

07 August 2024

India | Equity Research | Q1FY25 results review

Fusion Micro Finance

Financial Services

Elevated credit cost marred earnings; asset quality improvement would be gradual

Fusion Microfinance's (Fusion) Q1FY25 earnings were marred by elevated credit cost at INR 3.5bn vs INR 1.2bn QoQ. This was led by it proactively moving 55k customers with exposure of INR 2.21bn from stage-1/stage-2 to stage-3 resulting in additional credit cost of INR 1.4bn and INR 0.7bn due to tightening of ECL model. Incremental stress was more visible in TN, MP, Odisha, Rajasthan and Jharkhand with 95% customers of total 55k customers being from these 5 states. Cumulative exposure of these states to total AUM stands at 25-28% as on Jun'24. Uncertainty around credit cost trajectory in the near term persists given the exposure to borrowers with 4+ lenders is at ~24% and >30% its customer have systemic exposure at >INR0.1mn as on Mar'24. Factoring significantly higher-than-expected credit cost in Q1FY25 and likely elevated credit cost in near term, we trim our earnings estimates by 46% / 11% for FY25 / 26E. Downgrade to **REDUCE** (from Hold) with revised TP of INR 385 (from INR 500), valuing Fusion at 1.1x (1.3x earlier) on Sep'25E BVPS.

Reported net loss of INR 356mn

While Fusion's steady growth momentum sustained during Q1FY25 as reflected in 6% QoQ AUM growth and 8% QoQ NII growth, higher sequential operating cost (up 9% QoQ) and elevated credit cost led to it reporting loss of INR 356mn. NIM remained steady at 11.6% with stable asset yield at 21.7% and 10bps QoQ reduction in cost of borrowing during Q1FY25. Notably, marginal cost of borrowing fell 19bps QoQ to 10.05% vs blended cost of borrowing at 10.1%. Disbursement stood at INR 29.7bn. Average ticket size grew 4% QoQ due to higher disbursements to existing borrower base. Average outstanding per borrower stood at INR 30,867 and net borrower base stood at 3.95mn (up 2% QoQ) as on Jun'24.

GNPL increases sharply to 5.46% vs 2.9% QoQ

Fusions' asset quality was impacted sharply during Q1FY25 as reflected in GNPL ratio increasing to 5.5% vs 2.9% QoQ. Taking cognisance of customer over leverage (many borrowers are having lending relationship with 6-7 lenders including non-MFI loans), it classified account worth INR 2.2bn as stage 3 from stage 1-2 assets where payment behaviour was irregular with NIL payment in Jul'24. Management also highlighted that given the dynamic situation, it withdraws full year FY25 credit cost guidance of <3% and would wait for Q2 before giving any guidance on credit cost.

Financial Summary

| Y/E March (INR mn) | FY23A | FY24A | FY25E | FY26E |
|------------------------------|---------|--------|--------|--------|
| Net Interest Income (INR mn) | 9,573 | 13,011 | 15,196 | 18,145 |
| PAT (INR mn) | 3,872 | 5,053 | 3,317 | 6,873 |
| EPS (INR) | 38.6 | 50.2 | 33.0 | 68.3 |
| % Chg YoY | 1,372.8 | 30.2 | (34.4) | 107.2 |
| P/E (x) | 11.2 | 8.6 | 13.1 | 6.3 |
| P/BV (x) | 1.9 | 1.5 | 1.4 | 1.1 |
| Gross Stage - 3 (%) | 3.5 | 2.9 | 2.7 | 2.7 |
| RoAA (%) | 4.6 | 4.8 | 2.5 | 4.2 |
| RoAE (%) | 21.2 | 19.5 | 11.0 | 19.5 |

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Market Data

| | |
|---------------------|-----------|
| Market Cap (INR) | 49bn |
| Market Cap (USD) | 591mn |
| Bloomberg Code | FUSION IN |
| Reuters Code | FUSN.BO |
| 52-week Range (INR) | 691 / 419 |
| Free Float (%) | 42.0 |
| ADTV-3M (mn) (USD) | 2.0 |

| Price Performance (%) | 3m | 6m | 12m |
|-----------------------|--------|--------|--------|
| Absolute | (15.5) | (14.2) | 10.3 |
| Relative to Sensex | (17.4) | (27.4) | (10.1) |

| Earnings Revisions (%) | FY25E | FY26E |
|------------------------|-------|-------|
| PAT | (46) | (11) |

Previous Reports

20-05-2024: [Company Update](#)

08-05-2024: [Q4FY24 results review](#)

Disbursement growth tepid as company cuts back on growth; likely to return to normalcy in H2

Disbursements were weak at INR 29.9bn, up 1% QoQ but up 31% YoY. AUM was up 6% QoQ to INR 121.9bn, up 25.5% YoY. However, Fusion has stopped disbursements in 104 branches (total network of 1,398 branches) and is calibrating growth in some geographies. It stopped disbursements in 50-60 branches in Jul'24 and rest 40-50 branches Aug 1, '24 onwards. Hence, we believe growth is likely to be muted in Q2 and Fusion expects to get back to its normal course of business only in H2FY25.

