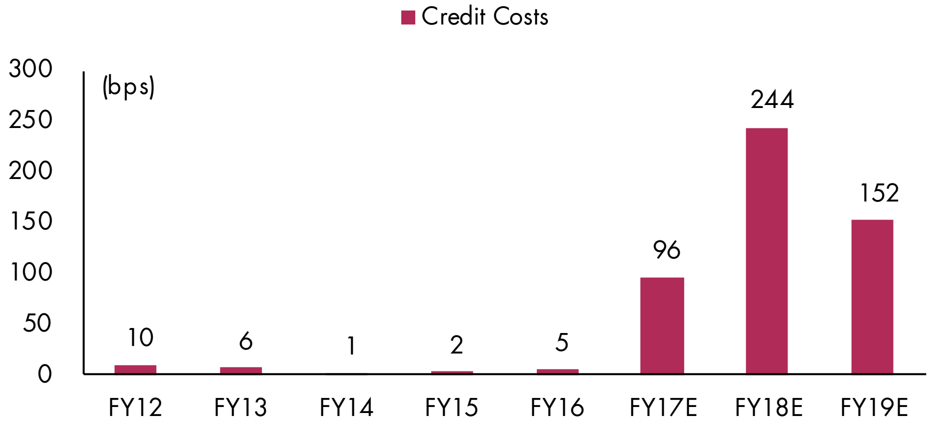
Source: Company, Axis Capital *On Book PAR

Exhibit 2: Improvement in collection efficiency remains slow, but steady



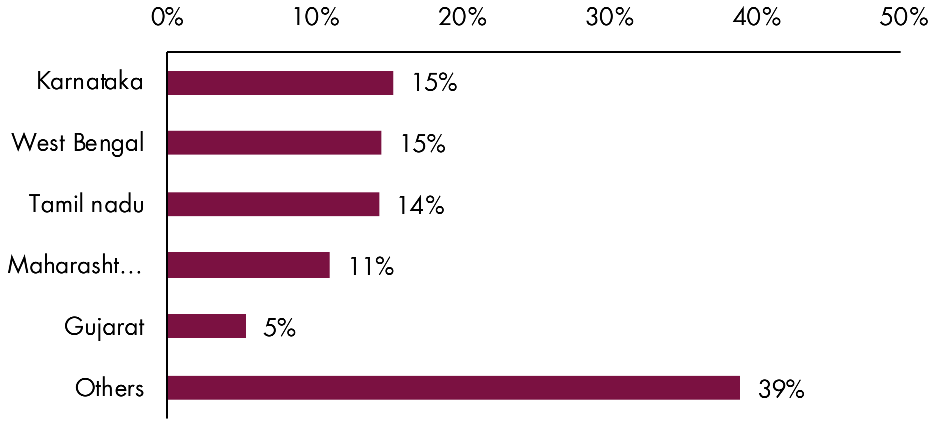
Source: Company, Axis Capital

Exhibit 3: Credit cost will spike over FY17-18E, but moderate thereafter



Source: Company, Axis Capital

Exhibit 4: No single state accounts for more than 16% of total loans



Source: Axis Capital, Company

Eastern states of Bihar, West Bengal and the southern state of Tamil Nadu have been little or no impact, with collection efficiencies near 100%

Exhibit 5: Impacted region and reason behind turmoil

Impacted States/Region	Exposure (% of AUM)	Root cause of stress
Uttar Pradesh (UP)		
- Western UP	~4.0	Demonetization and intervention by influential groups
Maharashtra		
- Vidarbha	Not present	Intervention by fringe groups
- Nashik	Negligible (< 0.5%)	Peer-induced contagion effect
Karnataka		
- Bangalore	6.8	Inappropriate business practices by smaller MFIs, and consequent communal agitation
- North Karnataka	Not present	Drought-induced slump in economic activity

Source: Company, Axis Capital

Exhibit 6: Average ticket size (FY17) remains comfortably low – room for growth

Product	(Rs)
MFI	23,711
Micro Individual Loan	64,212
MSE	259,106
Housing Finance	405,316

