BUY (Maintained)

CMP: INR 49 Target Price: INR 70 ▲ 43%

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06 August 2024

India | Equity Research | Q1FY25 results review

Utkarsh Small Finance Bank

Financials

Core operating performance remains robust, PPoP up 10% QoQ; elevated credit cost dents profitability in Q1FY25

Utkarsh SFB's (Utkarsh) Q1FY25 core operating performance continued to be robust as reflected in 10% QoQ PPoP growth and RoE sustaining at >18% despite challenges due to heatwaves and election. While asset quality parameters deteriorated sequentially as reflected in SMA 1 & 2 increasing to 2.6% vs 1.9% QoQ, collection in MFI falling to 96% vs 98% QoQ and elevated slippage ratio at ~4% during Q1FY25, management sounded confident of achieving FY25 credit cost guidance of ~2% vs 2.7% in Q1FY25. It has implemented new guardrails announced by MFIN and does not foresee any material impact on its FY25 credit growth guidance of 30%. We continue to prefer Utkarsh within SFB space considering its balanced growth approach and sharp focus on asset quality, even while growing balance sheet and profitability. Maintain **BUY** with an unchanged TP of INR 70, valuing the stock at 2x Sep'25E BVPS.

Retail asset scale-up progressing well

In line with its stated strategy of improving retail asset share by 3-4% every year, the share of non-MFI book increased to 39% in Q1FY25 from 37% in Q1FY24. MSME contributes 15%, housing 4% and CV / CE 5% as on Jun'24. MSME / housing / CV-CE each grew 6-7% QoQ during Q1FY25. Notably, disbursement yields in all three products improved by 20-70bps QoQ during Q1FY25, reflecting its focus on profitable growth rather than just volume growth. Notably, it offers MSME at 86 branches, housing at 56 and CV/CE at 43 of total 280 general bank branches as on Jun'24.

RoA remained robust at >2% despite elevated credit cost

Utkarsh SFB's PPoP grew strong 10% QoQ to INR 3.1bn driven by robust 6% QoQ growth in NII and controlled opex (down 3% QoQ). While credit growth remained muted at 3% QoQ and NIM contracted 50bps QoQ to 9.4%, strong credit growth in H2FY24 supported top line in Q1FY25. Management highlighted that of 40bps NIM contraction, ~20bps was due to excess liquidity on balance sheet. Asset yields contracted marginally by 10bps QoQ to 19.4% and cost of fund remained flat QoQ at 8%. Strong revenue growth led to sharp 300bps improvement in cost-income ratio to 54% vs 57% QoQ. Credit cost increased to 2.7%, adjusted for floating provision of INR 0.2bn, the same stood at 2.2% vs 1.7% QoQ. Lower collection in MFI at 96% vs 98% QoQ led to gross slippages increasing to ~4% vs 2.3% QoQ and the same impacted asset quality.

Financial Summary

Y/E March	FY23A	FY24A	FY25E	FY26E
NII (INR bn)	15.3	18.9	23.1	28.3
Op. profit (INR bn)	8.4	10.0	12.2	15.1
Net Profit (INR bn)	4.0	5.0	6.1	7.6
EPS (INR)	4.5	4.5	5.5	6.9
EPS % change YoY	560.8	0.2	21.7	25.4
P/E (x)	10.6	10.6	8.7	7.0
P/BV (x)	2.1	1.8	1.5	1.2
GNPA (%)	3.2	2.5	2.0	1.9
RoA (%)	2.4	2.3	2.2	2.2
RoE (%)	22.6	20.0	18.5	19.2

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Market Data

Market Cap (INR)	54bn
Market Cap (USD)	638mn
Bloomberg Code	UTKARSHB IN Equity
Reuters Code	UTKR.BO
52-week Range (INR)	68 /45
Free Float (%)	23.0
ADTV-3M (mn) (USD)	1.8

Price Performance (%)	3m	6m	12m
Absolute	(12.8)	(19.0)	(4.0)
Relative to Sensex	(19.4)	(28.7)	(23.9)

Previous Reports

27-04-2024: Q4FY24 results review
11-04-2024: Company update

Credit cost increased to 2.7% during Q1FY25, but management sounded confident of maintaining at 2% in FY25

Lower collection in microfinance at 96% vs 98%, though on expected lines due to seasonality and operational challenges owing to general election and heatwaves, led to gross slippages increasing to INR 1.8bn vs INR0.9bn QoQ during Q1FY25. Of total slippages, MFI segment contributed INR 1.25bn and balance was flown from retail assets in Q1. Recovery also remained lower at INR 180mn vs INR 490mn QoQ during Q1FY25. As a result, GNPL ratio increased to 2.8% vs 2.5% QoQ while NNPL remained at 0.3%. PCR stood at 91%, one of the highest within SFB space.

