BUY

CMP: **INR 82** Target Price: **INR 115** ▲ 40%

ICICI Securities

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03 November 2023

India | Equity Research | Initiating Coverage

SBFC Finance

NBFCs

Pan-India MSME financier; high visibility on >30% AUM growth in near term

SBFC Finance (SBFC) is a direct play on 'increasing formalisation of MSME financing,' with its a) most diversified distribution network (presence in >15 states with no single state contributing >20% of AUM), targeting formal MSME customers (ITR is mandatory for all borrowers), b) in-house operations divided into six independent verticals, and c) highly experienced management team having the potential to drive >25% AUM growth in the near term. Further, strong focus on collection (average >1 collection person per branch) and score-card based underwriting could help credit cost remain at <100bps in the near term. We build in 36% AUM CAGR over FY23-25E with RoA / RoE at 3.8%/10.4% by FY25E. We initiate coverage on the stock with a **BUY** rating and a target price of INR 115, valuing it at 4x FY25E PBV.

Creating a space in small-ticket MSME financing differently…

While small-ticket MSME financing is a go-to product for most financiers in India, there is a huge difference in the way these financiers approach MSME lending. One set of financiers (banks) caters to large-ticket formal segment and other set (NBFCs, SFBs and others) caters to small-ticket informal segment, leaving open space for small-ticket formal segment. That is where SBFC is acting as a 'category creator' and building a tech-based scalable, sustainable and profitable business model. For all its customers, ITR is mandatory and >80% of its customers have >700 CIBIL score. Further, most MSME financiers are running a concentrated portfolio with their home state contributing >30-40% of total MSME AUM, wherein SBFC has built a strong network of >150 branches covering 16 states and is now focusing on deepening presence in existing geographies.

…the same to help drive >25% AUM CAGR in near term

SBFC has delivered industry leading 44% AUM CAGR between FY20-23 – despite covid-led disruption – driven by 152 branches spread across >15 states and focus on left-out formal small-ticket (<INR 3mn) MSME loans. Considering the underutilisation of newly opened branches (as reflected in branches with >36 months vintage (~54% of branches) having o/s AUM at INR 390mn vs branches with >12 month to <36 months' vintage (~27%) o/s AUM at INR 350mn and branches (19%) with <12 months' o/s AUM at INR 8mn), we expect SBFC to sustain a high growth trajectory in the near term.

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Interest Income (INR mn)	2,525	3,777	5,164	6,931
PAT (INR mn)	645	1,497	2,194	3,162
EPS (Rs)	0.8	1.7	2.1	3.0
% Chg YoY	(21.9)	111.0	20.8	44.1
P/E (x)	101.2	48.0	39.7	27.6
P/BV (x)	5.2	4.4	3.0	2.7
Gross Stage - 3 (%)	2.8	2.4	2.5	2.5
RoA (%)	1.5	2.9	3.4	3.8
RoE (%)	5.2	9.9	9.5	10.4

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Market Data

Market Cap (INR)	87bn
Market Cap (USD)	1,047mn
Bloomberg Code	SBFC IN Equity
Reuters Code	SBFC.BO
52-week Range (INR)	95 /80
Free Float (%)	16.0
ADTV-3M (mn) (USD)	0.0

Price Performance (%)	3m	6m	12m
Absolute	-	-	-
Relative to Sensex	-	-	-

ESG Disclosure	2021	2022	Change
ESG score	-	-	-
Environment	-	-	-
Social	-	-	-
Governance	-	-	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Strong focus on collection and formal customer segment…

SBFC has approached MSME financing in a different way – strategically it is focusing on formal self-employed segment, given the banks are targeting big-ticket MSMEs while NBFCs and SFBs are targeting small-ticket informal self-employed segment, leaving small-ticket formal self-employed segment financing open. Credit cost trajectory for banks (formal MSME) and NBFCs (informal MSME) suggests informal self-employed segment is more vulnerable to credit cycles.

In any lending business, irrespective of customer and product segment, building a strong collection mechanism is a must and SBFC has learnt this very early in its lending journey. The company has an independent collection infrastructure with a minimum of one resource per branch deployed for collection. The hierarchy would have a supervisory role for zonal heads, regional heads, area collection heads and the feet on street. It also has an independent legal structure that facilitates the recovery in delinquent pool. As on Mar'23, it has total 170 collection staff.

…coupled with dual underwriting process to help ensure <100bps credit cost in near term

Given it lends only to borrowers with ITR, first level of cashflow screening is done digitally. However, it also conducts on-field investigation to cover qualitative aspects such as reference check from the neighbourhood, locality and its customer and suppliers and cashflow from non-documented income, if any, at household level. Its conservative underwriting reflects in –

- >80% of customers have >700 CIBIL score
- Sector exposure not more than 10% of its loan portfolio
- ~94% AUM secured by self-occupied residential/ commercial property
- 100% co-borrower; spouse or parent act as co-borrowers on all loans. ~90% women borrowers/ co-borrowers
- LTV at 42.4%

Robust collection mechanism and stringent underwriting process may ensure credit cost remaining <100bps in the near term.

Upfront investment towards franchise build-up; productivity improvement to drive operating leverage

During its short six years' organisation journey, SBFC has focused on building pan-India network and expanded its network to >160 branches as on Jun'23, covering >15 states. Strategically, it had prioritised building distribution and human infrastructure over portfolio growth during its initial journey. The same reflected in its gradual increase in people per branch in secured MSME business – manpower per branch increased to 19 by Mar'23 from 12 in Mar'20. While it would continue to add fleet on street to capture market opportunities, it believes supervisory cost will be minimal going ahead and incrementally it will focus on productivity improvement.

RoA to remain healthy at >3% over FY24-25E

SBFC has witnessed steady improvement in RoA over the past 5 years – it expanded to 2.9% by FY23 from 1.2% in FY20, largely driven by NIM expansion, improving fee income and credit cost moderation. Further, NIM expansion was largely driven by its strategic shift to small-ticket MSME loans in FY20 from large-ticket loans between FY17-20. The same enabled credit cost moderating to 60bps by FY23 from 100bps in FY20. Given its incremental focus on small-ticket MSME loans (high yielding), ability to pass on any rate increase to borrowers (to help in maintaining NIM) and likely productivity improvement, we expect RoA to remain >3% over FY24-25E.

Valuation

SBFC has created a niche for itself in MSME lending with its diversified presence spread across 16 states, mandatory ITR for borrowers (with >80% customers having CIBIL score of >700), 100% in-house operations and stable management team with rich experience (most of them have worked with HDFC, Kotak & Bajaj).

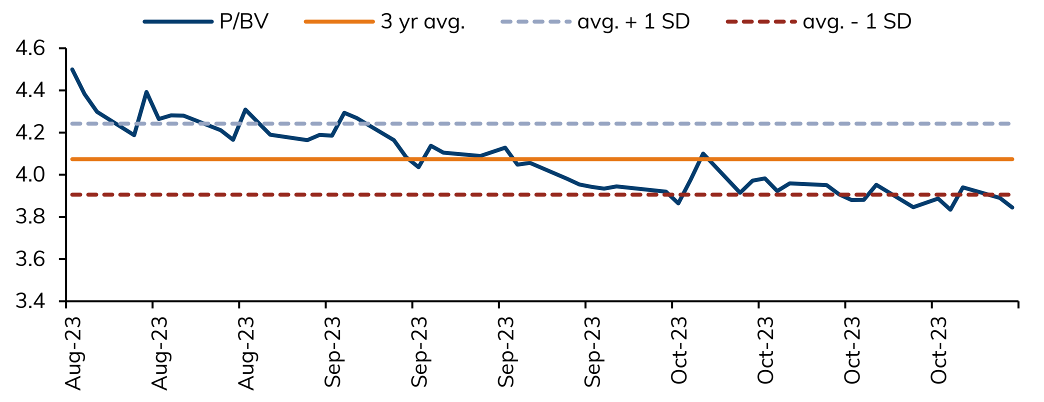
The company has built a business model that has the potential to deliver sustainable 25%+ AUM growth in near future – its 57% AUM CAGR between FY20-23 despite covid-led disruption reflects the capabilities of its infrastructure to deliver growth even during adverse situations. Further, SBFC's focus on building distribution network in high-growth states like UP, Karnataka, Telangana, Bihar and MP would help it sustain a high-growth trajectory in near future.

During FY20, it strategically shifted its focus towards small-ticket MSME loans (high yields) from large-ticket loans. This, coupled with its ability to pass on rate increases to borrowers (given limited competition in formal self-employed segment), could help it in maintain NIM going ahead.

Likely productivity improvement would also act as a major RoA expansion driver. Overall, we expect RoA to remain >3% over FY24-25E.

In listed universe, players having similar growth profile (25%+) and profitability (RoA >3%) are trading at an average 3.5x 1-year forward PBV. We assign 4x to FY25E BVPS as the company is uniquely placed in the small-ticket formal segment with a large distribution network of 156 branches spread across >15 states. We arrive at a TP of INR 115, implying ~40% upside from CMP. Initiate with BUY.

Exhibit 1: PBV (1-year forward)



Source: Company data, I-Sec research

Exhibit 2: Valuation summary

Particulars	CMP	P/E (x)			P/BV (x)			EPS (INR)			BV (INR)			RoAA (%)			RoAE (%)		
		FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
SFBs																			
Equitas SFB	93	18.0	13.6	10.7	2.0	1.7	1.5	5	7	9	46	53	62	1.9	1.9	2.0	12.2	13.7	15.1
Ujjivan SFB	52	9.2	8.3	7.4	2.5	1.9	1.5	6	6	7	21	27	34	3.9	3.3	3.1	31.4	25.3	22.4
HFCs/NBFCs																			
Credit Access	1,580	30.4	18.9	15.0	4.9	3.9	3.1	52	84	105	321	405	511	4.2	5.3	5.4	18.2	23.0	23.0
Spandana	887	507.6	12.2	8.7	2.0	1.7	1.5	2	73	102	437	509	611	0.2	5.1	5.4	0.4	15.4	18.2
Fusion	595	15.4	11.4	8.5	2.6	2.1	1.7	39	52	70	231	284	353	4.6	4.7	4.8	21.2	20.3	21.9
Aptus	288	28.5	23.5	18.8	4.3	3.8	3.3	10	12	15	67	75	86	7.8	7.6	7.5	16.1	17.2	18.9
Aavas	1,409	26.0	23.3	18.8	3.4	3.0	2.6	54	61	75	411	472	547	3.5	3.3	3.3	14.2	13.7	14.7
HomeFirst	921	35.4	27.7	21.1	4.6	3.9	3.3	26	33	44	199	237	277	3.9	3.8	3.9	13.5	15.0	17.0
PNB HF	738	11.9	13.8	11.6	1.1	1.3	1.2	62	54	64	649	571	634	1.5	2.0	2.1	10.0	10.8	10.6
LIC HF	458	8.7	6.1	5.4	0.9	0.8	0.7	53	75	85	492	559	636	1.1	1.4	1.4	11.2	14.3	14.3
Five Star	742	35.7	28.9	22.1	5.0	4.2	3.6	21	26	34	150	175	209	8.0	7.7	7.9	15.0	15.8	17.5
IIFL Finance	621	14.7	11.8	9.1	2.6	2.2	1.9	42	53	68	236	278	333	3.3	3.4	3.5	20.8	20.4	22.3

Source: Company data, I-Sec research

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SBFC is amongst the Top-10 MSME financiers. However, in formal self-employed small-ticket loans (mandatory ITR for borrowers), SBFC is uniquely placed.

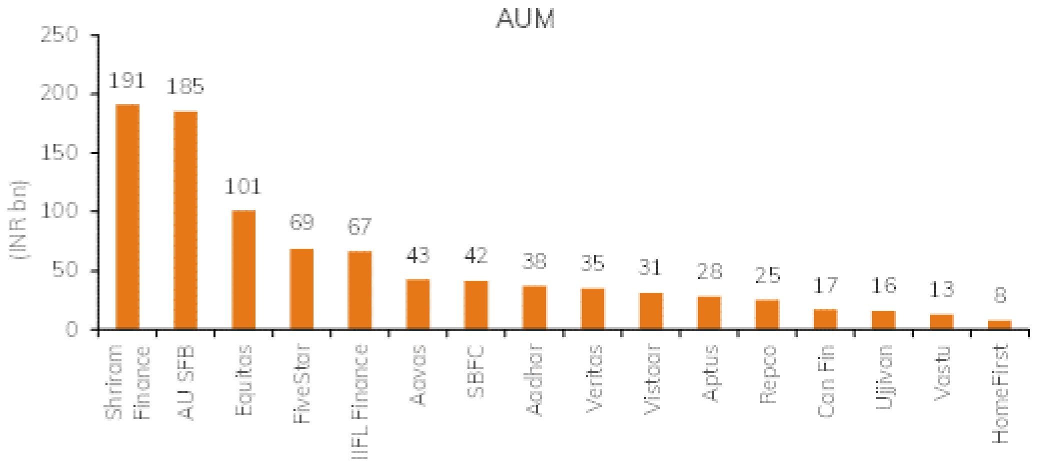
Industry overview – how SBFC is placed

The estimated market size for S-LAP stands at INR 22trn, as per CRISIL MI&A. However, lenders have captured only INR 1.8trn (ticket size of up to INR 1.5mn) as on Mar'23, implying <10% penetration. We have captured AUM size for 16 leading MSME players cumulatively accounting for >50% of outstanding industry AUM. SBFC is amongst the Top-10 MSME financiers.

Currently, S-LAP market is concentrated in five states namely Maharashtra (14% of total loans), Tamil Nadu (12%), Gujarat (10%), Karnataka (9%) and Rajasthan (8%), cumulatively accounting for 53% of total market.

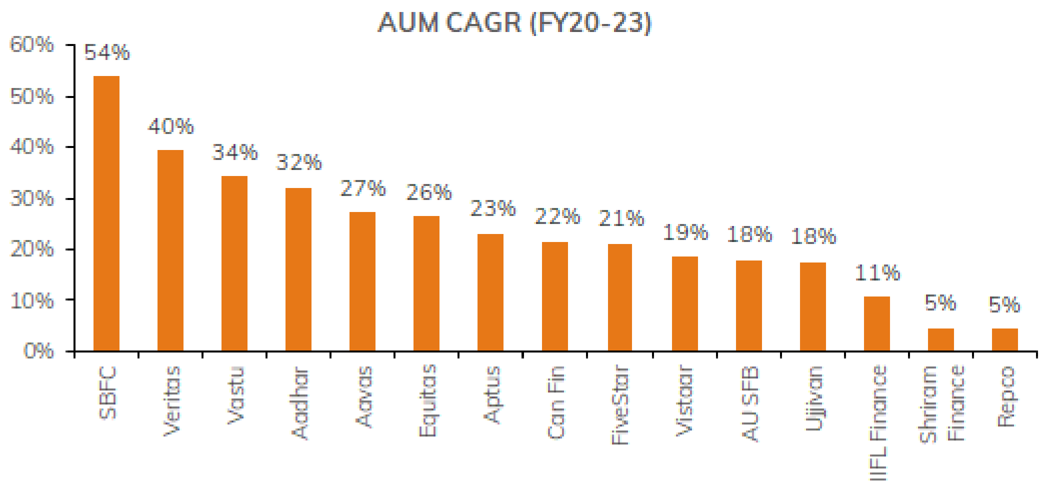
Including MSME loans of up to INR 3mn (SBFC's target market), industry AUM stands at INR 2.5trn as on Mar'23. Secured MSME loan (INR 0.5mn-3mn) CAGR stood at 24% for NBFCs and 23% for others over FY18-23.

Exhibit 3: SBFC is amongst Top-10 MSME financiers in less than INR 1.5mn category



Source: Company data, I-Sec research

Exhibit 4: SBFC has delivered industry leading 54% AUM CAGR during FY20-23 in MSME segment



Source: Company data, I-Sec research

Note; we have taken players with AUM >INR 10bn.

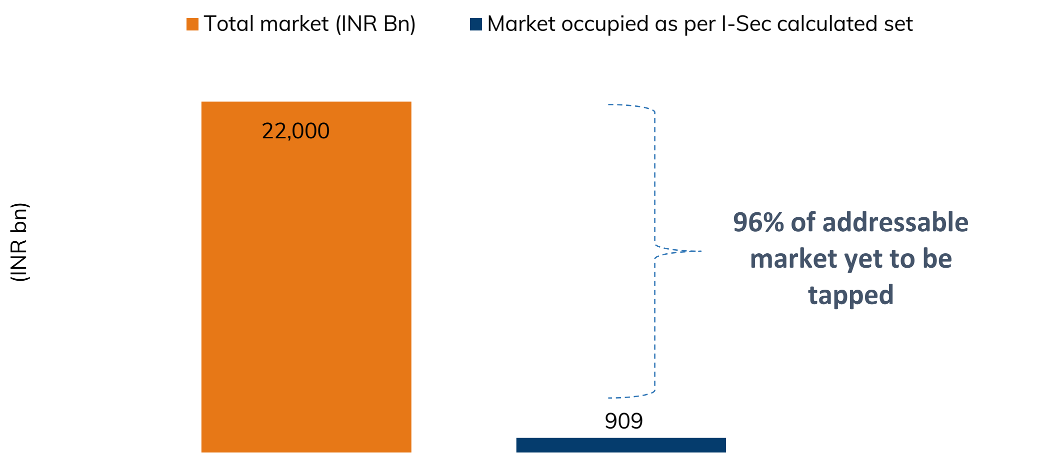
Small-ticket MSME credit gap at INR 22trn, of which only INR 8.5trn worth of market has been addressed as on Mar'23

Within overall outstanding secured MSME portfolio, around 30% of portfolio (INR 2.5trn) is towards small-ticket LAP (ticket size between INR 0.5mn to INR 3.0mn). Further, portfolio outstanding under INR 1.5mn ticket size stands at INR 1.8trn as on Mar'23.

Overall MSME credit gap stands at INR 92trn, but small-ticket MSME credit gap is estimated at INR 22trn, as per CRISIL. Of the total addressable market, secured MSME portfolio outstanding as of Mar'23 stands at INR 8.5trn. Within overall outstanding secured MSME portfolio, around 30% of portfolio (INR 2.5trn) is towards small-ticket LAP (ticket size between INR 0.5mn to INR 3.0mn). Further, portfolio outstanding under INR 1.5mn ticket size stands at INR 1.8trn as on Mar'23.

While the general perception is S-LAP is highly competitive and the same is likely to pressurise asset yields in near future, our analysis suggests S-LAP penetration is <10% and the same presents ample opportunities for players to grow profitably. The secured MSME portfolio within the ticket size of INR 0.5mn-INR 3.0mn grew by 24% CAGR between FY18-FY23, higher than overall MSME loan CAGR of 18% during the same period.

