VISIT NOTE

SATIN CREDITCARE NETWORK

Catch it young, watch it grow

India Equity Research| Banking and Financial Services

We met the top management of Satin Creditcare Network (Satin), visited its branches and attended centre meetings to understand the company's operational strategy for sustaining growth momentum and scaling up RoA. Satin has clocked stupendous 79% AUM CAGR over FY12-16 to INR32bn with a dominant presence in North India. Being an early mover in unchartered geographies has enabled the company to be not only the market maker, but market leader as well. Better operational productivity helps it clock one of the finest opex ratios—<6% (7% of peers). The only missing link is lower RoAs (at 2.2% which is >100bps lower compared to peers) owing to higher leverage and higher cost of funds. However, we envisage this to set right post a possible credit ratings upgrade. Satin is an attractive opportunity in the burgeoning MFI space, targeting stability in franchise, operating metrics and consistent earnings growth. 'NOT RATED'.

Fastest growing MFI with prudent branch ramp up strategy

Unabated growth in Satin's AUM of 79% CAGR to INR32.7bn in FY16 is undoubtedly an outcome of its well laid out strategy of deeper penetration in unchartered geographies (reflected in its dominance in UP, Bihar, Punjab, MP). Satin understands and creates MFI market nurturing JLG culture in its area of presence and in the process creates dominant leadership position (in its top 5 states it has market share of 15-40%).

Superior productivity; diversification, rating upgrade to boost NIM

Much higher AUM per employee and active borrowers per loan officer bear testimony to Satin's employee efficiency, which coupled with low cost per employee helps it contain opex/AUM below 6-7%—superior to industry leaders despite low scale. Back-ended nature of growth and higher funding cost has curtailed NIMs. However, the company's endeavour to diversify its borrowing profile, evenly balance growth through the fiscal and possible credit rating upgrade are bound to lead to expansion in NIM.

Outlook & valuation: At right time in right place; 'NOT RATED'

Humongous opportunities within the underserved segment render Satin's business model enduring as well as self perpetuating and hence we perceive minimal scalability and earnings risk. The only monitorable will be structural improvement in RoA stemming from fall in funding cost, product upselling, cross-selling efforts and contained credit cost. Since we do not cover the stock, it is **'NOT RATED'**.

Financials (INR mn)

Year to March	FY13	FY14	FY15	FY16
Net revenue	400	855	1,467	2,686
Net profit	39	156	317	579
Diluted EPS (INR)	2.1	6.7	11.9	20.0
Book value per share (INR)	54.5	61.0	76.2	101.4
P/BV (x)	1.3	1.9	6.5	4.9
RoAE (%)	3.8	11.6	18.4	22.1

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA *(R: SATR.BO, B: SATIN IN)*	
CMP	: INR 495
Target Price	: NA
52-week range (INR)	: 543 / 264
Share in issue (mn)	: 32.0
M cap (INR bn/USD mn)	: 16 / 236
Avg. Daily Vol.BSE ('000)	: 91.4

SHARE HOLDING PATTERN (%)

	Current	Q3FY16	Q2FY16
Promoters %	36.2	34.7	34.7
MF's, FI's & BK's	0.0	0.0	0.0
FII's	0.1	0.0	0.1
others	63.7	65.3	65.3

** Promoters pledged shares (% of share in issue) : 4.4*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	1.4	32.2	30.9
3 months	8.4	63.0	54.6
12 months	(1.6)	43.4	45.1

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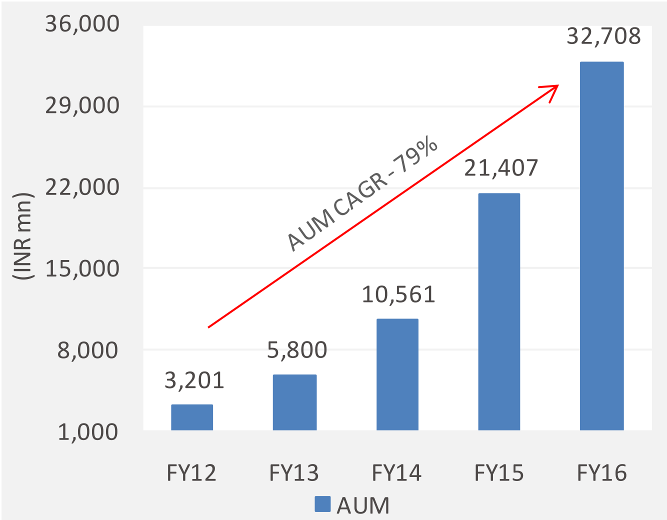
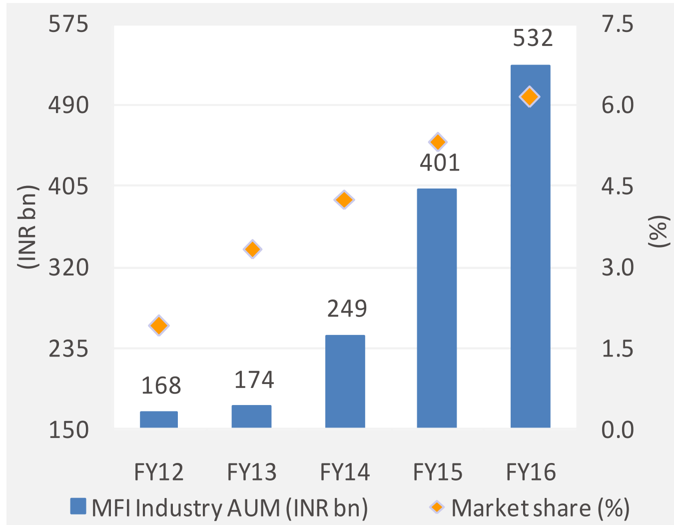
Fastest growing MFI with dominance in North India

Satin, with the mission to provide financial services to the unserved / underserved segment, commenced lending operations in 1990 by offering individual and small business loans. Retaining this mission as its pivot, the company diversified into MFI business in May 2008 and is now a formidable fifth largest MFI player in India (largest in North). Over FY12-16, it clocked a commendable AUM CAGR of 79% to INR32.7bn, outstripping the MFI industry's ~33% AUM CAGR, undeniably reflecting the company's market share gains. All this has cumulatively helped Satin up its position from being the ninth MFI player to fifth largest player.