Fusion has taken various steps to manage portfolio better

In order to manage the health of the portfolio in a more efficient way, Fusion has taken several steps such as calibrating Q2 disbursements in line with portfolio risk assessment, stopped disbursements in 104 branches, tightened sourcing criteria for new customers, rationalised customer handling at regional office level from ~540 to ~440, revamped incentive structure with focus towards collections from Aug 1, '24 and strengthened dedicated collections team which will target 60+ dpd customers. It is looking to add more members in collection team and is also expanding tele calling infra. It added 50 people in collection team until Jul'24 and another 100 will be added in Aug'24. Moreover, it has hired a senior collection member who will join from Aug 20, '24.

Key risks

1) Asset quality and business normalisation sooner than expected and 2) AUM growth pick up faster than expected.

Exhibit 1: Q1FY25 result review

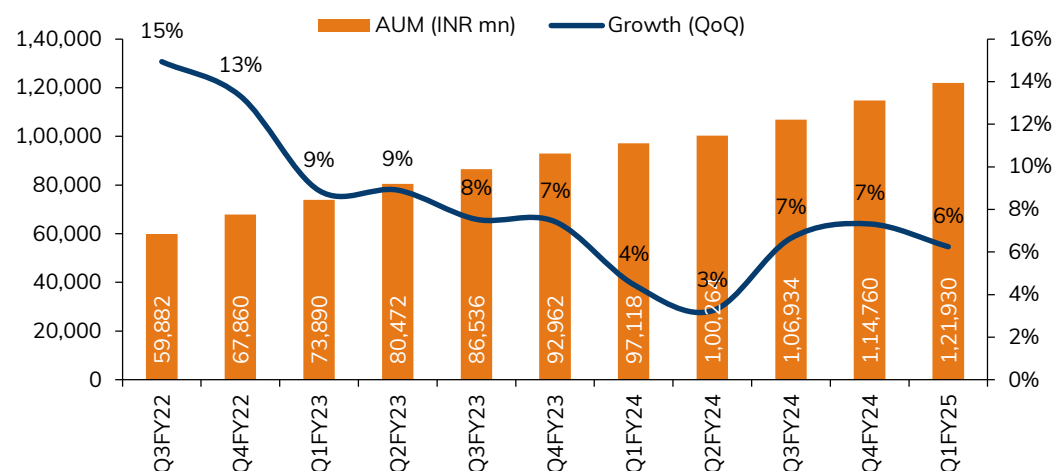
| (INR mn) | Q1FY25 | Q1FY24 | % chg YoY | Q4FY24 | % chg QoQ |
|----------------------------------|--------------|--------------|----------------|--------------|----------------|
| Interest Income | 6,883 | 5,311 | 29.6 | 6,460 | 6.6 |
| Interest Expended | 2,234 | 1,835 | 21.8 | 2,149 | 4.0 |
| Net interest income (NII) | 4,649 | 3,476 | 33.8 | 4,311 | 7.8 |
| Other income | 184 | 217 | (15.4) | 292 | (37.0) |
| Total income | 4,833 | 3,693 | 30.9 | 4,603 | 5.0 |
| Operating expenses | 1,855 | 1,339 | 38.5 | 1,696 | 9.4 |
| -Staff expenses | 1,354 | 978 | 38.4 | 1,222 | 10.8 |
| -Other expenses | 501 | 361 | 39.0 | 474 | 5.9 |
| Operating profit | 2,978 | 2,354 | 26.5 | 2,907 | 2.4 |
| Total provisions | 3,485 | 759 | 358.9 | 1,190 | 192.9 |
| Profit before tax | (507) | 1,595 | (131.8) | 1,717 | (129.5) |
| Tax | (151) | 390 | (138.7) | 390 | (138.7) |
| Profit after tax | (356) | 1,205 | (129.6) | 1,327 | (126.8) |

Key statistic (INR mn)

