

CMP: INR 39.65

Rating: Buy | Outlook: Positive

**Target Price: Upgraded to
INR 49.4 from INR 36**

UFSL Price Objective: INR 573

Stock Info

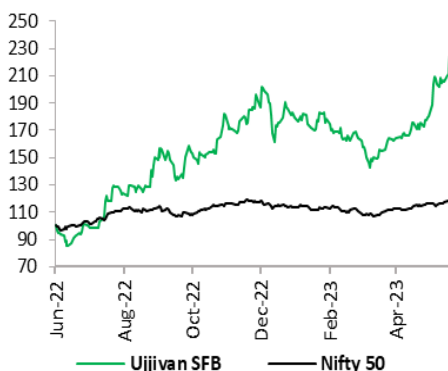
BSE	542904
NSE	UJJIVANSFB
Bloomberg	UJJIVANS IN
Reuters	UJJI.BO
Sector	Banks
Face Value (INR)	10
Equity Capital (INR Cr)	1,954.71
Mkt Cap (INR Cr)	7,721
52w H/L (INR)	39.89 / 13.5

Shareholding Pattern %

(As on June, 2023)

Promoters	73.67
Public & Others	26.33

Stock Performance (%)	1m	6m	12m
Ujjivan SFB	19.9	21.5	135
Nifty 50	1.4	0.4	17.7



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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. Ujjivan's journey towards building retail portfolio is progressing well and its liability franchise trending better with NIMs at 9.5% and CASA ratio at 26.4%.

Rationale

We believe the long-term prospects of the bank remain attractive on the back of:

- 1) Banks focus will be on building Affordable housing and micro lending portfolio, which has the better NIMS as compared to other products.
- 2) Ability to manage asset quality post covid disruption. GNPA declined to 2.9% in Q4FY23 and NNPA remained at close to 0% for last three consecutive quarters. Recovery in FY23, played a significant role in improving asset quality.
- 3) The reverse merger with their promoter company, UFSL Ujjivan Financial Services Limited is expected to be finalized by Q3FY24. This reverse merger will increase the book value per share.
- 4) Banks focus on digitalization has increased which will help them reach under served segments. They also launched a new app "Hello Ujjivan" for the same, which operates in 8 vernacular languages + English.
- 5) Withdrawal of RBI appointed director Mr. PN Raghunath from the Ujjivan SFB board prior to the end of his tenure on May 29, 2023, which was originally set to end on November 28, 2023, indicates that the RBI has confidence in the book or portfolio of Ujjivan Small Finance Bank.

Building a mass market bank

- 1) **Expanding their geographic presence:** Last year, Ujjivan small finance bank had started operations in the state of Telangana. This year, their focus is to extend their operations to the state of Andhra Pradesh. Going forward, contribution of information technology will increase, which will help them tap the underserved market.
- 2) **MSME & Affordable Housing Finance book expected to grow:** The MSME book has reduced to INR 1,593 Cr in FY23 (declined 7% YoY). However, in FY24, USFL's focus will be on affordable housing and microfinance, since MFI yields are at 23% and Individual micro yields are at 25% currently. The MSME book is expected to grow at CAGR of 25% till FY26. This will help them improve their profitability.
- 3) **Strong NIMs:** USFL's NIMs for the FY23, stands at 9.5%. Because of strong NIM, liability franchise is strong and it gives flexibility to increase interest rates. Rates were increased in August 2022 and growth has been good, since then. The interest rates offered by Ujjivan SFB was increased upto 8.25%. Going forward, NIMs are expected to be greater than 9%.
- 4) **Reverse Merger with Ujjivan Financial Services Limited:** Bank have submitted an application to the Bangalore NCLT for merger with their promoter company UFSL Ujjivan Financial Services Limited. This reverse merger is expected to be finalized by Q3FY24. This reverse merger will increase the book value per share.
- 5) **Succession for USFL:** Tenure of Mr. David is till January 2025. USFB is currently looking for a successor, both internally and externally. Most Small finance bank have founders as MD, except Ujjivan, since founder stepped down in FY19.
- 6) **Improving Asset Quality:** GNPA declined to 2.9% in Q4FY23 and NNPA remained at close to 0% for last three consecutive quarters, which is expected to stabilize in the coming periods. Recovery in FY23, played a significant role in improving asset quality. Slippages in FY23 were INR 335 crores with recoveries of INR 506 crores, which have started to normalize towards the end of FY23. Bank believes bad debt recoveries would continue during FY24.

