# CRISIL IER

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Enhancing investment decisions

# Satin Creditcare Network Ltd

Initiating Coverage

## Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

| CRISIL Fundamental Grade | Assessment | CRISIL Valuation Grade | Assessment |
|---|---|---|---|
| 5/5 | Excellent fundamentals | 5/5 | Strong upside (>25% from CMP) |
| 4/5 | Superior fundamentals | 4/5 | Upside (10-25% from CMP) |
| 3/5 | Good fundamentals | 3/5 | Align (+-10% from CMP) |
| 2/5 | Moderate fundamentals | 2/5 | Downside (negative 10-25% from CMP) |
| 1/5 | Poor fundamentals | 1/5 | Strong downside (<-25% from CMP) |


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CRISIL
An S&P Global Company

# Satin Creditcare Network Ltd

**October 21, 2016**

## Strengthening its market position

**Fundamental Grade: 3/5 (Good fundamentals)** **Valuation Grade: 3/5 (CMP is aligned)**

**Industry: Microfinance** **Fair Value: ₹620** **CMP: ₹593**

Satin Creditcare Network Ltd (Satin) is one of the fastest growing microfinance NBFCs in India with a gross loan portfolio (GLP) of ₹32.8 bn as of Q1FY17. The company is well placed – extensive branch network, trained loan officers and lowest operating expense/average GLP ratio – to benefit from the industry's growth potential, especially in underpenetrated states. Uttar Pradesh (UP), Bihar, Madhya Pradesh (MP) and Punjab account for 85% of its Q1FY17 GLP. The company is in the process of diversifying its loan book and is currently present in 16 states, but we expect the geographic concentration risk to persist in the near term. Successful completion of qualified institutional placement (QIP) amounting to ₹2.5 bn in October 2016 augurs well for the company in the medium term. Prior to QIP, Satin had a relatively weaker credit rating and higher leverage than selected peers (until FY16), which is expected to improve. We initiate coverage on the company with a fundamental grade of **3/5**.

**GLP to grow at 44% CAGR over FY16-18 with increase in the number of branches**
We expect GLP to grow at a two-year CAGR of 44% to ₹6.7 bn in FY18. High growth potential arises from relatively low penetration of microfinance in the northern and eastern states, and Satin being one of the largest players in the aforementioned regions. Strong growth in GLP is expected to be backed by robust expansion of the branch network. We expect the number of branches to increase to ~695 in FY18 from 431 in FY16.

**Equity capital infusion of ₹2.5 bn to support growth in the medium term**
Satin successfully completed its QIP in October 2016, wherein it raised ₹2.5 bn of equity capital. This will enable the company to improve its capital adequacy ratio (CAR) to ~26% in FY17, significantly reducing the risk to GLP growth in the medium term.

**Moving towards more evolved risk management policies to align with business growth**
The company is in the process of establishing more evolved risk management policies backed by suitable IT systems. It plans to move almost all its branches to cashless collections by FY17.

**Loan book exposed to geographic concentration – the company taking steps to diversify**
In Q1FY17, UP accounted for 39% of Satin's loan book. This potentially exposes the company to systemic and localised risks in the state. The company has reduced UP's contribution to GLP from 59% in FY13 to 39% in Q1FY17 and we expect it to diversify further into underpenetrated states to reduce geographic concentration.

**Relatively low reported RoA* amongst selected peers owing to high borrowing cost**
Compared to selected peers, Satin has a relatively low reported RoA of 2.2% in FY16. Higher finance cost* of 13.2% owing to relatively weaker credit rating and lower non-income than peers led to lower RoA for Satin, which is expected to improve going forward.

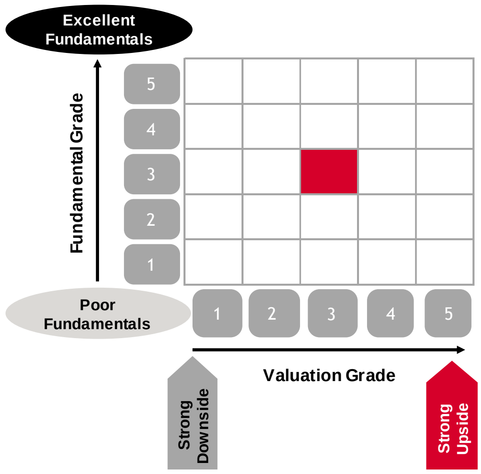
**Fair value of ₹620 using one-year forward P/B of 2.8x**
We have valued Satin by the P/B method. Using a multiple of 2.8x on FY18 book value of ₹221 per share, our fair value is ₹620. Based on the CMP of ₹593, the valuation grade is **3/5**.

## KEY FORECAST

| ₹ mn | FY14 | FY15 | FY16# | FY17E | FY18E |
|---|---|---|---|---|---|
| Total operating income | 856 | 1,467 | 2,687 | 4,150 | 6,222 |
| Pre-provision profit | 332 | 581 | 1,112 | 1,722 | 2,548 |
| Adj. net profit | 156 | 317 | 579 | 970 | 1,435 |
| Adj. EPS (₹) | 6.9 | 12.5 | 18.4 | 26.1 | 38.7 |
| Adj. book value (₹ per share) | 58.7 | 71.6 | 96.5 | 189.4 | 227.8 |
| P/E (x) | 86.4 | 47.5 | 32.2 | 22.7 | 15.3 |
| P/ABV (x) | 10.1 | 8.3 | 6.1 | 3.1 | 2.6 |
| Adj. ROE* (%) | 12.1% | 20.1% | 23.7% | 19.2% | 18.5% |
| Adj. ROA* (%) (including managed assets) | 1.4% | 1.6% | 1.7% | 1.9% | 2.0% |
| Provision & write-offs (as % of loan book) | 1.6% | 1.1% | 0.6% | 1.3% | 1.3% |
| Capital adequacy ratio (%) | 15.3% | 15.7% | 16.8% | ~26% | ~21% |

*Source: Company, CRISIL Research estimates; #Abridged financials (Selected peers: Bharat Financial Inclusion, Equitas Microfinance, Janalakshmi, and Ujjivan)*
**Note: Reported parameters are as per company annual reports, while Adj. parameters are as per CRISIL Research estimates (as discussed in the respective charts/ tables)*

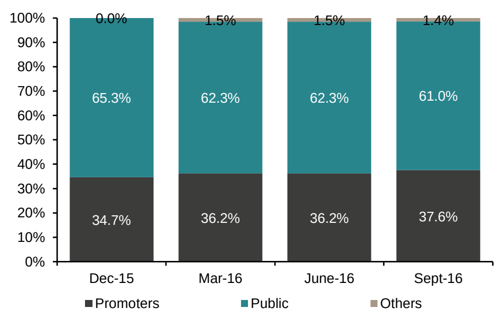
## CFV MATRIX




## KEY STOCK STATISTICS

| | |
|---|---|
| NIFTY/SENSEX | 8699/28130 |
| NSE/BSE ticker | SATIN |
| Face value (₹ per share) | 10 |
| Shares outstanding (mn) | 37.1 |
| Market cap (₹ mn)/(US$ mn) | 22,015/329 |
| 52-week range (₹)/(H/L) | 245/717 |
| Beta | 1.3 |
| Free float (%) | 62.4% |
| Avg daily volumes (30-days) | 183,250 |
| Avg daily value (30-days) (₹ mn) | 107 |

## SHAREHOLDING PATTERN




## PERFORMANCE VIS-À-VIS MARKET

| | Returns | | | |
|---|---|---|---|---|
| | 1-m | 3-m | 6-m | 12-m |
| Satin | 2% | 18% | 73% | 71% |
| CNX 500 | 1% | 5% | 14% | 9% |

For detailed initiating coverage report please visit: www.crisil.com
CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

**Table 1: Business environment**

| Segment | Microfinance |
|---|---|
| **Split of GLP (Q1FY17)** | ● Microfinance loans: ₹32.7 bn (Including MSME portfolio - ₹42.4mn)<br>● Loans for solar lamps: ₹0.1 bn |
| **Split of GLP (FY17E)** | ● Microfinance loans: ₹46.5 bn<br>● Loans for solar lamps: ₹0.9 bn |
| **Product/ service offering** | Provides credit in the range of ₹15,000 to ₹50,000 to women, whose rural household annual income does not exceed ₹100,000 or urban or semi-urban household income not exceeding ₹160,000. The company levies an average interest rate of ~24% on microfinance loans |
| **Geographical presence** | Present in 16 states. Geographical presence as a percentage of GLP, as of Q1FY17<br>● UP: 39%<br>● Bihar: 18%,<br>● MP: 15%<br>● Punjab: 13%<br>● Uttarakhand : 3%<br>● Other states : 12% |
| **GLP growth (FY12-16; 4-year CAGR)** | ● Top four states (UP, Bihar, MP, Punjab): 90%<br>● Other states : 44% |
| **GLP growth (FY16-18; 2-year CAGR)** | ● Top four states (UP, Bihar, MP, Punjab): 37%<br>● Other states : 81% |
| **Key growth drivers** | ● For the forecast period, expanding its loan portfolio into newer states along with moderate increase in the ticket size.<br>● Over the long term, forays into new loan products such as product financing, MSME loans and individual micro lending |
| **Key competitors** | **<u>NBFC-microfinance institutions (MFIs)</u>**<br>Bharat Financial Inclusion Ltd* (BFIL) and other smaller players<br><br>**<u>NBFC-MFI turned small finance banks (SFBs)</u>**<br>NBFCs such as Ujjivan, Equitas, Janalakshmi Utkarsh, etc. who have been granted approvals for conversion to SFB. |
| **Key risks** | ● Geographic concentration risk exists. However, in the long term, reduction in UP's share of GLP can be achieved, with other states taking its share |

**Bharat Financial Inclusion Ltd – previously known as SKS Microfinance Ltd*

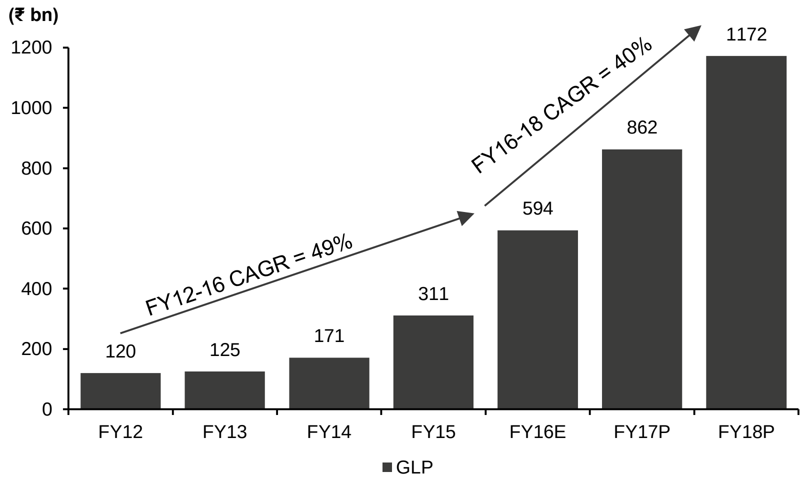
*Source: Company, CRISIL Research*

# Grading Rationale

## Microfinance industry: To maintain high growth trajectory, with 40% growth in GLP until FY18

The environment for microfinance institutions has improved significantly after the establishment of NBFC regulations in 2012. The industry's GLP increased at 49% CAGR over FY12-16 following a relatively low growth period in FY10-12 (owing primarily to the Andhra Pradesh or AP crisis[1] in 2010). Growth is expected to sustain for MFIs on the back of the Central government's focus on financial inclusion, expected availability of funding for large MFIs via PSL and MUDRA (Micro Units Development Refinance Agency) Bank and diversification of loan portfolio to beyond southern states. We estimate GLP growth for the industry to be robust and increase at 40% CAGR over FY16-18.

**Figure 1: High growth fuelled by regulatory stability**




Note: 1) MFIN data is assumed to cover over 90% of the overall market.
2) GLP includes only NBFC-MFIs; excludes Bandhan Financial Services Ltd (now a bank)
3) MFIs, who have been granted SFB licence, have also been considered in future GLP growth.
4) E: Estimates P: Projections
*Source: MFIN, CRISIL Research*

### *Basking in a supportive regulatory environment post AP crisis*

Introduction of NBFC-MFI regulations in 2012 by the Reserve Bank of India (RBI) reduced the uncertainty caused by the AP crisis to a great extent. NBFC-MFI regulations were instrumental in significantly mitigating the political risks faced by MFIs. Establishment of Microfinance Institution Network (MFIN), a member funded self-regulatory organisation, has aided in higher level of transparency and monitoring of the industry. Credit Information Bureaus (CIBIL, Equifax, CRIF Highmark and Experian) mandatorily receive data from all

[1] In 2010, the AP government put a stop to MFI operations in the state leading to significant write-offs. Refer to Annexure for further details.

MFIs before disbursing loans, thereby enhancing the capability of MFIs to manage risk of default caused by indebtedness of borrowers.