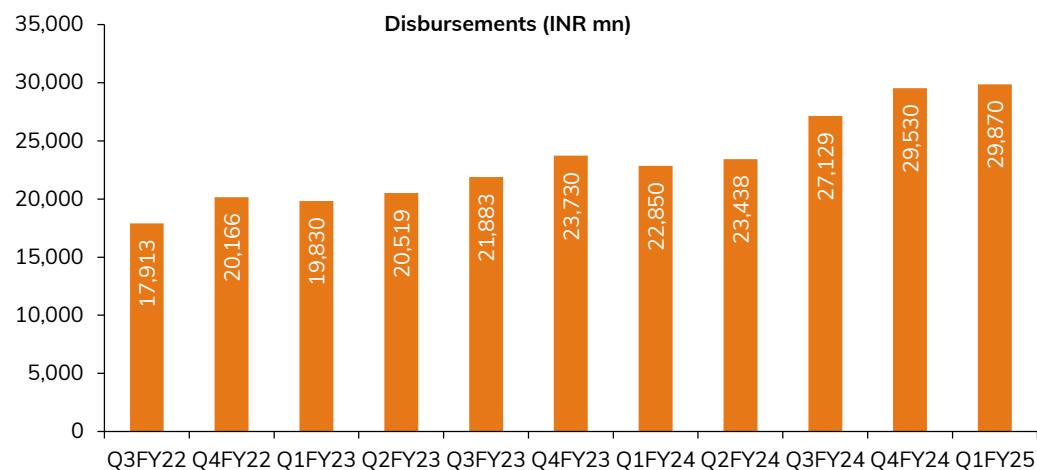
| | | | | | |
|-----------------------|-----------------|---------------|-------------|-----------------|------------|
| AuM | 1,21,930 | 97,118 | 25.5 | 1,14,760 | 6.2 |
| Borrowers (in mn) | 4.0 | 3.6 | 9.7 | 3.9 | 2.3 |
| Calc. Avg ticket size | 30,868 | 26,977 | 14.4 | 29,731 | 3.8 |

| Ratios (%) | | bps chg YoY | | bps chg QoQ | |
|-------------------------|-------|-------------|-------|-------------|-------|
| Profitability ratios | | | | | |
| Portfolio Yields | 21.7 | 21.5 | 20 | 21.8 | (10) |
| Cost of Funds | 10.1 | 10.6 | (50) | 10.2 | (10) |
| NIM | 11.6 | 10.9 | 74 | 11.6 | 5 |
| RoAum | (1.2) | 5.0 | (618) | 4.6 | (584) |
| Asset Quality | | | | | |
| Gross NPL ratio | 5.5 | 3.2 | 226 | 2.9 | 257 |
| Net NPL ratio | 1.3 | 0.8 | 47 | 0.6 | 65 |
| PCR | 77.1 | 75.6 | 148 | 79.2 | (213) |
| Business & Other Ratios | | | | | |
| Cost-income ratio | 38.4 | 36.3 | 213 | 36.8 | 154 |
| CAR | 25.9 | 28.3 | (240) | 27.5 | (167) |

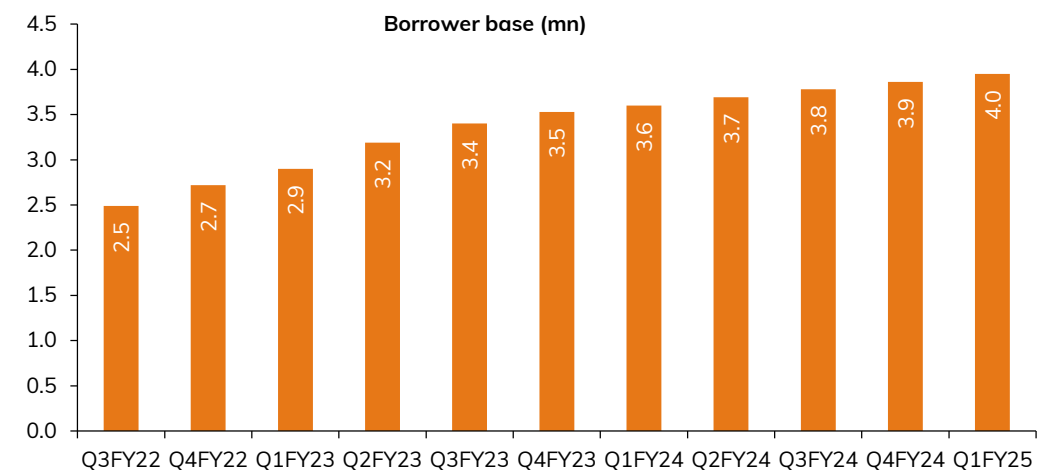
Source: Company data, I-Sec research

Exhibit 2: Growth momentum sustains as AUM grows 6% QoQ...