Early bucket delinquencies, too, remained elevated as reflected in SMA 1 & 2 increasing to 2.6% vs 1.9% QoQ. SMA 0 / 1/ 2/ in MFI segment increased to 1.8% / 1.2% / 1.2% vs 0.5% / 0.5% / 1.1% QoQ, respectively. Management highlighted that stress seen in Jharkhand, Odisha, UP, Rajasthan, Haryana and its nearby locations continue. This was largely due to general elections, migration due to heatwaves and floods. Hence, it believes stress is transitory in nature and Q2FY25 onwards CE in MFI should improve. Therefore, despite higher credit cost at 2.7% in Q1FY25, it maintains its credit cost guidance of 2% for FY25.

Credit growth aimed at 30% in FY25, but deposit growth will be higher leading to dip in LDR

In line with its stated strategy of improving non-MFI asset share by 3-4% every year, the share of non-MFI book increased to 39% in Q1FY25 from 37% in Q1FY24. More importantly, disbursement yields in non-MFI products improved by 20-70bps QoQ during Q1FY25 but dipped by ~10bp in MFI portfolio, reflecting its focus on profitable volume growth rather than just volume growth. For the quarter, QoQ AUM growth was relatively weak at 3% (though healthy at 31% YoY) on account of operational limitations due to general elections and heatwave.

Utkarsh has implemented new guardrails announced by MFIN and does not foresee any material impact on its full year FY25 credit growth guidance of 30%. Overall, management expects ~20% loan growth in micro banking (15% in JLG and higher growth from individual lending) and ~50% in non-micro banking business in FY25, primarily due to lower base and opening up of non-MFI products in its branches. As a result, its overall growth guidance of 30% remains intact. In the next three years, Utkarsh envisages 45:55 secured:unsecured mix, with MFI contributing ~50% of overall portfolio.

On the deposits front, Utkarsh saw continued healthy traction in retail TD acquisition with retail TD growth of 48% YoY. It is looking to strengthen liability franchise by continuing to focus on CASA and retail deposit base. The bank continued to build its retail deposit franchise with CASA plus retail term deposits growing at 6% QoQ and 43% YoY in Q1FY25. As a result, retail term deposits + CASA of the bank further increased to 67% in Jun'24 vs 62% YoY, with CASA being stable YoY at 19%. LDR for Utkarsh stood at 92.7% vs. 93.7% QoQ and 96.7% YoY. Overall, management continues to guide for deposit growth higher than loan growth, which should lead to a decline in LDR as well.

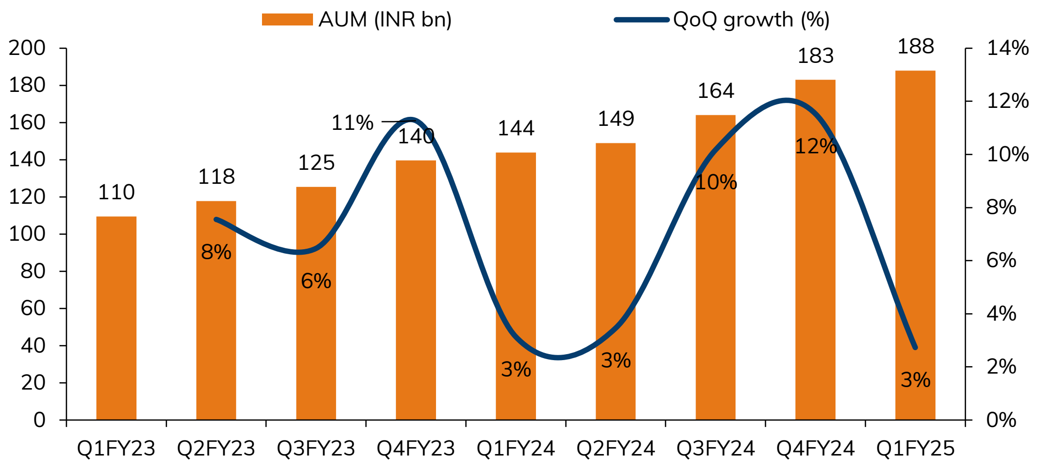
Key risks: 1) Sharp margin deterioration due to stiff competition in secured lending; and 2) higher than expected credit cost.