**Table 2: Salient points of RBI guidelines for MFIs (October 2015)**

| | RBI final regulations | Comments |
|---|---|---|
| **Loan characteristics** | • Loans for income generation activities >50%<br>• Tenure for higher value loans (more than ₹30,000) shall not be less than 24 months with prepayment without penalty | • This ensures majority of loans are for income generating activities, reducing the risk of default<br>• Higher repayment tenure for higher loan size to reduce financial burden on clients |
| **Interest rates** | Minimum of<br>• i) Cost of funds + 10% margin cap for large MFIs and 12% margin cap for small (GLP of <₹1 bn) MFIs<br>• ii) Interest rate equal to 2.75x of average base rate of top five commercial banks by assets | • Standardised interest rate charged across the industry. Made sure that borrowers are not over-charged and at the same time, maintained the financial viability of MFIs |
| **Borrowing limit** | • Not less than 85% of the net assets shall be “qualifying assets”<br>**Qualifying asset shall mean a loan which satisfies the following criteria :-**<br>• Loans disbursed to a borrower whose rural household annual income does not exceed ₹100,000 or urban or semi-urban household income not exceeding ₹160,000.<br>• Loan amount does not exceed ₹60,000 in the first cycle and ₹100,000 in the subsequent cycles.<br>• Total indebtedness does not exceed ₹100,000 | • Addresses the issue of multiple lending and over-leveraging of the borrower<br>• Credit bureaus provide the relevant information for conducting credit checks of the borrowers |
| **Transparency** | • MFIs can levy only three charges for a loan: interest, processing fee of 1% and insurance premium on actuals<br>• One cannot collect collateral or security deposit<br>• All the details of the loan should be clearly documented on a paper in local language | • Addresses the issues of non-transparency of the borrower |
| **Collection** | • No coercive method to be used by the loan officer | • Adopted the middle path where the business viability of MFIs is maintained along with reducing political risks |

***Government’s focus on financial inclusion to boost demand***

The Central government has taken positive steps towards financial inclusion by setting up the Pradhan Mantri Jan Dhan Yojna (PMJDY) in August 2014. Until October 5, 2016, 250 mn accounts have been opened as a part of this scheme, having a balance of ~₹442 bn. Since traditional banks lack the cost effective infrastructure to reach the rural unbanked population, the role of MFIs becomes crucial for achieving ‘last mile credit’. Until Q1FY17, MFIs brought under formal financial coverage ~35.8 mn people across the country. There is still significant room for growth, with the World Bank’s Global Financial Inclusion (Findex) database (2014) revealing that 53% of India’s adult population lacks access to formal source of financing. For women in India, financial inclusion stands at a poor 43%. As the government focuses on deepening financial inclusion in rural areas, MFIs are expected to play a crucial role.

### *Select MFIs obtaining SFB licence to boost funding availability for other NBFC-MFIs*

On conversion of some large MFIs into SFBs, the on-lending by banks to these SFBs will no longer qualify for PSL. Banks (including foreign banks) and SFBs would, therefore, be required to meet their PSL targets of 40% and 75%, respectively, by lending to players who continue to be NBFC-MFIs. This is expected to boost the funding availability and lower the cost of funds for microfinance players in the medium to long term.

### *MUDRA Bank – Strong source for future credit disbursements*

Stabilisation of the regulatory environment has improved the industry scenario and brought back investor confidence. Further, establishment of MUDRA Bank in April 2015 by the Ministry of Finance augurs well for MFIs such as Satin as the main objective of this bank is to refinance MFIs who give micro loans for manufacturing, service or trading activities. Formed with a refinance corpus of ₹200 bn and corpus of ₹30 bn, MUDRA provides access to funds carrying lower interest rates.

**Table 3: Primary objectives of MUDRA Bank**

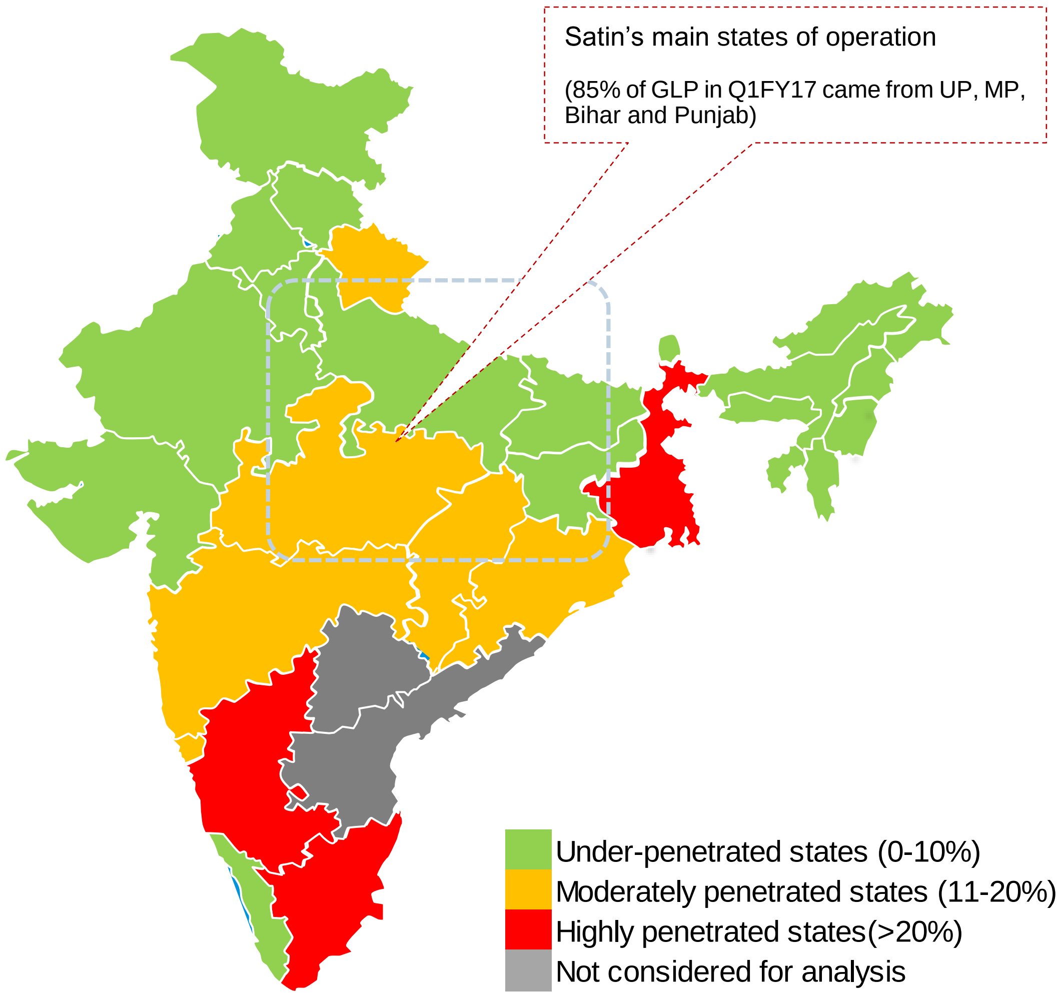
| |
|---|
| • Refinancing MFIs which are in the business of lending to micro or small business entities engaged in manufacturing, trading and services activities. |
| • Laying down policy guidelines for micro/small enterprise financing business. |
| • Accreditation/rating of MFI entities. |
| • Assist lower income groups to develop and grow small businesses. |
| • Increase finance access to the un-banked and to also bring down the cost of finance. |
| • Formulate and run a credit guarantee scheme for providing guarantees to loans which are being extended to micro-enterprises. |

*Source: MFIN*

### *Under-penetration indicates growth potential for MFIs; to be driven by states other than South India*

Despite robust growth in the past three years, the Indian microfinance industry remains highly underpenetrated. MFIs are estimated to have reached only ~14% of ~250 mn households in 2016 compared with ~11% in 2012. While growth in southern states has been relatively weaker owing to increasing focus of MFIs to diversify to new territories, northern states have been the main growth drivers. In terms of client outreach, states such as UP, Punjab, Bihar and MP have shown impressive growth of ~25% CAGR over FY12-16. Despite strong growth in client outreach, penetration in these states is estimated at ~10% in FY16. In contrast, penetration in states such as Karnataka and Tamil Nadu is estimated to have reached ~33%. Going forward, strong growth in GLP is expected to continue as MFIs expand their borrower base and strengthen portfolios in relatively underpenetrated states.

**Figure 2: Northern and western states are relatively underpenetrated (as of March 2016)**




Note: Penetration for states has been computed by dividing the no. of MFI clients (as of March 2016) by estimated no. of households

*Source: MFIN, CRISIL Research*

## UP, Bihar, Jharkhand and MP are states with high potential for microfinance growth

For assessing the growth potential for indivdual states, we have evaluated the top 20 states (in terms of population) on five parameters - bank offices per lakh population, per capita income, population of the state, rural credit outstanding per lakh population and estimated MFI penetration. As per our analysis, states such as UP, Bihar, Jharkhand and MP have the highest potential for growth in GLP.

**Table 4: Parameters for assessing growth potential for individual states**

| Sr. No. | Parameters | Significance |
|---|---|---|
| 1) | Bank offices per lakh population | Indicates the ease of accessing financial services through normal banking channels. A lower number of bank offices indicates high growth potential for MFIs |
| 2) | Estimated penetration of MFIs | Indicates the estimated level of penetration reached by MFIs. Lower penetration indicates higher potential growth for MFIs |
| 3) | Estimated population | Larger population indicates higher potential for increasing the number of MFI borrowers in that particular state |
| 4) | Per capita income (2014) | Low per capita income for the population indicates potential demand for microfinance loans |
| 5) | Rural credit outstanding per person | Indicates the level of credit penetration in a particular state. Lower credit penetration could be a potential driver for MFI penetration in a particular state |

**Table 5: Top 20 states by population: Key statistics (sorted by microfinance growth potential)**

| States | Bank offices per lakh population | Estimated MFI penetration in 2016 | Population (2011) in lakh | Per capita income | Rural credit O/s (mn) in per person |
|---|---|---|---|---|---|
| UP | 7.4 | 7% | 1,996 | 36,250 | 4,409 |
| Bihar | 5.6 | 9% | 1,038 | 31,199 | 2541 |
| Jharkhand | 7.9 | 8% | 330 | 46,131 | 3,192 |
| MP | 7.8 | 18% | 726 | 51,798 | 4,982 |
| Chhattisgarh | 8.3 | 11% | 255 | 58,547 | 2,751 |
| Rajasthan | 8.8 | 5% | 686 | 65,974 | 6,718 |
| Assam | 6.4 | 8% | 312 | 44,263 | 3,072 |
| Odisha | 9.9 | 19% | 419 | 52,559 | 4,866 |
| West Bengal | 7.6 | 23% | 913 | 70,059 | 3,662 |
| J&K | 12.3 | 0% | 125 | 58,593 | 17,184 |
| Andhra Pradesh | 12.3 | NA | 847 | 81,397 | 7,636 |
| Maharashtra | 9.9 | 12% | 1,124 | 114,392 | 7,760 |
| Gujarat | 11.3 | 8% | 604 | 106,831 | 8,657 |
| Kerala | 17.5 | 10% | 334 | 103,820 | 7,070 |
| Uttarakhand | 17.7 | 15% | 101 | 103,716 | 10,776 |
| Himachal Pradesh | 20.1 | 0% | 69 | 92,300 | 19,196 |
| Punjab | 20.5 | 9% | 277 | 92,638 | 25,746 |
| Haryana | 16.4 | 9% | 254 | 133,427 | 17,703 |
| Tamil Nadu | 12.9 | 36% | 721 | 112,664 | 17,566 |
| **Karnataka** | **14.4** | **29%** | **611** | **84,709** | **12,593** |

*Notes:* *1) Data for bank offices and rural credit per person is as of 2015 and per capita income is as of 2014*
*2) The state of AP has not been considered for analysis.*
3) Penetration for states has been computed by dividing no. of MFI clients (as of March 2016) by estimated no. of households

*Source: RBI, MFIN, Press Information Bureau, CRISIL Research*

**Table 6: Brief profile of the states with high growth potential**

| States | Key growth drivers for respective states |
|---|---|
| **Uttar Pradesh** | • UP has the highest potential for GLP growth. It has the largest estimated population of ~199 mn as of 2011.<br>• The penetration of bank offices is fairly low. It has 15,573 bank offices - average of ~7 bank offices per lakh of population.<br>• The estimated level of MFI penetration is estimated to be at low ~7% as of 2016.<br>• The state has a low rural credit outstanding of only ₹4,400 per person. |
| **Bihar** | • The state has the lowest per capita income of ~₹31,200 as of FY14.<br>• For an estimated population of ~104 mn it has only 6,210 bank offices – average of ~6 branches per lakh population.<br>• The estimated MFI penetration is also relatively low at ~9% as of FY16. |
| **Jharkhand** | • The state has an estimated population of ~33 mn and 2,763 bank offices as of 2015 – average eight bank offices per lakh of population.<br>• The estimated MFI penetration is also low at ~8% as of FY16.<br>• Rural credit outstanding is amongst the lowest at ~₹3,100 per person. |
| **Madhya Pradesh** | • The state has a low bank office penetration of about eight offices per lakh population.<br>• The estimated MFI penetration is ~18% as of FY16.<br>• Rural credit outstanding is also quite low at ~₹5,000 per person. |
| **Chhattisgarh** | • Rural credit outstanding from banks is the lowest amongst states at ~₹2,800 per person.<br>• State has an estimated population of ~26 mn as of 2011.<br>• The estimated MFI penetration is relatively low at 11% as of FY16. |

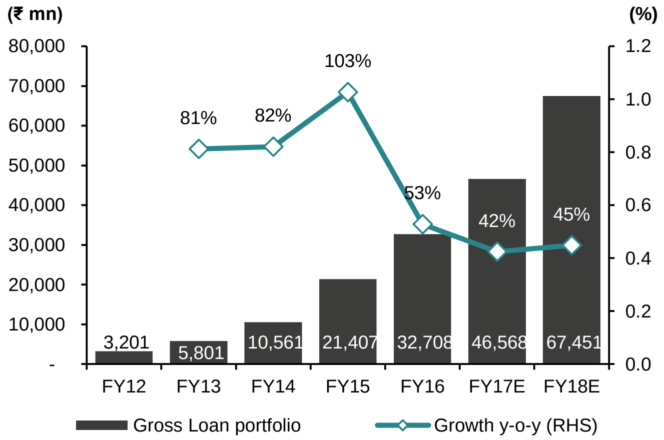
## Satin well placed to benefit from strong industry growth

Satin is a microfinance NBFC with a GLP of ₹32.8 bn as of Q1FY17. It lends over 98% of its loans under the joint liability group (JLG) model and is predominantly rural-based. UP, Bihar, MP and Punjab accounted for 85% of its loan book in Q1FY17, though it is present in 16 states serving more than 2 mn active clients. It is well placed to benefit from high growth prospects of the microfinance industry as it primarily operates in relatively underpenetrated states. This has been complemented by expansion of its branch network by ~61% in FY16.