Chart 1: Strong AUM growth of 79% over FY12-16 with consistent market share gains





Source: Company, MFIN Micrometer

Fig. 1: 90% of AUM from low/medium penetrated areas

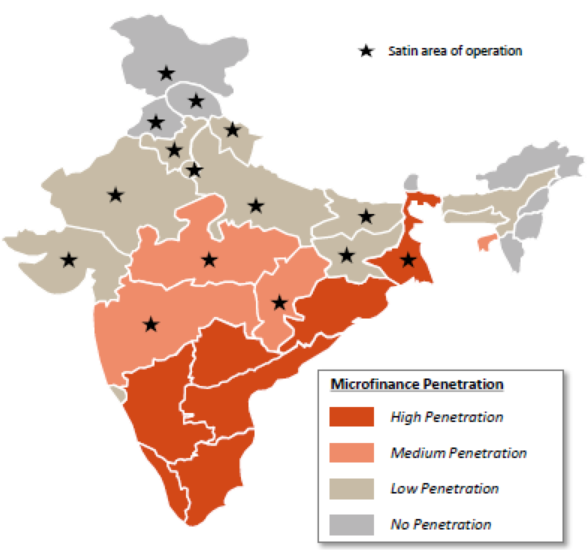


Table 1: Strong AUM growth from underpenetrated geographies

State	GLP -FY16 (INR mn)	FY16 AUM mix (%)	FY13 AUM mix (%)	FY13 -FY16 CAGR %
Uttar Pradesh	13,385	41.0	59.0	58.0
Bihar	5,803	18.0	7.0	138.0
Madhya Pradesh	5,077	16.0	13.0	90.0
Punjab	4,151	13.0	-	431.0
Uttrakhand	1,062	3.0	3.0	75.0
Rajasthan	768	2.0	2.0	103.0
Delhi & NCR	651	2.0	15.0	(10.0)
Haryana	614	2.0	-	193.0
Maharashtra	517	2.0	-	NA
Jharkhand	235	1.0	-	NA
Chhattisgarh	180	1.0	-	NA
Gujarat	168	1.0	-	NA
West Bengal	40	-	-	NA
Jammu	36	-	-	291.0
Himachal Pradesh	16	-	-	NA
Chandigarh	5	-	-	3.0
Total	**32,708**	**100.0**	-	**78.0**

Source: Company

Prudent branch strategy of being market maker and market leader

As of March 31, 2016, Satin had 431 branches spread across 16 states, serving 1.85mn plus active borrowers. Before entering a new geography, its core business development team undertakes area survey, assimilates & analyses several variables including population, household incomes, employment, literacy rates, sources of income, financial dependency, etc. Only post detailed findings does Satin decide to or not to venture into a new geography.

Satin's robust AUM growth stems from a well thought out strategy of venturing into unchartered geographies, understanding & creating MFI market in those geographies, building & nurturing a Joint Liability Group (JLG) culture and in the process creating brand value for itself. This prudent modus operandi has enabled Satin establish dominant presence in North India compared to other larger MFI players who dominate in South or East. With dominance in North India, the company had the first-mover advantage in a few geographies, enabling it to be the market maker as well as market leader. A case in point is the Punjab geography wherein Satin presciently captured the huge unmet opportunity—the state contributes 13% of AUM, but commands ~42% market share.

Table 2: Created leadership position in its operational geographies

	Satin		MFIN Industry			
	AUM (INR mn)	AUM mix (%)	No of MFIs players	Industry AUM	Industry AUM mix (%)	Satin's Mkt share (%)
Uttar pradesh	13,385	40.9	19	56,450	10.6	23.7
Bihar	5,803	17.7	21	29,210	5.5	19.9
Madhya pradesh	5,077	15.5	27	40,840	7.7	12.4
Punjab	4,151	12.7	10	9,880	1.9	42.0
Uttarakhand	1,062	3.2	11	5,930	1.1	17.9
Rajasthan	768	2.3	14	12,590	2.4	6.1
Delhi & NCR	651	2.0	8	5,820	1.1	11.2
Haryana	614	1.9	14	11,650	2.2	5.3
Maharashtra	517	1.6	32	63,290	11.9	0.8
Jharkhand	235	0.7	17	8,980	1.7	2.6
Chattisgarh	180	0.6	17	8,770	1.6	2.1
Gujarat	168	0.5	19	20,640	3.9	0.8
West bengal	40	0.1	14	30,750	5.8	0.1
Jammu	36	0.1	1	36	0.0	100.0
Himachal Pradesh	16	0.0	4	NA	NA	NA
Chandigarh	5	0.0	3	NA	NA	NA
Total	**32,708**			**532,000**		

Source: Company, MFIN Micrometer

Table 3: Not so significant presence of top MFI players in Satin's top geographies

(INR mn)	Satin - GLP (FY16)	SKSM - GLP (FY16)	Equitas - GLP (FY16)	Ujjivan - GLP (FY16)
Uttar Pradesh	13,385	7,216	-	2,866
Bihar	5,803	8,445	-	-
Madhya Pradesh	5,077	4,069	1,884	656
Punjab	4,151	1,228	7	1,436
Uttrakhand	1,062	844	-	489

Source: Company, SKSM, Equitas, Ujjivan

Branch visit update: Few differentiations followed at operational level

To review Satin's operational structure, appraisal/disbursal/collection processes, risk management controls, system checks & balances, profile of customers etc, we visited Satin's MFI network in rural areas of Uttar Pradesh and attended few Centre meetings as well. During our site visits, we found few key differentiations which Satin follow at operational level:

- There are 3 level checks both for disbursals as well as collections: **CSOs (Community Service Officers)** are responsible for village survey, lead generation, basic customer house & KYS verification, conducting center meetings, group training, intimating company updates & policies etc; **Branch Managers** key responsibilities include conducting Pre-GRT (Group Recognition Test) to verify KYC information, managing team of CSOs, making disbursals (as compared to other MFIs, disbursals for Satin happens at respective branches); **Territory Manager** is the one who has final authority for approving loan disbursals after conducting GRT and visiting 33% households in the group, monitoring collections if there is any delay in payment etc.

