

Fusion Microfinance

Estimate change 

TP change 

Rating change 

CMP: INR642

TP: INR740 (+15%)

Buy

NIM expansion continues but credit costs still elevated

Stable disbursement momentum; 1QFY24 RoA/RoE at 5%/20%

- FUSION's 1QFY24 PAT grew 60% YoY to ~INR1.2b, aided by NIM expansion and higher other income. NII increased by 59% YoY to ~INR2.95b, while PPop grew ~96% YoY to INR2.35b.
- The cost-to-income ratio stood at ~36% (PY: ~45%). Net credit costs (annualized) remained high and rose ~10bp QoQ to 3.3%.
- Disbursements grew 15% YoY to INR22.8b, driving AUM growth of 31% YoY/5% QoQ to ~INR97b.
- FUSION has transmitted higher borrowing costs to customers and also benefitted from the spread deregulation that was announced in Mar'22. NIM expanded by ~30bp QoQ in 1QFY24 and we expect this margin expansion to sustain over the next two years, with NIM of 13.8%/14% in FY24/FY25. We increase our FY24/FY25 EPS estimates by ~2%/3% to factor in higher other income.
- We model an AUM and PAT CAGR of 28% and 39% over FY23-FY25E, respectively, driven by strong borrower additions, NIM improvement, operating leverage and moderation in credit costs. These factors will also lead to an improvement in the return ratios and we estimate RoA/RoE of ~5.7%/23% in FY25. FUSION currently trades at 1.8x FY25E P/BV and we believe its valuations would re-rate as it demonstrates healthy execution on loan growth and asset quality. **Maintain BUY rating with a TP of INR740 (based on 2x FY25E P/BV).**
- **Key risks include:** a) Political interference, announcement of loan waivers or natural calamity resulting in asset quality deterioration; b) regulatory changes toward asset recognition and provisioning; and c) increase in competitive intensity leading to NIM compression

Increase in yields drives margin expansion

- NIM (calc.) expanded sequentially by ~10bp to 13.8%. Reported spreads increased ~30bp QoQ to 10.9%, due to higher yields (up ~50bp QoQ), offsetting CoF increase of ~20bp.
- The share of foreign borrowings in the borrowing mix increased by ~2pp to 15% in 1QFY24 (PQ: 13%).

Asset quality exhibits sequential improvement but GS3 still elevated

- Asset quality improved QoQ, with GS3/NS3 declining ~25bp/ ~10bp to ~3.2%/0.8% and PCR on S3 loans increasing ~70bp QoQ to ~76%.
- 30+ dpd improved ~20bp QoQ to 4% (PQ: 4.2%), while ECL/EAD (incl. management overlay of ~INR580m) stood at 3.8% of gross loans. Write-offs for the quarter stood at ~INR600m.
- FUSION has a pre-Covid portfolio of INR680m that will run down over the next two quarters. The company has recently approved a new policy that allows write-offs to be made after 275 days, as opposed to the previous policy of 365 days. This change is expected to expedite the process of write-offs in the future.



Bloomberg	FUSION IN
Equity Shares (m)	100
M.Cap.(INRb)/(USDb)	64.6 / 0.8
52-Week Range (INR)	690 / 321
1, 6, 12 Rel. Per (%)	15/51/-
12M Avg Val (INR M)	212

Financials & Valuations (INR b)

Y/E March	FY23	FY24E	FY25E
Total Income	11.6	15.4	19.3
PPP	7.1	9.7	12.3
PAT	3.9	5.6	7.5
EPS (INR)	38.6	56.1	74.5
EPS Gr. (%)	-	45	33
BV (INR)	231	287	362

Valuations

NIM (%)	13.3	13.8	14.0
C/I ratio (%)	38.4	37.2	36.4
RoAA (%)	4.6	5.3	5.7
RoE (%)	21.2	21.6	22.9

Valuations

P/E (x)	16.6	11.4	8.6
P/BV (x)	2.8	2.2	1.8

Shareholding pattern (%)

As On	Jun-23	Mar-23
Promoter	68.2	68.2
DII	16.5	13.6
FII/FIIFII	5.7	6.3
Others	9.6	12.0

FII Includes depository receipts

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Highlights from the management commentary

- Credit costs are still elevated and the company will share the guidance on credit costs in the next quarter. Credit costs will normalize from 3QFY24 onward. Over the longer term, FUSION has guided for normalized credit costs of 1.5-2.0%.
- The company is maturing in many geographies and the ticket size can increase to INR45-46k by Mar'24. The ticket size could grow by 10-12% over the next three quarters.