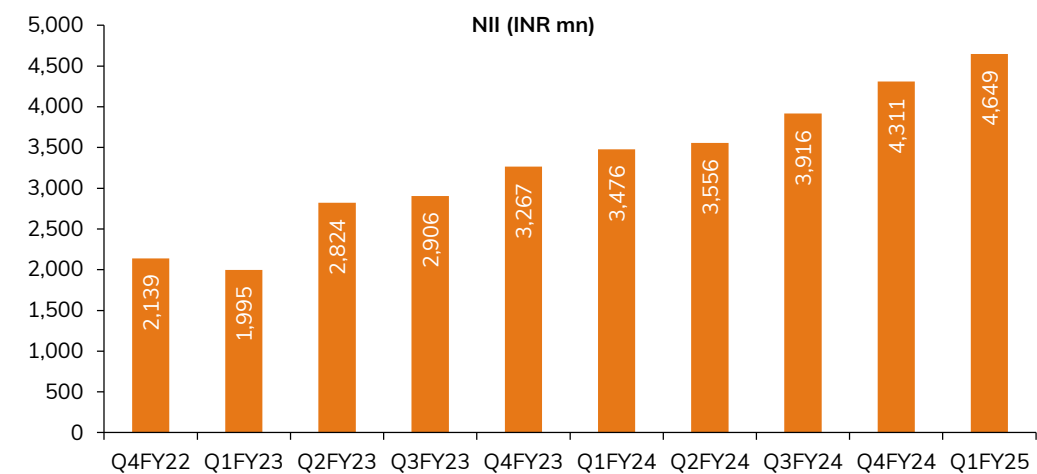
Source: Company data, I-Sec research

Exhibit 3: Disbursement growth tepid as company cuts back on growth; likely to return to normalcy in H2