- The company has initiated efforts to lower cash movements during field visits to avoid risk of theft:

    - Customers are required to visit branch offices & collect their disbursals after they are intimated during Centre meeting that their loan is approved.

    - Collection is being outsourced through a tie up arrangement with Itz Cash: 2 women from Centre are required to travel within 24 hrs of Centre meeting to Itz Cash Centre (located within 2km reach of centre) to deposit money collected from their Centre & vouched by CSO during Centre meeting.

- We found that customer records are maintained, updated & monitored at Regional Offices while branches are responsible for disbursements & review of collections due for a particular month or fortnight with data updated by CSOs during Centre meetings. Since records are maintained manually & physically transferred to Regional Offices, there is a lag of 2-3 days. We believe technology would play a key role to narrow down the turnaround time.

- With respect to products, company offers two types of MFI loans: fortnightly & monthly installments. We found that even though loans are provided for 2 years, installments are frontloaded in the first year (thereby collecting >70% of interest & principal in first year itself).

- Incremental lending rate is lowered by 75-100 bps to 24.5-25.0%. It charges processing fees at the rate of 1% on every disbursal & provides insurance cover translating into insurance premium of 1.75-2.25%.

- Customer records are updated for credit bureau verification at Regional Office. During our visits we found that 17-20% applications are rejected based on credit bureau information & around 10-12% rejection happens during 3-level appraisal process.

- To avoid risk of fraud, there is compulsory rotation of field staff at regular intervals (of 18-24 months).

- Surprisingly, we found that CSOs are provided facility to reside at branches itself (stay at work place creates cohesive relationship amongst the staff).

- Field level staff (CSOs, branch managers) and data entry operators at Regional Offices are generally young with average age of 24-27 years, while Territory Managers, Regional Managers, Cluster Heads, Deputy CEOs are well experienced in the field of MFI lending.
- With respect to productivity metrics, on an average each CSO manages >30 Centres and with each Centre comprising of >20 customers, average active borrowers per loan officer translates to much higher than 600. With each branch comprising of 4-6 CSOs, average customers per branch translates to 3,000-4,500. Territory Manager is responsible for 3 branches & with each regional office ideally managing 15 branches there is a need for 5 Territory Managers per regional office.

Fig. 2: Our branch visit to assess operational structure, processes, systems and controls

Source: Company

Consistently improving on operational efficiency parameters

Satin's robust AUM growth (79% over FY12-16) stems from increase in the number of borrowers (56% CAGR over FY12-16) and the balance fuelled by increase in disbursement per loan account.

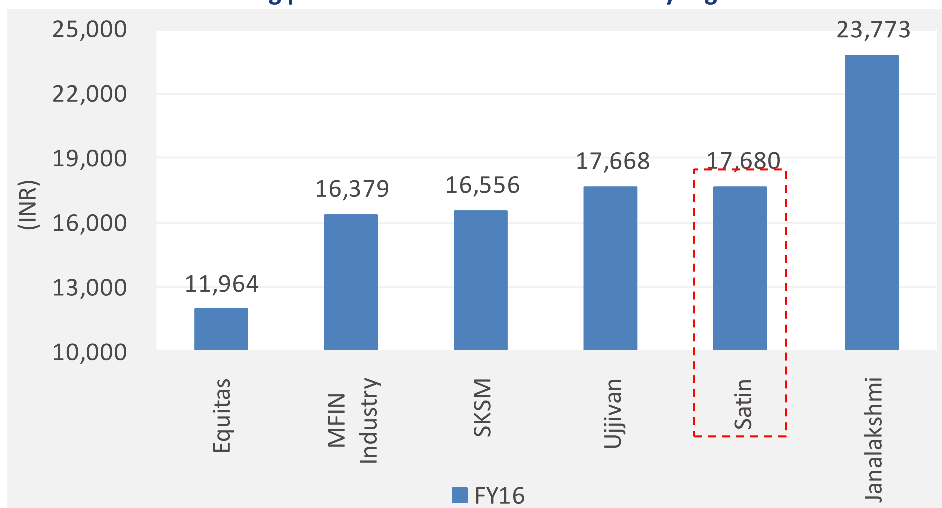
With rising presence in new geographies and tapping new borrowers, >50% of Satin's AUM emanates from loans disbursed to borrowers in their first cycle and >75% from loans disbursed to borrowers in their first 2 cycles. Along with this, >85% of its total borrowers have undergone maximum 2 rounds of borrowing—further data point indicates the company's rising dominance in different geographies, thereby netting new borrowers. Though one may argue that the company's incremental lending is to an untested borrower, the JLG model mitigates chances of worsening of asset quality.

Table 4: >75% of GLP & >85% of borrowers falls in first two loan cycles categories

Cycles	FY13	FY14	FY15	FY16
1	59.6	50.3	46.2	52.3
2	21.9	29.4	33.2	25.0
3	13.2	10.8	12.2	14.4
4	4.8	7.2	5.1	4.6
5	0.5	2.3	2.6	2.6
6	-	0.0	0.5	1.0
7	-	-	0.0	0.1
8	-	-	-	0.0
	100	100	100	100

Cycles	FY13	FY14	FY15	FY16
1	65.8	62.8	53.9	63.9
2	19.1	23.7	30.9	21.5
3	11.3	8.2	9.3	9.6
4	3.6	4.3	4.1	3.0
5	0.3	1.1	1.7	1.6
6	-	0.0	0.3	0.5
7	-	-	0.0	0.0
8	-	-	-	0.0
	100	100	100	100

