

BUY Fusion Micro Finance**Sustained strong growth/RoAs**

BFSI - Banks ▶ Result Update ▶ August 3, 2023

TARGET PRICE (Rs): 810

Fusion MFI delivered 15% earnings beat with PAT at Rs1.2bn/~5% RoA in Q1, mainly on the back of strong AUM growth (31% YoY), continued margin uptick (+32bps QoQ to 10.9%) and higher fees, partly offset by increased LLP (3.6% of loans), including prudent management overlay. Management has guided for continued strong AUM growth, led by customer growth as well as re-aligning ticket size for vintage customers, while margins are likely to rise, benefiting from the recent increase in lending rates. However, credit cost should remain elevated in the near term due to some impact of floods in Northern India, shoring-up of PCR and change in write-off policy (270 days vs. 360 days) similar to peers. Factoring in strong growth/margin delivery, partly offset by elevated credit cost, we have revised our earnings estimates for FY24-26E by 8-12% and expect Fusion to report a strong RoA/RoE of 4.5-4.9%/19-20%. Thus, we revise our TP upwards to Rs810 (earlier Rs725), valuing the stock at 2.3x its June 25E ABV. We retain our BUY rating on the stock.

Fusion Micro Finance: Financial Snapshot (Standalone)

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net profit	217	3,871	5,198	6,234	7,385
AUM growth (%)	46.3	37.0	26.0	25.0	23.0
NII growth (%)	25.6	68.4	34.7	22.4	20.9
NIM (%)	9.0	12.0	12.6	12.3	11.9
PPOP growth (%)	41.6	81.2	34.8	19.5	18.6
Adj. EPS (Rs)	2.7	42.3	51.8	62.1	73.6
Adj. EPS growth (%)	(51.8)	1,477.6	22.5	19.9	18.5
Adj. BV (INR)	157.0	248.5	278.5	341.1	413.9
Adj. BVPS growth (%)	4.7	53.8	11.7	22.0	21.4
RoA (%)	0.3	4.6	4.9	4.7	4.5
RoE (%)	1.7	21.2	20.1	19.8	19.3
P/E (x)	239.8	15.2	12.4	10.3	8.7
P/ABV (x)	4.3	2.6	2.3	1.9	1.6

Source: Company, Emkay Research

Robust growth coupled with better loan yields led to healthy margins

Fusion reported healthy AUM growth at 31% YoY/4.5% QoQ in a typically lean quarter for the MFI sector on the back of healthy disbursements (+15% YoY). This was mainly led by a strong customer base (up 26% YoY/3% QoQ) and a gradual increase in ticket size for vintage customers, which management claims was not made for long due to Covid-19. Thus, better growth coupled with higher yields benefiting from new RBI regulations led to improved margins at 10.9% (up 150bps YoY/30 bps QoQ). Going forward, management has guided for stronger growth vs. the industry due to continued strong customer growth from existing geographies (UP) as well as new geographies in western (Gujarat)/southern India (Karnataka). Additionally, the company has taken another hike of 40bps in July and thus expects continued improvement in margins over next two quarters.

Floods in North India, PCR bump-up and change in write-off policy to keep the near-term LLP elevated

Headline NPAs continued to trend down by 26bps QoQ to 3.2% mainly due to better net recoveries/higher write-offs. Though the restructured pool is now negligible at 0.1% of loans, Fusion may see some bump in NPAs during Q2 due to the impact of the recent floods in Northern India. The overall LLP during Q1 was at 3.6% of AUM, partly due to PCR bump-up to 76% and partly because of management overlay of Rs0.6bn, given its stated strategy to build provision buffers during good times. Additionally, the company has changed its write-off policy (270 days vs. 360 days) similar to peers, which may reduce the NPAs, but it could lead to elevated credit costs in the near term. Thus, we build-in LLP around 2.8% of loans in FY24 (similar to FY23).