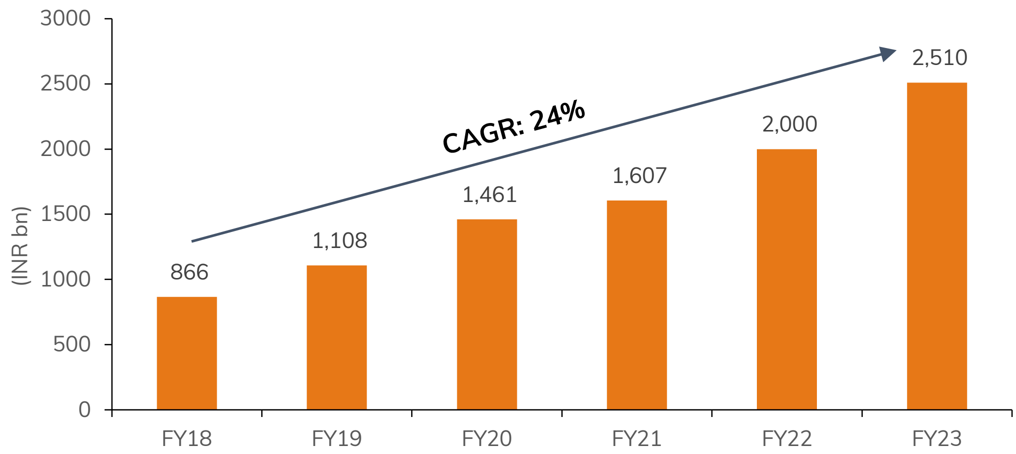
Exhibit 5: Huge market gap in secured MSME space with less than 10% of addressable secured MSME market being occupied as per our calculated set



Source: CRISIL, , I-Sec research

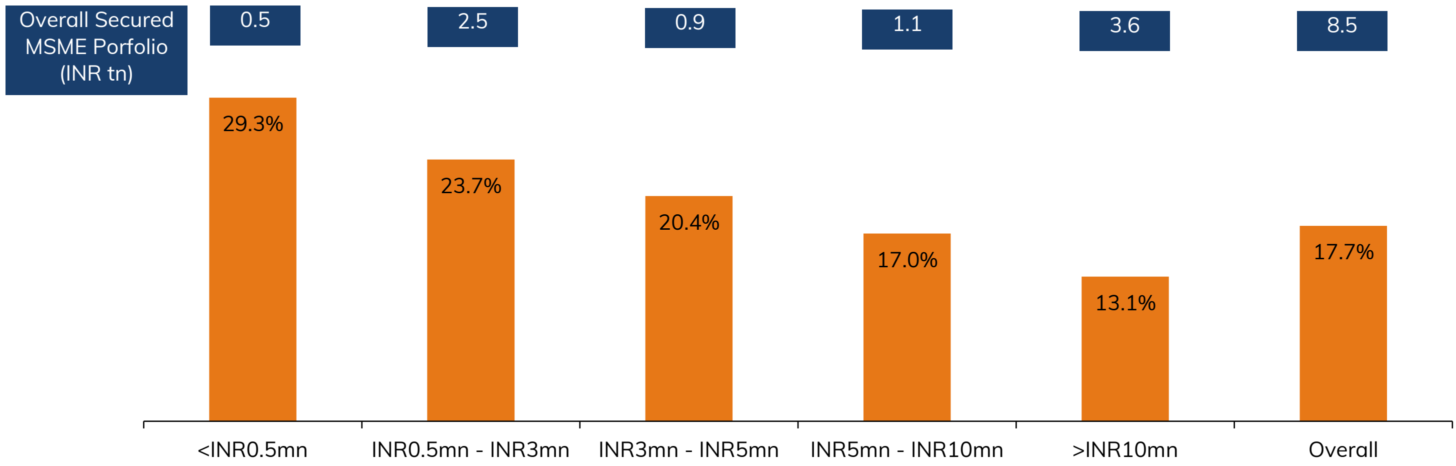
SBFC's market share in secured MSME stands at 2% as on Mar'23.

Exhibit 6: Secured MSME portfolio (ticket size of INR 0.5mn-INR 3.0mn) grew by 24% CAGR between FY18-FY23...



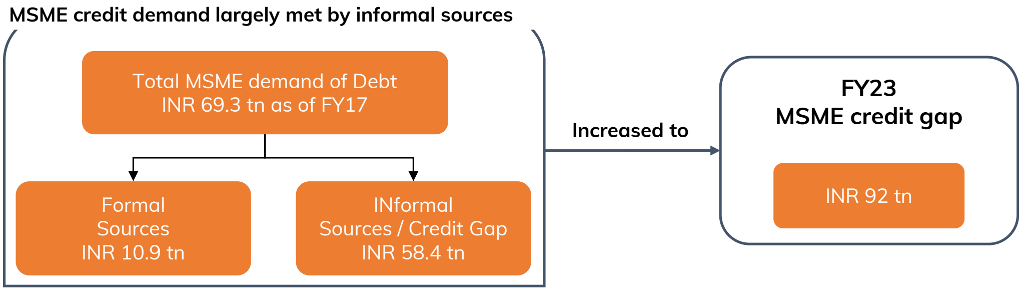
Source: CRIF Highmark, CRISIL MI&A, I-Sec research

Exhibit 7: …which remained higher than the overall secured MSME portfolio growth



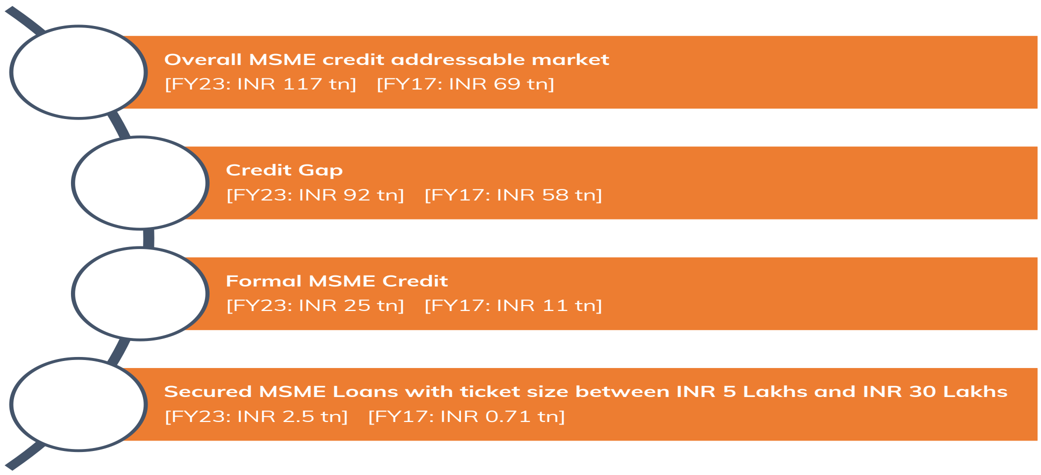
Source: CRIF Highmark, CRISIL MI&A, I-Sec research

Exhibit 8: Overall MSME credit gap increased to INR 92trn as on Mar'23



Source: IFC report on financing India's MSME dated November 2018, CRISIL M I&A

Exhibit 9: Secured MSME loan with ticket size of INR 0.5mn-3mn stands at INR 2.5trn as on Mar'23

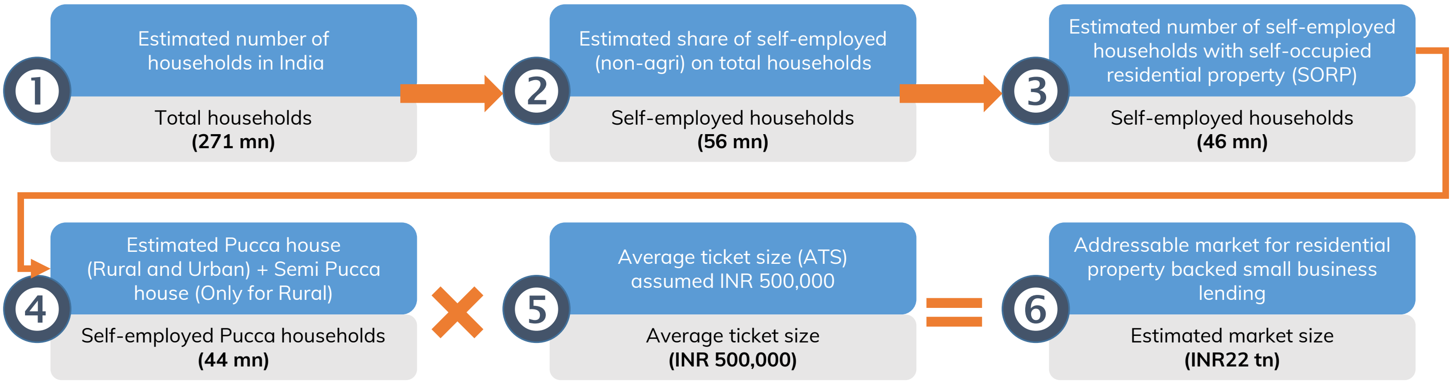


Note: Overall formal MSME credit given above includes all kinds of secured and unsecured loans given to MSMEs across ticket sizes by organised lenders.

Source: MSME Ministry Annual report for Fiscal 2021, IFC report on Financing India's MSMEs dated November 2018, CRIF Highmark, CRISIL MI&A

As per CRISIL Research, addressable MSME credit gap stood at INR 92trn as on Mar'23. Of this, secured MSME loan portfolio outstanding as of FY23 stood at INR 8.5trn, implying <10% penetration. Within this market, small-ticket LAP portfolio for ticket size INR 0.5mn-3mn stood at INR 2.5trn and INR 1.8trn for ticket size INR 0.5mn-1.5mn (S-LAP). Our calculated set also represents >50% of S-LAP market.

Exhibit 10: Estimated market size for small-ticket MSME loan stands at INR 22trn



Source: CRISIL MI&A, I-Sec research

Exhibit 11: SBFC's focus segment is growing at 24% CAGR

Segment	Market Size[1] (₹ tn)	CAGR[2] (%)	% of Market	
>₹1 cr	3.6	13.1%	42%	
₹0.5 – 1 cr	1.1	17.0%	13%	
₹0.3 – 0.5 cr	0.9	20.4%	10%	
₹0.05– 0.3 cr	2.5	23.7%	30%	Focus Segment
<₹0.05 cr	0.5	29.3%	6%	
Total	8.5	17.7%	100%	

Source: Company data, I-Sec research

1 As of Mar-23

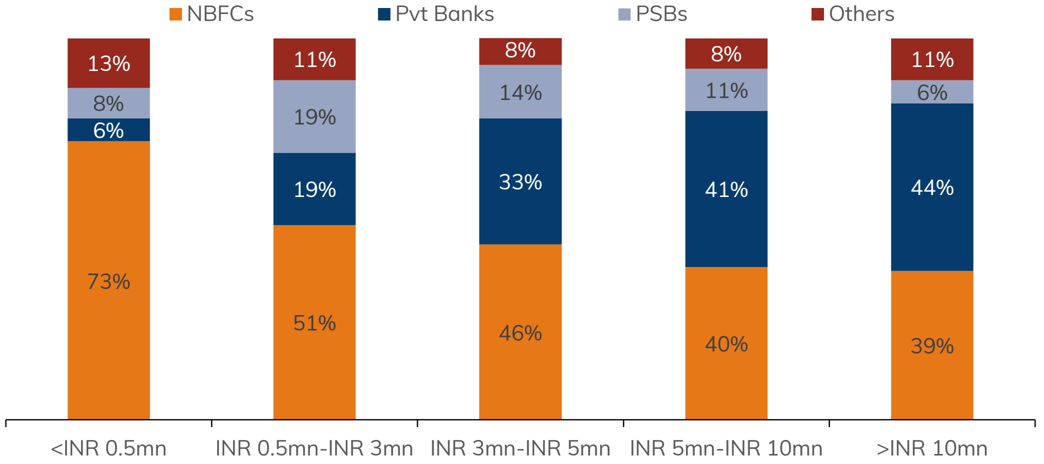
2 CAGR period over FY18 to FY23

NBFCs command >50% market share in secured MSME loans below INR 3mn

- Huge untapped secured MSME lending opportunity coupled with better yields and profitability (cal. RoA at >3.5%). Most financiers are actively pursuing S-LAP over medium / high ticket LAP. S-LAP is predominantly captured by NBFCs as reflected in >50% market share in secured MSME loans below INR 3mn.
- SFBs are incrementally focusing on scaling S-LAP to leverage branch network and cost of fund advantage over NBFCs.
- Shriram Finance, AU and Equitas are market leaders (in-terms of AUM) in S-LAP segment with SBFC delivering the highest 54% AUM CAGR between FY20-23.

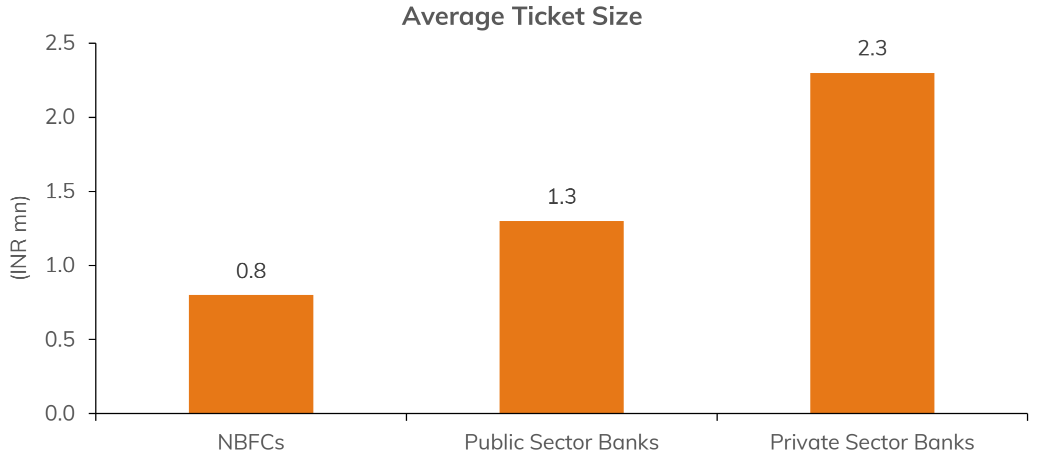
SBFC's market share in secured MSME within NBFC space stands at ~4% as on Mar'23.

Exhibit 12: NBFCs market share in ticket size of less than INR 3.0mn (FY23) stands much higher at >50%



Source: CRIF Highmark, CRISIL MI&A, I-Sec research

Exhibit 13: S-LAP market is largely serviced by NBFCs and PSBs



Source: Industry data, I-Sec research

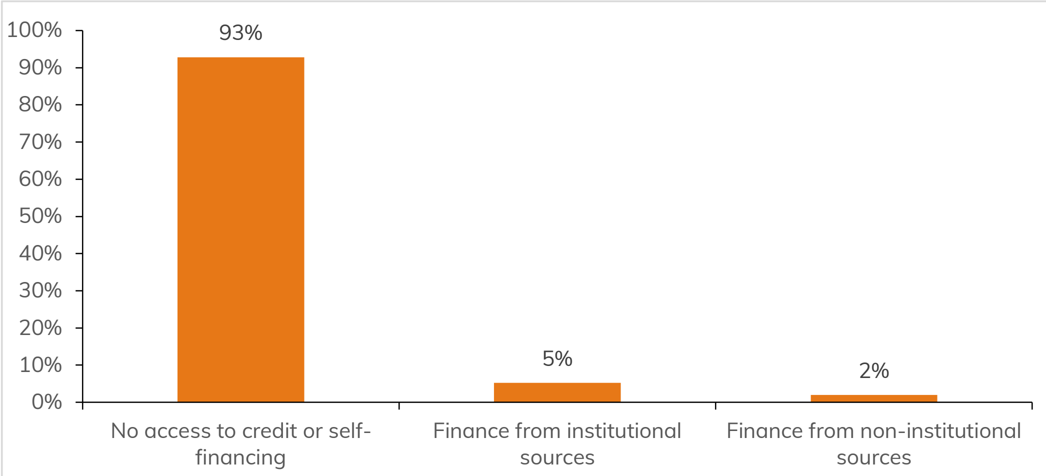
Increasing 'formalisation' augurs well for S-LAP segment; >90% of SMEs are still dependent on informal financing

SBFC is uniquely placed to capture the largest pie in 'increasing formalisation' in MSME segment as reflected in its robust growth in 'Udyam' registration. Within NBFCs (commanding >50% market share in small-ticket MSME), SBFC is the only player catering to formal self-employed segment (mandatory ITR for borrowers). Hence, we believe it may be the biggest beneficiary of increasing formalisation.

MSME registration under 'Udyam' grew robust 60% (CAGR) between FY16-23 driven by micro enterprise which grew 63% (highest CAGR), followed by medium enterprises by 47% and small at 30%. As per Udyam data, 97% of units are micro enterprise (investment in plant and machinery <INR 10mn) as of Sep'23 vs 94% in Sep'21. The same implies increasing 'formalisation' especially amongst small units.

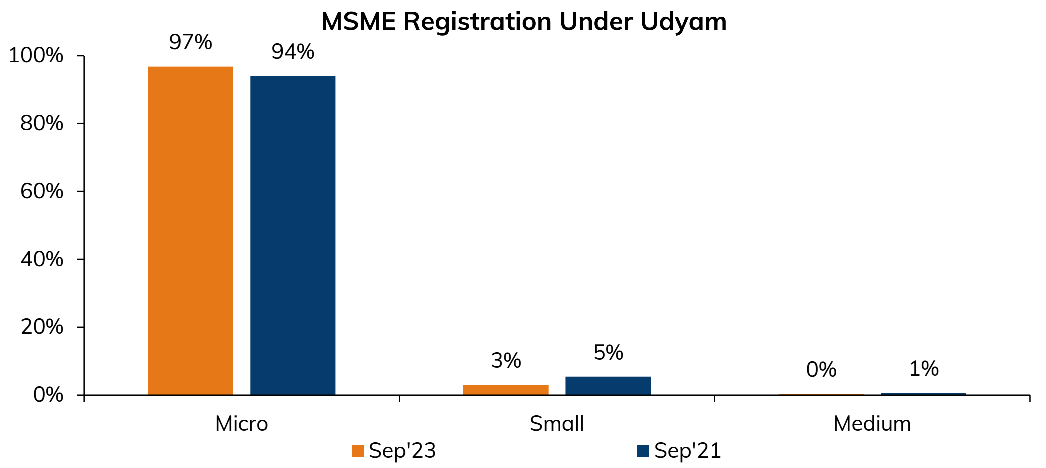
Given >90% of SMEs are dependent on informal financing, increasing 'formalisation' augurs well for S-LAP segment.