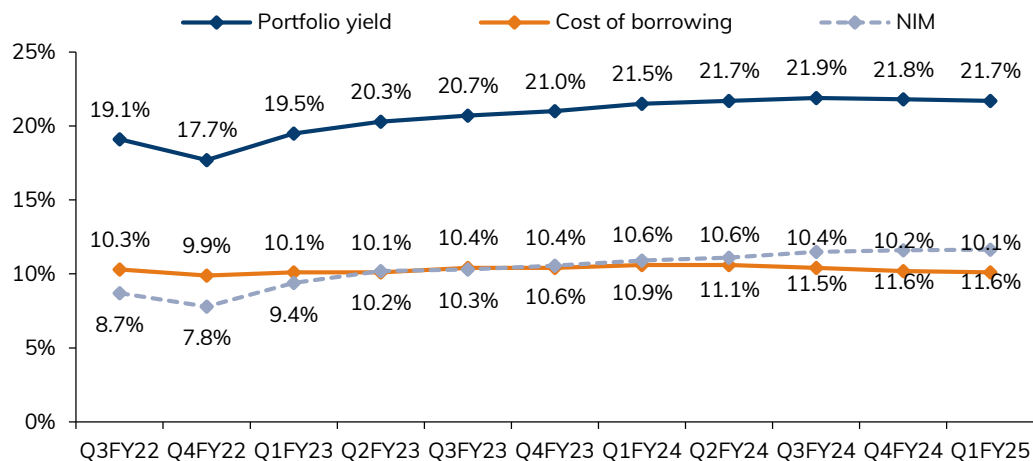
Source: Company data, I-Sec research

Exhibit 4: AUM growth continues to be driven by new customer acquisitions


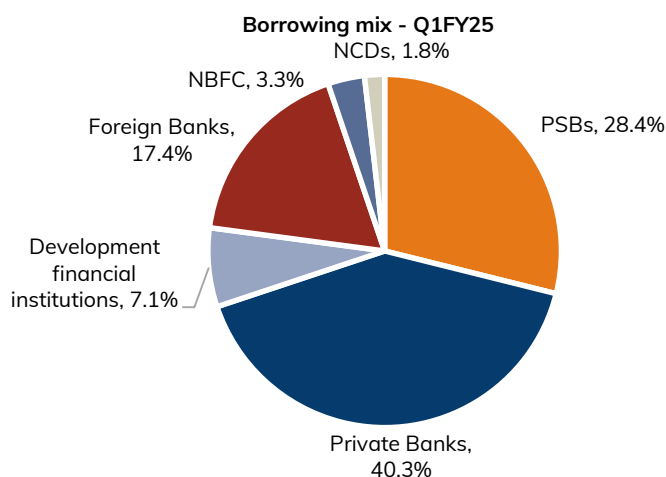
Source: Company data, I-Sec research

Exhibit 5: Higher AUM growth supported QoQ NII growth


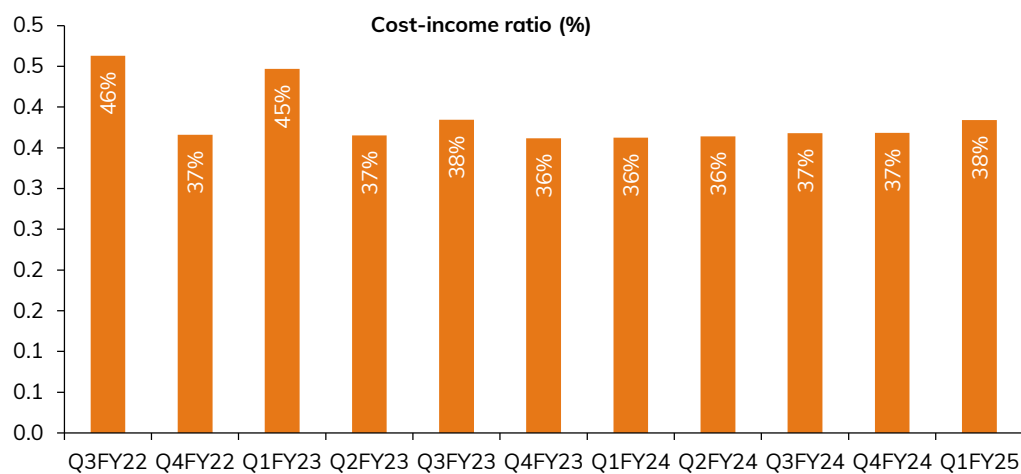
Source: Company data, I-Sec research

Exhibit 6: Margins dip 10bps QoQ due to decline in portfolio yield

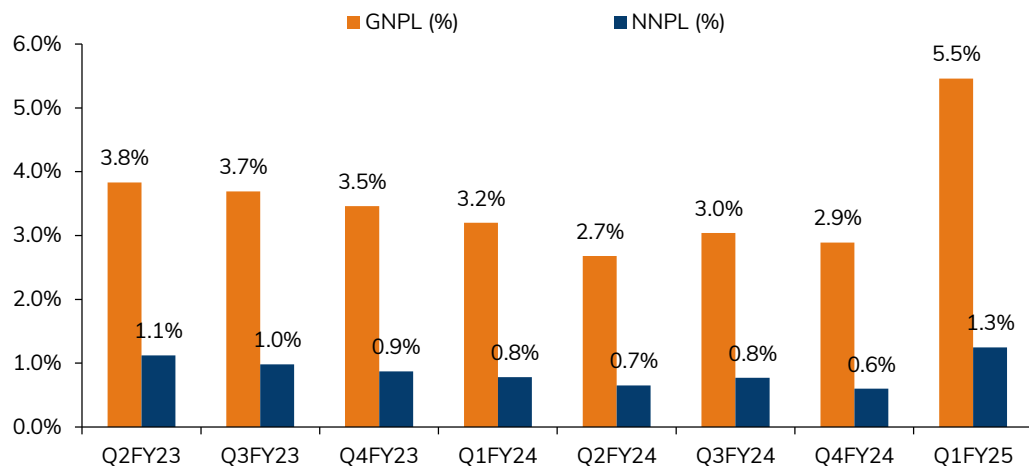
Source: Company data, I-Sec research

Exhibit 7: Bank borrowing remains the major source of funding

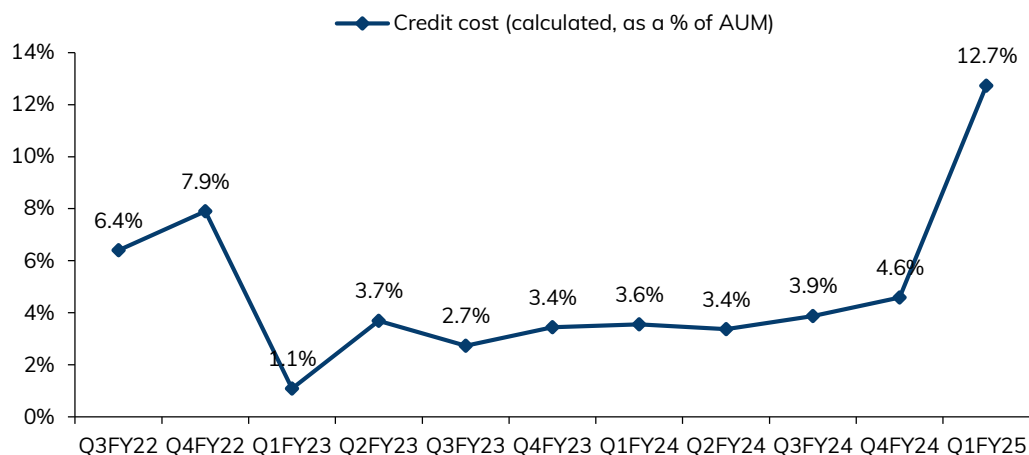
Source: Company data, I-Sec research

Exhibit 8: Cost to income broadly steady over the quarters

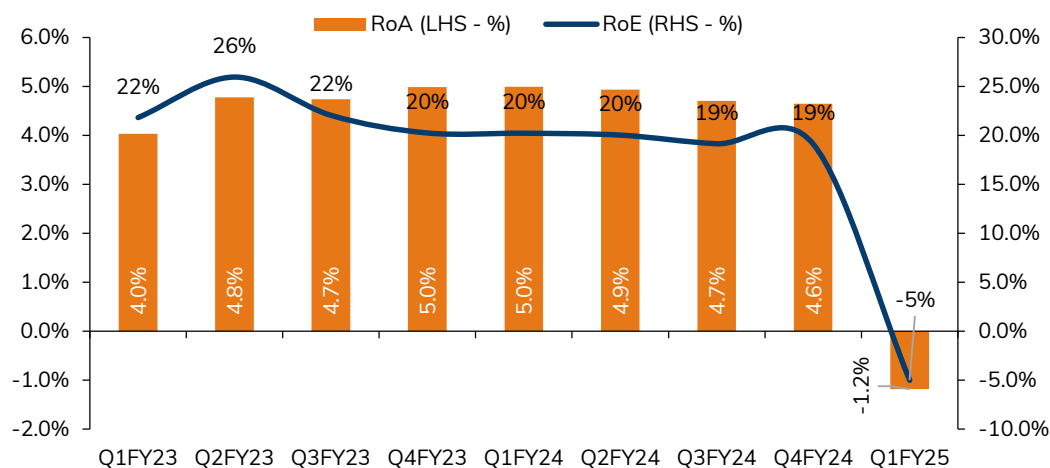
Source: Company data, I-Sec research

Exhibit 9: Gross NPAs spiked to 5.5% vs 2.9% QoQ

Source: Company data, I-Sec research

Exhibit 10: Elevated credit cost due to proactively moving 55k customers with exposure of INR 2.21bn from stage-1/stage-2 to stage-3

Source: Company data, I-Sec research

Exhibit 11: RoA in negative due to spike in credit cost

Source: Company data, I-Sec research

Exhibit 12: Shareholding pattern

| % | Dec'23 | Mar'24 | Jun'24 |
|-------------------------|--------|--------|--------|
| Promoters | 57.7 | 57.7 | 57.7 |
| Institutional investors | 29.6 | 29.3 | 26.9 |
| MFs and other | 15.8 | 16.4 | 16.3 |