## GLP to grow faster than industry at 44% CAGR over FY16-18

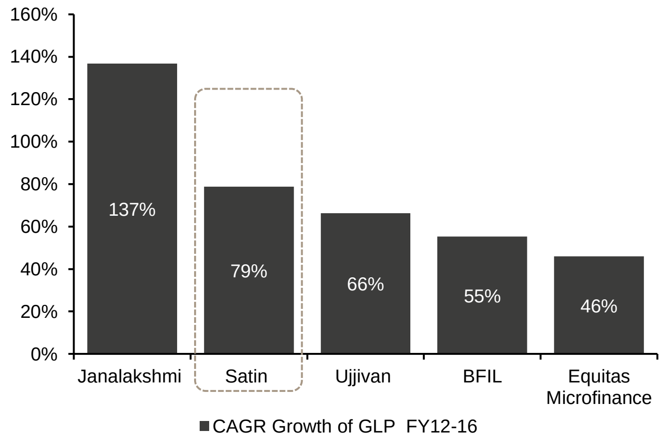
Satin's GLP expanded at a robust CAGR of 79% over FY12-16. Going forward, we expect loan book growth to moderate from historical levels but still increase at a strong rate of 44% CAGR over FY16-18. Diversification to new states, backed by rapid build-up of branch network, should ensure strong GLP growth of 44% in the medium term.

**Figure 3: Satin's strong GLP growth at 44% CAGR in FY16-18**




*Source: Company, MFIN, CRISIL Research*

**Figure 4: Faster than median growth in GLPs**



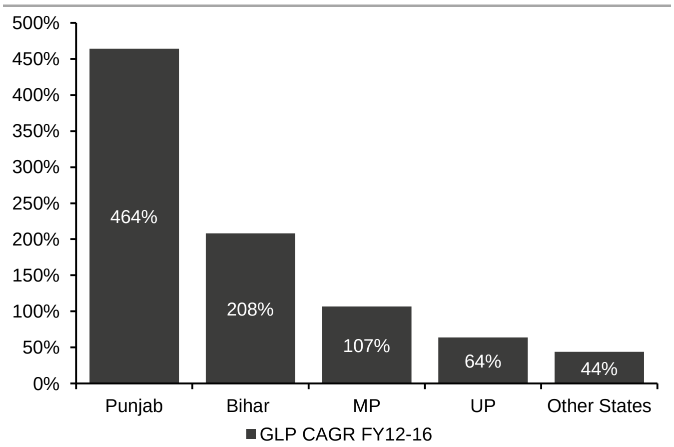

Data for selected peers is at company level;

*Source: MFIN, CRISIL Research*

### *Expansion to new and underpenetrated states to drive growth*

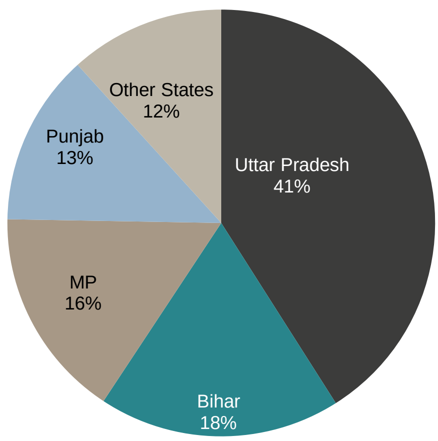
Satin has expanded its operations from 10 states in FY13 to 16 states in FY16. Concentration in UP has reduced from 59% in FY13 to 39% in Q1FY17. Market share in UP is more than 20% as of Q1FY17. The company has recorded strong growth in Punjab where its GLP touched ₹4.1 bn in Q1FY17 and has a market share of more than 30% from virtually nil in FY13. Operations in Bihar also recorded phenomenal growth of ~200% CAGR over FY12-16, albeit on a lower base. Going forward, as penetration in UP, Bihar, MP and Punjab deepens, we expect the growth rate to moderate but still be ~35% in the medium term. Uttarakhand, Rajasthan, Maharashtra and Gujarat are expected be the next growth drivers for the company, with GLP estimated to grow at a robust pace of ~80% CAGR over FY16-18.

**Figure 5: Key states driving Satin's growth**




*Source: Company, CRISIL Research*

**Figure 6: State-wise mix of GLP as of Q1FY17**




*Source: Company, CRISIL Research*

### *Moderate increase in ticket size to add to loan book growth*

In FY17, Satin's loan book growth is expected to be largely fuelled by increase in the number of borrowers. In addition, we expect moderate increase of 6-8% in the average ticket size. Moderate growth in ticket size is attributable to the following factors:

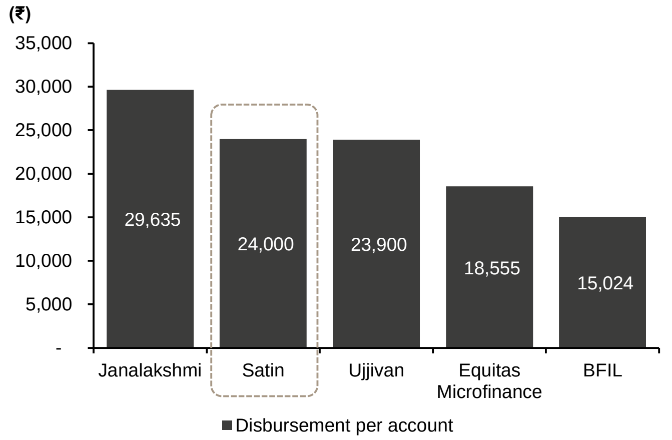
- As the company expands to newer territories, higher proportion of lending would be to first-time borowers. The ticket size for first-time borrowers is relatively lower than the overall average ticket size of ~₹24,000 in FY16.
- However, the revision in RBI guidelines to increase maximum indebtness to ₹100,000 from ₹60,000 is expected to have a moderate impact in increasing the ticket size.
- The company's client retention ratio of ~70% (of first-time borrowers) in the top four states of UP, Bihar, MP and Punjab augurs well for growth in ticket size. As these borrowers move to subsequent cycles of loan disbursement, the ticket size for these loans can increase by ~10%.

**Table 7: Factors affecting growth of ticket size**

| Key parameters | Impact on ticket size | Intensity of Impact | Comments |
|---|---|---|---|
| Limit of borrowing | ↑ | Low | Loan amount cannot exceed ₹60,000 in the first cycle and ₹100,000 in the subsequent cycles, while total indebtedness cannot exceed ₹100,000<br>This will have a low impact on ticket size as loans disbursed by Satin until FY16 are below ₹50,000 |
| Lending loans in new states | ↓ | Moderate – high | Expansion to new states would result in lending to first-time borrowers, therefore reducing the average ticket size |
| Retention of clients from existing states | ↑ | Moderate | As borrowers from existing states obtain the subsequent round of funding, the ticket size is expected to increase |

*Source: RBI, CRISIL Research*

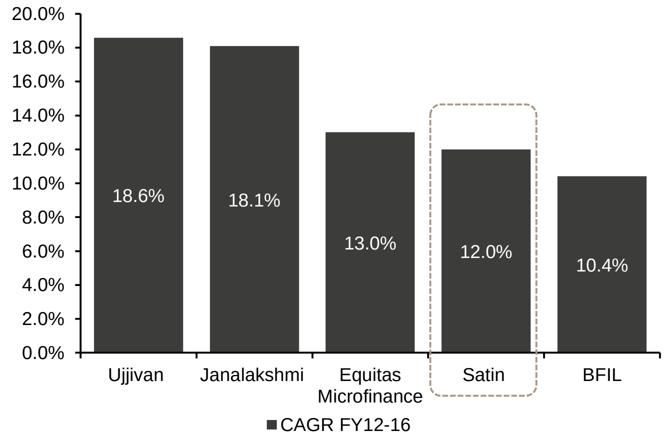
**Figure 7: Slightly higher than median disbursement per account in FY16**




Note: Data for selected peers is for MFI JLG loans.

*Source: MFIN, Investor presentations, CRISIL Research*

**Figure 8: However, lower-than-median growth in disbursement per account over CAGR FY12-16**



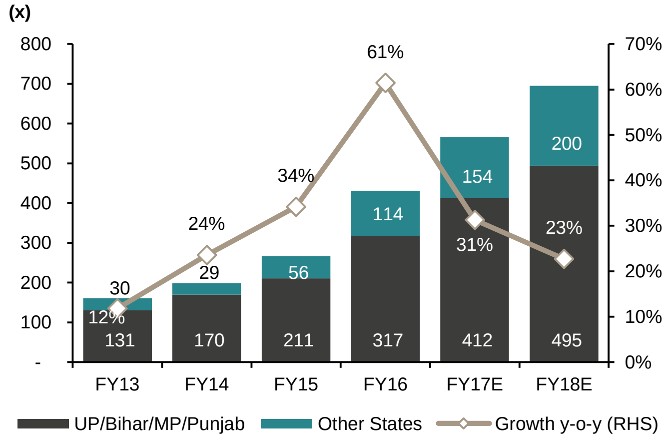

Note: Data for selected peers is for MFI JLG loans.

*Source: MFIN, CRISIL Research*

## Branch network expansion to support growth in loan portfolio

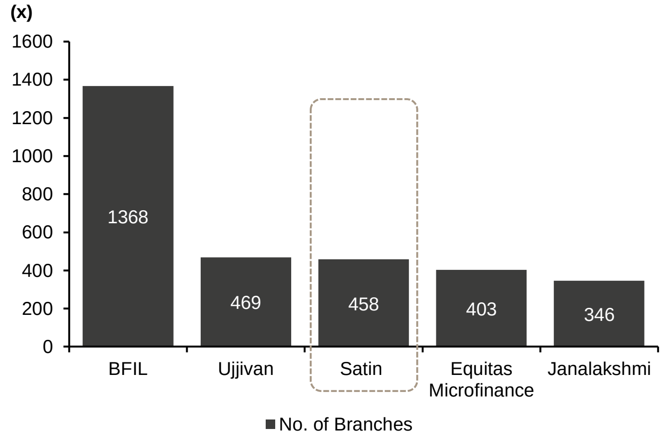
State-wise expansion has resulted in the number of branches increasing from 144 in FY12 to 458 as of Q1FY17. Notably, the number of branches grew 61% from 267 in FY15 to 431 in FY16. We expect the number of branches to increase to 695 by FY18 with 200 branches becoming operational in states other than the top four states. Outside of the top four states, the company has more than doubled the number of branches to 114 in FY16 from 56 in FY15. This was aimed at reducing the risk of geographical concentration and expanding business in states other than the top four. For the top four states, the network increased ~50% in FY16 to a total of 317 branches.

**Figure 9: Satin's branch expansion to continue in the near term**




*Source: Company, CRISIL Research*

**Figure 10: Satin's number of branches was at the median level among selected peers in Q1FY17**



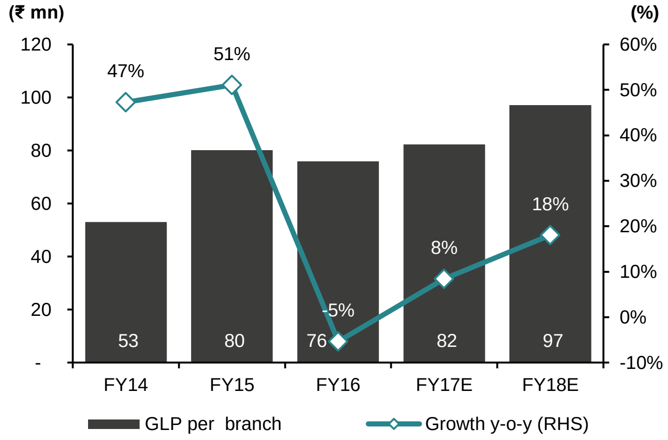

Note: Data for selected peers is at a company level.

*Source: Company, MFIN, CRISIL Research*

### *GLP per branch to improve in the near term*

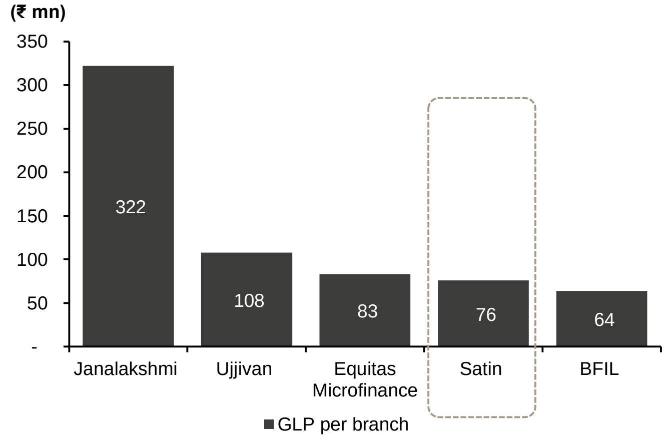
Satin's GLP per branch was ₹76 mn as of FY16 and ~₹71 mn in Q1FY17 compared to ₹80 mn in FY15. The slight decline in GLP per branch is attributable to jump in the number of branches over the period. We expect utilisation at branches to improve, but at a moderate rate of 13% CAGR over FY16-18 as further expansion of branches is expected to take place parallelly.