Retain BUY with a revised TP of Rs810

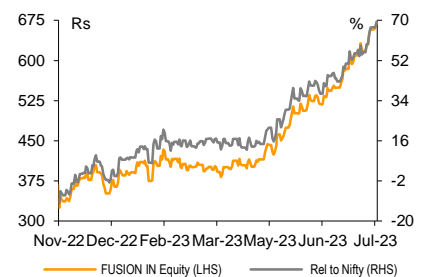
Factoring in strong growth/margin delivery, partly offset by elevated credit cost, we have revised our earnings estimates for FY24-26E by 8-12% and expect Fusion to clock strong RoA/RoE of 4.5-4.9%/19-20%. Thus, we revise our TP to Rs810 (earlier Rs725), valuing it at 2.3x its June 25E ABV. We retain our BUY rating on the stock. Key risks: Impact on asset quality due to rising micro/climatic disruptions, execution risk in the highly penetrated Southern India and managing cost in a build-up phase.

Target Price – 12M	Jun-24
Change in TP (%)	11.7
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	26.0
CMP (03-Aug-23) (Rs)	642.8

Stock Data	Ticker
52-week High (Rs)	691
52-week Low (Rs)	321
Shares outstanding (mn)	100.6
Market-cap (Rs bn)	65
Market-cap (USD mn)	782
Net-debt, FY24E (Rs mn)	NA
ADTV-3M (mn shares)	-
ADTV-3M (Rs mn)	161.6
ADTV-3M (USD mn)	2.0
Free float (%)	32.0
Nifty-50	19,382
INR/USD	82.7
Shareholding, Jun-23	
Promoters (%)	68.2
FPIs/MFs (%)	5.4/16.5

Price Performance

(%)	1M	3M	12M
Absolute	15.2	46.9	-
Rel. to Nifty	14.8	37.1	-

1-Year share price trend (Rs)**Anand Dama**

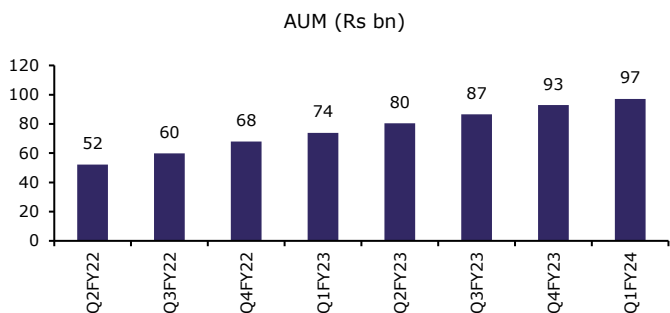
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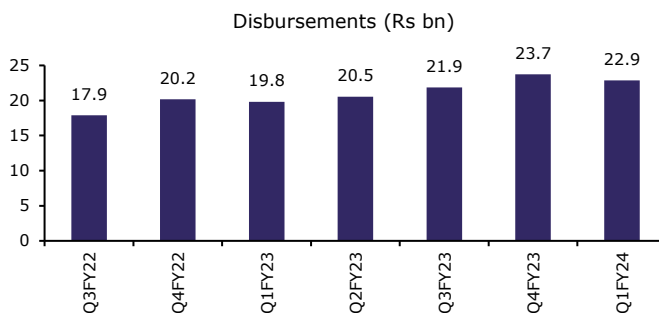
Story in Charts

Exhibit 1: Strong AUM growth at 31% YoY in a lean quarter...