Source: Company, Axis Capital

Exhibit 7: Results update

	Quarter ended					12 months ended		
(Rs mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg	Mar-18E	Mar-17	% Chg
Interest income	3,145	2,940	7	3,622	(13)	14,981	12,258	22
Interest expended	1,617	1,179	37	1,332	21	6,982	5,427	29
Net interest income	**1,528**	**1,761**	**(13)**	**2,290**	**(33)**	**7,999**	**6,831**	**17**
Non-interest income	255	39	549	91	179	2,129	1,718	24
Net income	**1,783**	**1,800**	**(1)**	**2,381**	**(25)**	**10,127**	**8,549**	**18**
Operating expenses	1,365	875	56	1,170	17	6,709	4,581	46
Operating profit	**418**	**925**	**(55)**	**1,211**	**(66)**	3,418	3,969	(14)
Provision & Contingencies	72	82	(13)	547	(87)	1,637	751	118
PBT	**346**	**843**	**(59)**	**664**	**(48)**	**1,781**	**3,217**	**(45)**
Tax	153	294	(48)	225	(32)	623	1,141	(45)
Net Profit	**194**	**549**	**(65)**	**439**	**(56)**	**1,157**	**2,077**	**(44)**
Yields & Margins (%)								
Net interest margin	8.6	12.7	(404) bps	13.2	(461) bps	9.2	10.0	(81) bps
Asset quality								
Gross NPAs (%)	0.28	0.15	13 bps	0.25	3 bps	1.09	0.28	81 bps
Net NPAs (%)	0.03	0.04	(1) bps	0.05	(2) bps	0.27	0.03	24 bps
Provisioning coverage (%)	89.3	73.3	1,595 bps	80.0	929 bps	75.0	89.3	(1,429) bps
Capital (%)								
Tier-I	16.8	22.4	(557) bps	0.0	1,683	16.3	16.8	(51) bps
CAR	18.2	24.1	(586) bps	26.4	(816)	17.7	18.2	(56) bps
Balance sheet (Rsbn)								
Gross AUM	64	54	18	66	(3)	74	64	17

Source: Company, Axis Capital

Note: Full year ratios are on calculated basis & may be different from reported nos.

Financial summary (Standalone)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	9,310	12,258	14,981	17,613
Interest expended	(4,235)	(5,427)	(6,982)	(8,222)
Net interest income	**5,075**	**6,831**	**7,999**	**9,391**
Non-interest income	966	1,718	2,129	2,262
Net income	**6,041**	**8,549**	**10,127**	**11,653**
Operating expenses	**(3,068)**	**(4,581)**	**(6,709)**	**(6,566)**
Staff expenses	(1,967)	(2,716)	(3,513)	(3,873)
Other operating expenses	(1,102)	(1,864)	(3,196)	(2,693)
Operating profit	**2,973**	**3,969**	**3,418**	**5,087**
Provisions & contingencies	(253)	(751)	(1,637)	(1,310)
Pre-tax profit	**2,720**	**3,217**	**1,781**	**3,778**
Tax expense	(948)	(1,141)	(623)	(1,322)
Profit after tax	**1,772**	**2,077**	**1,157**	**2,455**
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	1,772	2,077	1,157	2,455

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	**57,273**	**84,786**	**97,564**	**126,154**
Cash & Balances with RBI	4,913	7,601	5,220	5,879
Investments	1	14,468	17,072	24,242
Advances	50,644	58,712	70,669	89,618
Fixed assets	242	1,398	2,261	3,391
Other assets	1,233	2,138	1,779	2,347
Total liabilities	**57,273**	**84,786**	**97,564**	**126,154**
Equity capital	1,012	1,194	1,194	1,194
Reserves & surplus	10,966	16,373	17,382	19,665
Networth	11,978	17,567	18,575	20,858
Borrowings	43,380	62,914	51,275	63,581
Deposits	-	1,064	23,590	36,597
Other liabilities & prov.	1,916	3,241	4,124	5,118

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	18	17	10	21
BV (Rs.)	118	147	156	175
Adj. BV (Rs.)	118	147	155	172
DPS (Rs.)	1	1	1	1
Dividend payout (%)	3	5	10	6
Yields & Margins (%)				
Yield on advances	22.5	21.5	21.5	20.3
Cost of deposit	-	-	7.0	6.9
Net interest margin	10.8	10.0	9.2	8.8
Asset quality (%)				
Gross NPAs	0.2	0.3	1.1	1.6
Net NPAs	-	-	0.3	0.5
Credit cost	-	1.0	2.4	1.5
Provisioning coverage	73.9	89.3	75.0	70.0
Efficiency (%)				
ROA	3.7	2.9	1.3	2.2
ROE	18.3	14.1	6.4	12.5
Cost to income	51	54	66	56
CASA	-	3	15	18
Effective tax rate	35	35	35	35
Growth (%)				
Net interest income	82	35	17	17
Fee income	58	2	40	20
Operating expenses	50	49	46	(2)
Profit after tax	134	17	(44)	112
Advances	57	16	20	27
Deposits	-	-	2,117	55
Total assets	44	48	15	29

Source: Company, Axis Capital

Note: NPA ratios are on balance sheet loan assets

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