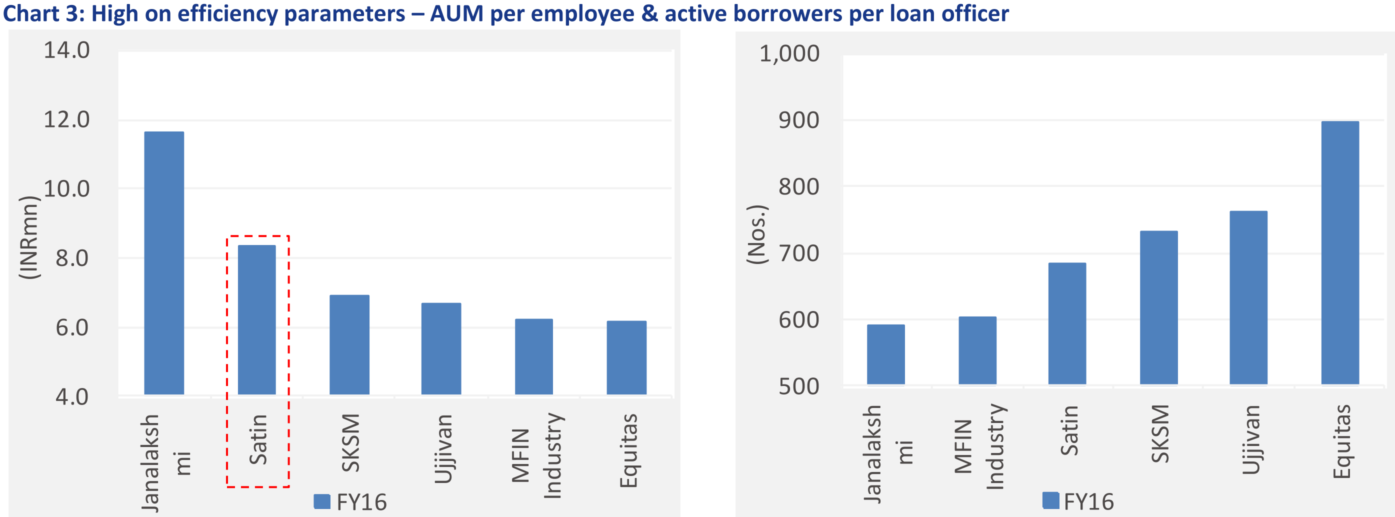
Chart 2: Loan outstanding per borrower within MFIN Industry rage



Source: Company, MFIN Micrometer

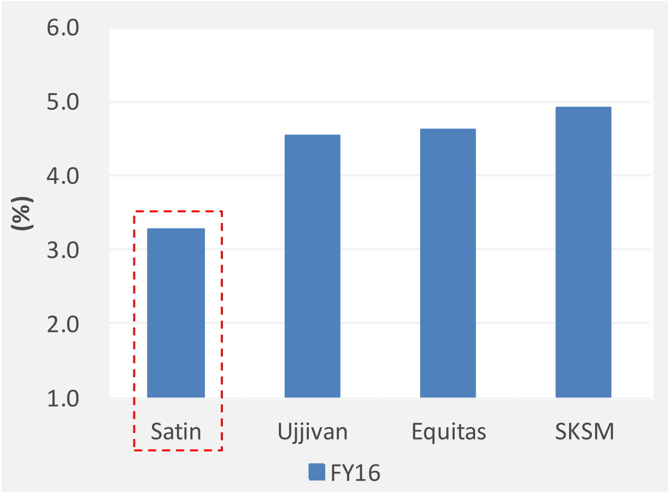
The company has consistently improved on various efficiency parameters with AUM per employee being amongst the best. Further, active borrowers per loan officers—a key metric to gauge efficiency—catapulted to ~685 in FY16 from 349 in FY12 (compared to 604 in MFI industry).

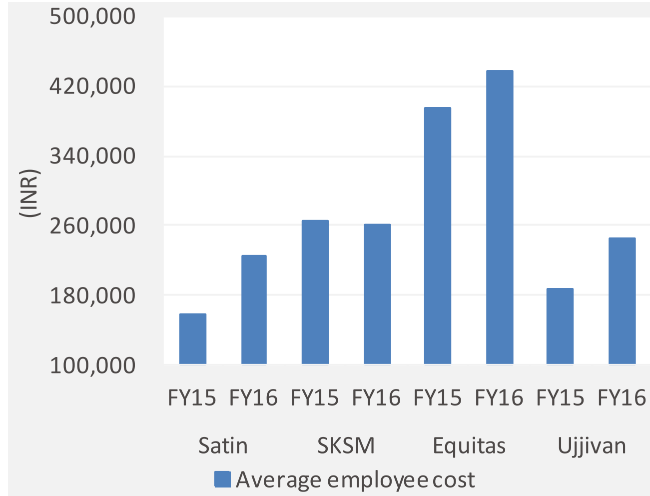
Chart 3: High on efficiency parameters – AUM per employee & active borrowers per loan officer



Source: MFIN micrometer

Chart 4: Lower average cost per employee with efficiency lead to lowest employee cost/AUM





Source: MFIN micrometer

Such high employee efficiency has helped the company keep its overall employee cost and hence average cost per employee in check and relatively lower than peers.

Table 5: Improving productivity metrics helps lower opex/AUM and improve cost to income ratio

	Satin					Ujjivan	Janalakshmi	SKSM	Equitas	MFIN Industry
	FY12	FY13	FY14	FY15	FY16					
No. of branches	144	161	199	267	431	469	341	1,191	397	9,669
No. of employees	1,058	1,437	1,958	2,496	3,918	8,049	9,441	11,154	5,337	85,888
No. of loan officers *	887	1,210	1,650	1,377	2,700	4,008	7,803	6,323	3,055	53,830
No. of active borrowers (in '000)	310	490	800	1,190	1,850	3,050	4,620	4,637	2,744	32,500
Number of loans disbursed (in '000) *	250	400	620	1,060	1,500	2,225	3,886	8,029	1,710	34,700
Disbursements (INRmn)	3,875	6,264	12,292	23,658	36,061	66,192	115,160	120,630	31,730	618,600
Loan portfolio (INRmn)	3,201	5,800	10,561	21,407	32,708	53,886	109,830	76,770	32,830	532,330
Analysis										
No. of loan officers/branch	6.2	7.5	8.3	5.2	6.3	8.5	22.9	5.3	7.7	5.6
No. of active borrowers/branch (in'000	2.2	3.0	4.0	4.5	4.3	6.5	13.5	3.9	6.9	3.4
Disbursement/loan	15,500	15,660	19,826	22,319	24,000	29,749	29,635	15,024	18,556	17,827
AUM/disbursement	0.8	0.9	0.9	0.9	0.9	0.8	1.0	0.6	1.0	0.9
Loan outstanding/active borower (INR)	10,326	11,837	13,201	17,989	17,680	17,668	23,773	16,556	11,964	16,379
Loans disbursed / loan officer	282	331	376	770	556	555	498	1,270	560	645
Active borrowers / loan officer	349	405	485	864	685	761	592	733	898	604
GLP / employees	3.0	4.0	5.4	8.6	8.3	6.7	11.6	6.9	6.2	6.2