Valuation and view

- FUSION has a vintage of over a decade in MFI lending and has navigated multiple credit and economic cycles with resilience.
- It has a stable and experienced management team and the company's digital orientation through its 'touch and tech' strategy has positioned it well to deliver a strong operating performance. It enjoys a strong rural presence, with its portfolio comprising ~94% of rural AUM.
- FUSION, in our view, can deliver a calibrated AUM and PAT CAGR of 28% and 39%, respectively, over FY23-FY25E. It is also poised to deliver industry-leading RoA/RoE of 5.7%/23% in FY25, aided by: a) margin expansion due to creditable liability management, b) scale and productivity benefits leading to a decline in the cost ratios, and c) moderation in credit costs as the tail risk of Covid-19 recedes and credit costs stabilize around ~2.0%. **Maintain BUY rating and a TP of INR740 (based on 2x FY25E P/BV).**

Fusion: Quarterly Performance

(INR M)

Y/E March	FY23				FY24	FY23	FY24E
	1Q	2Q	3Q	4Q	1Q		
Interest Income	3,294	3,998	4,202	4,507	4,790	16,001	21,009
Interest Expenses	1,432	1,573	1,680	1,742	1,835	6,428	7,998
Net Interest Income	1,862	2,424	2,522	2,765	2,955	9,573	13,011
YoY Growth (%)	47.1	115.4	59.0	62.0	58.7	68.4	35.9
Other Income	311	526	463	700	738	1,999	2,393
Total Income	2,173	2,950	2,985	3,465	3,693	11,572	15,404
YoY Growth (%)	53.5	97.4	67.3	46.8	70.0	64.1	33.1
Operating Expenses	971	1,077	1,147	1,253	1,339	4,448	5,736
Operating Profit	1,202	1,873	1,838	2,211	2,354	7,124	9,667
YoY Growth (%)	61.1	156.3	91.8	47.8	95.8	81.2	35.7
Provisions & Loan Losses	201	612	499	692	759	2,004	2,165
Profit before Tax	1,001	1,261	1,339	1,519	1,595	5,120	7,502
Tax Provisions	249	310	314	374	390	1,248	1,876
Net Profit	752	951	1,025	1,145	1,205	3,871	5,627
YoY Growth (%)	1,604.9	2,860.4	10,835.1	767.9	60.2	1,679.6	45.3
Key Parameters (%)							
Yield on loans	19.5	20.3	20.7	21.0	21.5		
Cost of funds	10.1	10.1	10.4	10.4	10.6		
Spread	9.4	10.2	10.3	10.6	10.9		
NIM	9.4	10.2	10.3	10.6	10.9		
Credit cost	0.2	0.8	0.6	0.8	0.8		
Cost to Income Ratio (%)	44.7	36.5	38.4	36.2	36.3		
Tax Rate (%)	24.9	24.6	23.5	24.6	24.5		
Performance ratios (%)							
Avg o/s per borrower (INR '000)	25	25	25	25	25		
AUM/ RO (INR m)	12.0	12.5	12.9	14.0	14.0		
AUM/ Branch (INR m)	779	794	840	880	910		
Borrower/ Branch (INR m)	3,116	3,223	3,381	3,452	3,513		
Balance Sheet Parameters							
AUM (INR B)	73.9	80.5	86.5	93.0	97.1		
Change YoY (%)	59.6	54.5	44.5	37.0	31.4		
Disbursements (INR B)	19.8	20.5	21.9	23.7	22.8		
Change YoY (%)		27.4	22.2	17.7	15.2		
Borrowings (INR B)	60.1	65.5	65.4	67.8	71.9		
Change YoY (%)				17.4	19.6		
Borrowings/Loans (%)	90.4	93.0	86.5	84.3	85.5		
Debt/Equity (x)	4.2	4.3	3.0	2.9	2.9		
Asset Quality (%)							
GS 3 (INR M)	2,529	2,803	2,894	2,889	2,790		
G3 %	3.7	3.8	3.7	3.5	3.2		
NS 3 (INR M)	928	799	751	708	664		
NS3 %	1.4	1.1	1.0	0.9	0.8		
PCR (%)	63.3	71.5	74.0	75.5	76.2		
ECL (%)	3.5	3.9	3.7	3.7	3.8		
Return Ratios - YTD (%)							
ROA (Rep)	4.0	4.8	4.7	5.0	5.0		
ROE (Rep)	21.8	26.0	22.0	20.2	20.2		