**Figure 11: GLP per branch to improve in the near term**




*Source: MFIN, CRISIL Research*

**Figure 12: Less-than-median GLP per branch in FY16**




Note: Data for all selected peers is at a company level

*Source: Companie s, MFIN, CRISIL Research*

## Cashless collections to address risks while improving operating efficiency

As a pioneer of branch level cashless collections, until June 30, 2016, the company has converted 165 branches (36% of the branches as of Q1FY17) into cashless collection centres. Also, in June 2016, ~11% of the collections were done on a cashless basis. Migrating to cashless transactions will help mitigate the cash-handling risk and improve operational efficiency. We expect the additional cost incurred by the company in implementing cashless transactions to be offset by savings on costs associated with handling cash across multiple locations on a regular basis. Collections from most of the branches are expected to be converted into cashless transactions by the end of FY17. Satin has partnered with ITz Cash for converting collections and disbursements to cashless transactions. However, owing to operational difficulties such as lack of ATM machines, limited technological awareness amongst clients etc., we expect disbursement transactions to take around two-three years to become completely cashless.

**How does the cashless collections scheme operate:**

- The loan officer counts the cash at the centre meetings. A centre meeting consists of 12-16 members who have been given micro-loans under the JLG model. After counting, the loan officer updates the registers manually and packs the cash in an envelope.
- Instead of carrying the cash, the loan officer hands over the cash to a member assigned for that meeting to deposit the cash at the nearest collection centre. Each time, a different member of the centre is given the task of depositing at the collection centres.
- The collection centre, typically, is in a radius of 2-3 km from the centre meeting location.
- After the cash is deposited at the collection centre, the collection partner (ITZ Cash) will credit Satin's account within five-six hours.
- Risk of cash loss in transit is transferred to the clients of the centre. The scheme aims to distribute the aggregated risk at the level of loan officer to multiple borrowers, thereby, reducing the concentration of cash with a single individual (loan officer).

## Well-managed costs, but cost to income ratio[2] affected by relatively low non-MFI income and recent branch expansions

Given its focus on operational efficiencies and improving productivity of loan officers, Satin has been able to consistently maintain the least opex/average GLP ratio amongst selected peers. It was able to reduce the ratio to 6.7% in FY16 from 7.7% in FY13. We expect the ratio to increase slightly, as the company would incur cost for increasing the branch network and recruiting more loan officers.

However, Satin's cost to income ratio is the highest amongst selected peers, mainly because of relatively low non-MFI income and higher costs on account of recent branch expansion. It has been primarily into microfinance lending and has historically not generated significant cross-sale of other products such as BFIL. BFIL's non-MFI income is ~15% of net interest income as of FY16 compared to less than 0.1% for Satin. On the cost side, additional employee expenses has been the key reason for 92% jump in operating cost in FY16. The number of loan officers have more than doubled to 3,173 as of Q1FY17 from 1,377 in FY15. Owing to the above factors, Satin's cost to income ratio (as outlined in the note below) reduced marginally to 59.7% in FY16 and further reduced to ~58% in Q1FY17 from 61.5% in FY15. Ujjivan and BFIL have been able to bring down their reported cost to income ratio to 51.0% and 48.3% in FY16, respectively. We expect Satin's cost to income ratio to remain at ~59% in FY18. This is attributable to a combination of moderation in borrowing cost, better utilisation of resources owing to migration to a cashless enviornment and increase in cost due to growth in number of branches.

[2] *Cost to income ratio = Operating expenses (excluding provisions and write-offs)/Net interest Income. Adjusting for insurance claims and write-offs (part of operating expenses), the cost to income ratio works out to 59.7% in FY16*

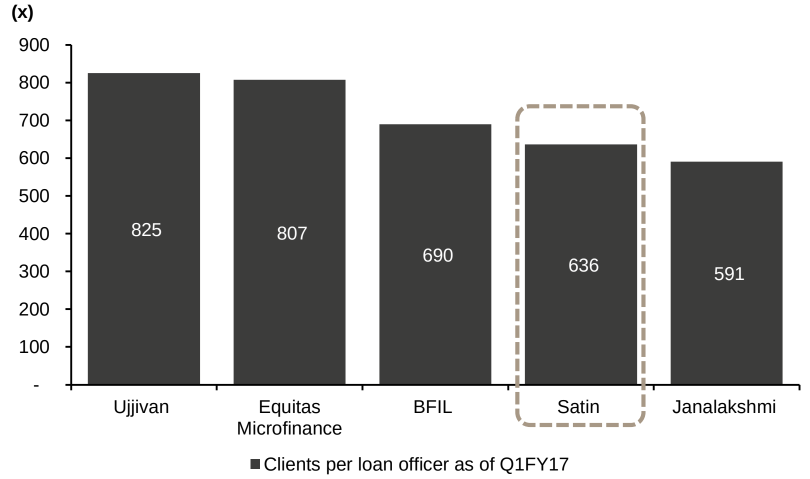
**Table 8: Lowest adjusted operating expenses/average GLP^ ratios**

| | FY13 | FY14 | FY15 | FY16 |
|---|---|---|---|---|
| BFIL | 25.2% | 10.1% | 9.4% | 7.5% |
| Equitas Microfinance | 10.1% | 8.2% | 8.1% | 8.1% |
| Janalakshmi | 12.4% | 11.6% | 11.4% | 10.7% |
| Satin | 7.7% | 7.6% | 6.3% | 6.7% |
| Ujjivan | 11.4% | 9.4% | 9.2% | 7.7% |

Note: 1) ^Adj Opex/Ave GLP = Operating expenses (including provisions and write-offs)/average GLP (including off balance assets)
2) Data for all selected peers is at company level.

*Source: Companies, CRISIL Research*

**Figure 13: Clients per loan officers for Satin and selected peers**




Data for all selected peers as is at company level.

*Source: Company's Investor presentations, MFIN, CRISIL Research*

**Table 9: However, cost to income ratio is amongst the highest in FY16**

| | FY13 | FY14 | FY15 | FY16 |
|---|---|---|---|---|
| BFIL | 125.1% | 74.5% | 61.1% | 48.3% |
| Equitas Microfinance | 65.4% | 52.9% | 54.9% | 58.6% |
| Janalakshmi | 72.0% | 63.5% | 69.0% | 67.6% |
| Satin | 81.2% | 62.0% | 61.5% | 59.7% |
| Ujjivan | 64.1% | 55.5% | 60.4% | 51.0% |

Note: 1) Cost to income ratio = Operating expenses (excluding provisions and write-offs)/Net Income
2) Data for all selected peers is at company level
3) Adjusting for Insurance claims and Write-offs (part of operating expenses) the ratio works out to 59.7%

*Source: Company, Investor presentation of respective companies, CRISIL Research*

## Conversion of large MFIs to small finance banks to boost Satin's securitised portfolio

Satin's securitised/off book portfolio as part of the GLP has seen a steady rise from 22% in FY13 to 30% in FY16. We expect securitisation to rise to ~33% of the GLP by FY18 driven by conversion of large MFIs to SFBs and revision in priority sector lending (PSL) norms by the RBI.

Conversion of large NBFC-MFIs to SFBs is expected to boost debt funding and securitisation for large remaining MFIs such as Satin, as on-lending to SFBs will cease to have PSL status once they commence their business as SFBs. Banks (including foreign banks) and SFBs will now have to look at other MFIs such as Satin to meet their own PSL targets of 40% and 75% respectively. Availability of bank funding, with increasing share of securitised loans in the funding mix is expected to aid in reduction of the cost of borrowing for MFIs.

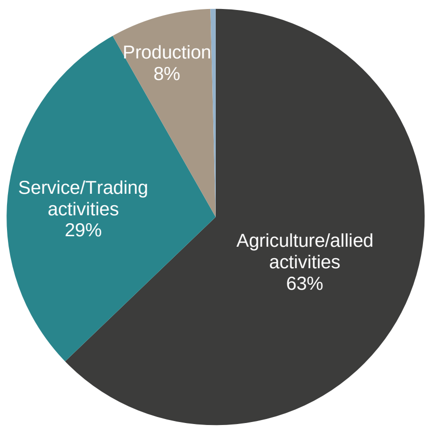
In March 2015, the RBI revised the PSL norms and recommended a sub-target of 8% of adjusted net bank credit (ANBC) to be met by March 2017, for small and marginal farmers. Owing to limited resources to reach out to farmers, banks will look at well-established MFIs for meeting their PSL targets.

**Table 10: Changes to PSL norms in March 2015**

| % of ANBC/CEOBE | Revised guidelines effective March 2015 | Earlier guidelines (Pre March 2015) |
|---|---|---|
| Total priority sector | 40% | 40% |
| Agriculture | | |
| Direct agriculture | - | 13.5% |
| Small and marginal farmers | 8% | - |
| Weaker sections | 10% | 10% |

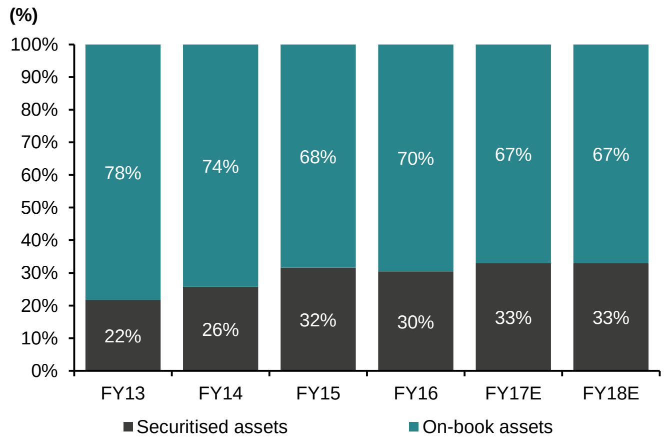
*Source: RBI, CRISIL Research*

**Figure 14: Satin's portfolio mix as on June, 2016**




*Source: Company, CRISIL Research*

**Figure 15: Securitised assets to be 33% of GLP by FY18**



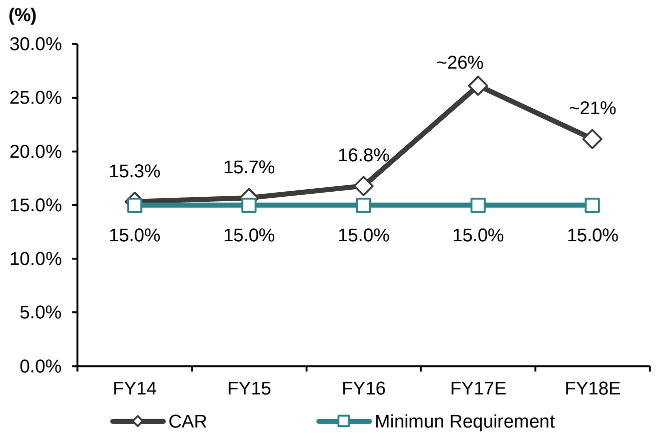

*Source: Company, CRISIL Research*

## Capital raise of ₹2.5 bn to strongly support growth in the medium term

Owing to the successful completion of QIP worth ₹2.5 bn in October 2016, Satin has managed to reduce the risk of capitalisation to a significantly low level. The gearing is expected to reduce to 5.9x in FY18 compared to 9.0x in FY16. CAR is expected to improve to ~26% for FY17, which was marginally above the regulatory requirement of 15%, i.e. 16.8% in FY16. With a considerably improved capital structure and better gearing, the company is well placed to maintain its robust growth rate with significantly reduced risk of breaching statutory CAR limit. Moreover, it could also lead to potentially lower interest cost for the company in the near to medium term.

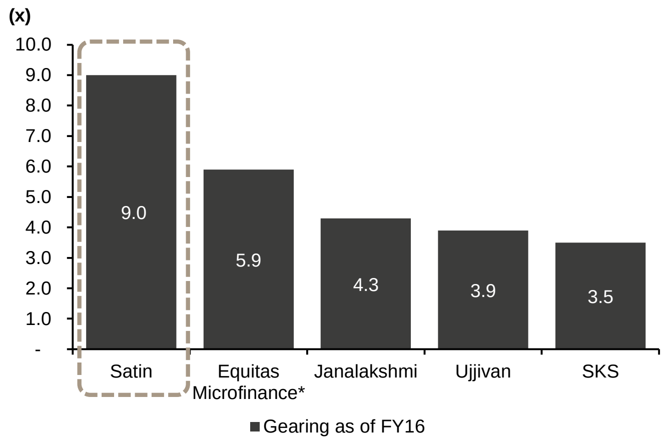
***QIP of ₹2.5 bn would improve CAR to ~26% in FY17***

**Figure 16: QIP of ₹2.5 bn places the CAR in a comfortable position for the next 2-3 years**




*Source: Company, CRISIL Research*

**Figure 17: As of FY16, gearing# is highest amongst selected peers**




#Gearing = Average debt/average adjusted net worth

Adjusted net worth = Reported Net worth less intangible assets and unamortized expenses

*Note: For Equitas Microfinance, total liabilities have been used as per investor presentation

*Source: Companies, CRISIL Research*

## Finance cost^ highest amongst selected peers, historically; expected to moderate in FY18

Cost of finance is expected to reduce from 13.2% in FY16 to 12.6% in FY18 on the back of change in liability mix and a shift towards cheaper source of financing such as securitisation and term loans from other institutions such as MUDRA Bank. Proportion of term loans reduced to 56% in FY16 from 61% in FY13. We expect the company's gearing* to reduce from 9x in FY16 to 5.9x in FY18 owing to the fresh equity capital raised via QIP amounting to ₹2.5 bn.