** No. of loan officers as well as Number of loans disbursed for FY16 for Satin is an assumed number as it is not publicly available;*

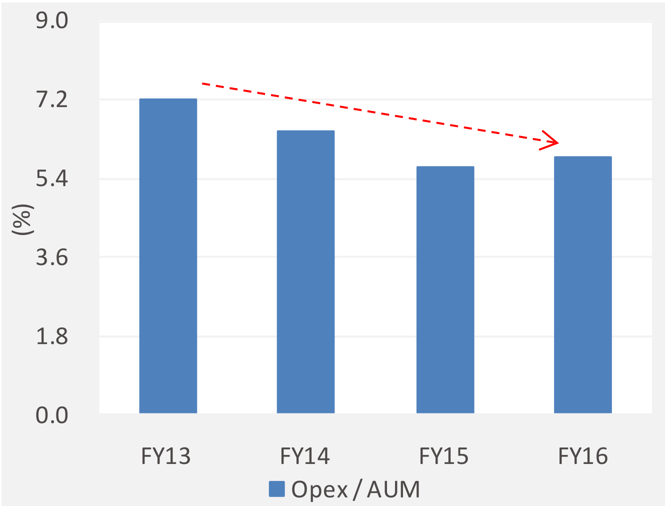
Note – For SKS, data does not include AP operations; For Ujjivan, loan officers and number of loans disbursed are as at Dec 2015;

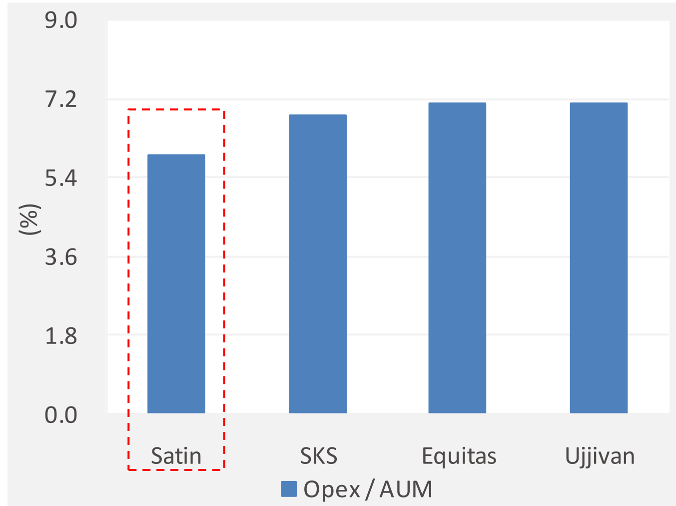
Source: MFIN Micrometer

While customer records are maintained manually at Branch Office & physically transferred to Regional Offices for system updation and monitoring, technology can play a key role to narrow down the lead time and duplication of records. Though not up the curve on technology front as of now, Satin plans to digitise its front-end process by providing tablets to MFI loan officers and individual loan sales force, aiding them access and assess customer information, financial position and credit bureau details on real-time basis.

Further, in order to move to cashless transactions, Satin has, on pilot basis, tied up with ITz Cash through which it plans to undertake a disbursement and collection programme via prepaid cards / cashless manner. This will improve efficiency and mitigate operational risk.

Chart 5: Continous decline seen in Opex / AUM; one of the finest within peers too





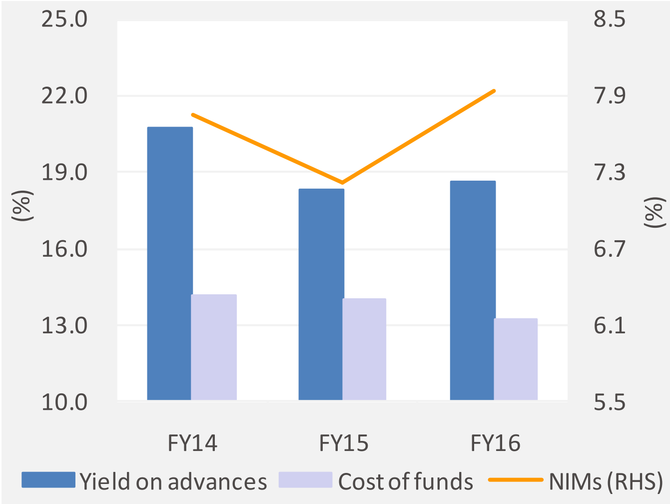
Source: Company, SKS Microfinance, Equitas, Ujjivan

NIMs weak due to back-ended growth and higher funding cost

During FY16, Satin primarily lent MFI loans at an interest rate between 22% and 26%, MSME loans at ~23% as well as product financing—solar lamps—at ~22-23%. However, calculated yields (excluding interest on fixed deposits) came in at ~18-19%. We believe that one of the reasons for such low yields could be back-ended nature of growth in AUM towards the fag end of the quarter.

At the same time, cost of funds has been relatively high for Satin upwards of 13%. We believe higher cost of borrowing has a direct correlation with the company's credit ratings, which is at BBB+. Satin has been bagging credit rating upgrade almost every 2 years, with the last upgrade in September 2014. However, this rating is still below peers. We believe, comfortable capitalisation levels (post capital raising), strong business model, adequate liquidity on balance sheet and stringent risk management process render a possibility for credit rating upgrade. This, along with capital raising, will reduce overall incremental borrowing requirement and also cost of funds, thereby improving margin.