Exhibit 14: Finance requirement for >90% of SMEs is met via informal sources



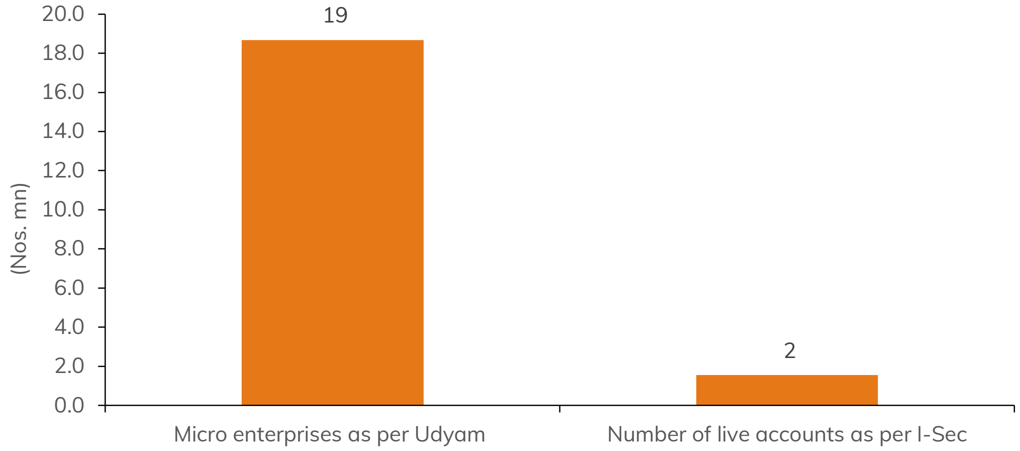
Source: Fourth Census of the MSME sector (September 2009)

Exhibit 15: Registration of micro enterprises under 'Udyam' increased to 97% as on Sep'23 vs 94% in Sep'21



Source: Industry data, I-Sec research

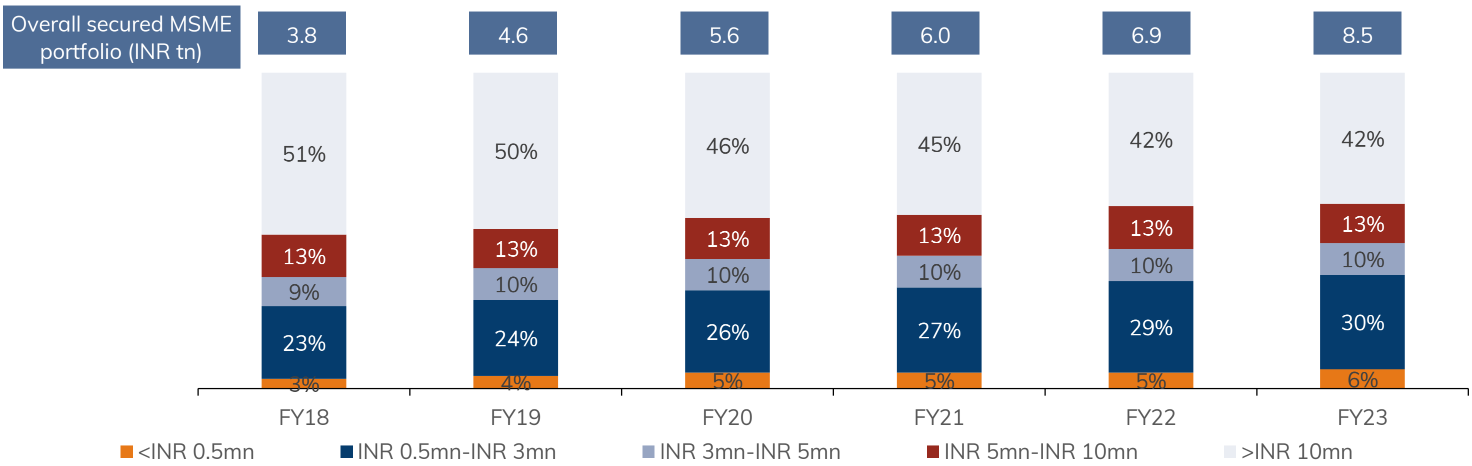
Exhibit 16: Number of micro enterprises financed through formal sources stands at <10% of total Udyam registration



Source: Industry data, I-Sec research

S-LAP segment grew at a CAGR of 24% to INR 2.5trn and the same was higher than overall secured MSME portfolio growth at 18% between FY18-FY23. The same resulted in the share of small-ticket LAP portfolio in overall secured MSME portfolio increasing to 30% in FY23 from 23% in FY18. The industry has seen further dip in the market as the share of secured MSME portfolio with less than INR 0.5mn ticket size has increased from 3% in FY18 to 6% in FY23.

Exhibit 17: Share of portfolio within ticket size of INR 0.5mn to INR 3mn increased from 23% in FY18 to 30% in FY23 in overall secured MSME portfolio



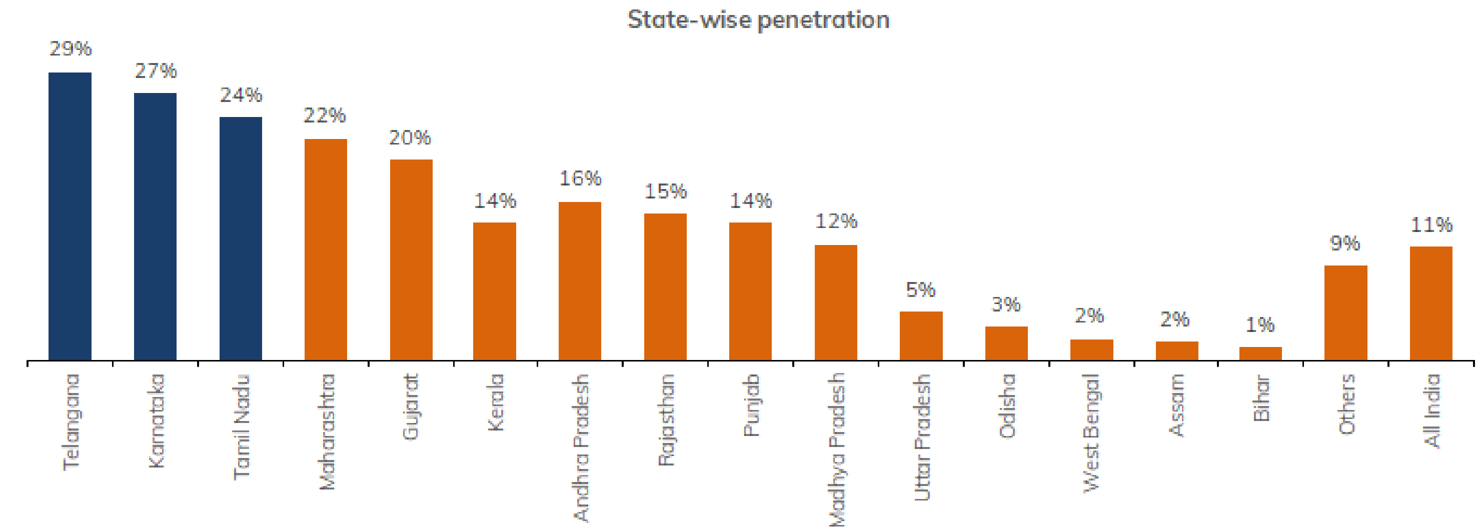
Source: CRIF Highmark, CRISIL MI&A, I-Sec research

Pan-India presence with focus on deepening distribution in high-growth states

SBFC currently has an average district-level penetration of 28% in the states it operates, implying a huge scope for deepening its presence in the existing states and given its 5 years of experience in operating in these states, SBFC would have edge over competitors in some of these states.

SBFC is amongst very few financiers who have strategically focused on building pan-India presence unlike other MSME lenders who have focused on scaling portfolio in one state / region. More importantly, it expanded its distribution network in non-South region given the low penetration. Our analysis suggests most MSME financiers are predominantly operating in Southern states like Tamil Nadu, AP, Telangana and KTK, while SBFC's ~60% business is originated outside Southern markets. It uniquely positioned itself to enjoy first-mover advantage and outpace industry growth in non-Southern markets.

Exhibit 18: Small-ticket LAP (ticket size between INR 0.5mn to INR 3.0mn) remained highly penetrated in Telangana, Karnataka and Tamil Nadu



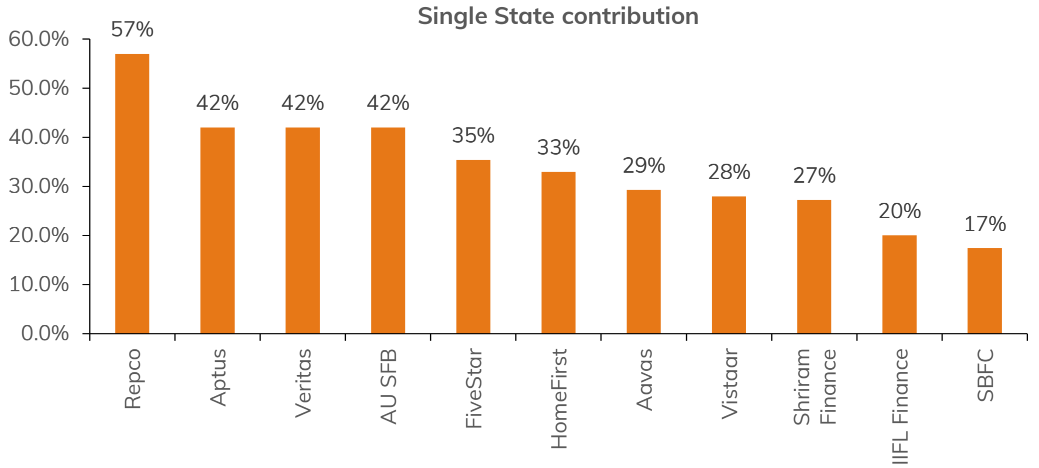
Source: CRISIL MI&A, I-Sec research

Exhibit 19: S/LAP market is hugely significantly under penetrated ex-south

	Repco	Aptus	Veritas	FiveStar	Vistaar	Shriram Finance	IIFL Finance	HomeFirst	Aavas	AU SFB
Largest Operating State	Tamil Nadu	Tamil Nadu	Tamil Nadu	Tamil Nadu	Tamil Nadu	Tamil Nadu	Andhra Pradesh	Gujarat	Rajasthan	Rajasthan

Source: Company data, I-Sec research

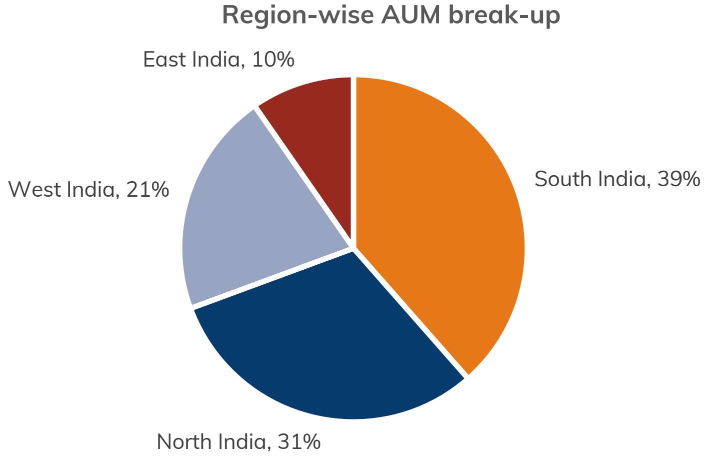
Exhibit 20: No single state contributing >20% of AUM for SBFC



Source: Company data, I-Sec research

As on Mar'23, its AUM was spread across different states with South at 39% of AUM, North at 31%, West at 21% and East at 10% and no single state contributing >20% of AUM.

Exhibit 21: SBFC has one of the most diversified geographical presence…

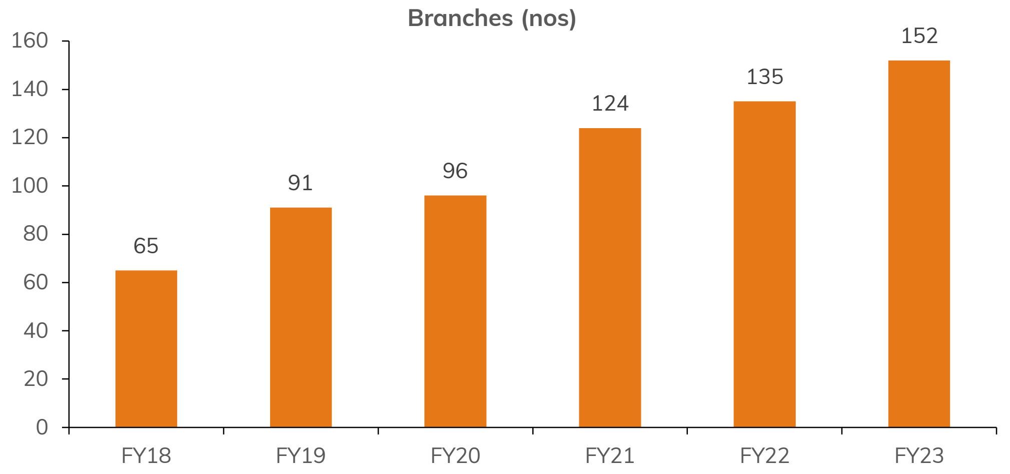


Source: Company data, I-Sec research

Most small businesses in India lack formal income proof, business registration, GST registration, income tax filings, and bank statements etc., which makes access to formal credit challenging. This is more prevalent in beyond tier 2 markets pan-India. SBFC has, thus, focused on building distribution network in tier 2 and beyond markets at pan-India level by rightly expanding its footprint in states with low credit penetration. As of Mar'23, its total branch network stood at 152 covering 120 cities, spanning over 16 Indian states and two union territories.

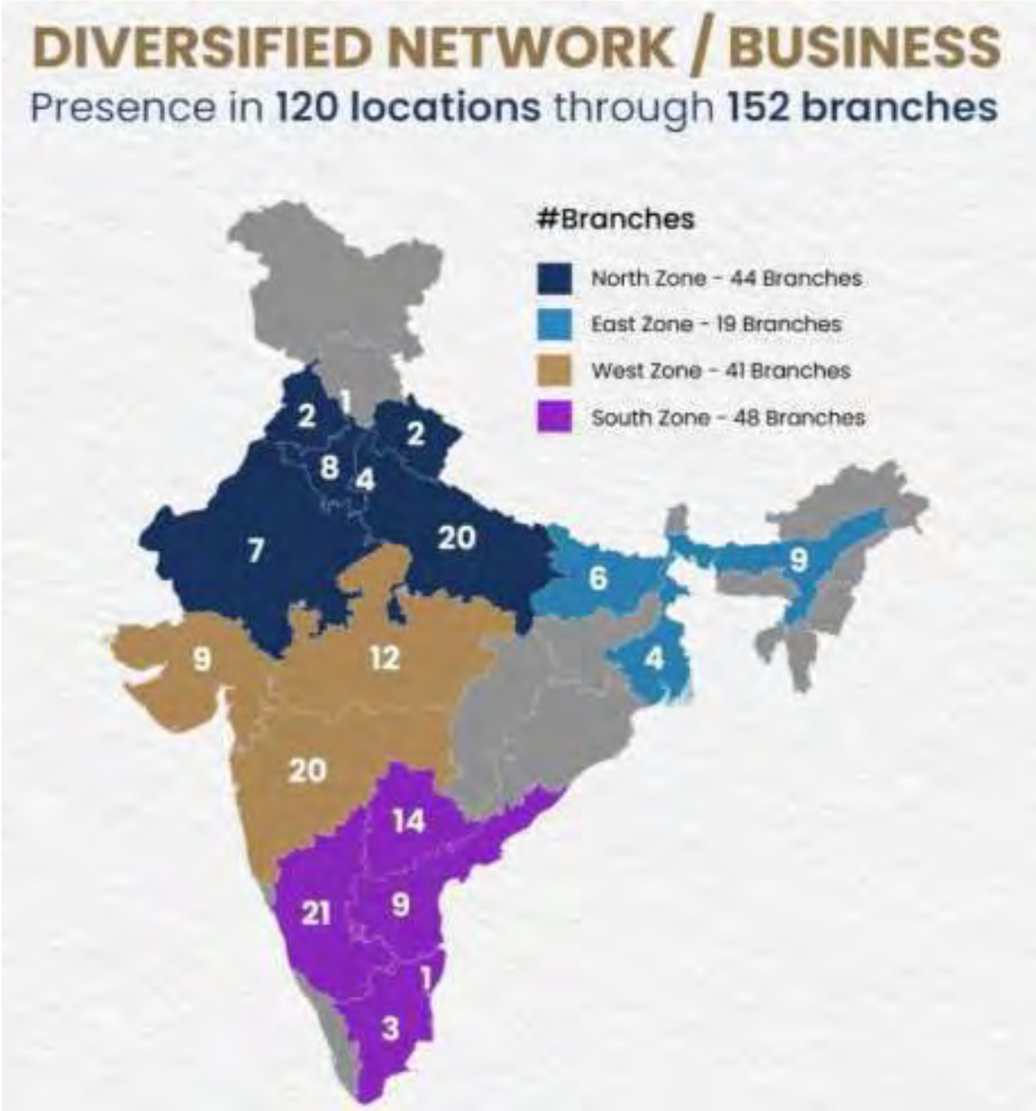
The idea behind steady investment towards building physical branch network is to understand the local characteristic of market and target customer better, build personal relationship through proximity and frequent interaction. The same has enabled it to address the needs of low and middle income customers and build a formidable franchise in small-ticket MSME financing.

Exhibit 22: Steady investment towards network expansion



Source: Company data, I-Sec research

Exhibit 23: Amongst very few NBFCs in MSME financing space having pan-India presence



Source: Company data, I-Sec research

Small-ticket MSME lending opportunity is huge, but at pan-India level, not many players, except SBFC, have focused on building a diversified distribution network. SBFC opted to spread its wings pan-India and actively managed geographical concentration risk. Its extensive, geographically diverse distribution network allows it to penetrate underbanked population in tier II and tier III cities in India.

As a result of its active management of state concentration, it has been able to maintain low levels of AUM concentration per state despite high growth over the years.

Exhibit 24: Largest state contributing 17% of total AUM speaks for its diversified presence and effective management of concentration risk

	Mar-23 (INR mn)	Mix (%)
Karnataka	8,611	17.4%
Uttar Pradesh	7,674	15.5%
Maharashtra	5,205	10.5%
Telangana	6,200	12.5%
Madhya Pradesh	3,617	7.3%
Andhra Pradesh	2,709	5.5%
Haryana	3,282	6.6%
Assam	2,286	4.6%
Gujarat	1,548	3.1%
Delhi	1,205	2.4%
Tamil Nadu	1,405	2.8%
Rajasthan	1,176	2.4%
Uttarakhand	1,044	2.1%
Bihar	1,956	4.0%
Punjab	728	1.5%
West Bengal	525	1.1%
Chandigarh	133	0.3%
Puducherry	124	0.2%
	49,428	**100.0%**

Source: Company data, I-Sec research

Product evolution based on learning from its lending experience over past 6 years

SBFC's journey from managing assets bought from Karvy in FY17 to become a pan-India small-ticket MSME financier by FY23 was not smooth and went through a bumpy ride. Before identifying small-ticket MSME loans as a go-to product, it tried and tested a few products like large-ticket LAP, unsecured loans etc.

It started its lending journey with a high-ticket LAP of up to INR 20mn. However, its first year of performance in high-ticket LAP was not up to the satisfaction given stiff competition from banks. Hence, management felt high-ticket LAP may not be the long-term strategy and it immediately shifted its focus to smaller ticket and found its niche in a bracket of INR 0.5-3mn ticket size with ATS of INR 1mn.