Until FY16, Satin's finance cost was higher than that of selected peers such as BFIL and Ujjivan (11.5% and 11.4%, respectively in FY16). Satin's credit rating of BBB+ (CARE) is weaker compared to compared to selected peers (A+(CARE) and A+(ICRA) for BFIL and Ujjivan, respectively). With the QIP of ₹2.5 bn, the capital structure has improved and any potential improvement in the credit ratings for Satin would be a key monitorable in the near term.

**Table 11: Satin's credit ratings**

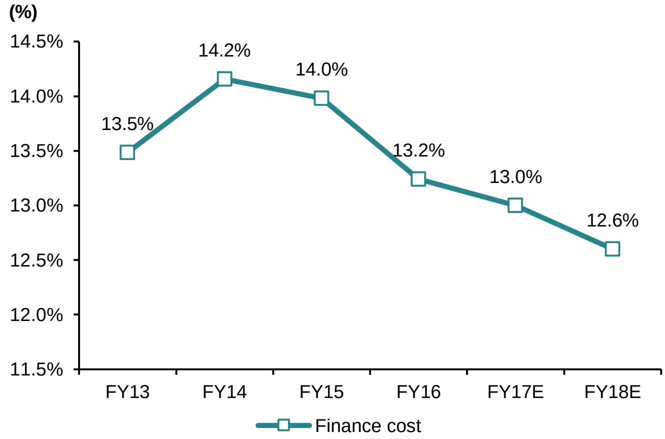
| Long term (CARE) | Pass through certificates issued in Aug 2016 (ICRA) |
|---|---|
| BBB+ | A- |

**Table 12: Finance cost highest amongst selected peers**

| Adjusted cost of borrowing | FY13 | FY14 | FY15 | FY16 |
|---|---|---|---|---|
| BFIL | 10.8% | 13.6% | 12.8% | 11.5% |
| Equitas Microfinance | 12.0% | 12.4% | 12.7% | 11.8% |
| Janalakshmi | 11.5% | 11.7% | 11.2% | 11.2% |
| Satin | 13.5% | 14.2% | 14.0% | 13.2% |
| Ujjivan | 10.0% | 10.9% | 11.4% | 11.4% |

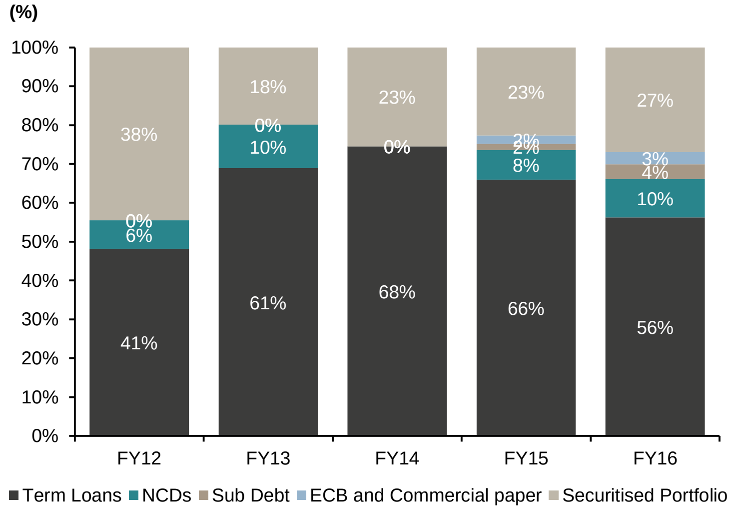
*Note: ^Finance cost = Interest expense/ Average borrowings*
**Gearing = Average borrowings/ Adjusted Net worth*
*Adjusted Net worth = Reported Net worth less intangible assets and unamortised expenses*
*Source: Companies, CRISIL Research*

**Figure 18: Finance cost to moderate by 60 bps…**




*Note: Finance cost = Interest expenses/ Average borrowings*
*Source: Company, CRISIL Research*

**Figure 19: … with move towards cheaper source of funds**



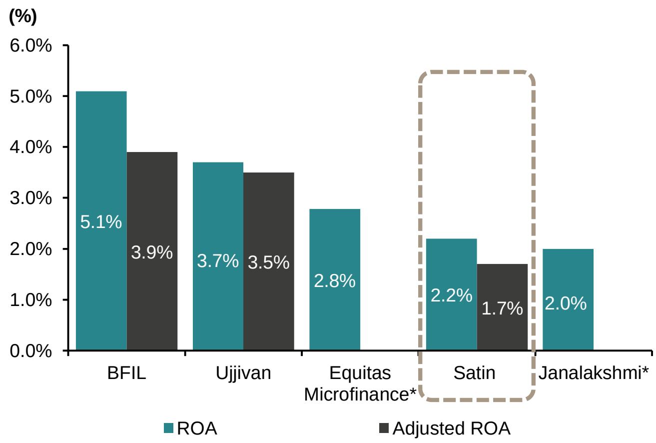

*Source : Company, CRISIL research*

## Reported RoA is one of the lowest amongst selected peers; high use of leverage has led to better reported RoE*

Satin had a low reported RoA of 2.2% in FY16 compared with BFIL and Ujjivan. Higher cost of borrowing owing to relatively weak credit rating has resulted in low reported RoA for Satin. As of Q1FY17, reported RoA was 2.85%. Owing to moderation of 60 bps expected in the finance cost and overall operational improvements, we expect adjusted RoA to improve to 2.7% in FY18 from 1.7% in FY16.

On the other hand, reported RoE of 22.1% in FY16 is one of the highest amongst selected peers. The ratio has improved significantly to 22.1% in FY16 from 3.8% in FY13 because of higher gearing. Going forward, we expect adjusted RoE* to moderate slightly to ~20% in FY18 owing to the fresh capital infusion worth ₹2.5 bn and consequent reduction in leverage to 5.9x in FY18 vis-à-vis 9.0x in FY16

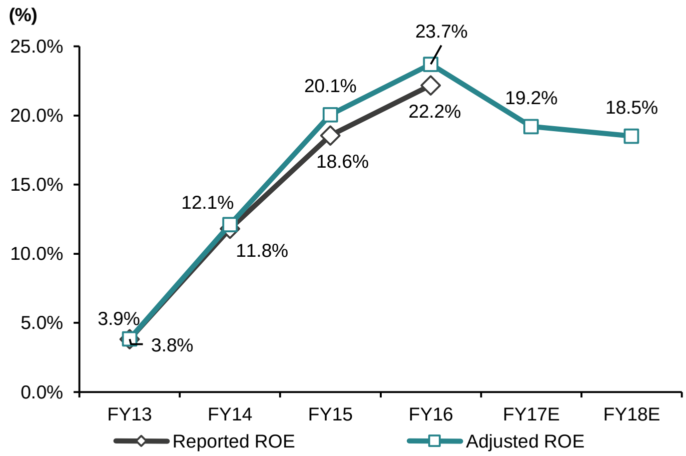
**Figure 20: Lower-than-median reported RoA (FY16)**




Adjusted RoA = PAT/(Total assets+managed assets); Data for Janalakshmi and Equitas Microfinance not available

*Source: Companies, CRISIL Research*

**Figure 21: Adjusted RoE expected to drop in FY17 owing to fresh capital infusion worth ₹2.5 bn**




Adjusted RoE = PAT/ Adjusted Net worth

Adjusted Net worth = Reported Net worth less intangible assets and unamortised expenses

*Source: Company, CRISIL Research*

## Evolving risk management process to aid asset quality stability

Site visit to Hapar district in UP helped us obtain perspective and understanding of the company's risk management processes.

### *Key observations from the site visit*

- The site visit indicated the effectiveness of the JLG model in managing risk through all the processes and, hence, is a key pillar that supports microfinance lending business.
- Overall, it also indicated the level of training and process adherence expected of loans officers and branch managers to smoothly manage the different processes.

***Site visit included:***

- Centre meetings
- Branch and regional office
- Interaction with borrowers, loan officers, branch manager and regional manager

### *The risk management process as observed in the centre is provided below:*

**Table 13: Risk management procedure**

| Stages of lending | Remarks |
|---|---|
| ***Preliminary research*** | • Loan officers conduct survey in nearby villages<br>• Survey includes analysing key parameters such as main source of income of that area, risk of natural calamity, crime rates in that district, number of households, presence of other MFIs, etc. |
| ***Village selection*** | • Based on the survey, the village/district is selected<br>• Loan officers conduct open meetings<br>• Based on the response, further meetings are conducted |
| ***Meetings*** | • Meeting are conducted with potential borrowers to inform them about loan terms<br>• To further strengthen the group, recognition tests are conducted |
| ***Credit checks*** | • Credit checks such as updating the KYC, visiting the borrowers residence and verifying the genuineness of borrowers are conducted before disbursement<br>• Data is sent to credit bureaus. Loans are disbursed after approval from credit bureaus |
| ***Disbursement*** | • At the time of disbursement, presence of all members is mandatory to ensure loan is handed to the appropriate borrower |
| ***Post disbursement*** | • Post disbursement checks are conducted to ensure loan is used for the designated purpose |

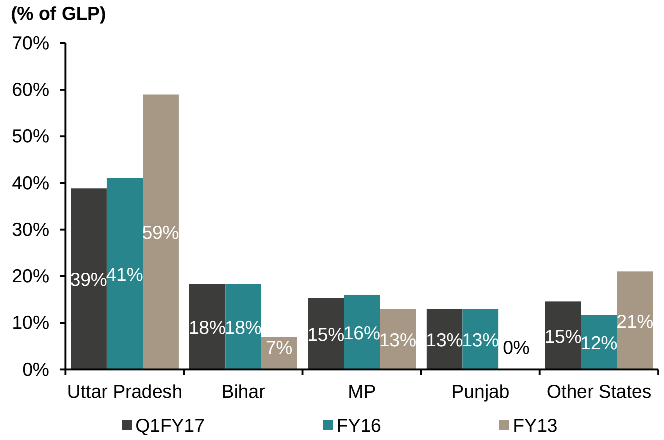
## Geographic concentration risk to remain high in the near term; company in the process of further diversification

We expect the concentration risk to persist despite strong growth of the loan book in other states. At a zonal level, Satin's concentration in the northern region is quite high at 77% in FY16 compared with BFIL and Ujjivan who have a fairly diversified loan book. It has a similar geographic concentration compared to Equitas Microfinance's exposure in southern India.

### *However, Satin has reduced its geographic concentration*

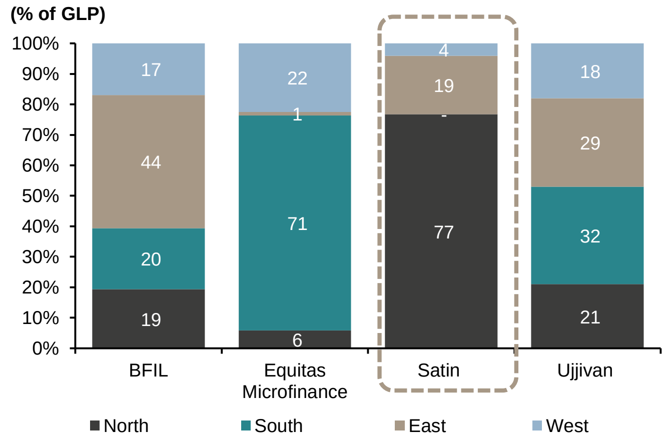
Satin has made continuous efforts to reduce presence in UP. The state's share of GLP reduced to 41% in FY16 and to 39% in Q1FY17 from 59% in FY13. Contribution of Bihar, MP and Punjab increased to ~47% in Q1FY17 from 20% in FY13. We expect the company to further reduce share of operations in the top four states (UP/Bihar/ MP/ Punjab) and increase contribution of other states to ~20% in FY18 from 12% in FY16.

**Figure 22: Geographic concentration risk has reduced compared to FY13**




*Source: Company, CRISIL Research*

**Figure 23: Satin's GLP in FY16 remained strongly North India-based**




Note: MP has been included as part of North zone

*Source: Companies, CRISIL Research*

## SFB licence – no major impact on Satin in the near term

Satin and BFIL were the large MFIs (part of top 5 MFIs by FY2016 GLPs) that were not awarded the SFB licence. This is expected to have no major impact on Satin in the near term.

We expect SFBs to start operations by January 2017. As part of transition into banking, SFBs are expected to focus on improving operational efficiencies and, thus, entail relatively lower management focus and bandwidth on expansion of MFI GLP and branch network. While in the long run, reduced cost of funds would be an advantage to SFBs, in the near term, this benefit is expected to be most likely offset by increase in cost of operations. For large MFIs such as Satin, this could be an opportunity to expand their core business activity supported by MUDRA Bank and PSL factors.