Exhibit 1: Q1FY25 result review

(INR mn)	Q1FY25	Q1FY24	% change YoY	Q4FY24	% change QoQ
Interest Income	9,659	8,956	7.8	7,205	34.1
Interest Expended	3,928	3,557	10.4	2,985	31.6
Net interest income (NII)	5,731	5,399	6.1	4,220	35.8
Other income	1,046	1,207	-13.3	919	13.9
Total income	6,778	6,606	2.6	5,139	31.9
Operating expenses	**3,665**	**3,784**	**-3.1**	**2,927**	**25.2**
-Staff expenses	2,052	2,104	-2.5	1,703	20.5
-Other expenses	1,613	1,680	-4.0	1,224	31.7
Operating profit	3,112	2,822	10.3	2,212	40.7
Total provisions	1,250	739	69.3	767	63.1
Profit before tax	1,862	2,083	-10.6	1,446	28.8
Tax	488	487	0.3	371	31.8
Profit after tax	1,374	1,597	-14.0	1,075	27.8
Balance sheet (INR mn)					
Deposits	1,81,630	1,74,730	3.9	1,39,670	30.0
Advances	1,68,340	1,63,650	2.9	1,35,130	24.6
Gross NPL (INR mn)	4,756	4,176	13.9	4,310	10.4
Gross NPL (%)	3	3	27	3.1	(32)
Net NPL (INR mn)	428	45	854.1	440	-2.7
Net NPL (%)	0.26	0.03	23	0.3	(4)
Coverage ratio	90.6	98.8	(816)	90.3	32
Ratios (%)					
Profitability ratios					
Yield on Advances	19.4	19.5	(10)	18.8	60
Cost of Funds	8.0	8.0	-	7.6	40
NIM	**9.4**	**9.9**	**(50)**	**9.2**	**20**
RoaA	2.3	2.9	(60)	2.3	-
RoaE	18.1	22.3	(420)	21.1	(300)
Business & Other Ratios					
CASA ratio	19.0	20.0	(100)	19.0	-
Cost-income ratio	54.1	57.3	(320)	57.0	(290)
CAR	23.2	22.6	62	19.8	335