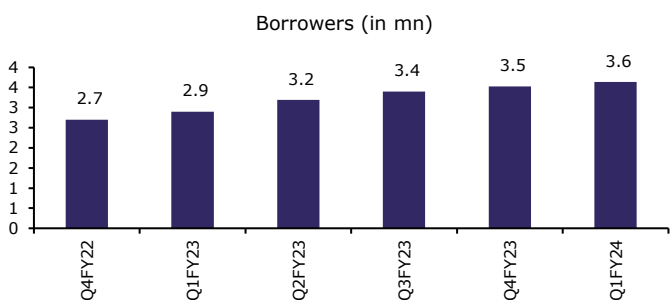
Source: Company, Emkay Research

Exhibit 2: ...led by strong disbursements



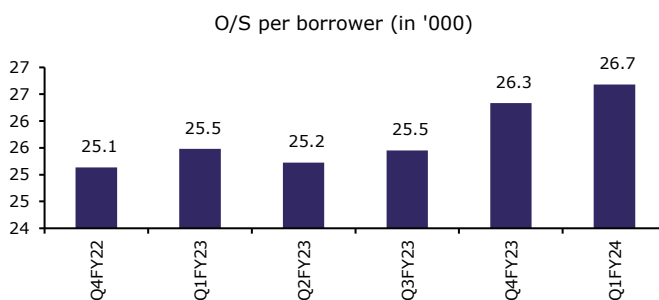
Source: Company, Emkay Research

Exhibit 3: Fusion continues to witness strong customer growth @26% YoY



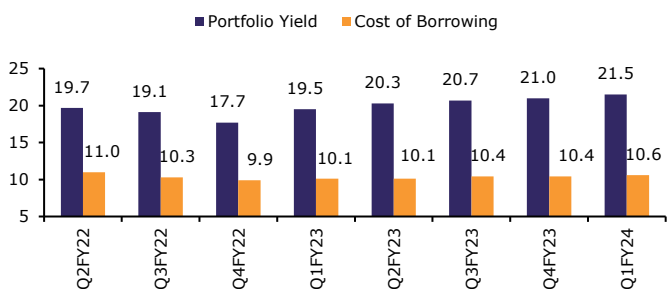
Source: Company, Emkay Research

Exhibit 4: ...while rising ticket size and customer vintage should lead to a steady increase in o/s per borrower