E: MOFSL Estimates



Highlights from the management commentary

Business Update

- 1QFY24 disbursements remained at the 4QFY23 level.
- NIM stood at 10.9%; there is still scope for NIM expansion before it stabilizes.
- RoA of 5% and RoE of 20.2%; confident of delivering RoA of 4.25-4.5% and RoE of ~20% on a sustainable basis
- Management overlay now stands at ~INR580m and it will keep building this management overlay in quarters where the operational performance is good.
- Witnessed floods in Northern India - Hopeful that credit costs will normalize after two more quarters.
- Top 5 states contribute ~70% to the AUM mix and going forward this concentration will reduce with the contribution from new states.
- The number of borrowers stood at 3.64m as on 1QFY24.
- A healthy mix of new and existing customers as reflected in average disbursement ticket size of INR42.4k
- The company has slightly increased its first cycle ticket size - it did not increase the ticket size in the last three years. Any such change will be done keeping in mind the risk/prudence and it will be very organic.

Collection Efficiency

- CE in the Top 5 states is above 99%. States like MP, TN and Odisha have also exhibited improvement in CE. Gradually CE will normalize at the industry level.

Asset Quality

- The company is used to handling floods in Bihar and Odisha for the last many years. Many geographies have faced the flooding situation for the first time this year. There have been some disruptions from the floods but the company is closely monitoring it.
- Bihar, UP, MP, TN, Odisha - Significant improvement in CE
- FUSION does not fund the customers that have more than five lender relationships.
- INR680m of the pre-Covid portfolio will run down in the next two quarters
- Credit cost is still elevated and the company will share the guidance on credit cost in the next quarter. Credit cost will normalize from 3QFY24 onward.
- Over the longer term, FUSION expects the normalized credit costs to remain between 1.5-2.0%
- State-wise 90+ DPD: Bihar: 0.7% | UP: 1.0% | Odisha: 2.8% | TN: 3.6% | MP: 3.0%
- Haryana (because of prolonged challenges - Farmer Agitation, COVID waves and recent uneven rainfall) has CE of ~94% and Punjab is also at similar levels.
- PAR 90+ of the post-Mar'21 portfolio is <2%. 40% of this comes from 2-3 states where there have been floods.
- Current policy allows it to write-off only after 365 days. Policy to write-off up to 275 days has been approved and we can see faster write-offs going forward.

Ticket Sizes

- Still below the ATS of the sector. As a strategy, FUSION does not give multiple loans. It is maturing in many geographies and the ticket size can increase to INR45-46k by Mar'24. There can be 10-12% growth in the ticket size over the next three quarters.
- Average ticket size in the first cycle is still ~INR37.5k (even though the maximum ticket size in the first cycle has been increased from INR30k to INR40k).
- The highest loan amount given by FUSION is ~INR85-90k. It is evaluating how it can offer higher ticket sizes to its matured/vintage customers. Vintage customers who need higher ticket sizes will be catered to by the MSME Team.