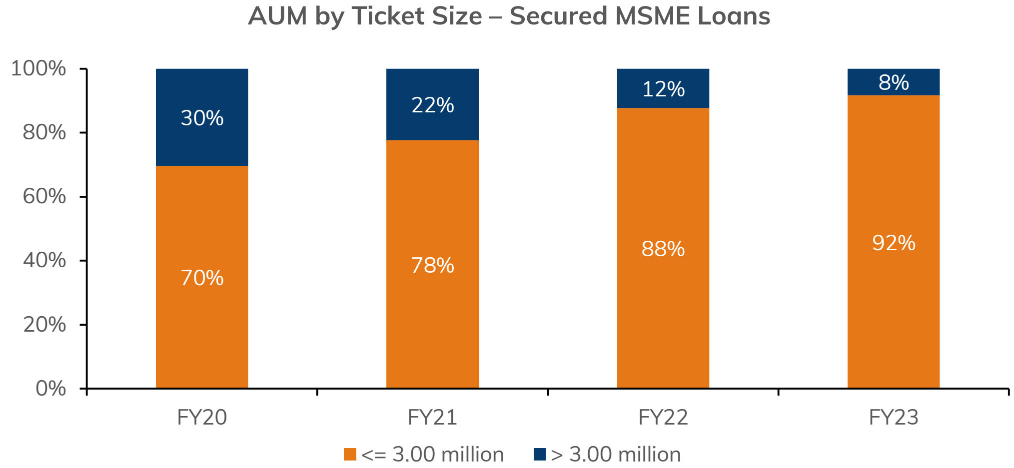
Exhibit 25: Strategic focus on small-ticket secured MSME loans as reflected in its share increasing to 79% by Mar'23 from 65% in Mar'20

	FY20		FY21		FY22		FY23		AUM CAGR
	AUM (INR mn)	Percentage of Total AUM (%)	AUM (INR mn)	Percentage of Total AUM (%)	AUM (INR mn)	Percentage of Total AUM (%)	AUM (INR mn)	Percentage of Total AUM (%)	FY20-23
Secured MSME Loans	10,792	65%	14,423	65%	23,263	73%	39,200	79%	54%
Loans against Gold	3,665	22%	5,601	25%	6,396	20%	8,641	17%	33%
Others *	2,025	12%	2,190	10%	2,263	7%	1,587	3%	-8%
Total	**16,482**	**100%**	**22,213**	**100%**	**31,922**	**100%**	**49,428**	**100%**	44%

Source: Company data, I-Sec research

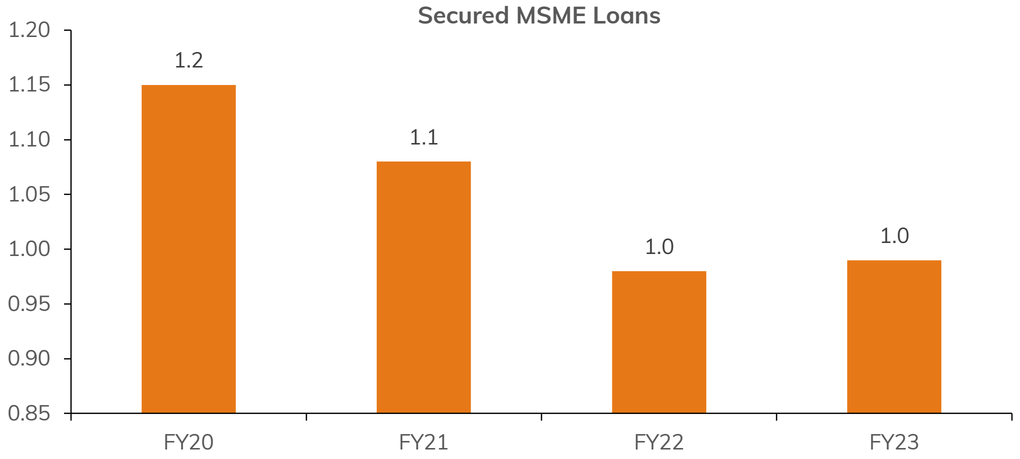
*Others include unsecured loans.

Exhibit 26: Shifted its focus towards small-ticket loans – share of <INR 3mn loans increased to 92% by Mar'23 from 70% in Mar'20…



Source: Company data, I-Sec research

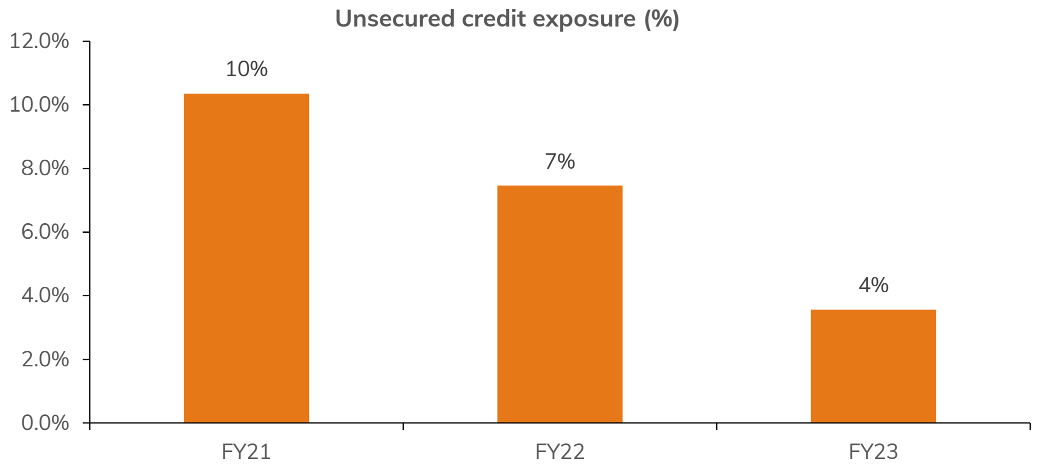
Exhibit 27: …this reflects in disbursement ticket size falling by >15% between FY20-23



Source: Company data, I-Sec research

SBFC also started unsecured loans in its early years in personal loans and business loans in a smaller-ticket segment. However, the impact of covid in unsecured segment was severe and the management realised its strength lies in secured assets. The company, therefore, moved out of the unsecured segment in CY22 and has run down the portfolio which remains at INR 1.54bn as on Mar 31, '23. It now has 97% of its portfolio as secured against the collateral.

Exhibit 28: Post covid, it scaled down its unsecured business loan segment



Source: Company data, I-Sec research

Focus on basic but the most effective business practices

While it is basic and imperative to build in-house capabilities, right from sourcing till disbursements, to ensure better asset quality outcome, many players are deviating from the traditional way of doing lending and outsourcing many activities to accelerate growth. SBFC is amongst the few who still believe in basics and building most functions in-house.

100% in-house sourcing

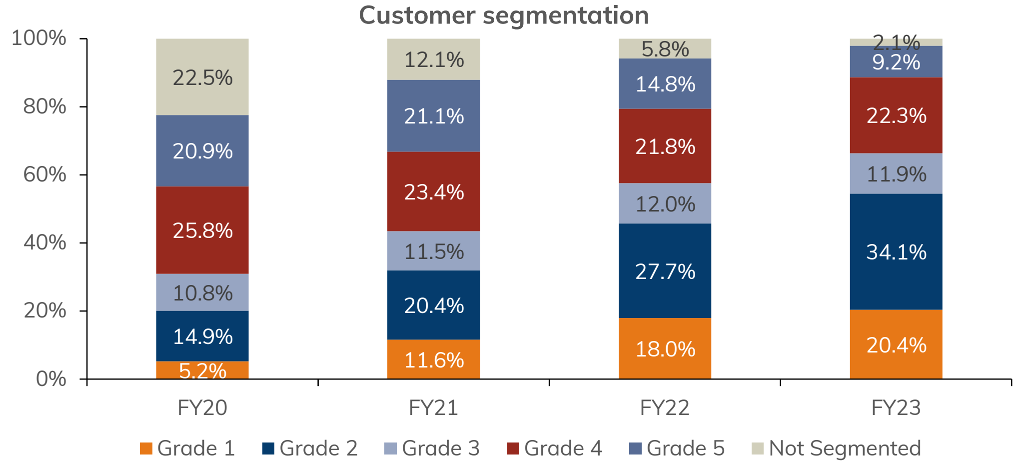
In-house sales

In any lending business (irrespective of product segment), on-boarding the right set of customers becomes the most critical aspect to manage book quality. Various players have adopted various channels to acquire customers like in-house sales, DSAs, connectors, fintech partnerships etc. SBFC has preferred 100% in-house sourcing to ensure the acquisition of quality customer, better customer service and faster TAT.

In-house sales structure also helps in better log-in to disbursement ratio given the internal sales team would be well aware of the eligibility criteria, preferable customer profile, negative locations and profiles etc. and more importantly would be aware about which profile is unlikely to clear credit filters. Hence, profiles where probability of rejection is high are likely to weed out at the initial screening stage itself. The same would force sales staff to search for profiles that meet eligibility criteria as per internal underwriting and sourcing filters in order to ensure their monthly / annual incentives.

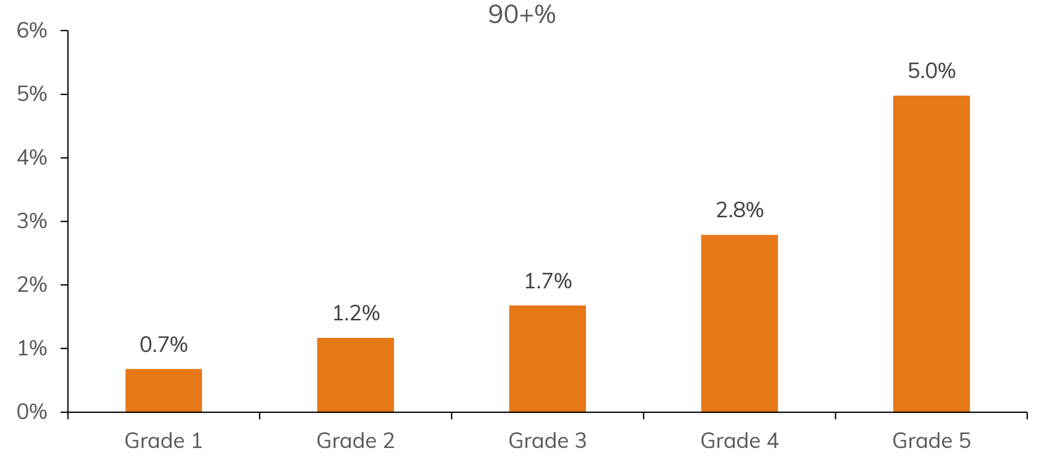
It follows individual file-based credit assessment but manages risk at a portfolio level. For this, it has developed a scorecard-based 'customer segmentation' approach for customer selection for ticket sizes of up to INR 3mn in order to ensure credit performance. This segmentation classifies customers into five categories based on risk behaviour, where top segments identify good credit behaviour. The categorisation has been done on the basis of filtering more than 100 data points, including key parameters such as LTV, credit bureau score, leverage, property type, among others.

Exhibit 29: Focus on acquiring quality customers – as reflected in increasing share of grade 1-2-3 customer and declining share of non-segmented, grade 4-5 customers



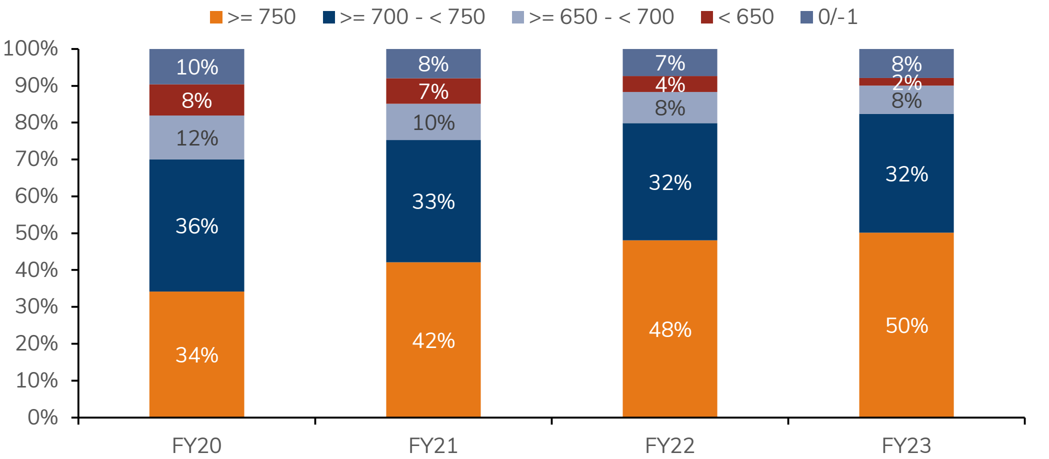
Source: Company data, I-Sec research

Exhibit 30: PAR 90+ in grade 4-5 customer is significantly higher at 2.8% and 5%, respectively



Source: Company data, I-Sec research

Exhibit 31: Focus on acquiring credit-tested customers - as reflected in increasing share of customers having >700 CIBIL score



Source: Company data, I-Sec research

Independent credit – stringent underwriting to ensure quality customer on-boarding

First-of-its kind hybrid underwriting model

The target customer for small-ticket MSME financiers (NBFCs command ~50% market share) are informal self-employed segment who often lacks documented income proofs and hence, assessed income model is the most commonly followed underwriting practise.

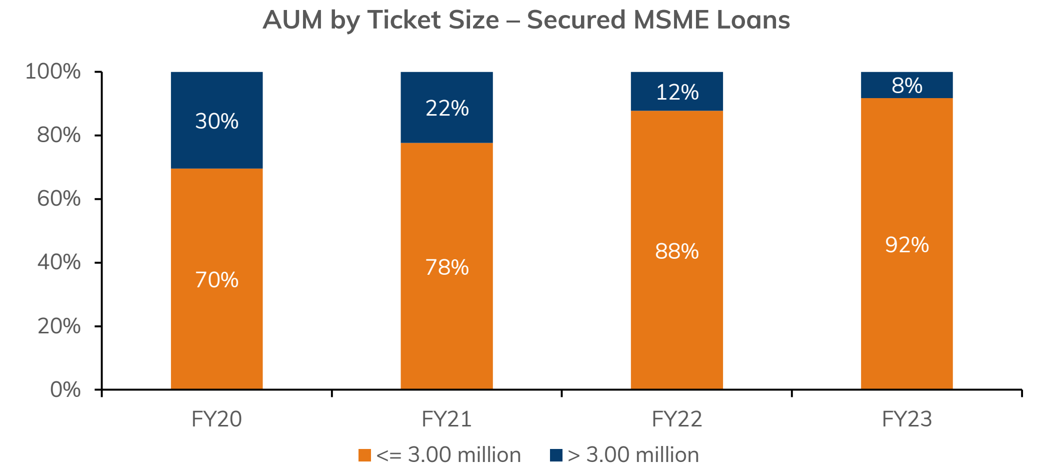
SBFC is pivoting itself by adopting first-of-its kind hybrid underwriting model – first level of eligibility is calculated based on the documented income proofs (ITR is mandatory for all its borrowers) and second level of quality screening is done by on-field credit officers. It conducts field visits to understand the formal and informal income sources at household level, savings capacity and credit track record with their formal and informal borrowings.

It deploys a dedicated credit team at branch level that visits a customer's residence and place of business, gathers detailed information about the customer from the neighbourhood, locality and their customers and suppliers and conducts a cashflow assessment of his/her income. Its credit team is hired locally. In addition, it physically inspects the collateral provided for loans. In addition, each loan has a spouse or a parent as a co-borrower to ensure there are joint holders for loans.

Key highlights of its credit policy

- Eligibility on declared income – ITR is mandatory for all borrowers. However, credit staff visits field to seek accuracy of information gathered from ITR and reference check. Most of its customers have accounts in top 5-6 banks.
- Standardised process – considering state-wise diversity in terms of business profiles and cyclicality, SBFC has focused on standardising the underwriting process based on ITR filing.
- Preference for women co-borrowers - nearly 90% of its borrowers or co-borrowers are women, which it believes has a better credit discipline.
- All supervisory teams are highly experienced – most zonal heads have more than 18-20 years of experience with prior history of working with large private sector banks and NBFCs like Kotak, Bajaj etc.
- Professional underwriter – credit officers either hold a degree in MBA or CA. Every branch is staffed with minimum 1 credit personal.
- De-centralised sanctioning but not at branch level – given the hyper-local underwriting process, SBFC has kept sanctioning power with Area Credit Manager. Typically, 1 ACM handles 1 or 2 branches based on his/her experience and performance.
- Calibrated LTVs - very tight at ~40%.
- CIBIL scrub on real-time basis, so even if a customer does any enquiry for other loans, SBFC will get alerts.
- Incentive structure for credit – no incentives on the number of files sanctioned (no monthly incentives), only annual bonus. Bonus is linked to TAT and asset quality performance and not on sanctioned numbers.

Exhibit 32: Strategic shift towards small-ticket loans



Source: Company data, I-Sec research

Exhibit 33: Rational behind shifting focus towards small-ticket MSME loans

Most small businesses in India have challenges	SBFC's business model, backed by experience in this segment
Partial Income Proof	• Credit officer spends time to understand income & cash flow (documented + non-documented) at family level • Evaluation of historical asset creation
Limited Commercial Credit History	• SBFC customers are often first-time commercial borrowers with past consumer loans • Reference check from the neighbourhood, locality and their customer and suppliers
Collateral with local nuances	• Local team with knowledge of local nuances and local collateral dynamics • Spouse or parent act as co-borrower on all loans
Bank Statements with Limited Transactions	• Analytics driven 'customer segmentation' • Triangulation of income sources from multiple data points
Small scale businesses lack resilience	• Focus on services/ trading/ retailing businesses • Customer with businesses in essential services - less impacted by macro down-cycles

Deep understanding of customer behavior (over 51K MSME customers) & strong knowledge of local markets (16 states, 2 UTs)

Source: Company data, I-Sec research

Exhibit 34: Stringent underwriting model backed by digital analytics and on-field verification by in-house credit team

	Sourcing	Appraisal	Credit	Disbursement	Account Management
Key Steps	100% in house loan sourcing	KYC Verification & DeDupe	Personal Discussion	Sanction Letter	NACH, PDC & EMI Presentation
	CIBIL Check (failure → rejection)	Analysis of Financials, Banking, Repayment Track Record	Property Visit	Loan details captured	Collections & Bounce tracking
	Capture details of customer, business and collateral	CAM Preparation	Legal & Valuation	Property document filing & charge creation	Legal
		RCU Checks, Collateral dedupe, RV, OV, BV, ITR, Reference checks	Case Proposal	CERSAI & CIBIL update	Customer Service

Source: Company data, I-Sec research

Exhibit 35: Product-wise average LTV (%)

Product Wise average LTV on AUM on Origination Basis (%)	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Secured MSME Loans	46.62%	45.17%	43.42%	42.51%
Loan against Gold	65.95%	67.88%	69.47%	68.51%

Source: Company data, I-Sec research

Exhibit 36: Focus on SORP as reflected in 83% of collateral being SORP in Mar'23 vs 74% in Mar'20

Property Type	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Self-Occupied Residential Property	74.44%	77.55%	80.19%	82.75%
Self -Occupied Commercial Property	18.93%	15.68%	12.39%	11.01%
Others	6.63%	6.77%	7.42%	6.24%

Source: Company data, I-Sec research

Robust collection mechanism…

In-house collections teams – ~90% collected digitally in FY23

Currently, total field collection staff stands at 170, implying >1 collection officer per branch, as on Mar'23.