Chart 6: NIMs relatively lower for Satin due to higher funding cost



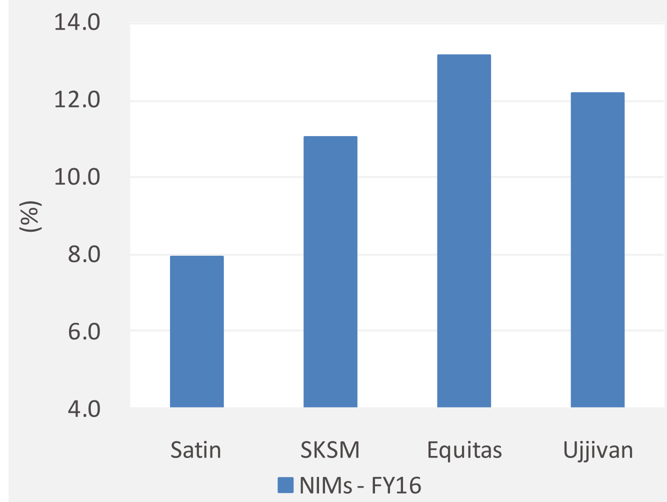


Table 6: Continuous credit rating upgrades; rating still below peers

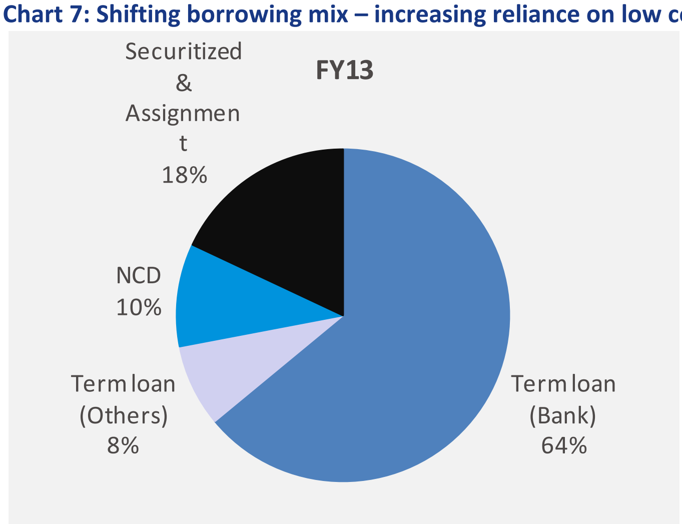
Date	Rating agency	Rating	Status
Jun-12	CARE	BBB-	Reaffirmed
Jun-13	CARE	BBB	Upgraded
Feb-14	CARE	BBB	Reaffirmed
Sep-14	CARE	BBB+	Upgraded
Dec-14	CARE	BBB+	Reaffirmed
Jun-15	CARE	BBB+	Reaffirmed
Nov-15	CARE	BBB+	Reaffirmed

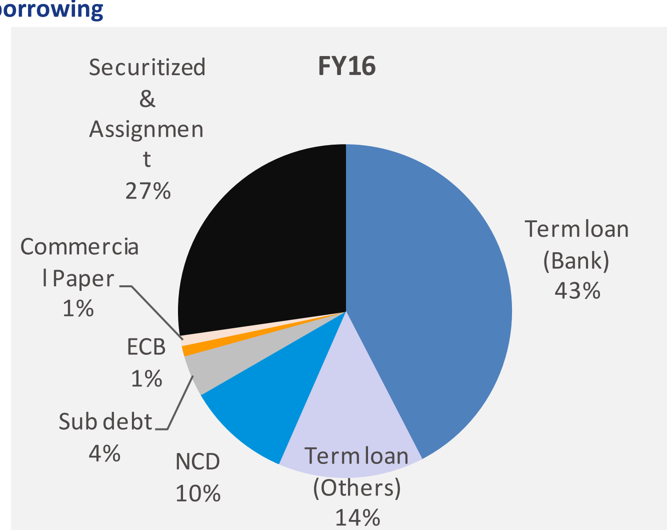
Name of the Company	Long term credit rating	Rating Agency
Satin	BBB+	CARE
SKSM	A+	CARE
Equitas	A / A-	CARE / CRISIL
Ujjivan	A	CARE

Source: Company, SKS Microfinance, Equitas, Ujjivan

Satin has active lending relationships with ~73 banks and financial institutions. To improve the funding cost, the company is moving away from high-cost bank borrowings to increasing reliance on capital market borrowings. Preliminary benefits of the shift are already reflected in the company's cost of funds—fell to 13.5% in FY16 from ~14.2% in FY14.

Chart 7: Shifting borrowing mix – increasing reliance on low cost borrowing



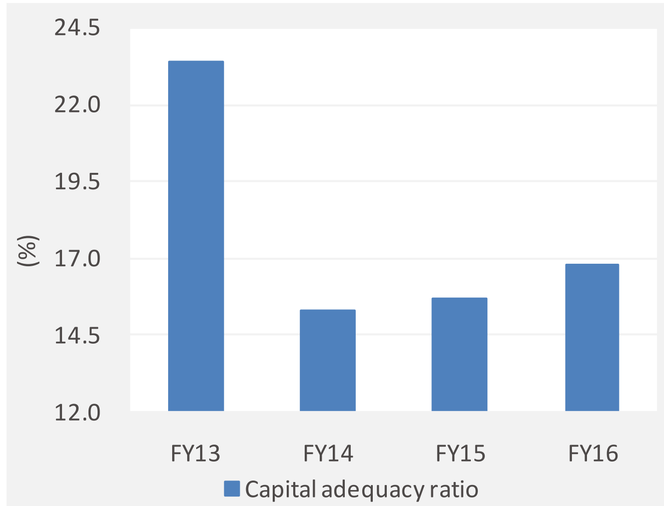


Source: Company

As at FY16, Satin's capital adequacy ratio (CAR) stands at 16.8% compared to SKSM's 23.1% and Ujjivan's 24.1%, versus regulatory threshold of 15.0%. Over the past 3 years, despite few rounds of equity raising (from FY13 to 15), capital consumption has been faster owing to strong AUM growth and hence CAR has not seen a decent uptick.