| FIs/ Banks | 0.0 | 0.0 | 2.5 |
| Insurance Cos. | 4.8 | 4.1 | 4.1 |
| FII's | 9.0 | 8.8 | 4.0 |
| Others | 12.7 | 13.0 | 15.4 |

Source: Bloomberg, I-Sec research

Exhibit 13: Price chart

Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 14: Profit & Loss

(INR mn, year ending March)

| | FY23A | FY24A | FY25E | FY26E |
|--|----------------|----------------|----------------|----------------|
| Interest Income | 16,001 | 20,919 | 25,441 | 30,719 |
| Net gain on fair value changes | - | - | - | - |
| Interest Expenses | (6,428) | (7,908) | (10,245) | (12,574) |
| Net Interest Income (NII) | 9,573 | 13,011 | 15,196 | 18,145 |
| Other Income | 1,999 | 3,205 | 3,971 | 4,681 |
| Total Income (net of interest expenses) | 11,572 | 16,216 | 19,167 | ,826 |
| Employee benefit expenses | (3,255) | (4,312) | (5,336) | (6,290) |
| Depreciation and amortization | (74) | (90) | (22,108) | (127) |
| Other operating expenses | (1,119) | (1,532) | (1,924) | (2,267) |
| Total Operating Expense | (4,448) | (5,935) | (7,368) | (8,684) |
| Pre Provisioning Profits (PPoP) | 7,124 | 10,281 | 11,800 | 14,142 |
| Provisions and write offs | (2,004) | (3,649) | (7,446) | (5,120) |
| Profit before tax (PBT) | 5,120 | 6,633 | 4,354 | 9,022 |
| Total tax expenses | (1,248) | (1,580) | (1,037) | (2,149) |
| Profit after tax (PAT) | 3,872 | 5,053 | 3,317 | 6,873 |

