Satin Creditcare Network

28 November 2018

Financials

Event Takeaways

Key Statistics

CMP (INR)*	209
Market Cap (INR/USDbn)	10.1/143
Shares outstanding (mn)	8,245
3 months avg volume (no)	61,546
52 Wk high/low	525/183
Sensex/Nifty	35,513/10,685
Bloomberg Code	SATIN IN

*As on 27th November 2018

Sh. Pattern, % (as on Sept-2018)

Promoter	26.7
FII	39.5
DII	17.3
Others	16.5
Total	**100.0**

Rajiv Mehta, Sachit Damani

rajiv.mehta@yessecuritiesltd.in

+91-22-3366 9000

On November 21 and 22, we hosted a two-day Mumbai roadshow for Satin Creditcare, India's leading NBFC-MFI with a GLP of Rs61.2bn as on September 30, 2018. Promoter & CMD Mr. H P Singh and Head of Capital Markets & Investor Relations Ms. Aditi Singh represented the company.

Satin's liquidity position is comfortable with a structurally positive ALM, substantial cash & equivalents on balance sheet and sizeable bank lines. Though availability of funds is not much of a concern, the company would not want to grow significantly ahead of the industry. Management believes that long-term implications of the ongoing liquidity crisis would be favourable for large MFIs. In its quest to insulate itself from credit shocks, Satin has strengthened its underwriting function. The company is also in the process of introducing some unprecedented systems and processes to ascertain the repayment ability and intention of prospective borrowers.

Although Satin was one of the most impacted MFIs during the demonetization phase given its higher exposure to affected regions, it has resiliently fought its way back to normalcy in reasonably quick time, spreading its wings to new geographies and initiating key product diversification. Leaving behind the lingering pain of write-offs and NPL provisioning, the company has raised significant capital from promoters, institutional investors and business partners post demonetization. Collection efficiency has normalized and new NPL accrual rate is on the lower side. Going forward, this resurrection coupled with sustained recoveries would positively influence Satin's ECL-based credit cost.

Business Correspondent (BC) partnership with IndusInd Bank is scaling rapidly and promises remarkable growth and profitability. Capital First tie-up for non-MFI loans is moving, albeit slowly post the merger announcement with IDFC Bank. There remains material headroom for operating leverage as branch/loan officer level productivity metric is below peers. Satin is confident of achieving 3% RoA in FY20. The stock trades at <1x P/BV and <5x P/E on our cursory estimates for FY20. Promoter has offered discernible comfort on other investor concerns through the willingness to convert warrants, and by virtue of adequate financial strength to avoid invoking of the pledge.

KEY TOPICAL TAKEAWAYS FROM INVESTOR MEETINGS

AUM Growth and Mix

- ✓ In the aftermath of current liquidity crisis, all MFI players have turned cautious and are moderating growth. None wants to defy the market to avoid being viewed negatively by lenders and investors.
- ✓ Satin has calibrated GLP growth expectation for FY19 to around 30% from earlier 40%. While liquidity needed to grow faster is at its disposal, Satin doesn't want to be perceived as an aggressive lender, at a time when the industry has had to bear the brunt of issues plaguing the smaller MFIs.
- ✓ Small MFIs (below Rs10bn Balance Sheet size) are deprived of money, so weak and marginal players can well get weeded out. The large MFIs will gain market share following this crisis, and the number of new players entering the market will significantly come down.
- ✓ Sanity will return to the market in good measure, and the industry will grow at 20-30% pa. The unbridled growth of some players could end soon. Even large players will become more disciplined in the process.
- ✓ Lenders would turn choosy, preferring to fund large MFIs. For smaller players, even equity funding will dry-up.
- ✓ While Satin has witnessed a marginal dip in disbursement rate in recent months, it will likely move to >Rs6bn/month in Q4 FY19. Disbursement ATS would stay put at Rs28000-30000. Notably, the portfolio ATS is lower at Rs23000-24000.
- ✓ FY20 AUM growth would depend on how quickly the funding situation normalizes and how the industry evolves. Satin is confident of delivering 20-25% growth in the next year without fresh equity infusion, ably supported by internal accruals and the IndusInd Bank BC tie-up. To move north of 25-30%, a small dose of fresh capital would be required, so as to sustain healthy capital levels. Ditto for capitalizing SME and Housing Finance businesses which are growing at a fast clip.
- ✓ As per the Management, competitive intensity will moderate also due to SFBs diluting their absolute focus on growing their microfinance portfolio. Lending rate differential (higher than SFBs) is not a threat to growth potential. Historically, H2 is a significant growth period for MFIs, and more so for Satin, as it remains dominant in the Northern region.
- ✓ In the long run, portfolio ATS will increase by 10% pa and volume growth can comfortably be 12-15% pa. Satin added about 2 lac new customers in Q2 FY19.
- ✓ Customer dropout rate is 30-35%. Company funds repeat customers typically for 5-6 cycles with the last loan not exceeding Rs45000.
- ✓ Satin is yet to offer individual micro loans; a potential opportunity that will be explored in later years. Five years hence, a substantial share of consolidated revenue would comprise non-MFI products including the BC business under the subsidiary Taraashna Services Ltd.
- ✓ Of the 25.2% CAR reported at the end of Q2 FY19, Tier-1 capital is ~17%. Valuation will be a key factor in determining quantity and timing of next capital raise.