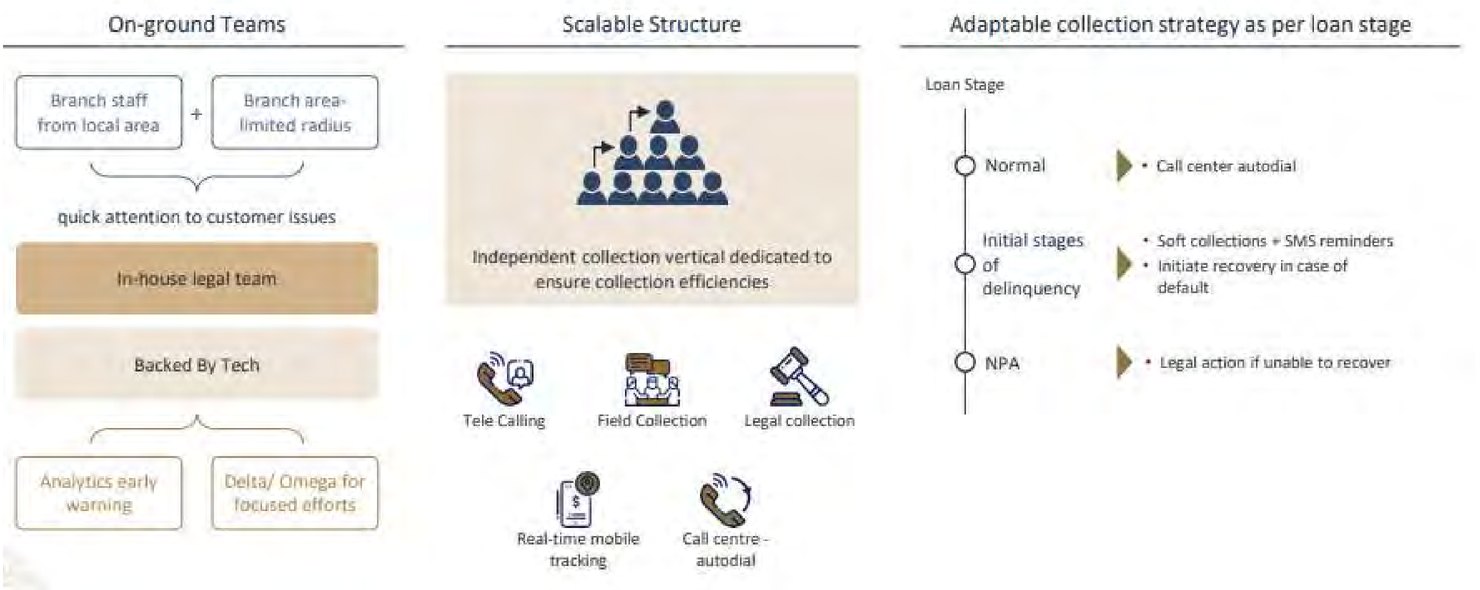
While it follows a conservative underwriting model to ensure quality customer on boarding, it has also created an extensive on-ground collections infrastructure to ensure it maintains a robust asset quality across cycles.

It has set-up a three-tier collections infrastructure comprising (i) tele-calling, (ii) field collection, and (iii) legal recovery. Its collection officers are equipped with collection applications - a mobile application 'Delta' and a web application 'Omega', which provides a priority list of overdue customers to the collection team in real time.

Focus on local hiring and limited servicing area help it quickly attend a customer's location, in case of any issue. Further, there are experienced regional supervisors reporting into an independent collection vertical dedicated to ensuring collection efficiencies.

SBFC's collections process is technology-driven with collection representatives being able to access customer data on the phone and issue receipts digitally through their mobile application. As of Mar'23, ~90% of its secured MSME and ~91% of unsecured loan collections were non-cash based EMI collections. The same reduces cash management risk and enables customers to receive real-time payment receipts through SMS.

Exhibit 37: Bucket-wise collection mechanism



Source: Company data, I-Sec research

Exhibit 38: Flow forwards restricted at 3% between FY20-23 despite covid…

Particulars (INR mn)	As at FY20				As at FY21				As at FY22				As at FY23			
	Stage-1	Stage-2	Stage-3	Total	Stage-1	Stage-2	Stage-3	Total	Stage-1	Stage-2	Stage-3	Total	Stage-1	Stage-2	Stage-3	Total
Gross carrying amount opening balance	**8,268**	**150**	**43**	**8,460**	**9,506**	**258**	**317**	**10,080**	**12,082**	**826**	**499**	**13,408**	**19,874**	**1,171**	**670**	**21,715**
New assets originated/Assets derecognized/repaid (excluding write offs)	1,636	(15)	17	1,637	3,293	86	38.18)	3,378	8,782	(111)	(225)	8,445	13,062	(149)	(159)	12,754
Transfers to Stage 1	29	(29)	-	-	96	(63)	33.33)	33	81	(41)	(40)	-	116	(63)	(53)	-
Transfers to Stage 2	(198)	198	-	-	(596)	596	-	-	(748)	755	(6)	0	(260)	298	(37)	-
Transfers to Stage 3	(229)	(45)	274	-	(212)	(49)	262	-	(291)	(229)	520	-	(329)	(207)	537	-
Flow forwards	*2.8%*	*30.3%*		*3.3%*	*2.2%*	*19.1%*		*2.7%*	*2.4%*	*27.7%*		*4.0%*	*1.7%*	*17.7%*		*2.5%*
Amounts written off	-	-	(18)	(18)	(4)	(1)	(8)	(13)	(31)	(29)	(78)	(138)	(10)	(15)	(21)	(46)
Gross carrying amount closing balance	**9,506**	**258**	**317**	**10,080**	**12,082**	**826**	**499**	**13,408**	**19,874**	**1,171**	**670**	**21,715**	**32,453**	**1,034**	**936**	**34,423**

Source: Company data, I-Sec research

Exhibit 39: ...the same helped it improve the share of stage 1 assets to 95% by FY23 from 91% in FY21

(INR mn, except percentages)	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Stage 1	9,443	12,048	19,861	32,410
Stage 2	246	809	1,154	1,013
Stage 3	292	454	619	875
Gross Loan Book – Secured MSME Loans	9,981	13,311	21,634	34,299
Secured MSME Loans (%)				
Stage 1	94.6%	90.5%	91.8%	94.5%
Stage 2	2.5%	6.1%	5.3%	3.0%
Stage 3	2.9%	3.4%	2.9%	2.6%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1) Stage 3 represents gross NPA of secured MSME as of the last day of the relevant period.

2) Stage 1% represents stage 1 of secured MSME to gross loan book of secured MSME of SBFC as of the last day of the relevant period.

3) Stage 2% represents stage 2 of secured MSME to gross loan book of secured MSME of SBFC as of the last day of the relevant period.

4) Stage 3% represents stage 3 / gross NPA of secured MSME to gross loan book of secured MSME of SBFC as of the last day of the relevant period.

Source: Company data, I-Sec Research

Exhibit 40: Strong collection mechanism is driving steady decline in 30+ DPD portfolio

	As of March 31,			
(INR mn, except percentages)	2020	2021	2022	2023
AUM	10,792.30	14,422.67	23,262.70	39,200.03
0 days AUM[(1)]	958.44	1,259.43	1,596.52	2,001.30
0 days AUM [(2)] (%)	8.88%	8.73%	6.86%	5.11%
30 days + AUM [(3)]	554.74	932.85	1,104.77	1,468.78
30 days + AUM [(4)] (%)	5.14%	6.47%	4.75%	3.75%

(1) 0 days AUM refers to accounts that are 0 days past due (DPD).

(2) 0 days AUM (%) to refers 0 DPD to the AUM of secured MSME loans as of the last day of the relevant period as a percentage.

(3) 30 days + AUM refers to accounts that are more than 30 DPD.

(4) 30 days + AUM (%) refers 30+ DPD to the AUM of secured MSME as of the last day of the relevant period as a percentage.

Source: Company data, I-Sec Research

...leading to superior asset quality performance

Cumulative write-offs between FY20-23 stood at ~2%

Focus on on-boarding quality customers, stringent risk management based on customer segmentation and rigorous collection mechanism have helped SBFC in managing asset quality better than peers even during covid phase. Further, ~17% of gold loan business helps in keeping credit losses minimal at total portfolio level. Cumulative write-offs between FY20-23 at 2% of AUM is a testimony to its quality underwriting and strong credit monitoring.

Asset quality metrics broadly remained steady during the past three years despite covid-led disruption as reflected in GNPL ratio remaining between 2-3% during FY20-23 with peak GNPL at 3.2% in FY21. Notably, it continued to strengthen its balance sheet by improving NPL coverage ratio. PCR improved to 42% by FY23 from 31% in FY21.

Exhibit 41: Average write-offs between FY20-23 stood at <1% despite covid

Particulars (INR mn, except ratios and percentages)	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Gross Loan Book	15,671	21,102	30,293	44,527
Gross NPA	357	667	829	1,082
Gross NPA ratio (%)	2.3%	3.2%	2.7%	2.4%
Net NPA	247	412	494	627
Net NPA ratio (%)	1.6%	2.0%	1.6%	1.4%
PCR coverage	**30.8%**	**38.3%**	**40.4%**	**42.0%**
Bad Debts Write-off	18	55	359	151
Bad Debts Write-off (%)	**0.1%**	**0.3%**	**1.2%**	**0.3%**

1) Gross NPA represents gross loan book pertaining to loans that are required to be classified as NPA as per the Income Recognition, Asset Classification and Provisioning norms issued and modified by the RBI from time to time.

2) Gross NPA ratio (%) represents the gross NPA to the gross loan book as of the last day of the relevant period.

3) NPA provisions represent total expected credit loss allowance on stage 3 loans held in the books as of the last day of the relevant period.

4) Net NPA represents gross NPA reduced by impairment loss allowance (i.e., expected credit loss allowance or ECLs) made against these loans as of the last day of the relevant reporting period.

5) Bad debts write-off (net of recovery) includes loss on settlement.

Source: Company data, I-Sec research

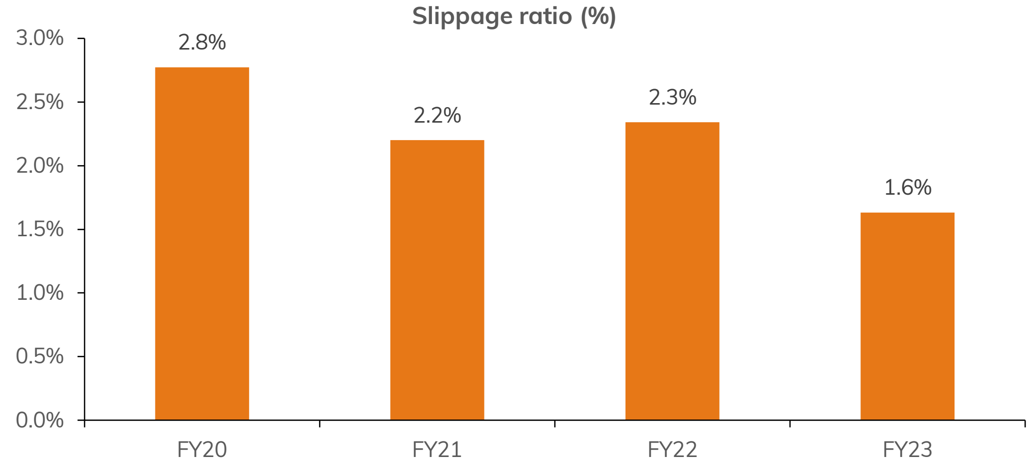
Segment-wise GNPL ratio suggests gold loans has been the best performing product throughout covid – GNPL in gold loans remained at an average 1.5% between FY20-23. While GNPL in secured MSME remained higher than gold loans, it still remained around 3% during FY20-23. GNPL in unsecured loans (included in others) remained elevated even in FY23 as reflected in GNPL increasing to 6.4% by FY23 from 4.4% in FY22. However, the share of unsecured loans stands at only 3% as on Mar'23.

Exhibit 42: Product-wise gross NPA (%)

(%)	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Secured MSME Loans	2.93%	3.41%	2.86%	2.55%
Loans against Gold	1.38%	1.50%	1.71%	1.21%
Others[(1)]	0.69%	5.87%	4.43%	6.43%
Total Gross NPA	**2.28%**	**3.16%**	**2.74%**	**2.43%**

Source: Company data, I-Sec research

Exhibit 43: Delinquencies moderated sharply in FY23 suggesting covid-related stress is behind



Source: Company data, I-Sec research

Exhibit 44: Steady improvement in PCR; the same improved to 42% by FY23 from 31% in FY20

(INR mn, except percentages)	As of/ For the year ended March 31,			
	2020	2021	2022	2023
Gross Loan Book -				
1. Stage 1	14,762	18,205	27,799	31,480
2. Stage 2	552	2,230	1,665	1,678
3. Stage 3	357	667	829	914
4. Total Gross Loan Book	**15,671**	**21,102**	**30,293**	**34,072**
ECL Allowance – Loans				
5. Stage 1	251	310	174	194
6. Stage 2	9	87	153	140
7. Stage 3	110	255	335	380
8. Total ECL Allowance Loans	**371**	**652**	**663**	**713**
ECL Coverage				
9. Stage 1	2%	2%	1%	1%
10. Stage 2	2%	4%	9%	8%
11. Stage 3	31%	38%	40%	42%
12. Total ECL coverage – Loans	**2.4%**	**3.1%**	**2.2%**	**2.1%**

Source: Company data, I-Sec research

Company evolution – unique transition from inorganic route to completely in-house organic business model

SBFC has uniquely transitioned itself from entering a lending business via inorganic route in FY17 to building a completely in-house business model by FY23. In its >5-year organisational journey, it entered into three inorganic transactions – 1) Karvy portfolio buyout in FY17, 2) co-origination partnership with ICICI Bank and 3) PTC transaction with HFC.

- **Karvy asset buyout** - SBFC started its organisation journey in 2017 by acquiring Karvy Finance Ltd's assets, branches, technology and employees. This was a unique way of setting up a business model – instead of trying and testing markets on its own, it chooses inorganic route to set the ground running. Slump sale allowed SBFC to handpick assets, thereby, leaving out distressed loans and an ability to recover NPAs up to INR 500mn that would arise within a year of loan takeover on a book of approximately INR 8bn comprising a secured MSME loan of INR 6bn and gold loans of INR 2bn. This asset base would have also ensured the company was profitable from the first quarter and generated cash that was re-invested in growth.

- SBFC was thus born Systemically Important NBFC and it gave the company an ability to register for Sarfaesi from the beginning. The infrastructure was being under-used and it could scale the business in these locations with the already present credit, operations and collections infrastructure. There were more than 50 branches with a fully enabled gold loan infrastructure with vaults and trained valuers for gold business. Over the years, Karvy had served more than 100,000 customers and the company saw an opportunity to bring some of the customers back as Karvy had stopped doing new loans two years before the closure of this sale transaction, as well as cross sell to existing customers. SBFC acquired a structure, basic scale, trained experienced resources – thus a platform that gave positive cashflow and earnings by getting a portfolio the company had scrubbed and screened and on top of that a downside protection of INR 0.5bn through an escrow mechanism. This would ensure it would have a zero NPA seasoned book post 12 months of the acquisition. With this in mind, the company was confident that the goodwill of INR 2.6bn will pay for itself over the next 5 years.

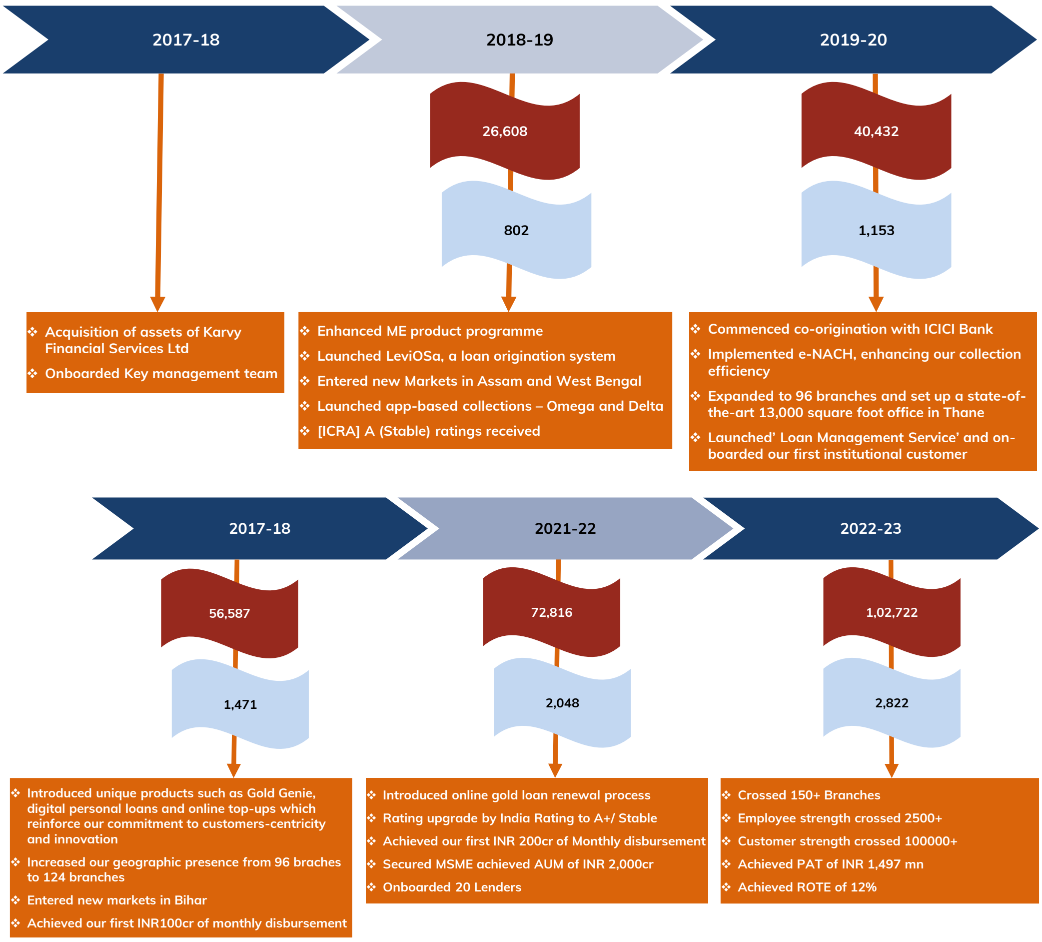
- **Co-origination with ICICI Bank** - Post ILFS-led liquidity crisis, SBFC sensed that as a nascent player it was at a disadvantage and so in Jan'19 it tied up with ICICI Bank for co-origination to keep the wheel running and build an asset light RoE-accretive model. Consistently, it co-originated between 15-20% of its monthly business. As each case is approved by banks credit as well, most credit policies and processes are aligned to the bank's compliance and policies.