Liability – Stable, Sustainable and scalable

Bank's target customer focus will be aspiring middle class, senior citizen, women, NRs, HNI, TASC, MSME and Enterprise. Bank is launching video banking, which will help them with salary based customers and students. Further, bank has targeted programs to target specific customer segments like HNI, senior citizen women. etc. For instance: They have a dedicated Program 'Ujjivan Navratna' to cater to the needs of HNI customers. Also, digital savings account and fixed deposit to be launched soon. Fintech investments made by the bank is expected to bear fruits in the coming years. Bank is targeting for Deposits from FY23 to FY26 is to grow by CAGR 30%+.

Micro lending

MFI yield is at 23% and Individual micro yield is at 25% currently. Micro lending is expected to drive business in the coming periods, both secured and unsecured. Industry has delivered 30%+ CAGR since 2012 despite demonetization and Covid. NIM in MFI is best and credit cost is very low, which makes it very attractive compared to other products. Higher the number of customers in this segment, higher will be the competitive advantage. Ujjivan small finance bank grew 36% vs 32% of industry over last decade. Bank has independent credit team at HO as well as office for MFI loans which makes it unique as compared to industry. Micro lending business at Ujjivan small finance bank can grow at CAGR of 20-25% over medium term.

Affordable Housing

Total affordable housing loans for FY23 stands at INR 3,401 Cr. There is a huge opportunity for bank to grow in the housing segment, since the individual home loan to GDP ratio in India is very low as compared to other countries. Affordable segment is growing at 32% CAGR against 12% for Housing industry. Banks focus is on acquiring customers from Tier 2 and 3 cities. Bank has a separate collection team for MFI and secured business.

MSME

Total MSME loans for FY23 stands at INR 1,593 Cr. Current customers with small ticket sizes has the requirement of higher ticket size loan. To cater to that requirement, new Product M – LAP was launched.

Investment in digitalization- Hello Ujjivan

Hello Ujjivan is a new digital app launched by the bank to cater to the underserved market. It operates in 9 different languages to target vernacular segment. This will enable end – to – end digital journey. This will help to reduce banks TAT.

Target for FY26

Banks target till the FY26 is to have CD Ratio of 80%, CASA of 35% and 70% retail with ROA/ROE of 2.5%/ 22%, respectively. NIM is expected to be greater than 9% with a gross Loan Book growth of more than 25% and Credit cost less than 150bps. Secured book is expected to increase from 30% to 40% by FY26.

Way ahead

Banks focus going ahead will be on Affordable housing and Micro lending. Focus on IT will increase to promote digitalization. Bank is targeting 30%+ CAGR growth in deposits from FY23 – 26.

Outlook

We continue to remain positive on UFSL and believe this transformational journey would pick up pace FY24 onwards. UFSL has surprised investors with outperforming its guidance on growth and credit cost in FY23 and we believe this trend would continue going forward also with granular loan book. We are valuing USFB 1.3x FY26e ABV of INR 38 and arrived at upgraded price objective of INR 49.4 respectively. We had initiated USFB at INR 22 in October 2022, which is already at 1.5x, and recommended UFSL at INR 110 in March 2022, which is at 3.5x but we believe there is still room for upside. Based on the merger ratio of 115 shares of USFB for every 10 shares of UFSL, UFSL is trading at a discount of around 15%, which is expected to reduce going forward. On our target of INR 49.4 USFL would trade at INR 573 respectively.