Risk mitigation

- ✓ Satin was one of the most impacted MFIs after demonetization due to its high AUM exposure in UP. The state witnessed much slower remonetization with assembly elections slated within few months from demonetization. The local politicians took advantage of the cash crunch in many areas by instigating customers to default on the loan repayments.
- ✓ With the need for regional diversification emerging as a key learning, Satin has substantially reduced its portfolio concentration in UP over the past three years without de-growing the book and despite pursuing collections from a sizeable defaulter base. The company expanded its presence in Eastern, North-Eastern and Western regions and has now entered Southern India.
- ✓ At present, Satin is a pan-India MFI with presence in more than 20 states. As per its internal policy, no state will contribute more than 20% of AUM by FY20. Currently UP contributes 22.8%, but its share will likely go below 20%.

IIB arrangement and Capital First Tie-up

- ✓ BC arrangement with IndusInd Bank (IIB) is making rapid strides with AUM reaching Rs2.15bn. As per the agreement, the partnership can reach up to 40% of Satin's AUM. It comprises only MFI loans under the JLG structure.
- ✓ Branches acting as BC for IIB are demarcated. At present, loan origination happens through ~160 branches spread across five states (even in areas where BFIL is present). Monthly disbursement rate has accelerated to Rs1bn.
- ✓ NIM earned on this portfolio is marginally higher than on usual loans. Given that capital requirement is to the extent of FLDG, company's overall RoE will rise with the increase in the BC arrangement's contribution to AUM.
- ✓ Besides the benefit of minimal capital requirement, this tie-up represents on-tap funding for Satin and reduces the need to carry excess balance sheet liquidity.
- ✓ This is an exclusive arrangement for Satin, so it cannot tie-up with other banks. The partnership exists till mutual consent remains. IIB has invested ~Rs450mn in the company via OCRPS which can be converted into equity shares @ Rs335 by July 2019.
- ✓ For non-MFI products such as two-wheeler loans, business loans, housing loans and consumer durable loans, Satin has a distribution tie-up with Capital First. However, it is moving slowly due to Capital First's merger with IDFC Bank.

Funding availability & NIM outlook

- ✓ Satin's liquidity position is comfortable with a structurally positive ALM. Maximum loan tenure offered is two years, and average duration of liabilities (22-23 months) is way longer than assets (9-10 months).
- ✓ As of September 30, 2018, Balance Sheet liquidity stood at ~Rs11bn. To top it all, there were undrawn committed sanctions of Rs6bn and a fresh funding pipeline of Rs5-6bn.
- ✓ Company has a diversified funding profile with negligible reliance on short-term money. It has funding facility from a large number (75-80) of lenders and dependence on loans from NBFCs (~20% of borrowings) is much lower compared to smaller MFIs.
- ✓ In Q2 FY19, Satin raised ~Rs2.2bn from SBI through an assignment transaction. The bank is willing to do further securitization. Another large PSU Bank has also

done due diligence for a potential Rs1-1.5bn assignment deal. The company recently got disbursement of ~Rs250mn from a small PSU Bank.