**Table 14: Key parameters of MFIs turned SFBs compared with Satin as of Q1FY17**

| NBFC-MFI turned banks (Other than Satin) | Rural/urban focus | GLP (₹ bn) | Clients (mn) | Presence in districts | Loan officers | Branches | Geography |
|---|---|---|---|---|---|---|---|
| Janalakshmi | Rural/Urban | 119.86 | 4.99 | 192 | 8,432 | 346 | Diversified presence |
| Ujjivan | Urban/Rural | 58.51 | 3.28 | 207 | 3,973 | 469 | Diversified presence |
| Equitas Microfinance | Urban/Rural | 34.49 | 2.83 | 153 | 3,507 | 403 | ~70% of the loan book from Tamil Nadu |
| **Satin Credit** | **Rural** | **32.78** | **2.02** | **222** | **3,173** | **458** | **Diversified presence** |
| ESAF | Rural | 21.57 | 1.06 | 87 | 1,731 | 261 | Kerala, TN, Maharashtra and Chhattisgarh |
| Utkarsh | Rural | 15.93 | 1.09 | 102 | 1,777 | 359 | UP, Bihar |
| Suryoday | Rural | 10.46 | 0.7 | 96 | 1,792 | 179 | Maharashtra, Tamil Nadu, Karnataka, Gujarat, Odisha |
| Disha | Urban | 5.41 | 0.3 | 84 | 646 | 276 | Gujarat, MP, Rajasthan, Maharashtra |
| RGVN | Rural | 5.23 | 0.31 | 33 | 293 | 131 | North-East |

*Source: MFIN, CRISIL Research; above list is sorted on descending order of Q1FY17 GLPs*

### Key guidelines for SFBs in the private sector

- Minimum paid-up capital of ₹1 bn
- Promoters' minimum initial contribution to paid-up equity will be at least 40% and gradually be brought down to 26% within 12 years from commencement
- Foreign shareholdings to be as per FDI norms

### Prudential norms

- Maintenance of cash reserve ratio (CRR) and statutory liquid ratio (SLR) as applicable to existing commercial banks
- Will be required to extend 75% of its adjusted net bank credit (ANBC) for sectors eligible under priority sector lending
- At least 50% of the portfolio should consist of loans and advances up to ₹2.5 mn

## Key Risks

### Geographic concentration of the loan book

To reiterate, Satin's concentration risk at state level is considerably higher than peers such as BFIL and Ujjivan, while it is relatively better than that of Equitas Microfinance. This is due to UP state forming 39% of the total loan portfolio as of Q1FY17. High exposure to a particular region and state exposes the company to systemic risk(s) in that region. Adverse changes to the income patterns of people living in the rural areas of western UP or a natural calamity or other systemic/ regulatory or law and order risks in the region could significantly impact Satin's asset quality or potentially cause significant disruption to operations.

### Expansion to new geographies could potentially affect asset quality

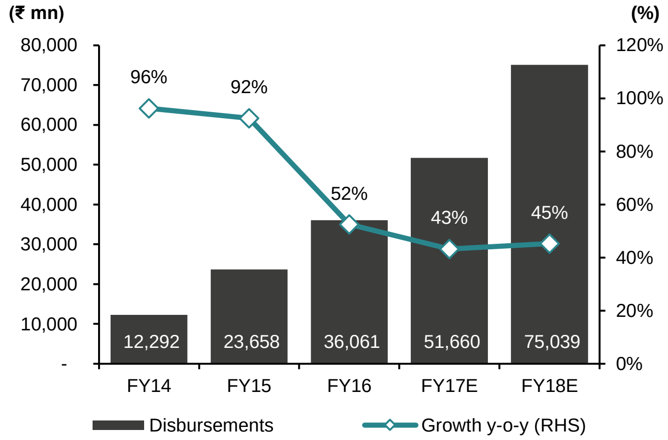
As the company looks to diversify regionally, asset quality in the relatively newer geographies would be a key monitorable. Despite the company having expanded its operations to 16 states in FY16 from 8 states in FY10, gross non-performing assets (GNPA's) remained fairly stable at ~0.02% until FY15, but rose to 0.2% in FY16. As the company increasingly lends in relatively newer territories, to people having different risk profiles and varied income generation capacities, defaults in these geographies beyond those anticipated could cause a risk to our estimates.

# Financial Outlook

## Disbursements estimated to grow at 44% CAGR over FY16-18

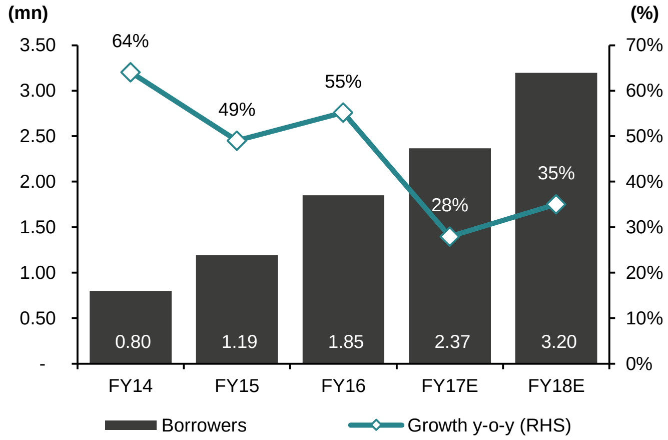
Satin's disbursements are expected to grow at a healthy 44% over FY16-18 driven by branch network expansion and a moderate increase in the ticket size. We expect Satin to increase its active borrower base to 3.2 mn in FY18 from 1.85 mn in FY16 by increasing operations beyond the top four states. Moreover, the average ticket size is expected to grow at a moderate rate of 6-8% CAGR over FY16-18, which is expected to take the total disbursement amount to ~₹75 bn by FY18.

**Figure 24: Disbursements to grow at 44% CAGR over FY16-18…**




*Source: Company, CRISIL Research*

**Figure 25: …driven by 31% CAGR in number of borrowers**

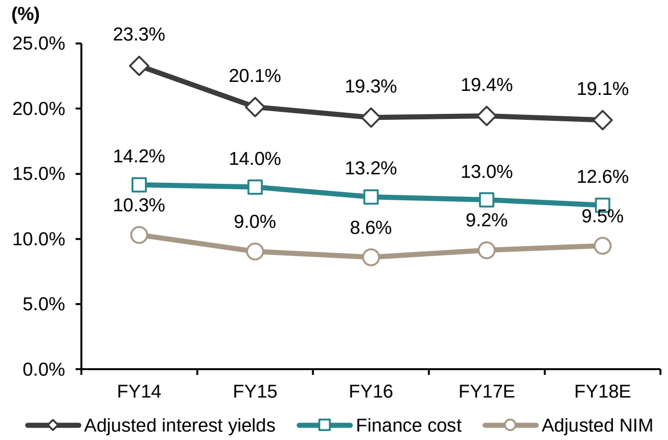



*Source: Company, CRISIL Research*

## Adjusted NIM to improve driven by moderation of finance cost

We expect adjusted net interest margin (NIM) to improve by 90 bps to 9.5% in FY18, driven by 60 bps reduction in borrowing cost to 12.6% in FY18. However, we expect yields to remain stable thereby enabling NIM to reach 9.5% by FY18.

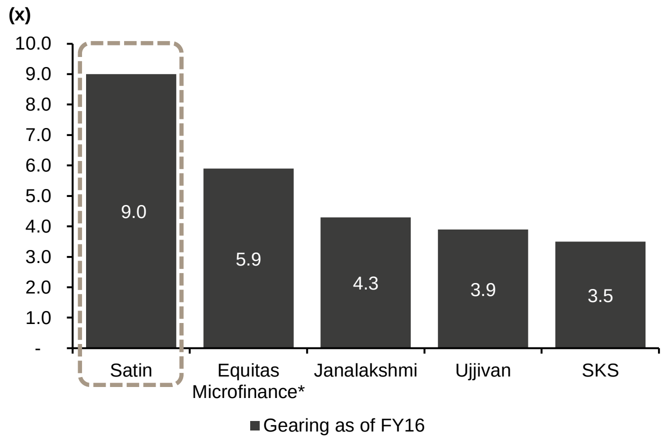
**Figure 26: Adjusted NIM* to expand by 90 bps over FY16-18E**




*Note: Loan processing fees and misc. other income has been excluded for calculation of net interest margin

*Source: Company, CRISIL Research*

**Figure 27: But gearing highest amongst peers in FY16**




Gearing = Average debt/average adjusted net worth

Adjusted net worth = Reported Net worth less intangible assets and unamortized expenses

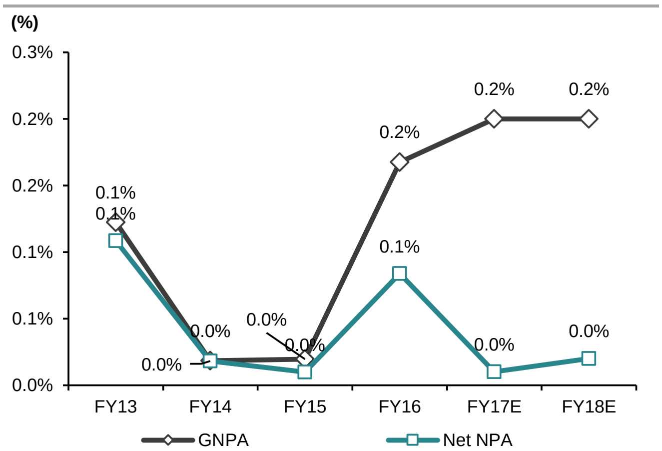
*Note: For Equitas microfinance total liabilities have been used for ratio as borrowings are not available

*Source: Company, CRISIL Research*

## GNPA to remain stable in near term

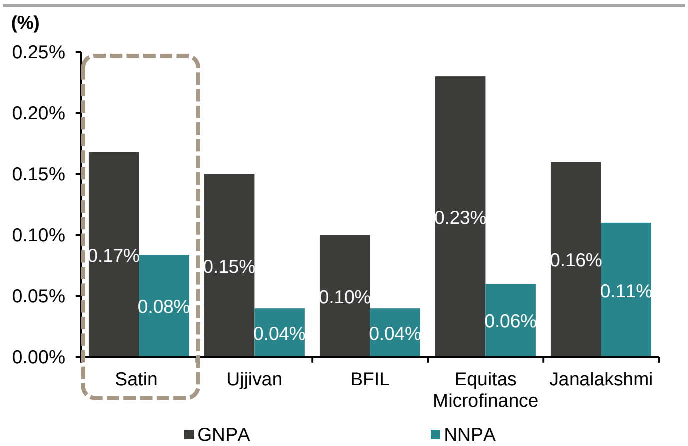
As the company moves to relatively newer territories, we expect the asset quality to come under slight pressure. However, we derive confidence from the company's good track record in maintaining its asset quality. Even in states such as UP, Punjab, MP and Bihar, where the concept of microfinance is relatively new, Satin has been able to keep GNPA as low as 0.02% in FY15. In FY16, it rose sharply to 0.2% owing to an event in one of the districts of MP, which impacted the MFI industry in that region. Considering the event, 0.2% level for GNPAs despite entering five new geographies in FY16 supports the company's track record in maintaining asset quality. We expect the company's evolving risk management framework to keep GNPA stable at 0.2% in the near term.

**Figure 28: Slight increase in GNPA in FY16…**




*Source: Company, CRISIL Research*

**Figure 29: … still at par with selected peers in FY16**




*Source: Companies, CRISIL Research*

## Q1FY17 result update

The company reported healthy business growth - GLP increased 62% y-o-y and 0.2% q-o-q to ₹32,780 mn in Q1FY17. Strong growth in GLP increased operating income by 83.3% y-o-y and 16.9% q-o-q to ₹993 mn. Finance cost increased at relatively lower rate (61.6% y-o-y and 10.6% q-o-q) than interest income.

### *Increasing loan officers to support growth*

To support business growth, the company increased the number of branches to 458 in Q1FY17 (up 70.3% y-o-y and 6.3% q-o-q) and loan officers to 3,173 (up 80.6% y-o-y and 17.6% q-o-q). This led to a sharp increase in other operating expenses (69.2% q-o-q and 39.4% y-o-y) to ₹265 mn in Q1FY17. Staff cost jumped 92.2% y-o-y, but declined 11.1% q-o-q. Thus, relatively lower increase in total operating costs (63.3% y-o-y and 14.4% q-o-q) caused cost to income ratio to moderate to 58.0% in Q1FY17 (down 686 bps y-o-y and 148 bps q-o-q).

### *Credit cost relatively stable q-o-q*

Credit cost shot up 460.3% y-o-y to ₹53 mn, but moderated by 43.7% q-o-q. It was below 0.2% of GLP in Q1FY17.

**Table 15: Q1FY17 results summary**

| Standalone (₹ mn) | Q1FY17 | Q4FY16 | Q1FY16 | q-o-q (%) | y-o-y (%) |
|---|---|---|---|---|---|
| Interest Income | 1,951 | 1,702 | 1,136 | 14.6 | 71.8 |
| Interest Expense | 975 | 881 | 603 | 10.6 | 61.6 |
| **Net Interest Income** | 976 | 821 | 532 | 18.9 | 83.3 |
| Non-Interest Income | 17 | 29 | 9 | (40.7) | 83.3 |
| **Total Operating Income** | 993 | 850 | 542 | 16.9 | 83.3 |
| Operating Expenses | 566 | 495 | 346 | 14.4 | 63.3 |
| Staff Costs | 301 | 338 | 156 | (11.1) | 92.3 |
| Other Operating Expenses | 265 | 157 | 190 | 69.2 | 39.4 |
| *Cost to income* | 58.0% | 59.5% | 64.8% | (148) bps | (686) bps |
| **Pre- provision profit (PPP)** | 427 | 355 | 195 | 20.3 | 118.8 |
| Provisions and write offs | 53 | 94 | 9 | (43.7) | 460.3 |
| **Profit before depreciation and tax** | 374 | 261 | 186 | 43.4 | 101.5 |
| Depreciation On Fixed Assets | 10 | 11 | 5 | (5.8) | 109.8 |
| PBT | 364 | 250 | 181 | 45.4 | 101.2 |
| Provision for tax | 118 | 87 | 60 | 36.0 | 96.1 |
| Tax rate | 32.5% | 34.7% | 33.3% | (6.5) | (2.5) |
| Net Profit | 246 | 163 | 121 | 50.5 | 103.8 |
| EPS (₹) (Basic) | 7.8 | 5.6 | 4.6 | 39.7 | 70.5 |

*(As reported by company, without any reclassification)*

# Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors, such as industry and business prospects, and financial performance.