Table 7: Constant round of fund raising but CAR still lower due to higher consumption resulting from robust growth

	(INR mn)
FY13	300
FY14	285
FY15	415



Source: Company

Upscaling and cross-selling to boost income

Having gained size and scale in the MFI segment, and as a logical progression, Satin is now eyeing portfolio diversification by adding other products—individual micro loan (IML), MSME loans, low ticket LAP, product financing (solar lamps)—to its overall bouquet of financial products. These loans will primarily be offered to existing MFI borrowers who have successfully completed 1-2 rounds of MFI loans.

Apart from this, Satin through Taraashna Services, erstwhile associate company now acquired by Satin provides business correspondence (BC) services for which it has partnered with 2 banks viz., RBL Bank and Yes Bank, and 2 NBFCs viz., Reliance Capital and IFMR Capital. Taraashna has strategically spread operations in 6 states (MP, Rajasthan, Gujarat, Maharashtra, Bihar and Chhatisgarh), geographies wherein Satin's presence otherwise is limited. Diversification of product suite along with BC services will enhance Satin's cross-sell opportunities and help it garner fee income, which will boost RoA.

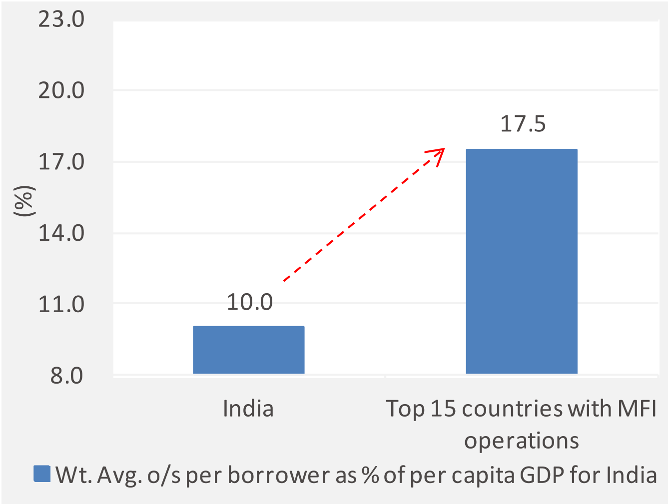
To leverage the benefit of franchise created by Satin, it is set to acquire Taraashna Services (TSPL), its erstwhile associate company as a wholly owned subsidiary by purchase of entire shareholding of TSPL from its existing shareholders through share swap and consequential preferential issue and allotment of equity shares of Satin to shareholders of TSPL.

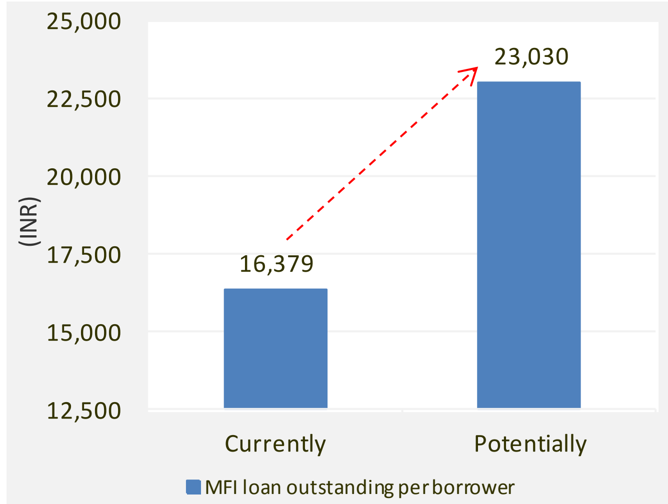
Huge industry potential and latent demand to fuel growth

The MFI industry now has >32mn unique borrowers under its ambit. However, considering that ~104mn households (~50% of total) in India earn an annual income in the INR40-130k range, penetration is still abysmally low. Moreover, average loan outstanding per borrower on pan-India basis of INR16k is merely ~12% of per capita income. This is lower compared to the trend in top 15 countries with largest MFI operations, where average loan outstanding per MFI borrower is 15-20% of per capita GDP.

The above macro indicators, further supported by humungous latent demand for micro credit, RBI's comfort with the functioning of the industry and government's financial inclusion push, throws open the MFI opportunity in India to an extent of ~INR2.4tn (MFI industry + SHG + co-operative societies). Ergo, in our view, the MFI industry is on the cusp of a sustained, stable medium-term growth of more than 25% for the next few years.

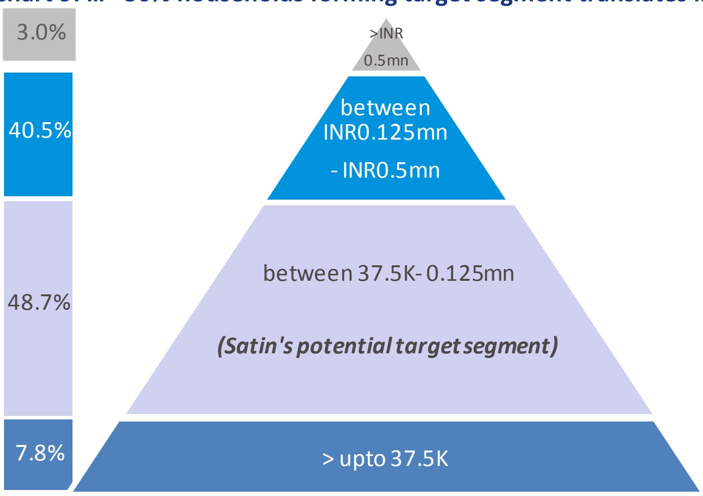
Chart 8: India—MFI's outstanding per borrower way lower than other countries; bridging this will provide tremendous fillip