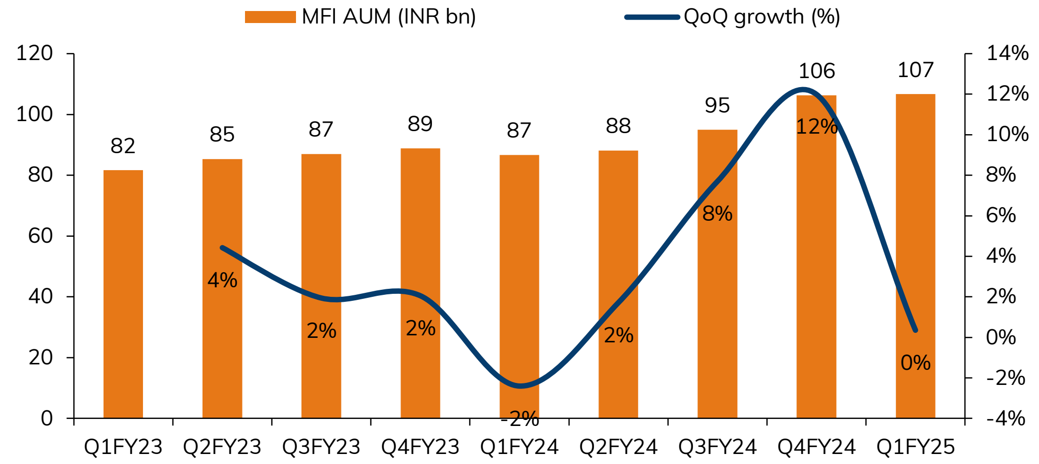
Source: Company data, I-Sec research

Exhibit 2: AUM growth moderated due to heatwaves and general elections



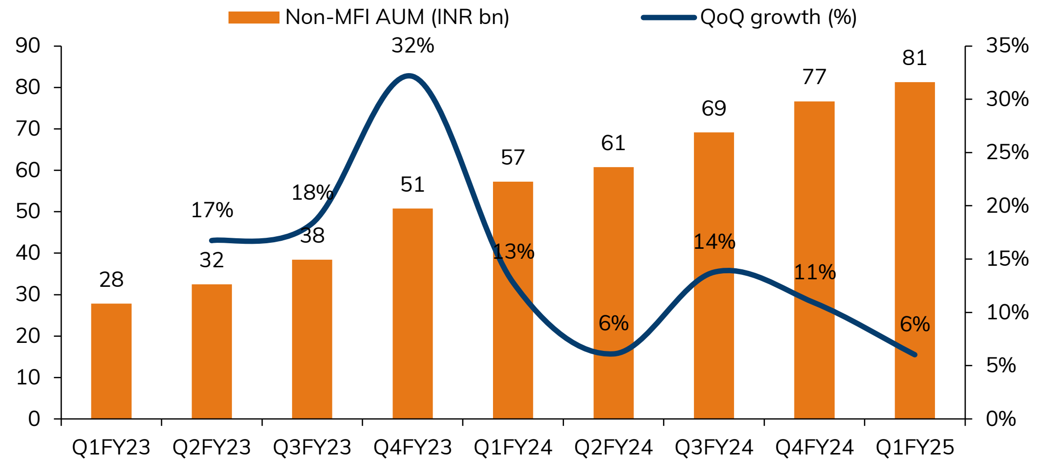
Source: Company data, I-Sec research

Exhibit 3: MFI book was flat QoQ…



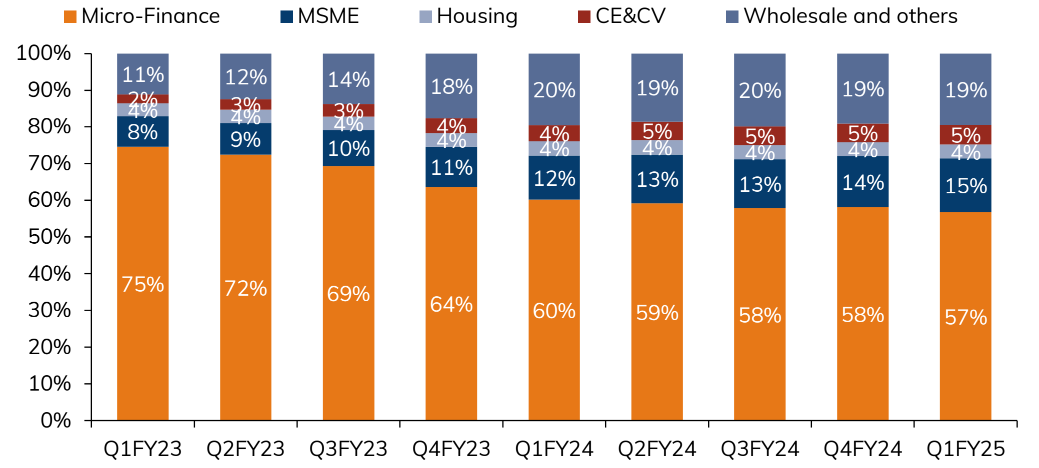
Source: Company data, I-Sec research

Exhibit 4: …while growth was largely driven by non-MFI book