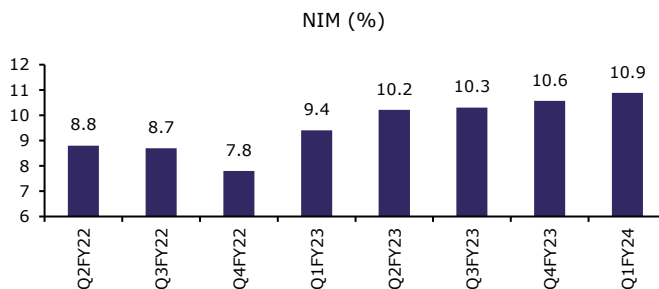
Source: Company, Emkay Research

Exhibit 5: Better portfolio yields coupled with contained CoF



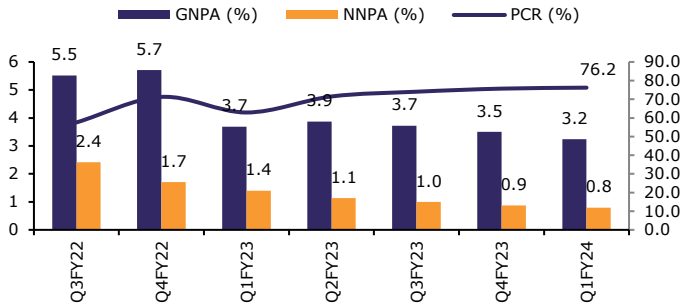
Source: Company, Emkay Research

Exhibit 6: ...led to continued margin expansion



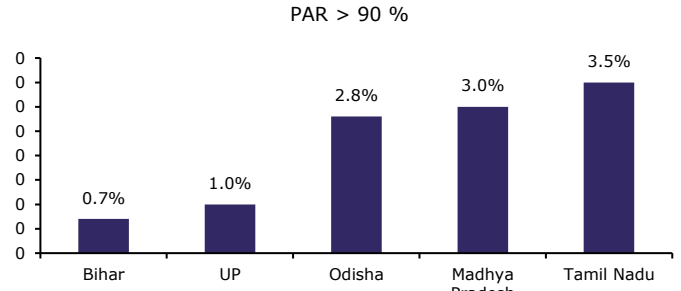
Source: Company, Emkay Research

Exhibit 7: Receding GNPA + rising PCR leading to lower NNPA



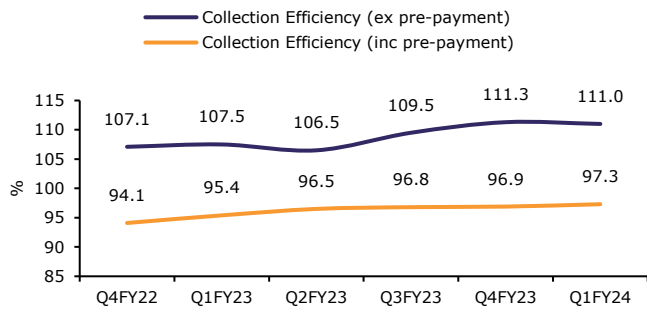
Source: Company, Emkay Research

Exhibit 8: PAR > 90 DPD remains higher for Eastern and Southern states



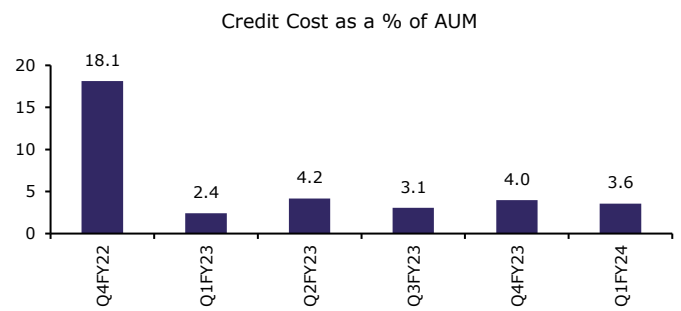
Source: Company, Emkay Research

Exhibit 9: Collection efficiency improved but remains sub-par vs. peers due to continued slower recovery in TN, Haryana and so on



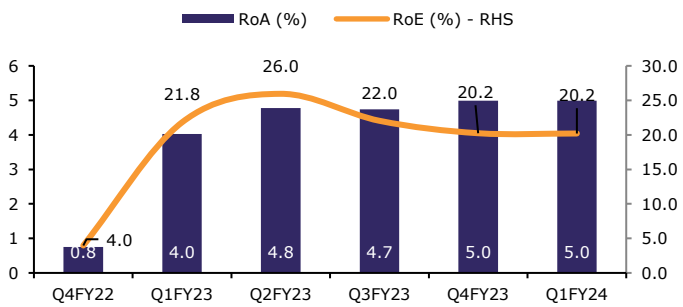
Source: Company, Emkay Research

Exhibit 10: Elevated credit cost due to rising PCR + management overlay + aggressive write-off policy