Source Company data, I-Sec research

Exhibit 15: Balance sheet

(INR mn, year ending March)

| | FY23A | FY24A | FY25E | FY26E |
|---|---------------|----------------|----------------|----------------|
| Share capital | 1,003 | 1,006 | 1,006 | 1,006 |
| Reserves & surplus | 22,216 | 27,475 | 30,792 | 37,665 |
| Shareholders' funds | 23,219 | 28,482 | 31,798 | 38,672 |
| Borrowings | 70,175 | 87,923 | 114,941 | 136,531 |
| Provisions & Other Liabilities | 241 | 1,339 | 1,339 | 1,339 |
| Total Liabilities and Stakeholder's Equity | 93,635 | 117,743 | 148,078 | 176,542 |
| Cash and balance with RBI | 10,650 | 15,532 | 14,745 | 17,583 |
| Fixed assets | 133 | 224 | 236 | 247 |
| Loans | 80,416 | 99,479 | 113,425 | 135,253 |
| Investments | - | - | - | - |
| Deferred tax assets (net) | 777 | 917 | 926 | 935 |
| Other Assets | 1,659 | 1,592 | 18,746 | 22,523 |
| Total Assets | 93,635 | 117,743 | 148,078 | 176,542 |

Source Company data, I-Sec research

Exhibit 16: Key ratios

(Year ending March)

| | FY23A | FY24A | FY25E | FY26E |
|---|--------|---------|---------|---------|
| AUM and Disbursements (INR mn) | | | | |
| AUM | 92,960 | 114,760 | 133,441 | 159,121 |
| Disbursements | 85,960 | 102,940 | 123,528 | 150,704 |
| Repayments | 60,860 | 81,140 | 104,847 | 125,024 |
| Growth (%): | | | | |
| Total AUM (%) | 37.0 | 23.5 | 16.3 | 19.2 |
| Disbursements (%) | 39.1 | 19.8 | 20.0 | 22.0 |
| Repayments (%) | 51.0 | 33.3 | 29.2 | 19.2 |
| Total Assets (%) | 28.4 | 25.7 | 25.8 | 19.2 |
| Net Interest Income (NII) (%) | 71 | 36 | 17 | 19 |
| Total Income (net of interest expenses) (%) | 64 | 40 | 18 | 19 |
| Operating Expenses (%) | 42.5 | 33.4 | 24.1 | 17.9 |
| Employee Cost (%) | 39.7 | 32.5 | 23.7 | 17.9 |
| Non-Employee Cost (%) | 51.6 | 36.9 | 25.5 | 17.9 |
| Pre provisioning operating profits (PPoP) (%) | 81 | 44 | 15 | 20 |
| Provisions (%) | (45.7) | 82.1 | 104.1 | -31.2 |
| PBT (%) | 1,996 | 30 | (34) | 107 |
| PAT (%) | 1,686 | 31 | (34) | 107 |
| EPS (%) | 1,686 | 31 | (34) | 107 |
| Yields, interest costs and spreads (%) | | | | |
| NIM on loan assets (%) | 11.9 | 12.5 | 12.2 | 12.4 |
| NIM on IEA (%) | 10.5 | 11.1 | 10.9 | 11.2 |
| NIM on AUM (%) | 11.9 | 12.5 | 12.2 | 12.4 |
| Yield on loan assets (%) | 19.9 | 20.1 | 20.5 | 21.0 |
| Yield on IEA (%) | 17.5 | 17.9 | 18.3 | 18.9 |
| Yield on AUM (%) | 19.9 | 20.1 | 20.5 | 21.0 |
| Cost of borrowings (%) | 9.9 | 10.0 | 10.1 | 10.0 |
| Interest Spreads (%) | 10.0 | 10.1 | 10.4 | 11.0 |
| Operating efficiencies | | | | |
| Non interest income as % of total income | 53.2 | 53.9 | 51.7 | 51.3 |
| Cost to income ratio | 38.4 | 36.6 | 38.4 | 38.0 |
| Op.costs/avg assets (%) | 5.3 | 5.6 | 5.5 | 5.4 |
| Op.costs/avg AUM (%) | 5.5 | 5.7 | 5.9 | 5.9 |
| Salaries as % of non-interest costs (%) | 73.2 | 72.7 | 72.4 | 72.4 |
| Capital Structure | | | | |
| Average gearing ratio (x) | 3.0 | 3.1 | 3.6 | 3.5 |
| Leverage (x) | 4.0 | 4.1 | 4.7 | 4.6 |
| CAR (%) | 26.8 | 23.7 | 19.1 | 17.7 |
| Tier 1 CAR (%) | 25.3 | 22.7 | 18.4 | 17.1 |
| Tier 2 CAR (%) | 1.4 | 1.0 | 0.7 | 0.6 |
| RWA (estimate) - INR mn | 87,663 | 121,256 | 167,745 | 219,988 |
| RWA as a % of loan assets | 109.0 | 121.9 | 147.9 | 162.6 |