- Financial intermediaries like MAS Financial have continued disbursing funds to Satin. The company is in process of raising funds from a foreign institution via NCD route.
- Borrowing cost has risen by 75-100bps; incremental cost of money at 11.5-12.5%. Generally, there is some lag in passing the higher funding cost, but loan rates would be commensurately hiked soon. Management does not foresee any sustained pressure on NIM.
- Considering a tight liquidity environment, the management is keeping a higher liquidity buffer. A reasonable level would be an equivalent of next two month's disbursements.

Headroom for cost productivity

- Regional diversification-led branch expansion limited the scope for controlling cost growth in the recent past. However, the management is hopeful of lowering Operating Cost/Avg.AUM ratio to 6% and Cost/Income ratio to 51-52% by FY20, assuming AUM growth remains strong.
- Cashless disbursement facility is available at 96% of branches and nearly 70% disbursements in September were under this mode. Cashless disbursement addresses the risk of carrying cash while contributing marginally towards improving cost ratios.
- No MFI player has been able to find a solution for the cashless collection. In Satin's assessment, 100% cashless collection can improve Opex/Avg. AUM ratio by 100-150bps. The company will start work on digitizing collections after reaching 100% cashless disbursements by March 2019.
- As compared to many of its peers, Satin's branch and loan officer productivity (in terms of AUM/customers) is low due to distribution expansion in new states during recent years. As the rate of new branch addition moderates and AUM in newly opened branches scales up, the productivity metric would improve.
- After entering Southern India, the company has discovered that a loan officer's salary is materially lower compared to North India. Generally, loan officer's attrition is high during first six months from joining; after which it stabilizes.

Asset quality and credit cost

- The portfolio stress caused by demonetization has been sufficiently addressed by taking substantial write-offs and making significant provisions on active NPLs. Management claims to follow conservative estimates for ECL. Versus PAR 90 portfolio of Rs2.27bn at the end of Q2 FY19, which represented Rs1bn overdue instalments, Satin had provisions of Rs1.8bn.
- Loans disbursed in CY17 have a cumulative collection efficiency of 97.7% and comprised 33% of the AUM. Loans disbursed in CY18 have a cumulative collection efficiency of 99.5%. Blended cumulative collection efficiency improved to 98.3% in Q2 FY19 from 98% in Q1 FY19, aided by increasing share of CY18 loans and recoveries.
- More than 1000 people are working on collections from NPL customers and written-off portfolio. Satin collected Rs60mn from PAR 360 portfolio during H1 FY19. Currently, PAR 360 portfolio stands at ~Rs2.8bn, including Rs2.4bn of write-off.

- ✓ Management expects PAR 90 figure to reduce meaningfully in coming quarters. These are largely loans disbursed in early CY17 and will run-off in the near term.
- ✓ Credit cost at annualized 1.3% in Q2 FY19 was substantially lower than 2.7% in Q1 FY19. Further recoveries from NPLs and written-off accounts and sustained high collection rate of the new portfolio will positively influence the ECL model. Management expects credit cost to stabilize at 1-1.2% eventually.
- ✓ Satin does not foresee any consequential impact on asset quality due to smaller MFIs curtailing disbursements or not growing for a transient period. Customers are well aware that farm loan waivers would never apply to them. Hollow announcements to that effect during elections could impact collections for a very brief period but would tend to self-correct in due course. Minor district level issues will always be prevalent in this business.
- ✓ MFI customers are generally perceived hand-to-mouth, but the fact of the matter is that every household has two to three streams of income and earns decent cash flows. Generally, non-payers are wilful defaulters.
- ✓ All loans are under bi-weekly collection model. Majority loans supported by income and two MFI rule is being followed to check indebtedness. For Satin, the rejection rate has increased due to regional expansion and tapping of new customers.

Profitability outlook

- ✓ Satin has guided for a PAT of Rs1.65bn in the current fiscal, implying RoA of 2.5%. This guidance factors some moderation in growth and lumpiness in assignment income.
- ✓ For FY20, the management is hopeful of achieving RoA of 3%+ aided by a decline in credit cost and improvement in opex productivity.