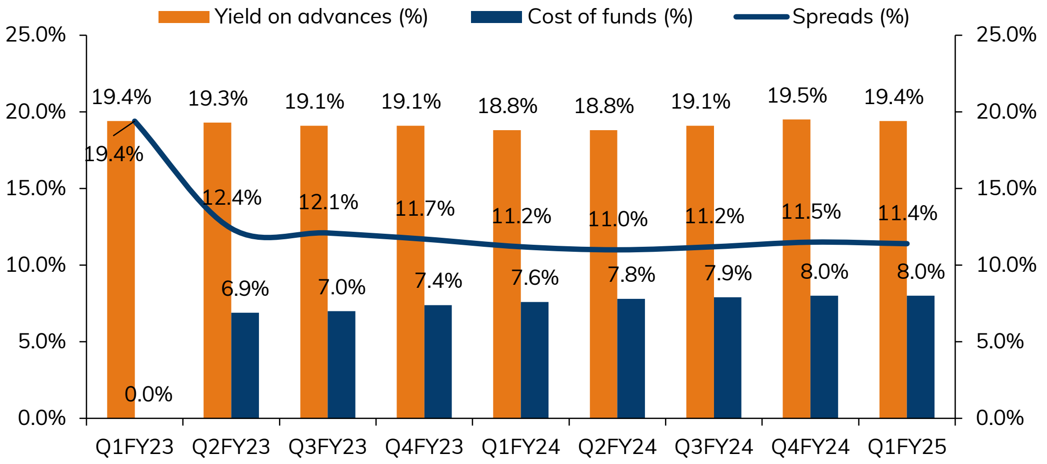
Source: Company data, I-Sec research

Exhibit 5: Share of MFI fell to 57% vs 60% YoY



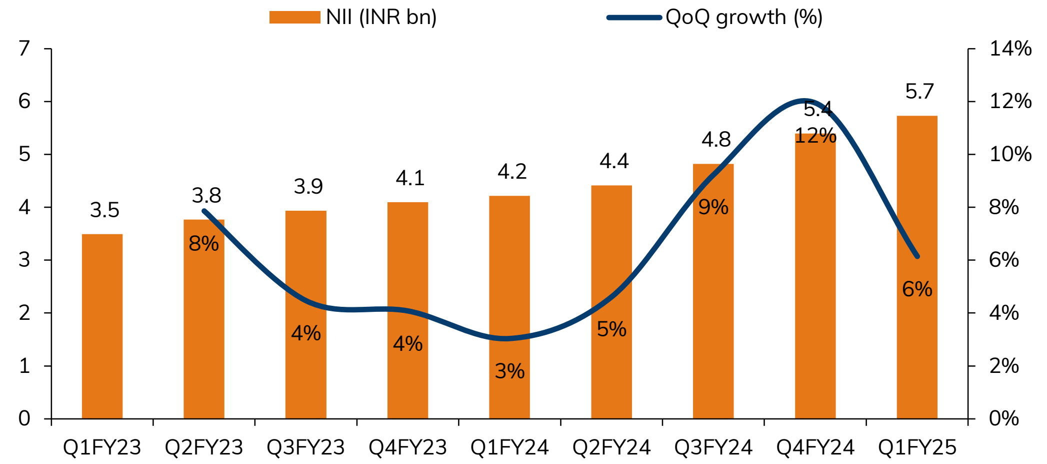
Source: Company data, I-Sec research

Exhibit 6: Spreads flat QoQ, but higher YoY



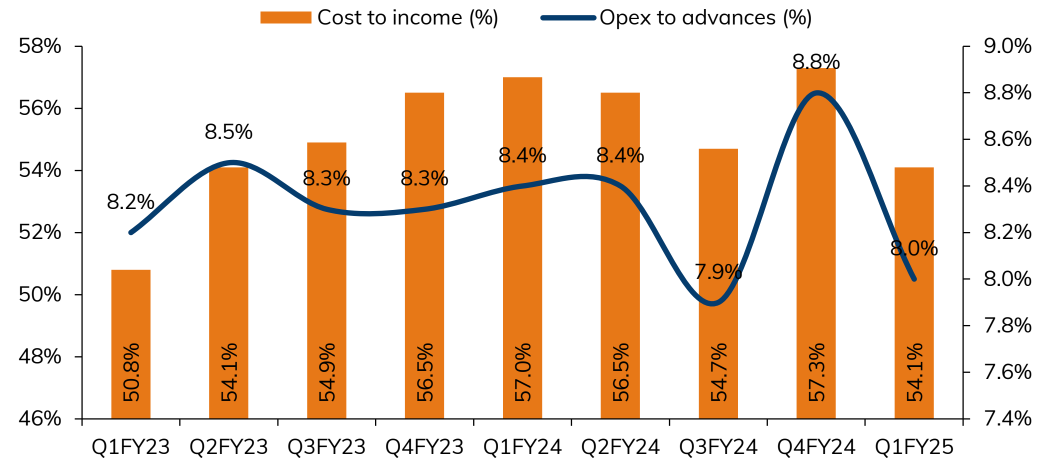
Source: Company data, I-Sec research