Source Company data, I-Sec research

| | FY23A | FY24A | FY25E | FY26E |
|--|-------|-------|-------|-------|
| Asset quality and provisioning | | | | |
| GNPA (%) | 3.46 | 2.89 | 2.7 | 2.7 |
| NNPA (%) | 0.87 | 0.6 | 0.8 | 0.8 |
| GNPA (INR mn) | 3,216 | 3,317 | 3,603 | 4,296 |
| NNPA (INR mn) | 809 | 689 | 1,068 | 1,273 |
| Coverage ratio (%) | 75 | 79 | 70 | 70 |
| Credit Costs as a % of avg AUM (bps) | 249.2 | 351.3 | 600 | 350 |
| Credit Costs as a % of avg on book loans (bps) | 249.2 | 351.3 | 600 | 350 |
| Return ratios | | | | |
| RoAA (%) | 4.6 | 4.8 | 2.5 | 4.2 |
| RoAE (%) | 21.2 | 19.5 | 11.0 | 19.5 |
| ROAAUM (%) | 4.2 | 4.4 | 2.5 | 4.3 |
| Valuation Ratios | | | | |
| No of shares | 100 | 101 | 101 | 101 |
| No of shares (fully diluted) | 100 | 101 | 101 | 101 |
| ESOP Outstanding | - | - | - | - |
| EPS (INR) | 38.6 | 50.2 | 33.0 | 68.3 |
| EPS fully diluted (INR) | 38.6 | 50.2 | 33.0 | 68.3 |
| Price to Earnings (x) | 11.2 | 8.6 | 13.1 | 6.3 |
| Price to Earnings (fully diluted) (x) | 11.2 | 8.6 | 13.1 | 6.3 |
| Book Value (fully diluted) | 231 | 283 | 316 | 384 |
| Adjusted book value | 225 | 278 | 308 | 375 |
| Price to Book | 1.9 | 1.5 | 1.4 | 1.1 |
| Price to Adjusted Book | 1.9 | 1.6 | 1.4 | 1.2 |

Source Company data, I-Sec research

Exhibit 17: Key metrics

(Year ending March)

| | FY23A | FY24A | FY25E | FY26E |
|----------------------------------|-------------|-------------|-------------|-------------|
| DuPont Analysis | | | | |
| Average Assets (INR mn) | 83,270 | 105,689 | 132,910 | 162,310 |
| Average Loans (INR mn) | 69,799 | 89,947 | 106,452 | 124,339 |
| Average Equity (INR mn) | 18,299 | 25,850 | 30,140 | 35,235 |
| Interest earned (%) | 19.2 | 19.8 | 19.1 | 18.9 |
| Interest expended (%) | 7.7 | 7.5 | 7.7 | 7.7 |
| Gross Interest Spread (%) | 11.5 | 12.3 | 11.4 | 11.2 |
| Credit cost (%) | 2.4 | 3.5 | 5.6 | 3.2 |
| Net Interest Spread (%) | 9.1 | 8.9 | 5.8 | 8.0 |
| Operating cost (%) | 5.3 | 5.6 | 5.5 | 5.4 |
| Lending spread (%) | 3.7 | 3.2 | 0.3 | 2.7 |
| Non interest income (%) | 2.4 | 3.0 | 3.0 | 2.9 |
| Operating Spread (%) | 6.1 | 6.3 | 3.3 | 5.6 |
| Tax rate (%) | 24.4 | 23.8 | 23.8 | 23.8 |
| ROAA (%) | 4.6 | 4.8 | 2.5 | 4.2 |
| Effective leverage (AA/ AE) | 4.6 | 4.1 | 4.4 | 4.6 |
| RoAE (%) | 21.2 | 19.5 | 11.0 | 19.5 |

Source Company data, I-Sec research

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