Customer Mix

- Customers with a loan of >INR100k are 20% of FUSION's customer mix.
- Unique customers stood at 33-34%; Fusion + 1 lender: 30%; Fusion + 2 lenders: 20%; Fusion + 3 lenders: 15%. Customers with loans from more than 4 or 5 lenders are 2.1%.

Yields, CoB and Margins

- Under the new pricing guidelines, rates were changed in May'22 and NIM will expand over the next two quarters before it stabilizes. Average tenor of 17 months and the wholesale book will churn over this tenor.
- Passed on ~40bp to the customers and has become effective from loans disbursed from 7th July 2023 onwards.

Cross-selling

- More focused on cross-selling of trampoline and mobile products. Products where the amount is >INR1000 is funded by the company. Cross-selling is primarily to retail the customers.

Financial Performance

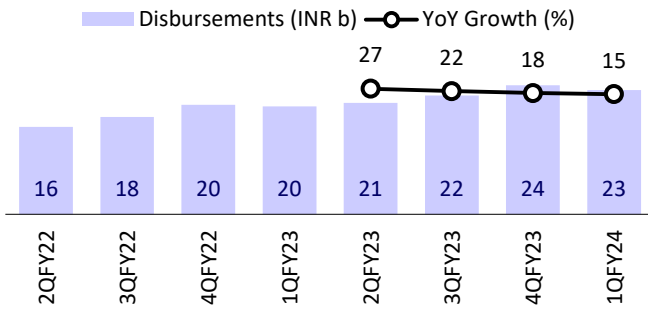
- Interest income rose 6.3% QoQ. Total income grew 6.2% QoQ. Fee/commission income rose because of higher cross-sell income. Marginal CoF rose ~7bp QoQ.
- In FY24, the endeavor will be to maintain the same levels of borrowings costs.
- Opened 17 branches across India; CIR rose ~10bp QoQ.
- PPop stood at INR2.35b, up 96% YoY and 6% QoQ.
- Write-offs of ~INR600m (~0.16% of closing AUM) and it has de-recognized interest income of INR194m in 1QFY24.
- Restructured pool stood at INR74m (~0.1% of the portfolio).
- Direct assignments of INR3.4b during the quarter.

Others

- >3 year old branches contribute 63% to volumes and 65% to the AUM mix.
- Retention level of 70-72%
- Within the next three quarters, the contribution of the Top 5 states to the AUM mix will become stable and start declining from thereon.
- Karnataka is a new geography and positively looking at AP and Telangana now after the favorable Court order.

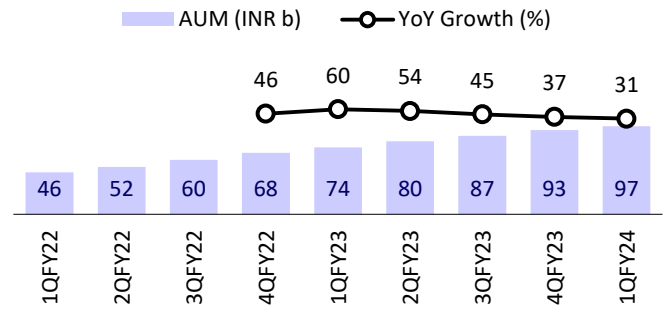
Story in charts

Exhibit 1: Disbursements grew 15% YoY...