Promoter pledge and warrant conversion

- ✓ About 45% of Promoter's holding is pledged currently. The loan outstanding has come off from the start. The pledge is across four lenders with whom the promoter shares a strong relationship.
- ✓ The management is confident that pledge will not be invoked. The promoter has substantial family assets that can be partially liquidated to release the pledge. In case of further fall in stock price, the promoter would prefer to make a partial loan repayment rather than topping-up shares.
- ✓ Promoters are keen on converting warrants priced at Rs335. They would do it closer to its expiry by July 2019. Promoter's holding will increase to 28.6% post warrants' conversion.

MSME Finance, Housing Finance and Taraashna

- ✓ MSME and Housing Finance businesses have separate CEO and teams. The CEOs have been asked to focus on building a high-quality portfolio. The head of MSME business has worked with Citigroup and Cholamandalam, and the head of housing finance is ex-Karvy Housing.
- ✓ These offerings, a conscious product diversification, would leverage distribution outreach and customer base. The plan to demerge the MSME business into a subsidiary to nourish the cocoon of its growth. At present, MSME AUM is Rs1.05bn and average loan ticket is Rs1.1mn.

- ✓ The housing finance subsidiary is operating from two branches, one each in Rajasthan and Delhi. Its AUM stood at ~Rs260mn and average loan ticket stands at Rs1.5mn. Current portfolio is funded pre-dominantly through equity. Company focuses on self-employed customers and there is no overlap with MFI customer base.
- ✓ Taraashna Services Ltd. (TSL), the BC subsidiary, is exploring a tie-up with a strong banking partner (akin to Satin-IIB arrangement) for scaling its AUM. Existing BC arrangements, especially with Reliance Capital, have not picked traction.
- ✓ Satin has developed an on-line financing platform called 'Loan Dost' which would be commercially launched soon. The long-term plan of the management is to list the SME, Housing and TSL businesses as distinct entities after they achieve reasonable scale.

Q2 FY19 FINANCIAL PERFORMANCE

Consolidated - Rs mn	Q2 FY19	Q1 FY19	% qoq	Q2 FY18	% yoy
Total Operating Income	3,648	3,278	11.3	2,469	47.7
Interest Expenses	(1,685)	(1,539)	9.5	(1,273)	32.4
Net Interest Income	**1,963**	**1,739**	**12.8**	**1,197**	**64.0**
Other income	4	0	1,708.3	1	201.6
Total Income	**1,967**	**1,740**	**13.1**	**1,198**	**64.2**
Operating expenses	(1,062)	(968)	9.7	(778)	36.4
Provisions	(185)	(359)	(48.5)	711	(126.0)
PBT	720	413	74.4	1,130	(36.3)
Tax	(259)	(138)	87.9	(397)	(34.7)
PAT	**461**	**275**	**67.7**	**734**	**(37.1)**

Key Ratios - %	Q2 FY19	Q1 FY19	chg qoq	Q2 FY18	chg yoy
Income/Avg.AUM	23.9	22.3	1.6	22.7	1.2
Int Exp/Avg.AUM	(11.0)	(10.4)	(0.6)	(11.7)	0.6
NII/Avg.AUM	**12.9**	**11.8**	**1.0**	**11.0**	**1.9**
C/I	54.0	55.6	(1.7)	65.0	(11.0)
PPOP/Avg.AUM	5.9	5.2	0.7	3.9	2.1
Prov/Avg.AUM	(1.2)	(2.4)	1.2	6.5	(7.7)
PAT/Avg.AUM	**3.0**	**1.8**	**1.2**	**6.7**	**(3.7)**
Gross NPA	**4.1**	**3.9**	**0.2**	**-**	**-**
CAR	25.2	24.4	0.9	16.7	8.5