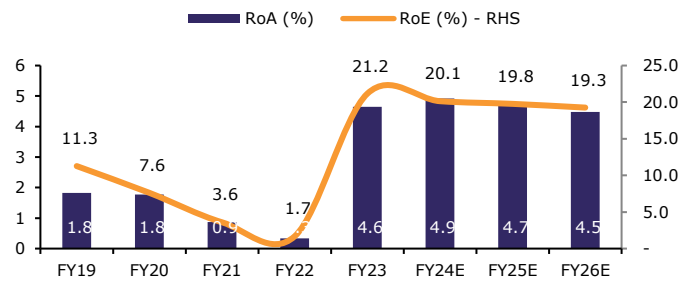
Source: Company, Emkay Research

Exhibit 11: Return ratios show an improving trend



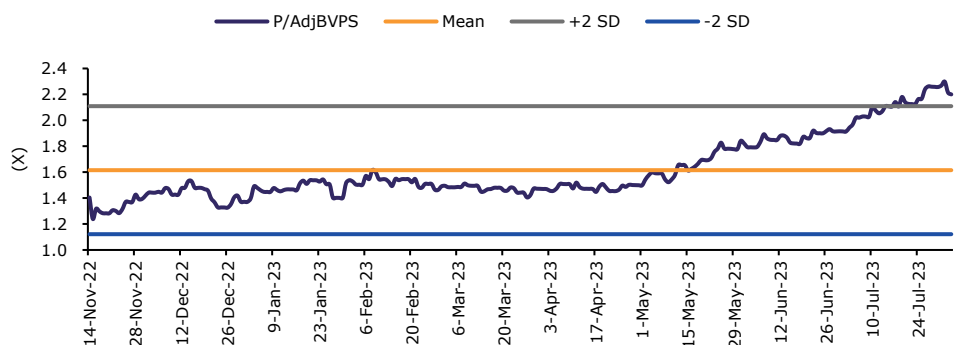
Source: Company, Emkay Research

Exhibit 12: Strong growth, margins partly offset by elevated credit cost, to keep return ratios healthy



Source: Company, Emkay Research

Exhibit 13: After the recent run-up, the stock trades at 2.2x one-year forward ABV



Source: Bloomberg, Emkay Research

Exhibit 14: Actuals vs Estimates (Q1FY24)

(Rs mn)	Actuals	Estimates		Variation (%)		Comments
		Emkay	Consensus	Emkay	Consensus	
Net income	3,693	3,172		16%		Better margins and higher other income led to a beat.
PPOP	2,354	1,909		23%		Higher net income led to a beat.
PAT	1,205	1,051	1,164	15%	3%	Higher PPOP, partly offset by increased provisions, led to a beat.

Source: Company, Emkay Research

Exhibit 15: Quarterly Summary

(Rs mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)	FY23A	FY24E	YoY (%)
Interest Earned	3,294	3,998	4,202	4,507	4,790	45	6	16,001	21,411	34
Interest Exp.	1,432	1,573	1,680	1,742	1,835	28	5	6,428	8,512	32
Net Interest Income	1,862	2,424	2,522	2,765	2,955	59	7	9,573	12,899	35
Global NIMs (reported)	9.40	10.21	10.31	10.57	10.89	149bps	32bps	8.54	9.29	74bps
Non-interest Income	311	526	463	700	738	137	5	1,999	2,287	14
Operating Expenses	971	1,077	1,147	1,253	1,339	38	7	4,448	5,583	26
Pre Provisioning Profit	1,202	1,873	1,838	2,211	2,354	96	6	7,124	9,603	35
Provision & Contingencies	201	612	499	692	759	278	10	2,004	2,653	32
PBT	1,001	1,261	1,339	1,519	1,595	59	5	5,120	6,950	36
Income Tax Expense (Gain)	250	310	314	374	390	56	4	1,248	1,751	40
Net Profit/(Loss)	751	951	1,025	1,145	1,205	60	5	3,871	5,198	34
Gross NPA (%)	3.69	3.87	3.72	3.50	3.24	-45bps	-26bps	1.14	5.67	453bps
Net NPA (%)	1.40	1.14	0.99	0.87	0.79	-61bps	-8bps	0.39	2.35	196bps
Net Advances (Rs in bn)	67	70	76	80	84	26	4	80	102	27

Source: Company, Emkay Research

Exhibit 16: Revision in Estimates

Y/E March (Rs mn)	FY24E			FY25E			FY26E		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Net income	13,815	15,186	9.9%	16,496	18,388	11.5%	19,606	22,042	12.4%
PPOP	8,283	9,603	15.9%	9,930	11,472	15.5%	11,874	13,604	14.6%
PAT	4,815	5,198	8.0%	5,655	6,234	10.3%	6,580	7,385	12.2%
EPS (Rs)	48.0	51.8	8.0%	56.4	62.1	10.3%	65.6	73.6	12.2%
BV (Rs)	278.4	282.2	1.4%	334.8	344.4	2.9%	400.4	418.0	4.4%