- **PTC transaction** – The banks were hesitant to finance risk assets, especially to new NBFCs like SBFC. At that stage, the company looked to buy seasoned assets in a structure where probability of on-book credit losses is minimal and banks would also be comfortable funding such ring fenced asset structures. The company identified an opportunity of doing a Pass Through Certificate (PTC) as an investment and bought INR 30bn worth of assets from a large HFC. This also enabled SBFC to test its underwriting ability as it conducted thorough due diligence of PTC assets which included customer calling and on-ground property and customer verification.

- It created structure with PTC A of INR 24bn as senior debt and PTC B of INR 6bn as junior debt. This ensured all dollars accruing would first pay down PTC A and only after PTC A is run down to zero, dollars accrue to PTC B. PTC B was retained by the HFC. Additionally, it was identified that servicing of the transaction going forward is a risk and decided to step in the shoes of the lender as a service provider. Towards this SBFC took all customer KYC records and took control of customer property documents. It would present the EMI and collect on the pool directly from the customer. A middleware was built to accept over 13,000 customer data from the host system, update the formats and bring it into its loan management system. This ensured SBFC could take over customer service with zero dependency on the originator. In effect, it created a structure that would insulate the investor from originator default risk. This structure would ensure that the company ring fenced itself from any potential risk that may arrive at the HFC's shore. As the portfolio would run down, it would create sustained liquidity release for SBFC to lend on its books.

- The investment of INR 24bn is now down to ~INR 2bn. The structure ensured the company had zero credit loss all through and a decent yield of 11% for such a risk free treasury investment.

Exhibit 45: Company evolution



Source: I-Sec research, Company data

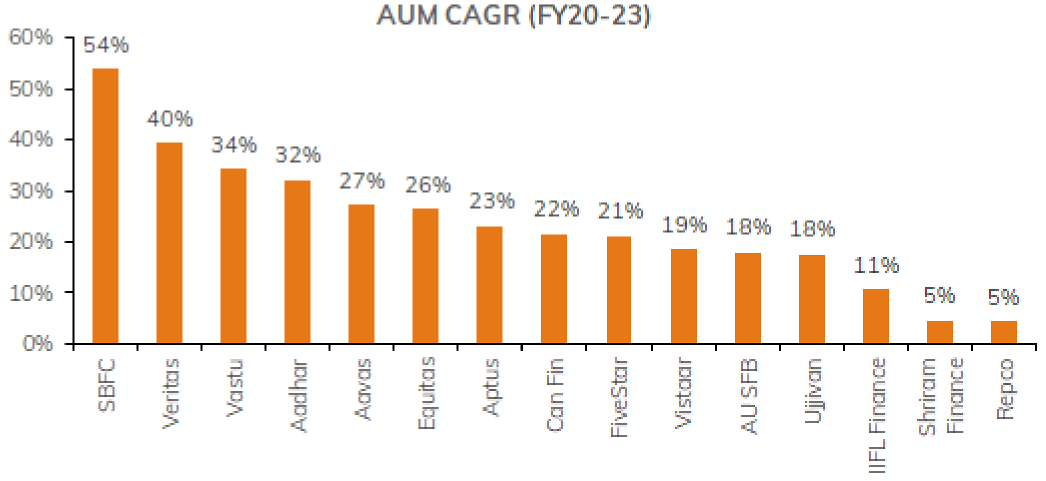
Financial outlook

SBFC has delivered 44% overall AUM CAGR driven by small-ticket LAP; we expect growth to remain at >30% over FY23-25E

SBFC's distribution strategy has been different vs players in NBFC space doing MSME loans. SBFC has put its presence in 16 states from the start, thus, being the only pan-India player in this space. These 16 states cover 92% of India's credit. With presence all across, it has covered an average 26% of the district from the total district in the state. Within these 26% districts, the company intends to penetrate further in places where it has not yet reached. Additionally, the opportunity to cover further is large and thus gives a long runway for growth in the segment.

More than 80% of credit in a state is served by 50% of its district and thus, the company is in the process of covering the districts that are currently underpenetrated by the industry. SBFC has actively managed concentration risk as reflected in well-diversified portfolio covering 39% in South, 31% in North and 30% in West and East. The highest concentration of a state is 17% of AUM. The company will continue to grow its INR 0.5m to INR3mn ticket size with focus on increasing penetration in the existing markets through steady investments in employees and branch network. SBFC intends to leverage on its diversified presence and continues to focus on its profitable growth.

Exhibit 46: SBFC has delivered industry-leading 54% AUM CAGR during FY20-23 in small-ticket LAP...



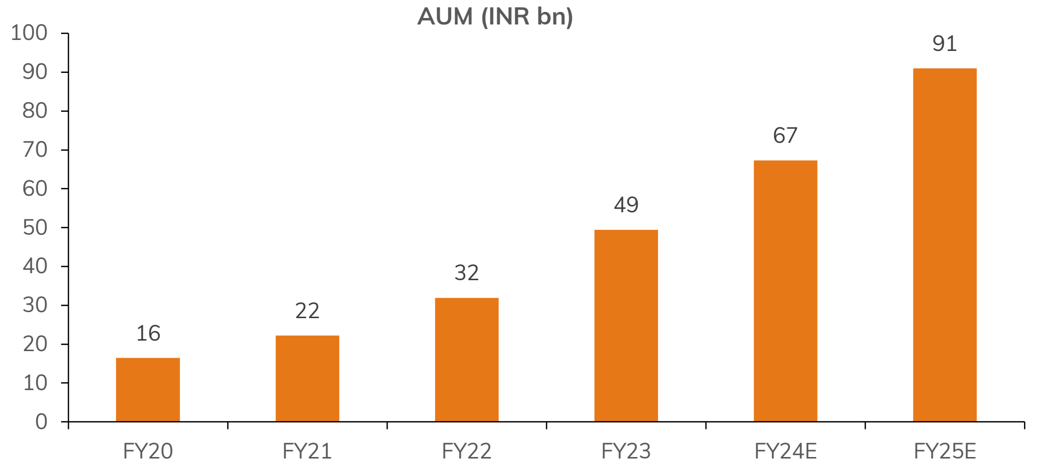
Source: Company data, I-Sec research

Exhibit 47: ...driven by strong new customer acquisition

	FY20	FY21	FY22	FY23	CAGR F20-23
Live MSME loan accounts	7,793	12,250	23,018	40,872	74%
MSME disbursements (INR mn)	4,455	5,955	13,328	22,768	72%
AUM from MSMEs (INR mn)	10,792	14,423	23,263	39,200	54%

Source: Company data, I-Sec research

Exhibit 48: Expect AUM CAGR at 35% over FY23-25E



Source: Company data, I-Sec research

Diversified borrowing profile, >90% floating rate borrowings and steady credit rating upgrade to drive borrowing cost lower

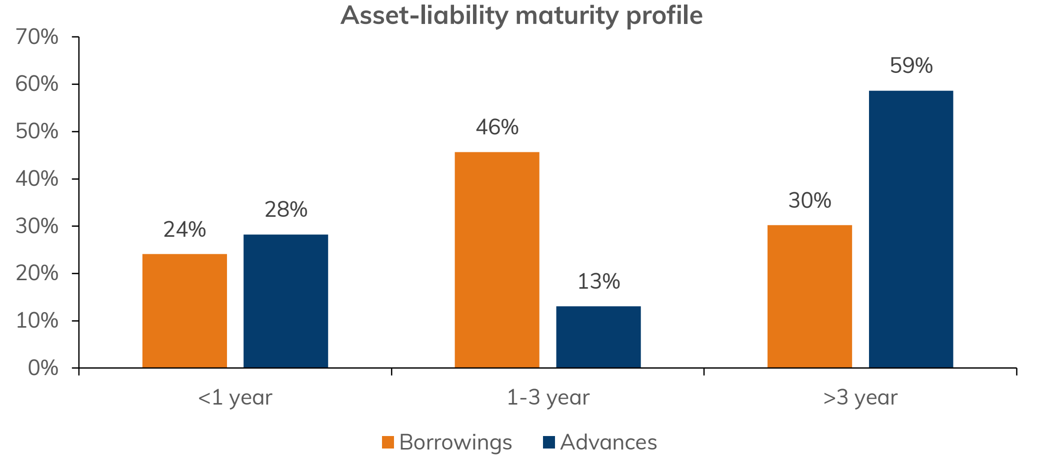
In lending space, especially under NBFC, managing funding profile and ALM becomes extremely important to secure steady funding flow and more importantly at competitive rates. SBFC has secured financing from diversified sources of capital, including term loans, proceeds from loans securitised, proceeds from the issuance of NCDs, from banks and financial institutions. Its ability to access diversified sources of funding is a key contributor to its growth and improving profitability. It intends to continue to diversify its funding sources, identify new sources and pools of capital and implement ALM policies with the aim of further optimising borrowing costs and help expand NIM going ahead.

Strong financial performance across cycles, navigating multiple challenging events like liquidity crisis led by ILFS failure, covid etc. without impacting profitability and track record of maintaining leverage <5x since inception, led to consistent improvement in its credit rating. Its credit rating upgraded to [ICRA] A+ (Stable) in Oct'22 from [ICRA] A (Positive) in Oct'21. Similarly, rating of CARE A+; Stable for its long-term bank facilities in Apr'23. Its ratings indicate resilient liability origination despite challenges faced by the Indian economy for varied factors.

Exhibit 49: Established borrowing relationship with industry leaders

Source: Company data, I-Sec research

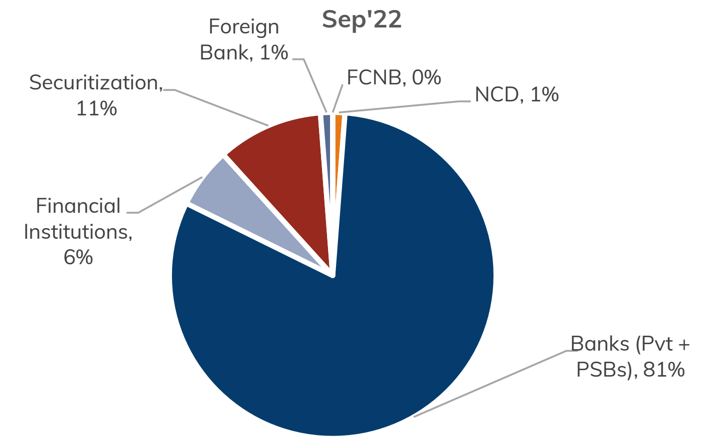
Exhibit 50: Positive ALM in <1 year maturity profile



Source: Company data, I-Sec research

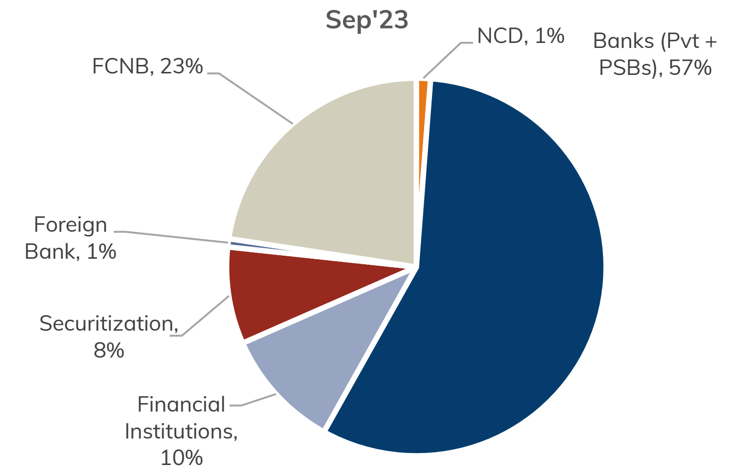
Over the past one year, SBFC has strategically reduced its dependence on bank borrowings and replaced the same with foreign borrowings and financial institutions. As of Jun'23, its total outstanding borrowings stood at INR 39bn of which ~72% is funded by banks, 10% by foreign bonds, 9% by financial institutions, 8% via securitisation and 1% each by foreign banks and NCDs.

Exhibit 51: Strategically focused on diversifying borrowing profile...



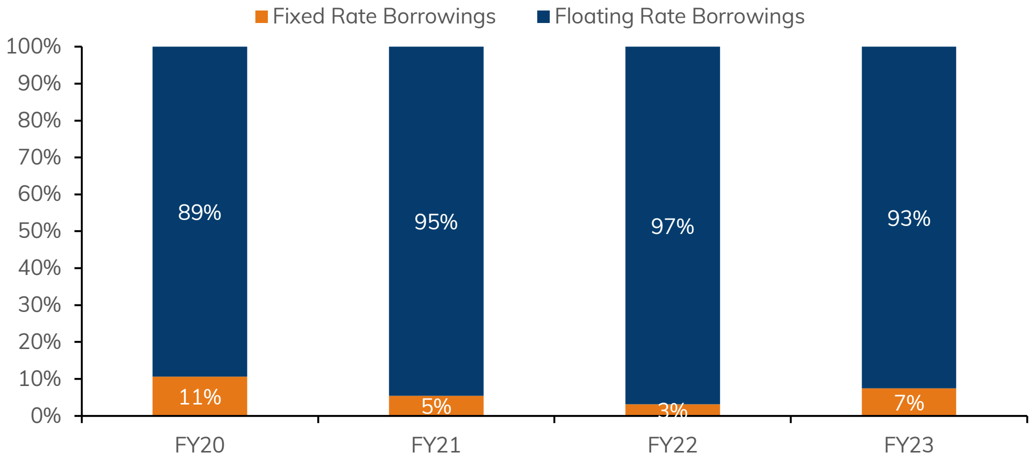
Source: Company data, I-Sec research

Exhibit 52: ...as reflected in the share of Bank borrowing falling to 72% by Jun'23 from 92% in Jun'22



Source: Company data, I-Sec research

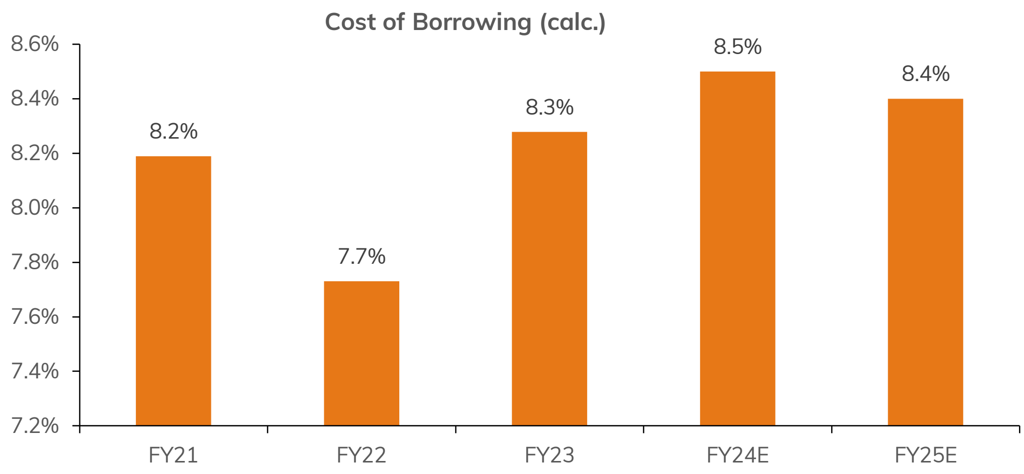
Exhibit 53: Higher share of floating rate borrowing to ensure steady cost of fund across interest rate cycles



Source: Company data, I-Sec research

Its stable credit history, credit ratings, conservative risk management policies and brand equity led to steady improvement in the cost of borrowing during the past 5 years. Its average cost of borrowing fell to 8.2% by FY23 from >12% in FY20. Further, despite >250bps of repo rate hike since Mar'21, its cost of borrowing has gone up by only 10bps by Mar'23 – CoF was 8.1% in FY21, 7.7% in FY22 and 8.2% in FY23. Given the incremental cost of borrowing was 8.8% in FY23, we expect CoF to increase by 30bps during FY24 and then moderate gradually in subsequent years. Over 90% of floating rate borrowings would ensure borrowing cost may peak out in H1FY24 and may also benefit from the declining rate cycle whenever it kick starts.

Exhibit 54: Expect CoB to peak out in FY24E and then gradually moderate in FY25E

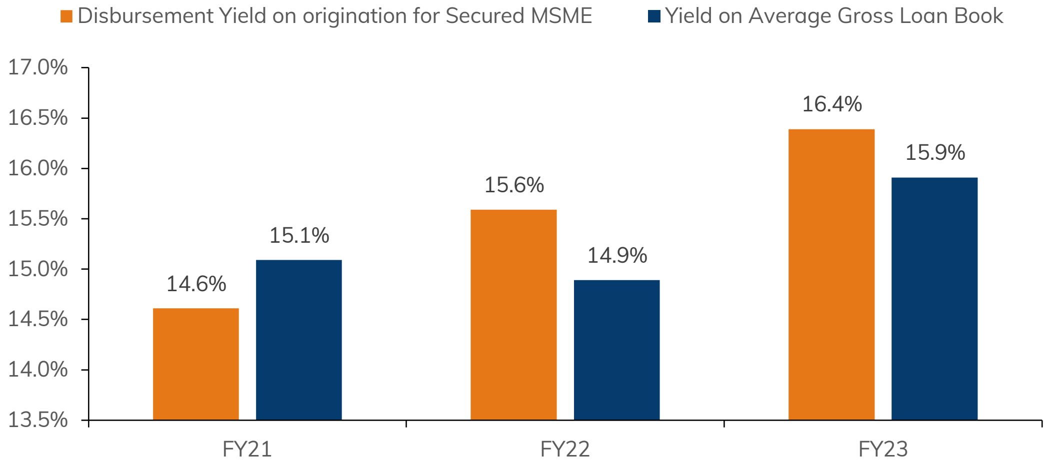


Source: Company data, I-Sec research

Fresh capital raising, >90% floating rate asset book and stable cost of fund to drive NIM expansion going ahead

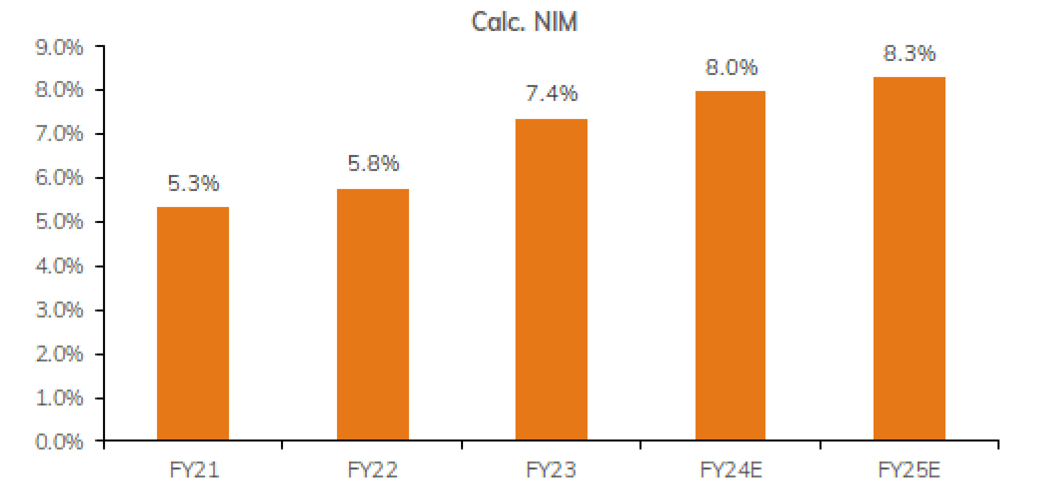
SBFC has proactively built >90% of its assets and liabilities on floating rates to ensure stable NIM across interest rate cycles. While in the near term, CoF is likely to increase, higher disbursement yield in secured MSME (>75% of total AUM) at 16.4% in FY23 vs 15.9% blended yield would partially offset spread compression. Further, capital raising of INR 7.5bn via IPO would lower borrowing / AUM ratio in the near term and the same would result in lower incremental interest expense in FY24E. Overall, we expect calculated NIM (on average assets) to expand by ~60bps over FY23-25E.