Business Data	Q2 FY19	Q1 FY19	% qoq	Q2 FY18	% yoy
AUM - Rs mn	**61,914**	**60,257**	**2.7**	**44,931**	**37.8**
MFI (SCNL)	54,560	53,140	2.7	39,271	38.9
Non-MFI (MSME)	1,052	862	22.0	604	74.2
TSL	6,038	6,136	(1.6)	5,056	19.4
Housing Finance	264	119	121.8	-	-
Average Ticket Size - Rs					
MFI (SCNL)	27,000	29,000	(6.9)	30,000	(10.0)
MSME (SCNL)	1,100,000	1,180,000	(6.8)	980,000	12.2
TSL	26,700	25,800	3.5	22,500	18.7
SHFL	1,493,000	1,250,000	19.4	-	-
Branches - No					
SCNL	885	838	5.6	680	30.1
TSL	179	177	1.1	165	8.5
SHFL	2	2	-	-	-
Employees - No					
SCNL	9,579	7,951	20.5	5,978	60.2
TSL	1,352	1,377	(1.8)	1,200	12.7
SHFL	41	40	2.5	-	-

Source: Company, YSL

ABOUT YES SECURITIES (INDIA) LIMITED

YES SECURITIES (INDIA) LIMITED (''YSL'') is a wholly owned subsidiary of YES BANK LIMITED.YSL is a SEBI registered stock broker holding membership of NSE and BSE. YSL is also a SEBI registered Category I Merchant Banker, Investment Adviser and a Research Analyst. YSL offers, inter alia, trading/investment in equity and other financial products along with various value added services. We hereby declare that there are no disciplinary actions taken against YSL by SEBI/Stock Exchanges.

DISCLAIMER

Investments in securities market are subject to market risks, read all the related documents carefully before investing.

The information and opinions in this report have been prepared by YSL and are subject to change without any notice. The report and information contained herein are strictly confidential and meant solely for the intended recipient and may not be altered in any way, transmitted to, copied or redistributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of YSL.

The information and opinions contained in the research report have been compiled or arrived at from sources believed to be reliable and have not been independently verified and no guarantee, representation of warranty, express or implied, is made as to their accuracy, completeness, authenticity or validity. No information or opinions expressed constitute an offer, or an invitation to make an offer, to buy or sell any securities or any derivative instruments related to such securities. Investments in securities are subject to market risk. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. Investors should note that each security's price or value may rise or fall and, accordingly, investors may even receive amounts which are less than originally invested. The investor is advised to take into consideration all risk factors including their own financial condition, suitability to risk return profile and the like, and take independent professional and/or tax advice before investing. Opinions expressed are our current opinions as of the date appearing on this report. Investor should understand that statements regarding future prospects may not materialize and are of general nature which may not be specifically suitable to any particular investor. Past performance may not necessarily be an indicator of future performance. Actual results may differ materially from those set forth in projections.

Technical Analysis reports focus on studying the price movement and trading turnover charts of securities or its derivatives, as opposed to focussing on a company's fundamentals and opinions, as such, may not match with reports published on a company's fundamentals.

YSL, its research analysts, directors, officers, employees and associates accept no liabilities for any loss or damage of any kind arising out of the use of this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject YSL and associates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

Disclosure of interest

Name of the Research Analyst : Rajiv Mehta

The analyst hereby certifies that opinion expressed in this research report accurately reflect his or her personal opinion about the subject securities and no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendation and opinion expressed in this research report.

Sr. No.	Particulars	Yes/No
1	Research Analyst or his/her relative's financial interest in the subject company(ies)	NO
2	Research Analyst or his/her relative or YSL's actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of the Research Report	NO
3	Research Analyst or his/her relative or YSL has any other material conflict of interest at the time of publication of the Research Report	NO
4	Research Analyst has served as an officer, director or employee of the subject company(ies)	NO
5	YSL has received compensation or other benefits from the subject company(ies) or third party in connection with this research report	NO
6	Broking/Investment Banking/Merchant Banking relationship with the subject company at the time of publication of Research Report	NO
7	YSL has managed or co-managed public offering of securities for the subject company in the past twelve months	NO
8	Research Analyst or YSL has been engaged in market making activity for the subject company(ies)	NO

Since YSL and its associates are engaged in various businesses in the financial services industry, they may have financial interest or may have received compensation for investment banking or merchant banking or brokerage services or for any other product or services of whatsoever nature from the subject company(ies) in the past twelve months or associates of YSL may have managed or co-managed public offering of securities in the past twelve months of the subject company(ies) whose securities are discussed herein.

Associates of YSL may have actual/beneficial ownership of 1% or more and/or other material conflict of interest in the securities discussed herein.