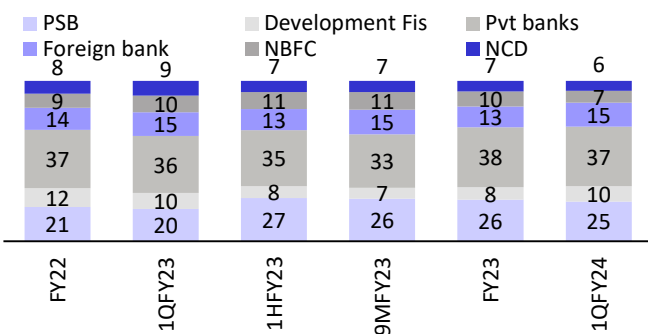
Source: MOFSL, Company

Exhibit 2: ...driving 31% YoY growth in AUM



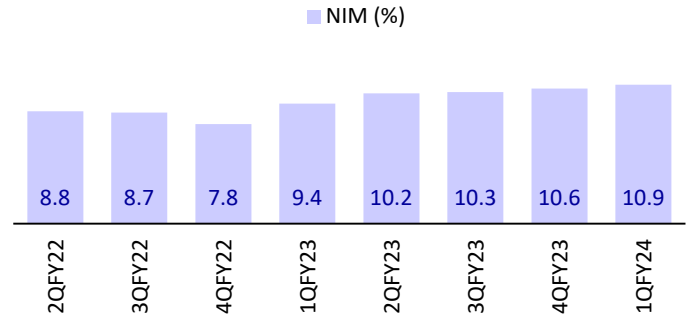
Source: MOFSL, Company

Exhibit 3: Borrowing mix (%)



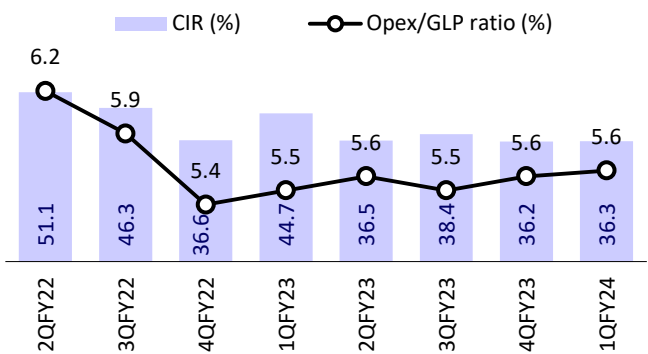
Source: MOFSL, Company

Exhibit 4: Reported NIM expanded ~30bp sequentially (%)



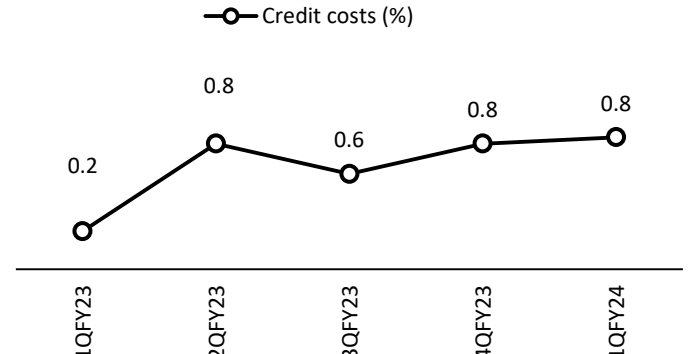
Source: MOFSL, Company

Exhibit 5: Opex/AUM stable sequentially (%)



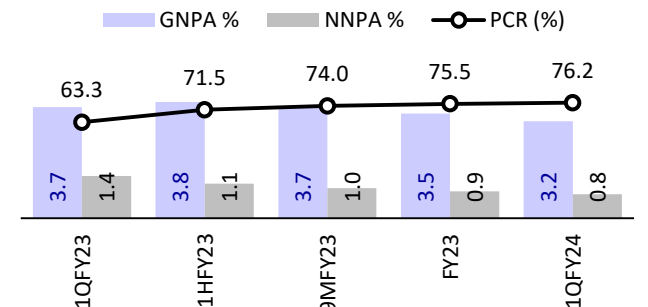
Source: MOFSL, Company

Exhibit 6: Credit costs (non-annualized) remained elevated at 0.8% (%)



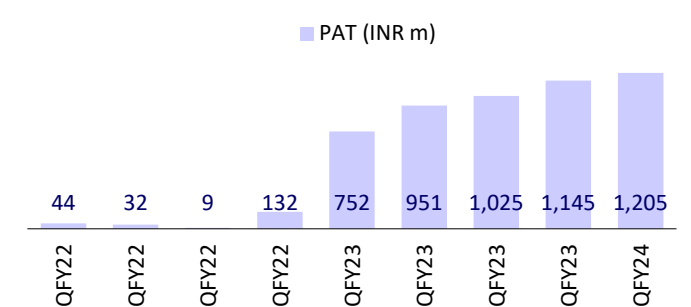
Source: MOFSL, Company

Exhibit 7: GS3 improved ~30bp sequentially (%)