Exhibit 7: NII growth moderated, but still healthy at 6% QoQ



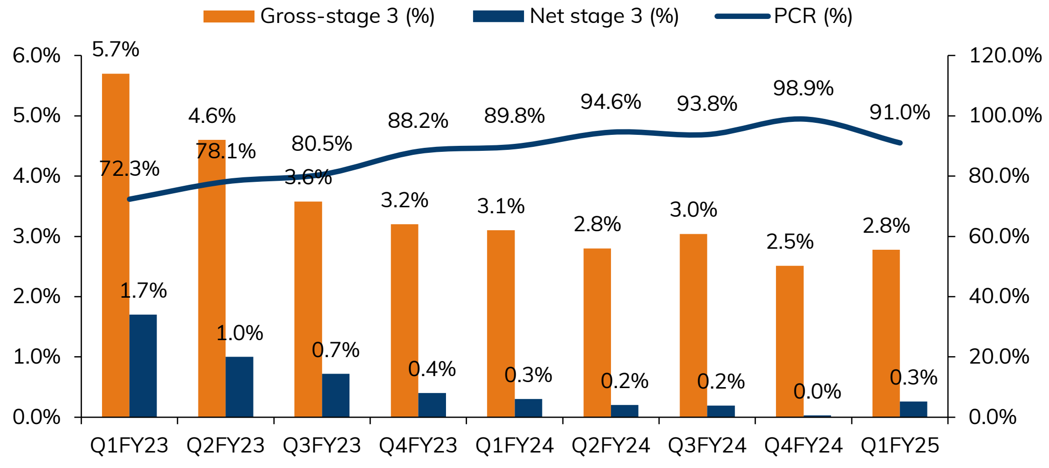
Source: Company data, I-Sec research

Exhibit 8: Cost to income improved to 54.1% despite expansion spree



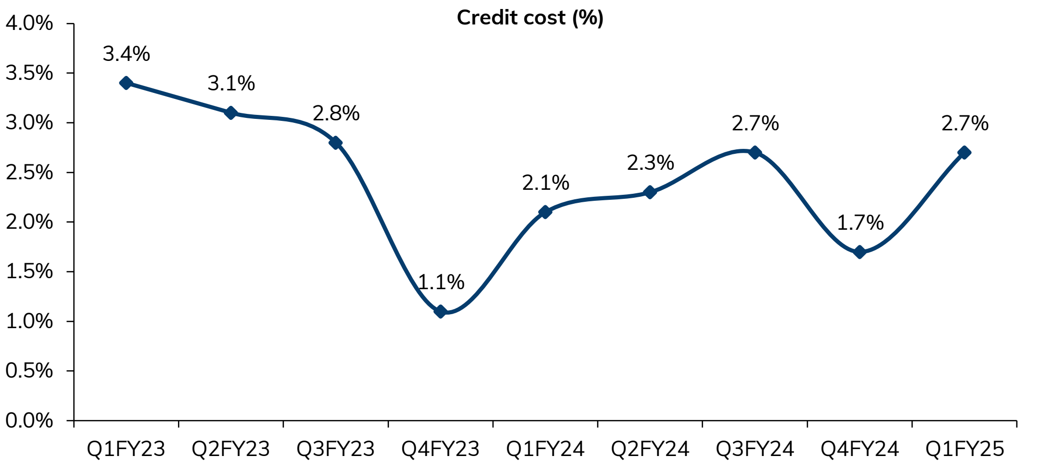
Source: Company data, I-Sec research

Exhibit 9: Asst quality moderated due to seasonality and operational challenges owing to general election and heatwaves