Profit & Loss Statement (in INR Cr)	FY22A	FY23A	FY24E	FY25E	FY26E
Interest Income	2,813	4,165	4,764	5,763	6,884
Interest Expended	1,039	1,467	1,820	2,151	2,402
Net Interest Income	1,774	2,698	2,944	3,612	4,483
Other Income	313	589	442	542	672
Operating Income	2,087	3,287	3,385	4,154	5,155
Operating Expenses	1,496	1,802	2,142	2,832	1,985
Employee Expenses	813	920	1,063	1,283	0
Other Operating Expenses	684	882	1,079	1,549	1,985
PPOP	590	1,485	1,244	1,321	3,170
Provisions	1,141	18	343	318	384
PBT	-550	1,467	900	1,003	2,787
Tax Expenses	-136	367	227	253	701
Net Income	-415	1,100	751	751	2,085

Balance Sheet (in INR Cr)	FY22A	FY23A	FY24E	FY25E	FY26E
Equity & Liabilities					
Share Capital	1,928	2,155	2,155	2,155	2,155
Reserves & Surplus	832	2,003	2,754	3,504	5,590
Net Worth	2,803	4,209	4,960	5,710	7,796
Deposits	18,292	25,538	31,320	38,548	47,636
Borrowings	1,764	2,641	1,908	909	-3,061
Other Liabilities and Provisions	746	929	1,123	1,227	1,505
Total Capital & Liabilities	23,604	33,317	39,311	46,395	53,876
Assets					
Cash & Balances with RBI	1,682	2,305	2,640	3,289	4,088
Balances with Other Banks & Call Money	486	178	221	267	321
Investments	4,153	8,510	8,936	9,829	9,829
Advances	16,303	21,290	26,405	31,819	38,356
Fixed Assets	249	283	321	364	413
Other Assets	731	750	788	827	869
Total Assets	23,604	33,317	39,311	46,395	53,876

Ratios	FY22A	FY23A	FY24E	FY25E	FY26E
Growth rates					
Advances (%)	12.5%	30.6%	24.0%	20.5%	20.5%
Deposits (%)	39.3%	39.6%	22.6%	23.1%	23.6%
Total assets (%)	15.8%	41.1%	18.0%	18.0%	16.1%
NII (%)	2.6%	52.1%	9.1%	22.7%	24.1%
Pre-provisioning profit (%)	-27.0%	151.5%	-16.3%	6.3%	139.9%
PAT (%)	-5144.8%	-365.3%	-31.8%	0.0%	177.8%
Balance sheet ratios					
Credit/Deposit (%)	89.1%	83.4%	84.3%	82.5%	80.5%
CASA (%)	27.3%	26.4%	30.0%	31.0%	32.0%
Advances/Total assets (%)	69.1%	63.9%	67.2%	68.6%	71.2%
Leverage (x) (Asset/Shareholder's Fund)	8.4	7.9	7.9	8.1	6.9
CAR (%)	19.0%	24.8%	25.2%	24.0%	26.9%
CAR - Tier I (%)	17.7%	21.8%	22.8%	21.9%	25.1%
Operating efficiency					
Cost/income (%)	71.7%	54.8%	63.3%	68.2%	38.5%
Opex/total assets (%)	6.3%	5.4%	5.4%	6.1%	3.7%
Opex/total interest earning assets	7.1%	6.6%	6.1%	6.8%	4.1%
Profitability					
NIM (%)	8.4%	9.8%	8.4%	8.7%	9.2%
RoA (%)	-1.8%	3.3%	1.9%	1.6%	3.9%
RoE (%)	-14.8%	26.1%	15.1%	13.1%	26.8%
Asset quality					
Gross NPA (%)	7.1%	4.0%	3.1%	3.1%	3.0%
Net NPA (%)	0.6%	1.1%	0.6%	0.7%	0.7%
PCR (%)	92.2%	75.9%	81.9%	80.4%	78.2%
Credit cost (%)	7.0%	0.1%	1.3%	1.0%	1.0%
Per share data / Valuation					
EPS (INR)	-2.4	5.6	3.8	3.8	10.7
BVPS (INR)	16	22	25	29	40
ABVPS (INR)	16	20	25	28	38
P/E (x)	-9.2	3.9	5.7	5.7	2.1
P/BV (x)	1.4	1.0	0.9	0.8	0.6
P/ABV (x)	1.4	1.1	0.9	0.8	0.6

Source: Company reports, Arihant Capital Research

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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%

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