Exhibit 55: Higher disbursement yield at 16.4% vs portfolio yield of 15.9% would ensure spread sustaining at >7% in near term



Source: Company data, I-Sec research

Exhibit 56: We expect >60bps NIM expansion over the next 2 years

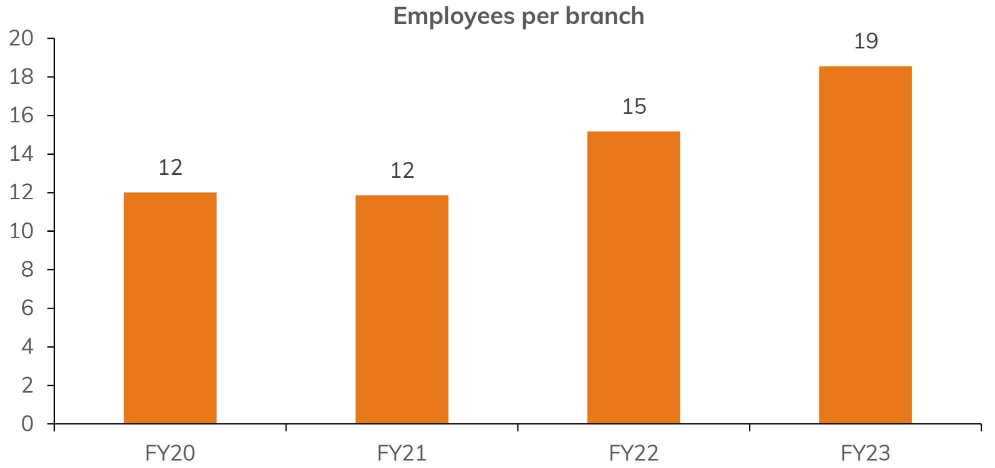


Source: Company data, I-Sec research

Improving productivity to drive operating leverage

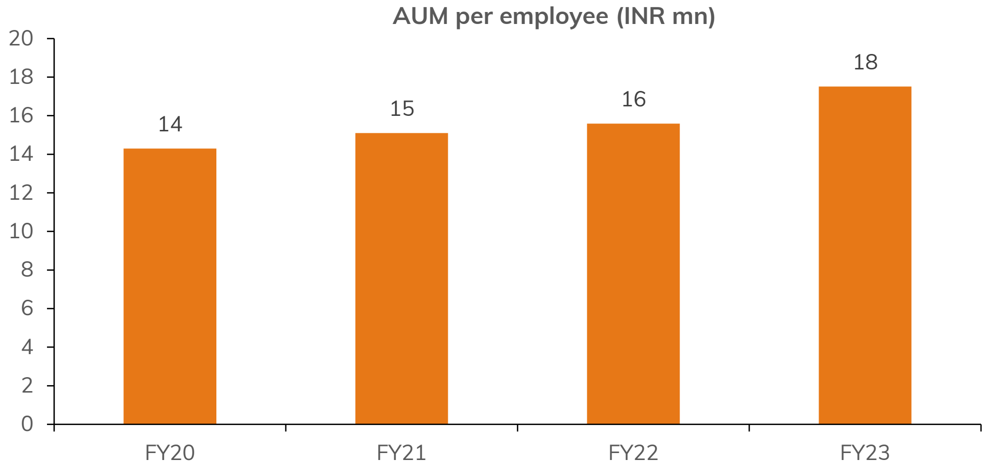
SBFC, over its 6 years of operations, has steadily invested in – a) IT systems and implemented automated, digitised technology-enabled platforms and tools, b) deploying higher sales staff at branch level to cater to wide catchment area and c) setting up pan-India presence backed by physical distribution network. Notably, total employee base grew by 35% CAGR over FY20-23 and branch network grew by 17% CAGR during the same period. Employee per branch increased to 19 by Mar'23 from 12 in FY20.

Exhibit 57: SBFC has accelerated the addition of new employees at branch level (sales) post covid



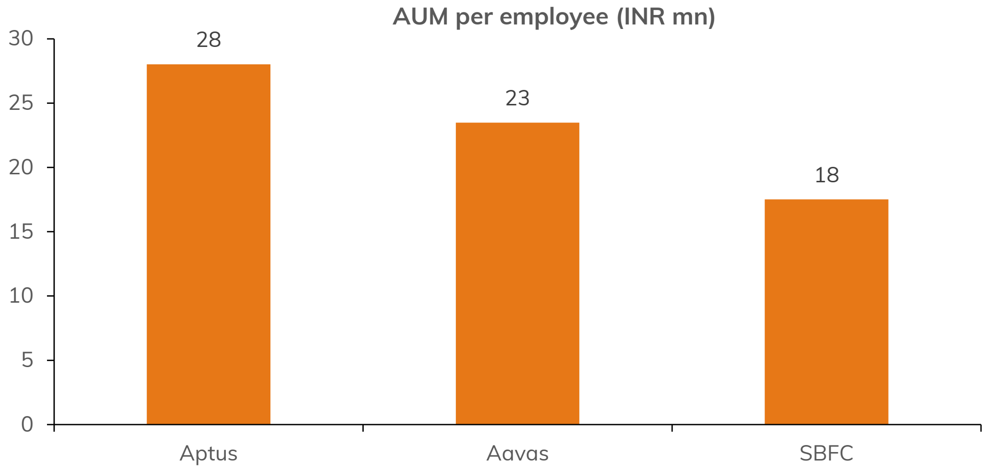
Source: Company data, I-Sec research

Exhibit 58: Steady improvement in AUM per employee…



Source: Company data, I-Sec research

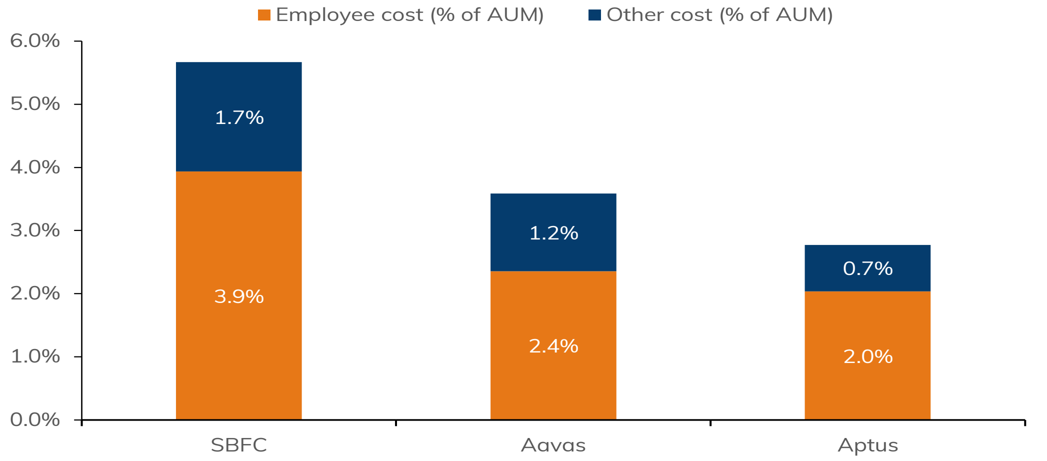
Exhibit 59: …but still scope for improvement



Source: Company data, I-Sec research

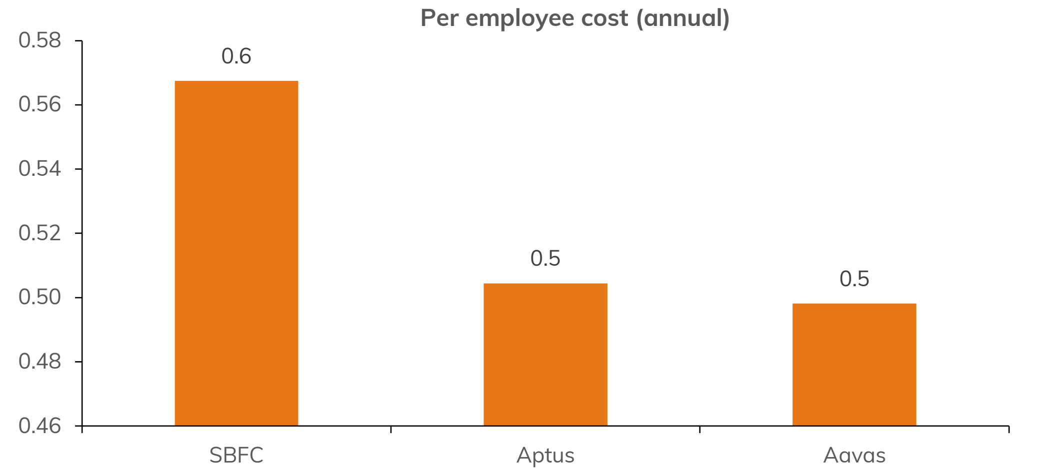
SBFC's cost ratios are higher than its closest peers largely due to higher staff cost – its employee cost as % of AUM stood at 3.9% in FY23 vs 2.4% for Aavas and 2% for Aptus. This is due to– a) lower productivity than peers as reflected in AUM per employee at INR 18mn as on Mar'23 vs INR 23mn for Aavas and INR 28mn for Aptus and b) higher payouts as reflected in annual salary per employee at INR 0.6mn vs INR 0.5mn for Aptus / Aavas.

Exhibit 60: Employee cost is higher than peers…



Source: Company data, I-Sec research

Exhibit 61: …as SBFC preferred hiring domain experts with prior experience in large NBFCs or private banks



Source: Company data, I-Sec research

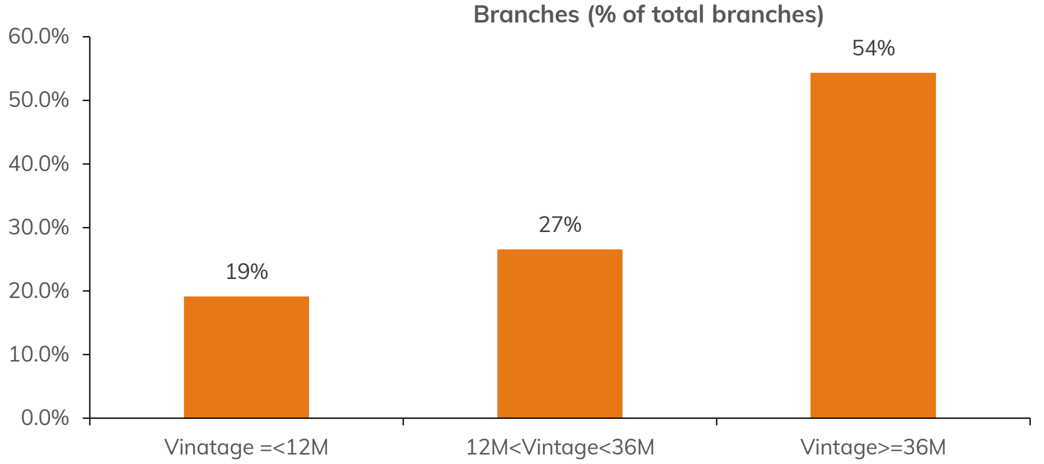
Exhibit 62: Operating expense broadly in line with peers

Other opex as %age of avg. AUM	Aavas	Aptus	SBFC
Travelling and conveyance	0.1%	0.1%	0.1%
Manpower outsourcing/manpower managemnt	0.3%		
Advertising	0.1%	0.0%	0.0%
CSR expenditure	0.1%	0.1%	0.0%
IT and analytics Expenses	0.1%	0.0%	0.2%
Communication cost/Postage & Courier charges	0.1%	0.0%	0.1%
Legal expenses	0.1%	0.1%	0.3%
Repairs and maintenance	0.0%	0.0%	0.2%
Electricity charges	0.0%	0.0%	0.0%
Collection and legal recovery expenses	0.0%		
General office expense	0.0%	0.1%	
Directors' fees and commission	0.0%	0.0%	0.0%
Printing and stationery	0.0%	0.0%	0.1%
Auditors' remuneration	0.0%	0.0%	0.0%
Rent, rates and taxes	0.0%	0.1%	0.1%
Other expenses	0.1%	0.0%	0.4%

Source: Company data, I-Sec research

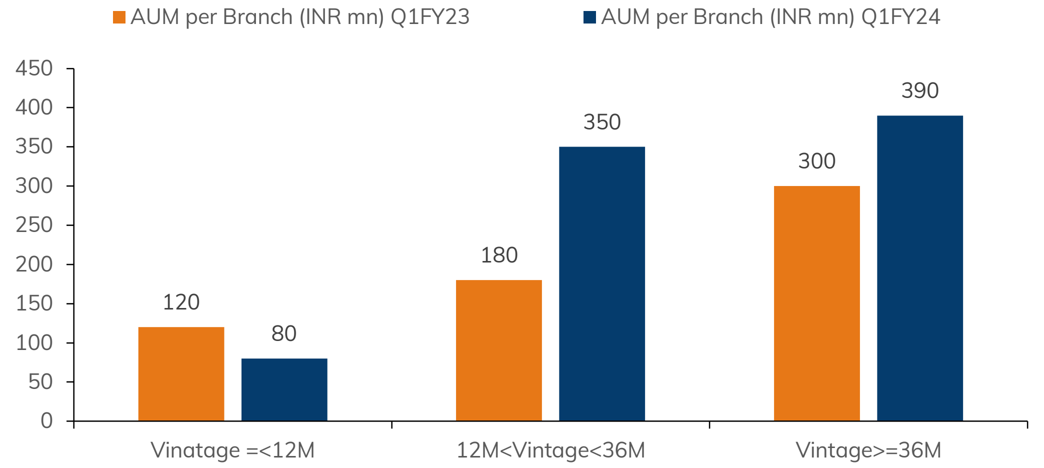
While its cost ratios are higher than peers, the same was largely due to business build-cost since its inception in FY17, >40% of branches with vintage <3 years augur well for continuous improvement in productivity going ahead. Secondly, its AUM build-up as per branch vintage shows branch after crossing 12 months may witness very strong business traction as reflected in branches with >12 months' vintage having AUM outstanding at >INR 30mn vs INR 8mn for branches with <12 months vintage.

Exhibit 63: With >40% of branches having vintage of <3 years, operating leverage is likely to kick in…



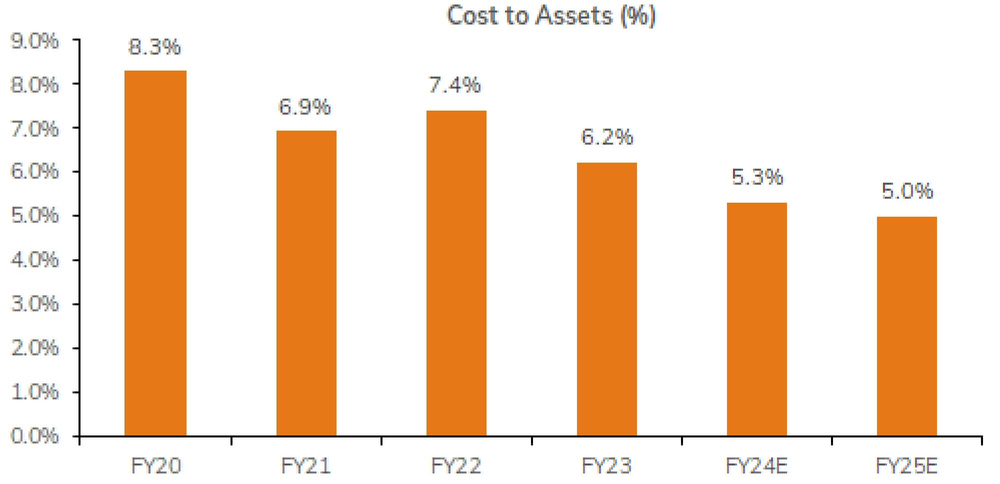
Source: Company data, I-Sec research

Exhibit 64: …given AUM per branch for <12M vintage branches is likely to improve going forward



Source: Company data, I-Sec research

Exhibit 65: Operational efficiency to drive steady improvement in cost ratios in near term

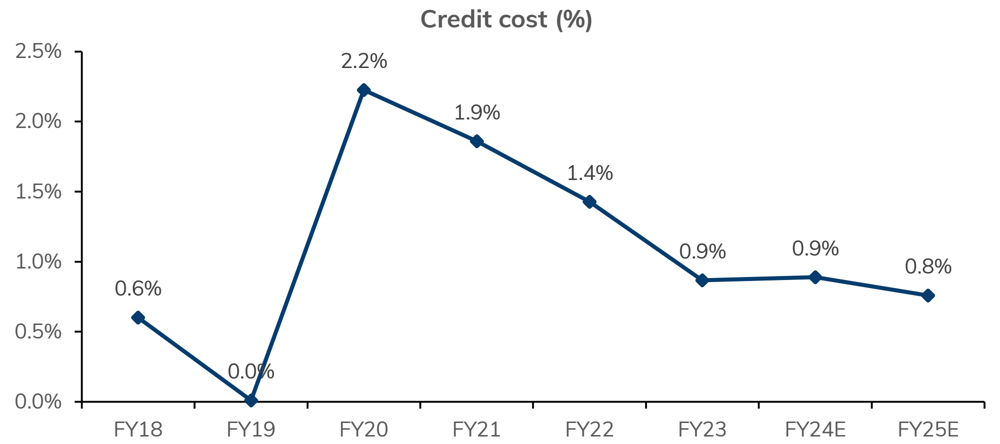


Source: Company data, I-Sec research

Credit cost to remain <100bps over FY23-25E

Average credit cost at 60bps between FY18-23, with peak credit cost at 100bps in FY20, speaks for its asset quality performance across cycles. Focus on on-boarding quality customers, stringent risk management based on customer segmentation and rigorous collection mechanism have helped SBFC in managing asset quality better than peers even during covid phase. Further, ~17% of gold loan business helps in keeping credit losses minimal at total portfolio level. Cumulative write-offs between FY20-23 at 2% of AUM is a testimony to its quality underwriting and strong credit monitoring.