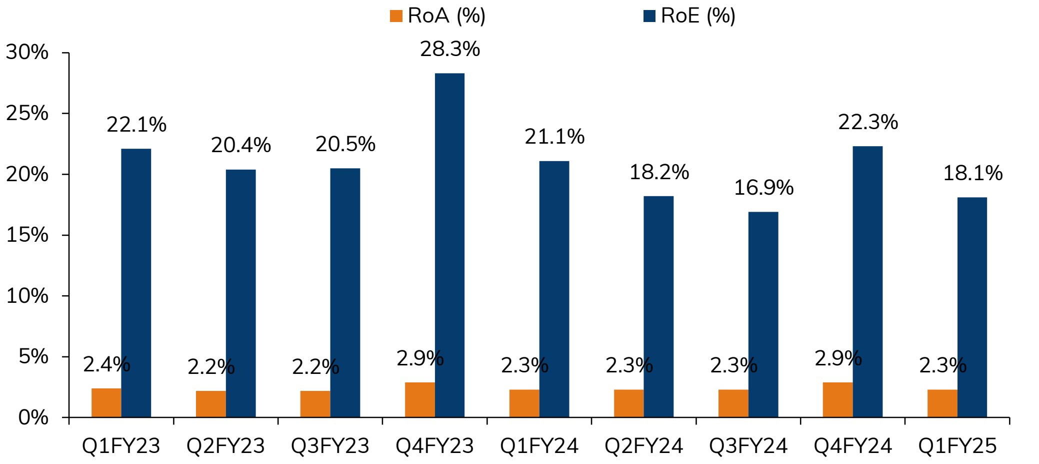
Source: Company data, I-Sec research

Exhibit 10: Credit cost including floating provisions at 2.7% and excluding floating provisions at 2.2%



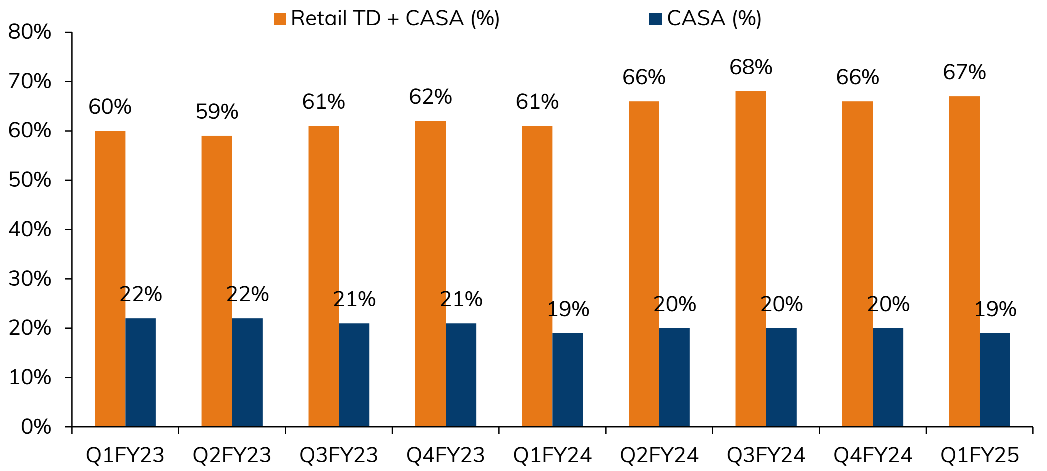
Source: Company data, I-Sec research

Exhibit 11: RoA sustained at >2%



Source: Company data, I-Sec research

Exhibit 12: Granular deposit franchise building; retail TD + CASA reached 67% vs 61% YoY



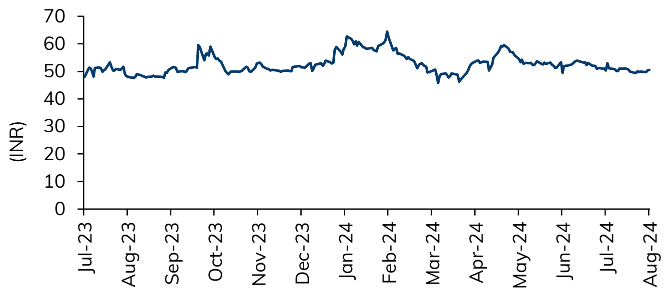
Source: Company data, I-Sec research

Exhibit 13: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	69.2	69.2	69.2
Institutional investors	12.0	12.0	11.7
MFs and others	6.5	6.5	7.1
FIs/Banks	0.0	0.0	1.2
Insurance	3.4	3.4	2.4
FIIs	2.1	2.1	1.0
Others	18.8	18.8	19.1