Source: MOFSL, Company

Exhibit 8: 1QFY24 PAT stood at ~INR1.2b



Source: MOFSL, Company

Exhibit 9: Increase our FY24/FY25 EPS estimates by ~2%/3% to factor in higher fee and commission income

INR B	Old Est.		New Est.		% change	
	FY24	FY25	FY24	FY25	FY24	FY25
NII	13.0	16.7	13.0	16.7	0.0	0.0
Other Income	2.2	2.4	2.4	2.6	8.9	9.8
Total Income	15.2	19.1	15.4	19.3	1.3	1.2
Operating Expenses	5.7	7.0	5.7	7.0	0.0	0.0
Operating Profits	9.5	12.1	9.7	12.3	2.1	2.0
Provisions	2.1	2.3	2.2	2.3	4.5	0.0
PBT	7.4	9.7	7.5	10.0	1.4	2.4
Tax	1.9	2.5	1.9	2.5	0.6	1.6
PAT	5.5	7.3	5.6	7.5	1.7	2.7
AUM	120	152	120	152	0.0	0.0
Borrowings	85	105	85	105	0.0	0.0
RoA	5.2	5.5	5.3	5.7	1.6	2.5
RoE	21.3	22.5	21.6	22.9	1.5	2.1

Source: MOFSL, Company

Financials and valuations

Income Statement								(INR M)
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Interest Income	2,545	4,694	6,665	8,276	10,643	16,001	21,009	26,608
Interest Expenses	1,366	2,540	3,377	3,751	4,960	6,428	7,998	9,915
Net Interest Income	1,179	2,154	3,288	4,525	5,684	9,573	13,011	16,693
Change (%)	34.8	82.7		37.6	25.6	68.4	35.9	28.3
Other Operating Income	128	249	538	282	869	1,418	1,743	1,955
Other Income	0	27	100	173	501	580	650	683
Net Income	1,307	2,431	3,926	4,980	7,054	11,572	15,404	19,331
Change (%)	26.2	86.0		26.8	41.6	64.1	33.1	25.5
Operating Expenses	1,624	1,540	1,999	2,204	3,123	4,448	5,736	7,041
Change (%)	91.3	-5.2		10.2	41.7	42.5	29.0	22.7
Employee Expenses	661	1,033	1,483	1,686	2,331	3,255	4,167	5,083
Depreciation	20	24	26	39	54	74	93	111
Other Operating Expenses	942	483	490	479	738	1,119	1,477	1,847
Operating Income	-317	891	1,927	2,776	3,931	7,124	9,667	12,290
Change (%)	-269.0	-381.4		44.0	41.6	81.2	35.7	27.1
Provisions and w/offes	220	207	927	2,208	3,687	2,004	2,165	2,322
PBT	-536	684	1,000	568	244	5,120	7,502	9,968
Tax Provisions	-142	177	304	128	27	1,248	1,876	2,492
Tax Rate (%)	26.5	25.9	30.4	22.6	10.9	24.4	25.0	25.0
PAT	-394	507	696	439	218	3,871	5,627	7,476
Change (%)				-37	-50		45	33

Balance Sheet								(INR M)
Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	442	616	790	790	828	1,003	1,003	1,003
Reserves & Surplus	2,298	5,643	11,199	11,673	12,552	22,216	27,842	35,318
Net Worth	2,740	6,259	11,989	12,464	13,380	23,219	28,846	36,322
Borrowings	15,980	29,286	29,737	44,323	57,758	67,784	85,432	1,04,877
Change (%)	151.4	83.3		49.0	30.3	17.4	26.0	22.8
Other liabilities			674	1,593	1,767	2,632	3,684	4,790
Total Liabilities	19,275	36,105	42,400	58,379	72,905	93,635	1,17,962	1,45,988
Cash and Bank balance	5,808	9,905	8,177	13,353	11,536	10,650	12,822	14,675
Investments	5	5	5	0	0	0	0	0
Loans	12,913	25,720	33,430	43,607	59,182	80,416	1,02,269	1,28,101
Change (%)	71.9	99.2		30.4	35.7	35.9	27.2	25.3
Fixed Assets	50	55	60	183	192	212	238	266
Other Assets			727	1,237	1,995	2,357	2,633	2,947
Total Assets	19,275	36,105	42,400	58,379	72,905	93,635	1,17,962	1,45,988