Exhibit 66: Credit cost to stabilise at 90-100bps in near term

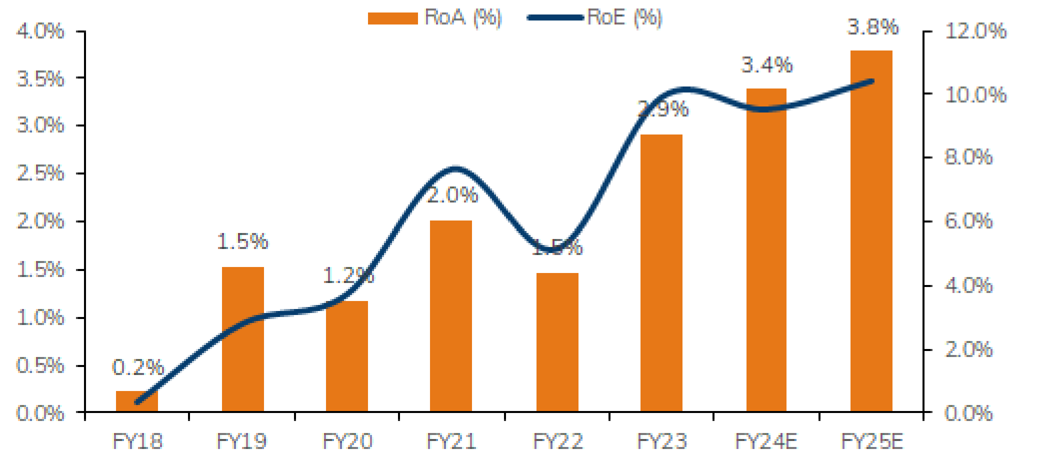


Source: Company data, I-Sec research

RoA is likely to remain at >3% during FY24-25E; however, fresh capital raising would keep RoE >10% in FY25E

SBFC is likely to witness steady improvement in RoA trajectory over FY23-25E led by NIM expansion, gradual moderation in cost ratios and contained credit cost. Higher disbursement yields at 16.4% in secured MSME (>70% of AUM) vs blended yield at 15.9% coupled with marginal increase in cost of funds would ensure spread improvement in the near term. Further, steady improvement in productivity and tech-enabled loan processes should drive operating leverage over FY23-25E. Overall, we expect RoA to improve to 3.4% by FY25E from 2.9% in FY23. However, fresh capital infusion of INR 7.5bn via IPO is resulting in a drop in leverage in the near term. Further, strong internal accruals and its calibrated growth strategy would likely result in gradual capital consumption.

Exhibit 67: Steady NIM, credit cost and operating leverage to drive profitability



Source: Company data, I-Sec research

Key Risks

- The company depend on the accuracy and completeness of information provided by its customers and certain third party service providers and its reliance on any erroneous or misleading information may affect company's judgement of its creditworthiness, as well as the value of and title to the collateral.
- The quality of its portfolio may be impacted due to higher levels of NPAs and its business may be adversely affected if the company is unable to provide for such higher levels of NPAs.
- SBFC's inability to assess and recover the full value of collateral, or amounts outstanding under defaulted loans in a timely manner, or at all, could adversely affect its business, results of operations and financial condition.
- Company's business is particularly vulnerable to interest rate risk, and volatility in interest rates for both lending and treasury operations, could have an adverse effect on its net interest income and net interest margin.

Key Management Personnel

Name	Designation	Profile
Aseem Dhru	Managing Director and Chief Executive Officer	Mr Aseem holds holds a bachelor's degree in commerce from Gujarat University. He is a member of the Institute of Chartered Accountants of India and has been certified by the Institute of Cost and Works Accountants of India. He has over 25 years of experience in the banking industry and has been associated with our Company since September 28, 2017. Prior to joining our Company, he was associated with HDFC Bank Limited as a group head – business banking working capital & retail agri business, HDFC Securities Limited as managing director and chief executive officer and was a director on the board of HDB Financial Services Limited.
Narayan Barasia	Chief Financial Officer	Mr Barasia joined the Company on October 24, 2018. In his current role, he is responsible for financial management, accounts, tax, treasury, secretarial and legal matters. He holds a bachelor's in commerce from the University of Calcutta, is an associate of the Institute of Chartered Accountants of India, is a member of the Institute of Company Secretaries of India and has successfully completed the Chartered Financial Analysts Program. He has more than two decades of experience, and has worked at Godrej Foods Limited, Godrej Sara Lee Limited, and subsequently worked with Olam Agro India Limited. Prior to joining the Company, he was working with Greaves Cotton Limited, where he was the president auxiliary power business & industrial, engineering business. He received a compensation of Rs 30.58 million in Fiscal 2022.
Mahesh Dayani	Chief Business Officer	Mr Dayani is chief business officer of the Company. He joined the Company on November 1, 2017. In his current role, he is responsible for developing the Company's distribution, products, marketing & delivering profitable growth. He holds a bachelors' in commerce from the University of Calcutta and a post graduate diploma in business administration from ICFAI Business School, Hyderabad and is also an associate member of the Indian Institute of Bankers. He has over 22 years of experience across wholesale and retail banking, and has worked at ICICI Bank Limited and HDFC Bank Limited. Prior to joining the Company, he was working with Kotak Mahindra Bank, where he was the senior executive vice president.
Pankaj Poddar	Chief Risk Officer	Mr Poddar is chief risk officer of the Company. He joined the Company on November 20, 2017. In his current role, he is involved in identification, measurement and mitigation of risks for the company including credit risk, operating risks, liquidity risk, market risk. He has managed the role of credit and risk management which included credit policy formulation, credit underwriting, fraud control, collateral management, portfolio management along with managing other operating risks for the Company. He holds a bachelor's in commerce from the Maharshi Dayanand Saraswati University, Ajmer and is an associate member of the Institute of Chartered Accountants of India wherein he achieved an 'all India rank 36' in the final examination conducted by ICAI. He has over 19 years of experience in the financial services sector where he has handled various leadership roles in the retail and SME space. He started his career with Kotak Mahindra Bank, and subsequently worked with Standard Chartered Bank. Prior to joining the Company, he was working with Bajaj Finance Limited, where he was the chief risk officer-small & medium enterprises.
Saiprashant Menon	Chief Collection Officer	Mr Menon is chief collection officer of the Company. He joined the Company on May 29, 2020. In his current role, he is responsible for creating and implementing collection & legal strategies so as to maximize collections whilst protecting customer relationship. He holds a bachelor's in commerce from the University of Mumbai. He has more than 21 years of experience in collections. He started his career with Standard Chartered Bank, and subsequently worked with Citi Financial Consumer Finance Limited, Royal Bank of Scotland and Fullerton India Credit Company Limited. Prior to joining the Company, he was working 33with Bajaj Housing Finance Limited, where he was the national head - collections.
Mr Sanket Agrawal	Chief Strategy Officer	Mr Agrawal is the Chief Strategy Officer and Investor Relations Officer of our Company. Sanket, in his current role, is responsible for developing and executing strategies by collaborating with the CEO, Senior Leadership and the Board of Directors of SBFC. Sanket will facilitate and enable automation and transformation of processes in the Company. He will assist the functions in monitoring and executing the Projects and benchmark best practices to bring operational efficiencies. His role includes providing objective assurance, advice and anticipative value-added support to functions. Sanket will also develop and Lead the Investor Relations function in SBFC. He holds a bachelor's in commerce from the G.S. College of Commerce & Economics and is an associate of the Institute of Chartered Accountants of India. He started his career with Deloitte Haskins & Sells LLP where he has audited and advised large multinational corporations in India and abroad.
VM Maneesh	Chief Operations Officer	Mr Maneesh is chief operations officer of the Company. He joined the Company on March 21, 2022. In his current role, he is responsible for managing critical systems and processes which underpin the Company's pan-India operations. He holds a bachelor's in commerce from the University of Mumbai and a master's degree in financial management from the University of Mumbai. He has over 19 years of financial services experience in credit, risk and operations. He started his career with ICICI Bank, and subsequently worked with HDFC Bank Limited and HSBC Bank Limited. Prior to joining the Company, he was working with Bajaj Finance Limited.
Sumeet Ghai	Chief Human Resource Officer	Mr Ghai is chief human resource officer of the Company. He joined the Company on February 4, 2022. In his current role, he is responsible for managing human resource dynamics through creation and adoption of a strategic plan that is in alignment with the business strategy of the Company. He holds a diploma in hotel management & catering technology from the National Council for Hotel Management and Catering Technology, New Delhi and a post graduate diploma in business administration with a specialization in human resource management. He has over 15 years of experience in human resource management. Prior to joining the Company, he started his career with the Taj Group of Hotels, and subsequently worked with Mahindra Holidays and Resorts India Limited as the general manager - human resources.
Viney Vaid	Head - Credit	Mr Vaid is the Head - Credit of SBFC. He joined the Company on December 18, 2017. He holds a bachelor's in commerce and a master's in financial management from the Kurukshetra University. He has worked at Reliance Home

		Finance Private Limited and Bajaj Finance Limited. Prior to joining the Company, he was working with HDB Financial Services Limited, where he was zonal manager - mortgage.
Mr Ganesh Vaidya	Chief Technology Officer	Mr Vaidya is the Chief Technology Officer of our Company. He holds a Master's degree in Software Development & Management from Symbiosis University. In his Current role he is responsible for & not limited to developing technical aspects of the company's strategy to ensure alignment with its business goals. Discover and implement new technologies yielding competitive advantage, also responsible for Supervising system infrastructure to ensure functionality and efficiency, Build quality assurance and data protection processes. He has over 15 years of experience in the banking industry and has been associated with our Company since May 7, 2018. Prior to joining SBFC, he was associated with Kotak Mahindra Bank as a AVP-IT, HDFC Bank as Senior Manager- IT where he was responsible to implement new initiatives around BI and regulatory requirements.

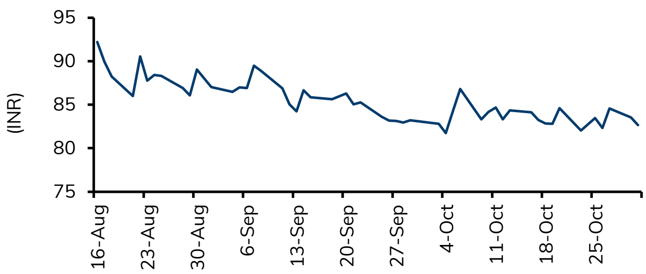
Source: Company data

Exhibit 68: Shareholding pattern

%	Aug'23	Sep'23
Promoters	64.0	64.1
Institutional investors	10.0	15.2
MFs and others	3.9	10.8
FIs/Banks	1.3	0.0
Insurance	0.8	0.8
FIIs	4.0	3.6
Others	26.0	20.7

Source: Bloomberg

Exhibit 69: Price chart



Source: Bloomberg

Financial Summary

Exhibit 70: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Interest Income	4,731	6,542	8,478	11,167
Net gain on fair value changes	157	120	94	75
Interest Expenses	(2,206)	(2,765)	(3,313)	(4,236)
Net Interest Income (NII)	**2,525**	**3,777**	**5,164**	**6,931**
Other Income	418	742	917	1,266
Total Income (net of interest expenses)	**3,101**	**4,639**	**6,175**	**8,272**
Employee benefit expenses	(1,095)	(1,601)	(1,845)	(2,283)
Depreciation and amortization	(118)	(127)	(140)	(156)
Fee and commission expenses	-	-	-	-
Other operating expenses	(660)	(577)	(778)	(1,051)
Total Operating Expense	**(1,873)**	**(2,305)**	**(2,763)**	**(3,490)**
Pre Provisioning Profits (PPoP)	**1,228**	**2,334**	**3,412**	**4,782**
Provisions and write offs	(361)	(321)	(462)	(530)
Profit before tax (PBT)	**867**	**2,014**	**2,950**	**4,252**
Total tax expenses	(222)	(516)	(756)	(1,090)
Profit after tax (PAT)	**645**	**1,497**	**2,194**	**3,162**

Source Company data, I-Sec research

Exhibit 71: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Share capital	8,068	8,896	10,642	10,642
Reserves & surplus	4,804	8,377	18,071	21,232
Shareholders' funds	**12,872**	**17,273**	**28,713**	**31,874**
Borrowings	29,399	37,391	40,572	60,281
Provisions & Other Liabilities	2,685	2,675	2,539	2,541
Deferred tax liabilities (net)	195	126	132	139
Total Liabilities and Stakeholder's Equity	**45,150**	**57,464**	**71,956**	**94,835**
Cash and balance with RBI	3,353	4,004	6,738	9,089
Fixed assets	357	337	353	371
Loans	**29,824**	**44,153**	**59,936**	**80,846**
Investments	8,481	6,066	1,879	1,327
Other Assets	3,135	2,904	3,050	3,202
Total Assets	**45,150**	**57,464**	**71,956**	**94,835**

Source Company data, I-Sec research

Exhibit 72: Key Ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
AUM and Disbursements (INR mn)				
AUM	31,922	49,428	67,274	90,977
On-book Loans	29,824	44,153	59,936	80,846
Off-book Loans	2,098	5,275	7,338	10,131
Disbursements	25,709	36,313	44,865	57,329
Growth (%):				
Total AUM (%)	43.7	54.8	36.1	35.2
Disbursements (%)	71.1	41.2	23.6	27.8
Loan book (on balance sheet) (%)	44.1	48.0	35.7	34.9
Total Assets (%)	6.7	27.3	25.2	31.8
Net Interest Income (NII) (%)	12.4	49.6	36.7	34.2
Non-interest income (%)	18.5	77.5	23.5	38.1
Total Income (net of interest expenses) (%)	15.2	49.6	33.1	34.0
Operating Expenses (%)	49.4	23.1	19.9	26.3
Employee Cost (%)	30.1	46.2	15.2	23.7
Non-Employee Cost (%)	108.5	(12.6)	35.0	35.0
Pre provisioning operating profits (PPoP) (%)	(14.6)	90.1	46.2	40.2
Provisions (%)	7.3	(11.2)	44.0	14.9
PBT (%)	(21.3)	132.3	46.5	44.1
PAT (%)	(20.4)	132.1	46.5	44.1
EPS (%)	(21.9)	111.0	20.8	44.1
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	8.5	8.6	8.6	8.6
NIM on IEA (%)	8.3	8.5	8.1	8.0
NIM on AUM (%)	9.3	9.3	8.9	8.8
Yield on loan assets (%)	15.9	14.8	14.1	13.8
Yield on IEA (%)	15.5	14.7	13.3	12.8
Yield on AUM (%)	17.5	16.1	14.5	14.1
Cost of borrowings (%)	7.7	8.3	8.5	8.4
Interest Spreads (%)	11.0	9.4	7.8	7.5
Operating efficiencies				
Non interest income as % of total income	47.6	51.0	54.4	55.4
Cost to income ratio	60.4	49.7	44.7	42.2
Op.costs/avg assets (%)	4.3	4.5	4.3	4.2
Op.costs/avg AUM (%)	6.9	5.7	4.7	4.4
No of employees (estimate) (x)	2,048	2,822	3,011	3,617
No of branches (x)	135	152	-	-
Salaries as % of non-interest costs (%)	58.5	69.5	66.8	65.4
NII /employee (INR mn)	1.2	1.3	1.7	1.9
AUM/employee(INR mn)	15.6	17.5	22.3	25.2
AUM/ branch (INR mn)	236.5	325.2	-	-
Capital Structure				
Average gearing ratio (x)	2.3	2.2	1.4	1.9
Leverage (x)	3.5	3.3	2.5	3.0
CAR (%)	26.2	31.9	45.2	38.3
Tier 1 CAR (%)	25.9	31.7	45.1	38.2
Tier 2 CAR (%)	0.3	0.2	0.1	0.1
RWA (estimate) - INR mn	38,087	44,300	57,565	75,868
RWA as a % of loan assets	127.7	100.3	96.0	93.8

Source Company data, I-Sec research

	FY22A	FY23A	FY24E	FY25E
Asset quality and provisioning				
GNPA (%)	2.8	2.4	2.5	2.5
NNPA (%)	1.7	1.4	1.5	1.5
GNPA (INR mn)	829	1,082	1,480	2,001
NNPA (INR mn)	494	627	875	1,183
Coverage ratio (%)	40.4	42.0	40.9	40.9
Credit Costs as a % of avg AUM (bps)	133	79	79	67
Credit Costs as a % of avg on book loans (bps)	143	87	89	75
Return ratios				
RoAA (%)	1.5	2.9	3.4	3.8
RoAE (%)	5.2	9.9	9.5	10.4
ROAAUM (%)	2.4	3.7	3.8	4.0
Valuation Ratios				
No of shares	798	878	1,064	1,064
No of shares (fully diluted)	816	926	1,064	1,064
ESOP Outstanding	-	-	-	-
EPS (INR)	0.8	1.7	2.1	3.0
EPS fully diluted (INR)	0.8	1.6	2.1	3.0
Price to Earnings (x)	101.2	48.0	39.7	27.6
Price to Earnings (fully diluted) (x)	103.6	50.6	39.7	27.6
Book Value (fully diluted)	16	19	27	30
Adjusted book value	15	18	26	29
Price to Book	5.2	4.4	3.0	2.7
Price to Adjusted Book	5.3	4.5	3.1	2.8

Source Company data, I-Sec research

Exhibit 73: Key Metrics

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
DuPont Analysis				
Average Assets (INR mn)	43,731	51,307	64,710	83,395
Average Loans (INR mn)	25,263	36,989	52,044	70,391
Average Equity (INR mn)	12,461	15,072	22,993	30,294
Interest earned (%)	10.8	12.7	13.1	13.4
Net gain on fair value changes (%)	0.4	0.2	0.1	0.1
Interest expended (%)	5.0	5.4	5.1	5.1
Gross Interest Spread (%)	**5.8**	**7.4**	**8.0**	**8.3**
Credit cost (%)	0.8	0.6	0.7	0.6
Net Interest Spread (%)	**4.9**	**6.7**	**7.3**	**7.7**
Operating cost (%)	4.3	4.5	4.3	4.2
Lending spread (%)	**0.7**	**2.2**	**3.0**	**3.5**
Non interest income (%)	1.0	1.4	1.4	1.5
Operating Spread (%)	**1.6**	**3.7**	**4.4**	**5.0**
Tax rate (%)	25.6	25.6	25.6	25.6
ROAA (%)	**1.5**	**2.9**	**3.4**	**3.8**
Effective leverage (AA/ AE)	3.5	3.4	2.8	2.8
RoAE (%)	**5.2**	**9.9**	**9.5**	**10.4**

Source Company data, I-Sec research

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