Source: Bloomberg

Exhibit 14: Price chart



Source: Bloomberg

Financial Summary

Exhibit 15: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest income	25,050	31,784	39,958	48,834
Interest expense	9,759	12,926	16,858	20,498
Net interest income	**15,290**	**18,858**	**23,100**	**28,336**
Non interest income	2,993	4,004	4,701	5,836
Operating income	18,283	22,862	27,801	34,172
Operating expense	(9,900)	(12,889)	(15,636)	(19,094)
- Staff expense	(5,701)	(7,370)	(9,211)	(11,145)
Pre-provisions profit	**8,383**	**9,972**	**12,166**	**15,078**
Core operating profit	**8,383**	**9,972**	**12,166**	**15,078**
Provisions & Contingencies	(3,081)	(3,379)	(4,069)	(4,927)
Pre-tax profit	**5,302**	**6,594**	**8,096**	**10,151**
Tax (current + deferred)	(1,257)	(1,618)	(2,040)	(2,558)
Net Profit	**4,045**	**4,976**	**6,056**	**7,593**
% Growth	**561.0**	**23.0**	**21.7**	**14.6**

Source Company data, I-Sec research

Exhibit 16: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Capital	8,959	10,995	10,995	10,995
Reserve & surplus	11,044	18,737	24,793	32,386
Deposits	137,101	174,726	224,698	282,888
Borrowings	23,495	19,950	32,712	37,308
Other liabilities	10,576	14,620	20,223	25,460
Total equity and liabilities	**191,175**	**239,028**	**313,420**	**389,037**
Cash and Bank balance	25,164	30,275	25,741	32,020
Investments	28,594	36,795	47,186	59,407
Advances	139,571	176,210	230,723	287,873
Fixed assets	3,033	3,116	4,577	4,544
Other assets	3,697	5,192	5,194	5,194
Total assets	**191,175**	**239,028**	**313,420**	**389,037**
% Growth	26.9	25.0	32.7	24.5

Source Company data, I-Sec research

Exhibit 17: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
No. of shares and per share data				
No. of shares (mn)	896	1,099	1,099	1,099
Adjusted EPS (INR)	4.5	4.5	5.5	6.9
Nominal Book Value per share (INR)	22	27	33	39
Adjusted BVPS (INR)	22	27	32	39
Subs Value per share (INR)	-	-	-	-
Valuation ratio				
PER (x)	10.6	10.6	8.7	7.0
Price/ Nominal Book (x)	2.1	1.8	1.5	1.2
Price/ Adjusted book (x)	-	-	-	-
Dividend Yield (%)	-	-	-	-
Profitability ratio				
Yield on advances (%)	18.5	18.2	18.3	17.4
Yields on Assets	15.2	15.3	15.0	14.3
Cost of deposits (%)	6.6	-	7.2	6.8
Cost of funds	6.8	7.3	7.5	7.1
NIMs (%)	9.3	9.1	8.6	8.3
Cost/Income (%)	54.1	56.4	56.2	55.9
Dupont Analysis (as % of Avg Assets)				
Interest Income	14.7	14.8	14.5	13.9
Interest expended	(5.7)	(6.0)	(6.1)	(5.8)
Net Interest Income	8.9	8.8	8.4	8.1
Non-interest income	1.8	1.9	1.7	1.7
Total Income	10.7	10.6	10.1	9.7
Staff costs	(3.3)	(3.4)	(3.3)	(3.2)
Total Cost	(5.8)	(6.0)	(5.7)	(5.4)
PPoP	4.9	4.6	4.4	4.3
Non-tax Provisions	(1.8)	(1.6)	(1.5)	(1.4)
PBT	3.1	3.1	2.9	2.9
Tax Provisions	(0.7)	(0.8)	(0.7)	(0.7)
ROA (%)	2.4	2.3	2.2	2.2
Leverage (x)	9.6	8.6	8.4	8.9
ROE (%)	22.6	20.0	18.5	19.2
Asset quality ratios				
Gross NPLs (%)	3.2	2.5	2.0	1.9
Net NPLs (%)	0.4	0.0	0.2	0.2
PCR (%)	88.3	98.9	90.0	90.0
Gross Slippages (% of PY loans)	4.9	3.1	1.9	1.8
Credit cost as a % of AUM	2.5	2.1	2.0	1.9
Net NPLs / Networth (%)	2.5	0.2	1.3	1.3
Capitalisation ratios				
Core Equity Capital (%)	-	-	-	-
Tier I cap.adequacy (%)	18.3	20.9	20.1	19.8
Total cap.adequacy (%)	20.6	22.6	21.3	20.7

Source Company data, I-Sec research

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