E: MOFSL Estimates

Financials and valuations

AUM Mix (%)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
AUM	15,556	26,414	36,065	46,378	67,860	92,960	1,20,327	1,51,996
YoY Growth (%)	88	70	37	29	46	37	29	26
Disbursements	12,913	25,720	35,740	37,103	61,798	85,962	1,09,172	1,37,556
YoY Growth (%)	72	99	39	4	67	39	27	26

E: MOFSL Estimates

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Spreads Analysis (%)								
Avg. Yield on Loans	24.9	24.3	22.5	21.5	20.7	22.9	23.0	23.1
Avg Cost of Funds	12.2	11.2	11.4	10.1	9.7	10.2	10.4	10.4
Spread of loans	12.7	13.1	11.1	11.4	11.0	12.7	12.6	12.7
NIM (on gross loans)	11.3	10.9	11.0	11.5	10.6	13.3	13.8	14.0

Profitability Ratios (%)

RoA	-2.5	1.8	1.8	0.9	0.3	4.6	5.3	5.7
RoE	-15.9	11.3	7.6	3.6	1.7	21.2	21.6	22.9
Debt: Equity (x)	5.8	4.7	2.5	3.6	4.3	2.9	3.0	2.9
Leverage (x)	7.0	5.8	3.5	4.7	5.4	4.0	4.1	4.0
CAR	21.9	26.9	35.8	27.3	21.9	27.9	25.4	24.9
o/w Tier 1	15.1	23.8	33.1	25.5	19.9	26.6	24.8	24.5
Int. Expended / Int.Earned	53.7	54.1	50.7	45.3	46.6	40.2	38.1	37.3
Other Inc. / Net Income	9.8	11.4	16.3	9.1	19.4	17.3	15.5	13.6

Efficiency Ratios (%)

Int. Expended/Int.Earned								
CIR	124.2	63.4	50.9	44.3	44.3	38.4	37.2	36.4
Opex/ AUM	13.6	7.3	6.4	5.3	5.5	5.5	5.4	5.2
Empl. Cost/Op. Exps.	40.7	67.1	74.2	76.5	74.6	73.2	72.6	72.2

Asset-Liability Profile (%)

Loans/Borrowings Ratio	0.8	0.9	1.1	1.0	1.0	1.2	1.2	1.2
Leverage (x)	7.0	5.8	3.5	4.7	5.4	4.0	4.1	4.0

Asset Quality

GNPA (INR m)	506	404	384	2,559	3,584	2,889	2,819	2,758
NNPA (INR m)	0	145	130	1,024	1,030	708	564	414
GNPA (%)	3.8	1.5	1.1	5.5	5.7	3.5	2.6	2.0
NNPA (%)	0.0	0.6	0.4	2.3	1.6	0.8	0.5	0.3
PCR (%)	100	64	66	60	71	75	80	85
Credit costs (%)	2.1	1.0	3.1	5.6	6.9	2.8	2.3	1.9

Valuations

	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (INR)	62	102	152	158	162	231	287	362
BV Growth (%)	4	64	49	4	3	43	24	26
P/BV	10.4	6.3	4.2	4.1	4.0	2.8	2.2	1.8

EPS (INR)	-8.9	8.2	8.8	5.6	2.6	38.6	56.1	74.5
EPS Growth (%)			7	-37	-53	1,368	45	33
Price-Earnings (x)	-72.0	78.0	72.8	115.5	244.2	16.6	11.4	8.6

E: MOFSL Estimates

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NOTES

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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