## Experienced top management

Satin's top management is professional and has decade-plus experience in microfinance and financial inclusion. The company is led by Mr H P Singh, MD and Chairman, who is a chartered accountant and a law graduate, and has over 25 years of experience in the lending space.

The management team has experience across fields such as banking, insurance and rural development. Over the past decade, management has an established track record in delivering strong growth and financial performance, even during slowdown in the industry in FY11-13. Robust expansion driven by growth in existing states as well as new states has boosted GLP growth over the years. Overall, we believe management has a strong understanding of the microfinance business and is capable of capitalising on growth opportunities as well as handling challenges.

## Supported by a professional second line

The second line of management is strong and ably supports the top management in executing business strategies. We interacted with the finance and operational teams, and found strong capability in line with the fast growing nature of business.

## Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Research analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Corporate governance at Satin is good and is supported by industry designed disclosure levels, good board practices and an independent board. The necessary committees - audit, stakeholders and risk management - are in place.

### Key observations

- **Composition of board:** The company's board consists of 13 members, of whom seven are independent directors. This is in line with requirements under Clause 49 of SEBI's listing guidelines. Directors on the board have extensive experience in banking, financial services, corporate finance and administration.
- **Promoters' stake higher than selected peers:** The stake of the promoters in Satin is relatively higher at ~33% as of October 3, 2016 than that of selected peers. BFIL has a far lower promoter stake of 1.75% and Ujjivan has no stake of promoters as of September 2016.
- **Instance of an employee fraud in the past; moving to cashless transactions would reduce the risk:** While internal controls are good, a cash embezzlement of ₹8.5 mn was reported at one of its branches in FY16. The company was able to recover ₹7.5 mn and the balance ₹1 mn was written off. Going forward, we expect the risk of cash handling to be mitigated to a great extent as the company moves towards a cashless environment.
- **High tenure of auditors:** A. K. Gangaher has been the auditor of the company for over 10 years. High tenure of the auditors can potentially impede their objectivity.
- **Disclosure levels at par with industry:** Disclosure levels of the company are at par with the industry as judged from the information available from the company website, investor presentations and quarterly updates released by MFIN.

## Valuation Grade: 3/5

We have valued Satin using a one-year forward P/B multiple of 2.8x on FY18E adjusted book value of ₹221 per share, and arrived at a fair value of ₹620 per share. Based on the current market price of ₹593, our valuation grade is **3/5.**

**Table 16: Calculation of Fair value per share**

| Particulars | Amount (₹) |
|---|---|
| FY18 net worth as per annexure | 8,469 |
| (Less: Consideration paid for acquiring group company Taraashna Services Pvt Ltd [TSPL] via share swap) | (498) |
| Adj FY18 net worth (A) | **7,972** |
| No of shares O/s as of FY17 (Excluding 1.1 mn shares issued to shareholders of TSPL) (B) | 36.0 |
| **Adj. book value per share (A/B) = (C)** | 221 |
| Multiple used (D) | **2.8x** |
| **Fair value per share (C*D)** | **620** |

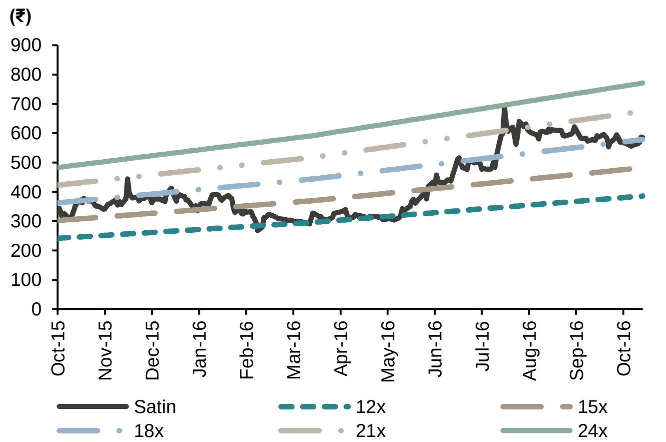
The implied multiples of the FY18 book value per share are in the range of 2.9x to 3.0x for Equitas Holdings and Ujjivan, and for BFIL in the range of 3.4x to 4.8x.

**Table 17: Implied multiples on FY18E book value per share**

| Selected listed peers | forward P/B(x) |
|---|---|
| BFIL | 3.4x-4.8x |
| Equitas Holdings | 2.9x-3.0x |
| Ujjivan | 2.9x-3.0x |

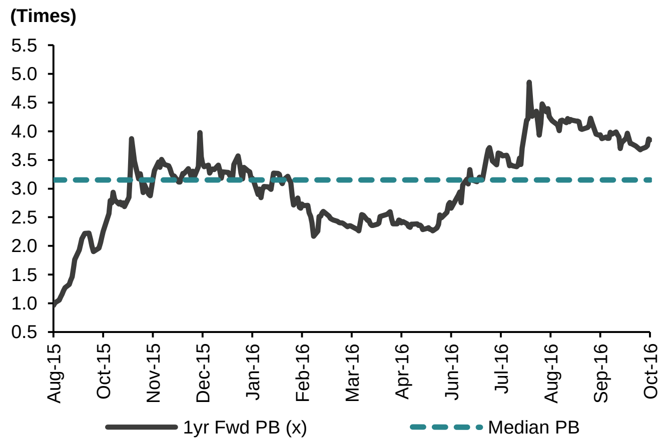
*Source: Industry data, CRISIL Research*

**One-year forward P/E band**



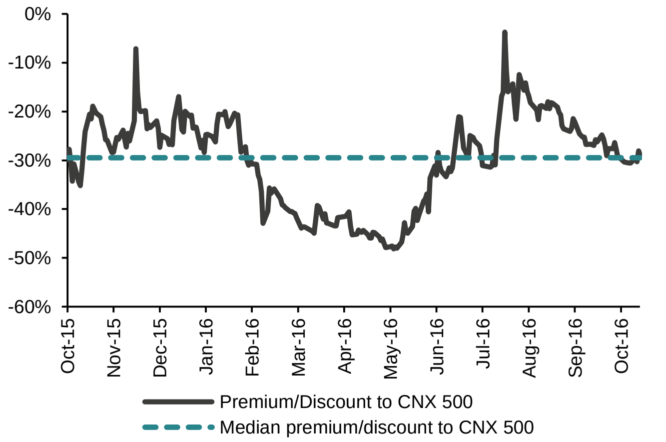

*Source: NSE, CRISIL Research*

**One-year forward P/B chart**



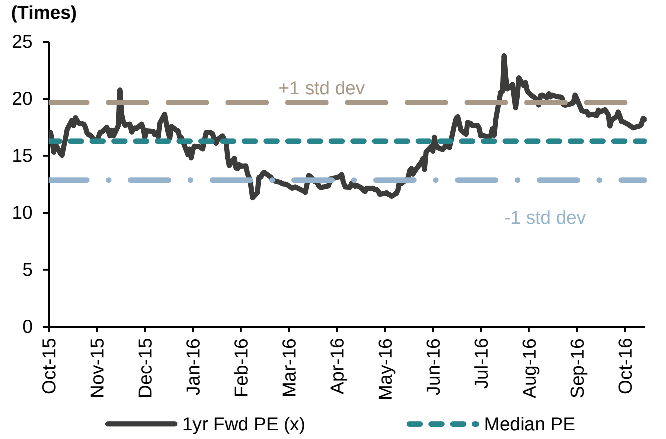

*Source: NSE, CRISIL Research*

**P/E – premium / discount to CNX 500**




*Source: NSE, CRISIL Research*

**Forward P/E chart**




*Source: NSE, CRISIL Research*

## Company Overview

Satin is a North India-based microfinance NBFC. It gives small loans to women in rural regions. The company was set up in 1990 and started with generator financing for retail borrowers. It got listed on the Delhi, Jaipur and Ludhiana stock exchanges in 1996. In 1998, it obtained the certificate of registration from the RBI as a NBFC. The rural group lending was started in 2008 based on the Grameen model. The company was converted as NBFC-MFI in November 2013. New products - loans for solar lamps was launched in FY16; SME loans and individual micro loans were launched in FY17. Currently, the company operates in 16 states, with 2.02 mn clients as of Q1FY17.

**Key Milestones (calendar years)**

| | |
|---|---|
| **1990** | Satin began operations |
| **1996** | Publicly listed on Delhi, Ludhiana, and Jaipur stock exchanges with an IPO of ₹3 mn |
| **1998** | Registered as an NBFC |
| **2005** | Got debt funding of ₹50 mn from SIDBI |
| **2008** | Began JLG lending backed by its first PE investment of ₹49 mn by Lok Capital and ₹10 mn infused by promoter group |
| **2009** | Raised ₹19 mn from Lok Capital |
| **2010** | Raised equity capital amounting to ₹244 mn from Lok Capital and ShoreCap II and ₹77.5 raised by promoter |
| **2011** | Raised capital amounting to ₹181 mn from DMP |
| **2013** | Registered as NBFC-MFI with the RBI |
| **2013** | Raised ₹300mn from DMP, Shore Capital and Microvest and ₹110 mn infused by promoter group |
| **2014** | Raised INR 285mn of equity from NMI and USD 10 mn of debt from World Business Capital in the form of ECB |
| **2014** | Raised floating rate long term unsecured Tier II debt |
| **2015** | Listed on NSE and BSE and raised ₹415 mn (including warrants) from SBI FMO. ₹378 mn was raised from promoter group |
| **2015** | Started a pilot project for cashless collections which is now live across 100 branches |
| **2015** | Raised ₹415 mn from SBI FMO (Including warrants) and ₹378 mn from promoter group |
| **2016** | Started MSME lending in FY17 |
| **2016** | Acquired group company Taraashna Services Pvt Ltd |
| **2016** | Successfully raised QIP worth ₹2.5 bn from various institutional investors |

*Source: Company, CRISIL Research*

# Annexure: Financials* (Standalone)

**Income Statement**

| (₹ mn) | FY14 | FY15 | FY16# | FY17E | FY18E |
|---|---|---|---|---|---|
| Interest Income | 1,905 | 3,219 | 5,227 | 7,705 | 10,904 |
| Interest expense | 1,061 | 1,775 | 2,899 | 4,078 | 5,438 |
| **Net Interest Income** | **845** | **1,444** | **2,328** | **3,627** | **5,466** |
| Fee income/ other income | 11 | 23 | 359 | 523 | 757 |
| **Total Operating Income** | **856** | **1,467** | **2,687** | **4,150** | **6,222** |
| **Operating Expenses** | **524** | **885** | **1,575** | **2,428** | **3,675** |
| Staff Costs | 236 | 392 | 884 | 1,228 | 1,834 |
| Other Operating Expenses | 288 | 493 | 691 | 1,200 | 1,841 |
| **Pre- provision profit (PPP)** | **332** | **581** | **1,112** | **1,722** | **2,547** |
| Provision & Contingency | 91 | 97 | 208 | 230 | 340 |
| **Profit before depreciation and tax** | **241** | **484** | **904** | **1,491** | **2,207** |
| Depreciation On Fixed Assets | 7 | 20 | 29 | 43 | 66 |
| Extra-ordinary gain / (loss) | - | - | - | - | - |
| **PBT** | **234** | **465** | **875** | **1,448** | **2,141** |
| Provision for tax | 78 | 148 | 296 | 478 | 707 |
| **PAT** | **156** | **317** | **579** | **970** | **1,434** |
| Minority Interest (MI) | - | - | - | - | - |
| **PAT after MI** | **156** | **317** | **579** | **970** | **1,434** |

**Balance sheet**

| (₹ mn) | FY14 | FY15 | FY16# | FY17E | FY18E |
|---|---|---|---|---|---|
| Equity share capital | 227 | 254 | 315 | 371 | 371 |
| Reserves | 1,108 | 1,566 | 2,752 | 6,664 | 8,098 |
| **Shareholders Funds** | **1,335** | **1,820** | **3,067** | **7,035** | **8,469** |
| Minority Interest | - | - | - | - | - |
| Preference capital | 60 | 60 | - | - | - |
| **Borrowings** | **9,086** | **16,301** | **27,483** | **35,256** | **51,067** |
| Other Liabilities & Provisions | 607 | 1,665 | 2,084 | 2,564 | 3,714 |
| Deferred tax liability | - | - | - | - | - |
| **Sources of funds** | **11,089** | **19,846** | **32,634** | **44,855** | **63,250** |
| | | | | | |
| Cash & Bank Balances | 2,872 | 4,588 | 8,344 | 12,546 | 16,682 |
| Investments | 1 | 1 | 1 | 498 | 498 |
| Net Loans and advances | 7,897 | 14,803 | 23,574 | 30,729 | 44,507 |
| Net Fixed Assets and Capital WIP | 118 | 139 | 191 | 192 | 342 |
| Deferred tax asset | 25 | 53 | 87 | 167 | 247 |
| Other Assets | 176 | 262 | 437 | 722 | 972 |
| **Application of funds** | **11,089** | **19,846** | **32,634** | **44,855** | **63,250** |

**Per share**

| | FY14 | FY15 | FY16# | FY17E | FY18E |
|---|---|---|---|---|---|
| Adj EPS (₹) | 6.9 | 12.5 | 18.4 | 26.1 | 38.6 |
| Adj Book Value (₹) | 59 | 72 | 97 | 189 | 228 |
| Dividend per share (₹) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Actual o/s shares - mn | 22.7 | 25.4 | 31.5 | 37.1 | 37.1 |