Source: Emkay Research

Exhibit 17: Key Assumptions

	FY23A	FY24E	FY25E	FY26E
Loan Growth (%)	35.9	27.0	26.8	24.2
Deposit Growth (%)	37.0	26.0	25.0	23.0
NIM (%)	12.0	12.6	12.3	11.9
GNPA (%)	3.5	2.7	2.2	2.3
Credit Cost (%)	2.8	2.8	2.7	2.5

Source: Emkay Research

Fusion Micro Finance: Standalone Financials and Valuations

Profit and Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	10,643	16,001	21,411	26,141	31,640
Interest Expense	4,960	6,428	8,512	10,346	12,545
Net interest income	5,684	9,573	12,899	15,795	19,095
NII growth (%)	25.6	68.4	34.7	22.4	20.9
Other income	1,370	1,999	2,287	2,593	2,947
Total Income	7,054	11,572	15,186	18,388	22,042
Operating expenses	3,123	4,448	5,583	6,916	8,438
PPOP	3,931	7,124	9,603	11,472	13,604
PPOP growth (%)	41.6	81.2	34.8	19.5	18.6
Core PPOP	3,931	7,124	9,603	11,472	13,604
Provisions & contingencies	3,687	2,004	2,653	3,137	3,730
PBT	244	5,120	6,950	8,335	9,874
Extraordinary items	0	0	0	0	0
Tax expense	27	1,248	1,751	2,100	2,488
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	217	3,871	5,198	6,234	7,385
PAT growth (%)	(50.7)	1,685.4	34.3	19.9	18.5
Adjusted PAT	217	3,871	5,198	6,234	7,385
Diluted EPS (Rs)	2.6	41.6	51.0	61.2	72.5
Diluted EPS growth (%)	(51.9)	1,475.6	22.7	19.9	18.5
DPS (Rs)	0.0	0.0	0.0	0.0	0.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
Effective tax rate (%)	11.2	24.4	25.2	25.2	25.2
Net interest margins (%)	9.0	12.0	12.6	12.3	11.9
Cost-income ratio (%)	44.3	38.4	36.8	37.6	38.3
Shares outstanding (mn)	92.3	109.9	109.9	109.9	109.9

Source: Company, Emkay Research

Asset Quality and Other Metrics					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Asset quality					
Gross NPLs	3,584.3	2,889.0	2,845.2	2,903.2	3,825.0
Net NPLs	1,030.3	707.9	711.3	638.7	765.0
GNPA ratio (%)	5.8	3.5	2.7	2.2	2.3
NNPA ratio (%)	1.7	0.9	0.7	0.5	0.5
Provision coverage (%)	71.3	75.5	75.0	78.0	80.0
Gross slippages	3,959.8	1,776.7	2,189.2	2,899.0	3,687.3
Gross slippage ratio (%)	6.4	2.2	2.1	2.2	2.3
LLP ratio (%)	6.9	2.8	2.8	2.7	2.5
NNPA to networth (%)	7.7	3.0	2.5	1.8	1.8
Capital adequacy					
Total CAR (%)	21.9	27.9	26.7	25.9	25.2
Tier-1 (%)	19.9	27.0	25.9	25.1	24.4
Tier-2 (%)	2.0	0.9	0.8	0.8	0.8
RWA-to-Total Assets (%)	83.1	88.4	90.4	91.4	92.4
Miscellaneous					
Total income growth (%)	37.6	49.8	31.7	21.3	20.4
Opex growth (%)	41.7	42.5	25.5	23.9	22.0
Core PPOP growth (%)	41.6	81.2	34.8	19.5	18.6
PPOP margin (%)	6.0	8.6	9.1	8.6	8.2
PAT/PPOP (%)	5.5	54.3	54.1	54.3	54.3
LLP-to-Core PPOP (%)	93.8	28.1	27.6	27.3	27.4
Yield on advances (%)	21.0	22.9	23.6	22.6	21.8
Cost of borrowings (%)	9.7	10.2	11.1	10.6	10.2