**Ratios (adjusted as per CRISIL Research's standard parameters)**

| (₹ mn) | FY14 | FY15 | FY16# | FY17E | FY18E |
|---|---|---|---|---|---|
| **Spread Analysis (Avg. GLP)** | | | | | |
| Interest yield | 23.3% | 20.1% | 19.3% | 19.4% | 19.1% |
| Cost of borrowings | 14.2% | 14.0% | 13.2% | 13.0% | 12.6% |
| Net Interest Margin (NIM) | 10.3% | 9.0% | 8.6% | 9.2% | 9.5% |
| **Return Ratios** | | | | | |
| Adj. ROA (%) | 1.4% | 1.6% | 1.7% | 1.9% | 2.0% |
| Adj. ROE (%) | 12.1% | 20.1% | 23.7% | 19.2% | 18.5% |
| **Growth ratios** | | | | | |
| Loan assets - including off-book (₹ mn) | 82% | 103% | 53% | 42% | 45% |
| Disbursements | 96% | 92% | 52% | 43% | 45% |
| Net Interest Income | 112% | 71% | 61% | 56% | 51% |
| Fee income/ other income | 446% | 104% | 1486% | 46% | 45% |
| Total Operating Income | 114% | 71% | 83% | 54% | 50% |
| Operating Expenses | 65% | 69% | 78% | 54% | 51% |
| Pre- provision profit (PPP) | 303% | 75% | 91% | 55% | 48% |
| Provision & Contingency | 304% | 7% | 114% | NM | NM |
| Adjusted Net Profit | 297% | 103% | 83% | 67% | 48% |
| EPS (₹) | 297% | 82% | 47% | 42% | 48% |
| Book Value (₹) | 8% | 22% | 36% | 95% | 20% |
| **Asset Quality** | | | | | |
| Gross NPA (%) | 0.02% | 0.02% | 0.17% | 0.20% | 0.20% |
| Net NPA (%) | 0.02% | 0.01% | 0.08% | 0.01% | 0.02% |
| Provision & writeoffs (as % of loan book) | 1.6% | 1.1% | 0.61% | 1.3% | 1.3% |
| **Valuation Data** | | | | | |
| P/E (x) | 85.8 | 47.2 | 32.0 | 22.5 | 15.2 |
| P/ABV (x) | 10.0 | 8.2 | 6.0 | 3.1 | 2.6 |
| | | | | | |
| **Key Parameters** | | | | | |
| GLP (₹ mn) | 10,561 | 21,407 | 32,708 | 46,568 | 67,451 |
| Disbursements (₹ mn) | 12,292 | 23,658 | 36,061 | 51,660 | 75,039 |
| **Capitalisation ratios (Adjusted)** | | | | | |
| Capital adequacy ratio | 15.3% | 15.7% | 16.8% | ~26% | ~21% |
| | | | | | |
| | | | | | |
| **Efficiency ratio** | | | | | |
| Cost to Income ratio | 62.0% | 61.7% | 59.7% | 58.5% | 59.1% |
| Opex/ average assets | 5.7% | 5.9% | 6.1% | 6.4% | 6.9% |
| Leverage (x) (including managed assets) | 8.8 | 12.7 | 12.2 | 7.2 | 8.7 |

**Quarterly Financials**

| (₹ mn) | Q1FY16 | Q2FY16 | Q3FY16 | Q4FY16 | Q1FY17 |
|---|---|---|---|---|---|
| **Total operating income** | **821** | **603** | **692** | **850** | **976** |
| Change (q-o-q) | 25% | -27% | 15% | 23% | 15% |
| **PAT** | **121** | **145** | **150** | **163** | **246** |
| Change (q-o-q) | 15% | 20% | 3% | 9% | 50% |
| **EPS (Basic)** | **4.6** | **5.1** | **5.0** | **5.6** | **7.8** |

*Source: CRISIL Research estimates*

**Note: We have reclassified certain items of the financial statements as per CRISIL Research standard parameters (provided in the Annexure 2)*

*#abridged financials*

*Annexure 2: Adjustment to reported financials:*

We have restated Satin's reported numbers as per our internal data standardisation framework. To arrive at net worth and total assets as per CRISIL Research's annexure, we have made the following adjustments:

| **Adjustments made to total assets** | | | |
|---|---|---|---|
| **Particulars** | **FY14** | **FY15** | **FY16** |
| **Total assets as per annual report (A)** | **11,217** | **20,107** | **33,034** |
| **a) Adjustments to Loans and Advances** | | | |
| Less :Unamortised share issue expenses - Short term loans and advances | (8) | (1) | - |
| Less :Unamortised cost of borrowings - Short term loans and advances | (25) | (56) | (86) |
| Less :Unamortised cost of borrowings - Long term loans and advances | (15) | (53) | (65) |
| Less : provision for bad & doubtful and contingent advances adjusted against standard assets | (78) | (146) | (227) |
| **Total Adjustments to Loans and advances (B)** | **(126)** | **(256)** | **(378)** |
| **b) Adjustments to Fixed assets** | | | |
| Less: Other Intangible assets stated under Fixed assets | (2) | (6) | (22) |
| **Total Adjustments to Fixed assets (C)** | **(2)** | **(6)** | **(22)** |
| **Total assets as per Annexure (A+B+C)** | **11,089** | **19,846** | **32,634** |

| **Adjustments made to total liabilities** | | | |
|---|---|---|---|
| **Particulars** | **FY14** | **FY15** | **FY16** |
| **Total Liabilities as per annual report (A)** | **11,217** | **20,107** | **33,034** |
| **a) Adjustment to reserves** | | | |
| Less :Unamortised share issue expenses | (8) | (1) | - |
| Less :Unamortised cost of borrowings - Short term | (25) | (56) | (86) |
| Less :Unamortised cost of borrowings - Long term | (15) | (53) | (65) |
| Less: Intangible assets | (2) | (6) | (22) |
| **Total Adjustments to Reserves (B)** | **(49)** | **(115)** | **(173)** |
| **b) Adjustments to Short term provisions** | | | |
| Less : provision for bad & doubtful and contingent advances adjusted against loans and advances | (78) | (146) | (227) |
| **Total Adjustments to Short term Provisions (C)** | **(78)** | **(146)** | **(227)** |
| **Total Liabilities as per Annexure (A+B+C)** | **11,089** | **19,846** | **32,634** |

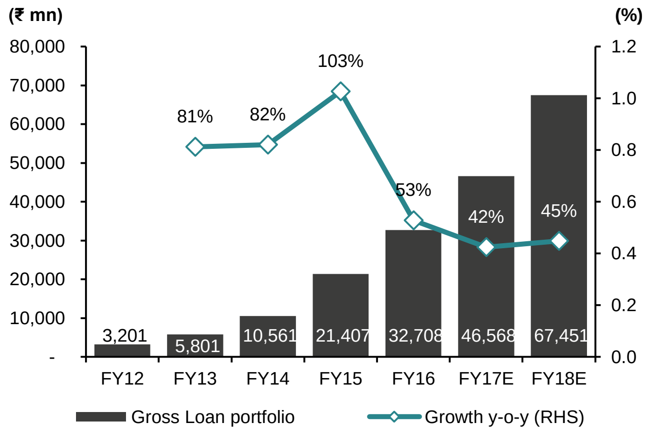
***Annexure 3: The Andhra Pradesh (AP) crisis in 2010***

Prior to 2010, AP had the highest share of microfinance loans and accounted for ~30% of active borrowers. In October 2010, the AP government issued an ordinance - AP microfinance ordinance. This ordinance was issued on the back of news reports of farmers committing suicide owing to coercive practices adopted by some MFIs. The ordinance applied severe restrictions on processing new loans applications and caused all repayments to be made only on a monthly instalment basis at AP government designated offices. It also required that every loan issued to a client by the MFIs to be individually approved by the AP government. The ordinance was followed by the AP-MFI Act in January 2011.

This had a severe impact on the MFI industry. Regulations set by the act led to a significant fall in repayment levels. Recovery rates of ~99% fell sharply to 10% in AP. Large exposure in AP coupled with sharp fall in repayments led to sharp rise in the NPAs for MFIs leading to erosion of their net worth. This resulted in many MFIs going for restructuring under the CDR route.

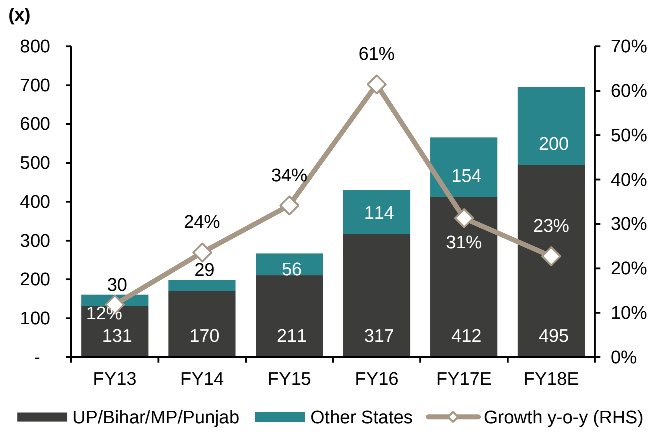
# Focus charts

**GLP growth to remain strong at 44% CAGR in FY16-18**



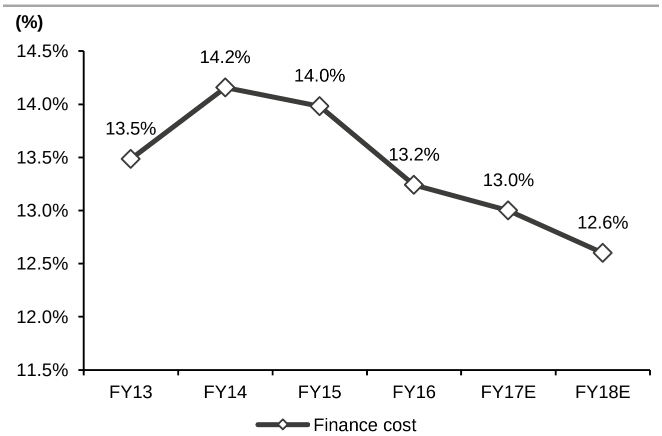

*Source: Company, CRISIL Research*

**Branch expansion to continue in the near term**




*Source: Company, CRISIL Research*

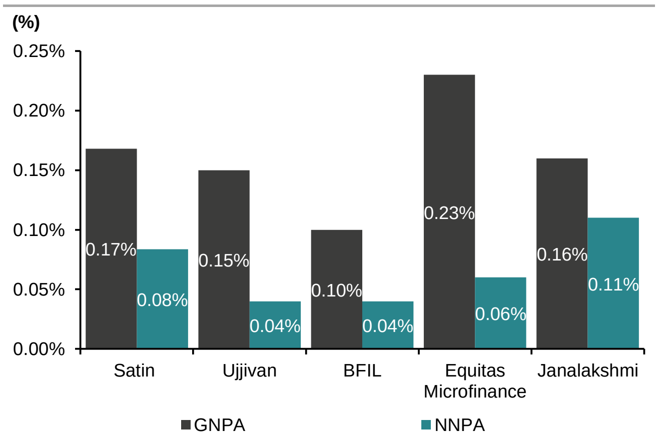
**Finance cost expected to reduce to 12.6% by FY18**




Note: Finance cost = Interest expenses/ Average borrowings

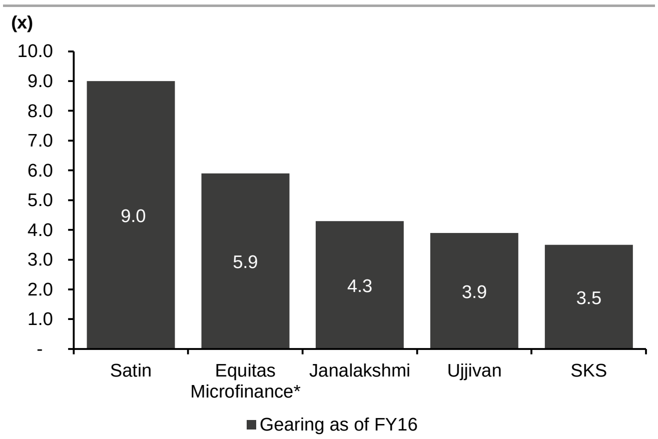
*Source: Company, CRISIL Research*

**GNPA at par with selected peers in FY16**




*Source: Companies, CRISIL Research*

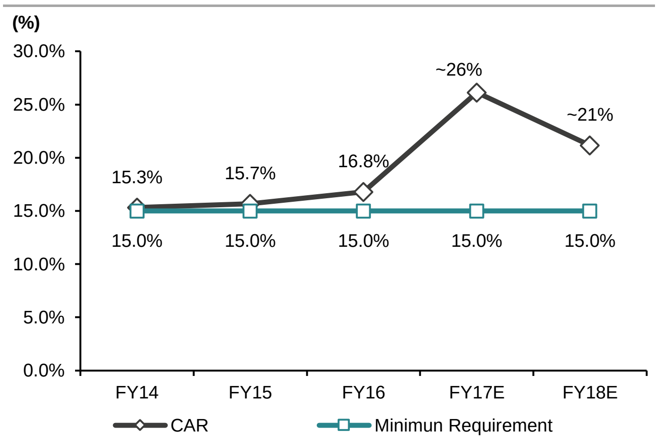
**Gearing^ highest amongst selected peers in FY16**




^Gearing = Average Debt/Average Adjusted net worth
Adjusted net worth = Reported Net worth less intangible assets and unamortized expenses *Note: For Equitas microfinance total liabilities have been used for ratio as borrowings are not available

*Source: Company, CRISIL Research*

**CAR to improve in the near term owing to the QIP of ₹2.5 bn**




*Source: Company, CRISIL Research*

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## Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

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