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	923	1,099	1,099	1,099	1,099
Reserves & surplus	12,457	22,121	27,319	33,553	40,939
Net worth	13,380	23,219	28,418	34,652	42,037
Deposits	0	0	0	0	0
Borrowings	57,758	67,784	84,997	109,416	136,860
Interest bearing liab.	57,758	67,784	84,997	109,416	136,860
Other liabilities & prov.	1,767	2,632	4,437	3,340	3,580
Total liabilities & equity	72,905	93,635	117,852	147,408	182,478
Net advances	59,182	80,416	102,111	129,506	160,819
Investments	0	0	0	0	0
Cash, other balances	11,536	10,650	12,884	14,641	18,009
Interest earning assets	70,718	91,066	114,996	144,148	178,828
Fixed assets	192	212	224	234	245
Other assets	1,995	2,357	2,631	3,026	3,405
Total assets	72,905	93,635	117,852	147,408	182,478
BVPS (Rs)	165.4	253.6	283.2	345.3	418.9
Adj. BVPS (INR)	157.0	248.5	278.5	341.1	413.9
Gross Loan Portfolio (Rs mn)	67,860	92,960	117,130	146,412	180,087
Loan to borrowings (%)	102.5	118.6	120.1	118.4	117.5
Cash + Invnt as a % of GLP	17.0	11.5	11.0	10.0	10.0
Cost of borrowings (%)	9.7	10.2	11.1	10.6	10.2
Loans-to-Assets (%)	81.2	85.9	86.6	87.9	88.1
AUM growth (%)	46.3	37.0	26.0	25.0	23.0
Borrowings growth (%)	30.3	17.4	25.4	28.7	25.1
Book value growth (%)	4.8	53.3	11.7	21.9	21.3

Source: Company, Emkay Research

Valuations and Key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	239.8	15.2	12.4	10.3	8.7
P/B (x)	4.1	2.6	2.3	1.9	1.6
P/ABV (x)	4.3	2.6	2.3	1.9	1.6
P/PPOP (x)	15.2	10.0	7.4	6.2	5.2
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
DuPont-RoE split (%)					
NII/avg assets	8.7	11.5	12.2	11.9	11.6
Other income	2.1	2.4	2.2	2.0	1.8
Fee income	1.6	1.9	1.8	1.7	1.6
Opex	4.8	5.3	5.3	5.2	5.1
PPOP	6.0	8.6	9.1	8.6	8.2
Core PPOP	6.0	8.6	9.1	8.6	8.2
Provisions	5.6	2.4	2.5	2.4	2.3
Tax expense	0.0	1.5	1.7	1.6	1.5
RoA (%)	0.3	4.6	4.9	4.7	4.5
Leverage ratio (x)	5.1	4.6	4.1	4.2	4.3
RoE (%)	1.7	21.2	20.1	19.8	19.3
Quarterly data					
Rs mn, Y/E Mar	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
NII	1,862	2,424	2,522	2,765	2,955
NIM(%)	9.4	10.2	10.3	10.6	10.9
PPOP	201	612	499	692	759
PAT	751	951	1,025	1,145	1,205
EPS (Rs)	9.1	11.5	10.2	11.4	12.0

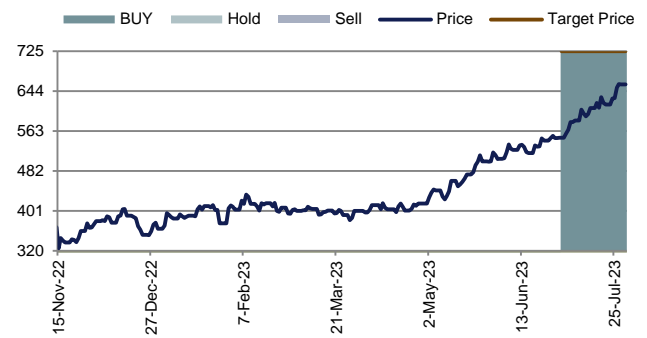
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
01-Jul-23	549	725	Buy	Anand Dama

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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