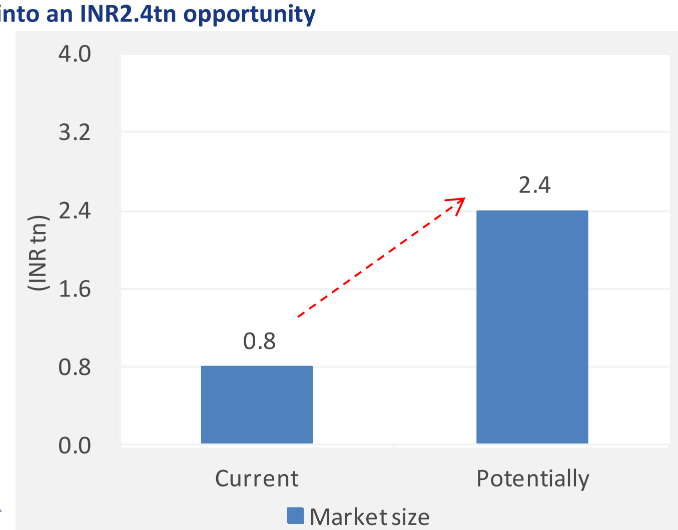




Source: Company, Indiastats.com

Chart 9: … ~50% households forming target segment translates into an INR2.4tn opportunity





Source: Company, Indiastats.com

RoAs subdued, but visible shift seen

Flowing from relatively lower NIMs, Satin's RoAs are relatively lower compared to peers (at 2.0-2.2% compared to peers' 3.0% plus). However, by virtue of higher leverage (~10x in FY16) compared to peers' 4-5x, Satin reports a respectful RoE of 20% plus.

Table 8: RoE decomposition for Satin vis-à-vis peers

(%)	Satin		SKSM		Equitas		Ujjivan	
	FY15	FY16	FY15	FY16	FY15	FY16	FY15	FY16
Net interest income/Average AUM	7.2	7.9	11.4	11.0	14.0	13.1	12.4	12.2
Other Income/Average AUM	2.0	2.0	2.8	2.9	0.3	0.5	2.2	2.0
Net revenues/Average AUM	9.2	9.9	14.2	13.9	14.2	13.6	14.6	14.2
Operating expense/Average AUM	5.6	5.9	9.1	6.8	7.6	7.1	9.0	7.4
Provisions/Average AUM	0.6	0.8	(0.5)	0.4	1.6	1.4	0.9	1.0
Taxes/Average AUM	0.9	1.1	0.2	1.5	1.7	1.7	1.6	1.9
Total costs/Average AUM	7.2	7.8	8.8	8.8	10.9	10.2	11.5	10.4
ROA	**2.0**	**2.2**	**5.4**	**5.1**	**3.3**	**3.4**	**3.1**	**3.8**
Equity/Average AUM	10.8	9.7	21.5	20.5	29.5	25.0	22.7	22.9
ROAE	**18.4**	**22.1**	**24.9**	**24.9**	**11.1**	**13.5**	**13.6**	**16.6**

Source: Satin, SKS Microfinance, Equitas & Ujjivan

Our back-of-the envelope calculation indicates that if Satin's leverage was comparable to leading peers like SKSM, Equitas and Ujjivan, there would have been clear boost of 130-140bps to NIMs.

Table 9: RoA differential propped by difference in leverage

Satin - with Equity / Avg AUM at 9.7%, leverage works out to be 10x

Liability	Proportion	CoF	Assets	Proportion	Yield
Shareholders funds	10%	-	Loans	100%	18.7
Borrowings	90%	13.2			
Total CoF		11.9	Total Yields		18.7
Gross spreads					**6.7**

Satin - with assumed Equity / Avg AUM at 20%, leverage works out to be 5x

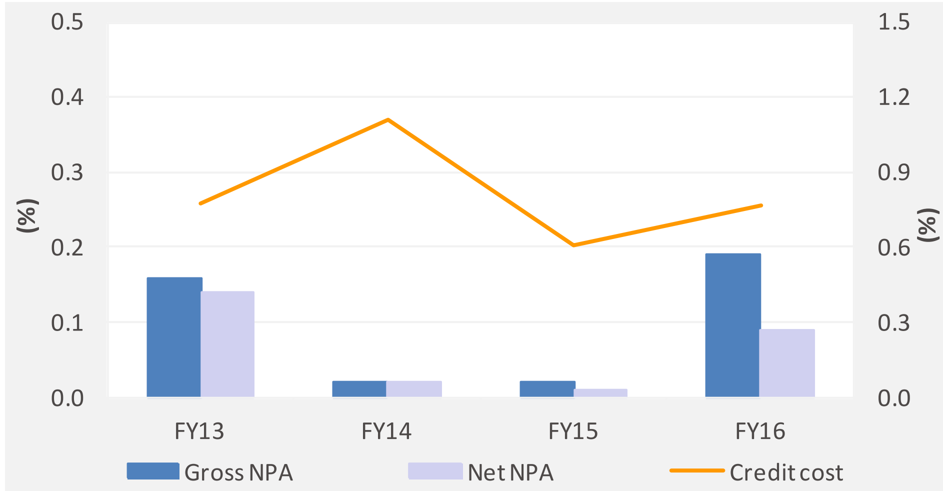
Liability	Proportion	CoF	Assets	Proportion	Yield
Shareholders funds	20%	-	Loans	100%	18.7
Borrowings	80%	13.2			
Total CoF		10.6	Total Yields		18.7
Gross spreads					**8.1**

Clear improvement in NIMs/RoA by 130-140bps

Source: Edelweiss research

Despite stupendous growth of 79% CAGR in AUM and penetrating into newer geographies, Satin has been able to curtail credit cost in line with its peers with well controlled NPL ratios.

Chart 10: Curtailed credit cost



Source: Company

So what next?

We believe there are 2 low hanging fruits, which once bagged will result in Satin's RoA jumping >150bps. Those 2 parameters are (i) reduction in leverage through fund raising; and (ii) credit rating upgrade. With almost all parameters for credit rating adhered to, barring healthy CAR, which will be achieved post capital raising, the company's cost of funds and leverage are primed to dip, which will improve RoA.

Apart from this, the company has already started diversifying its product suite, which will enable it to garner fee income via cross-sale and upscale which should boost RoAs.

Valuations

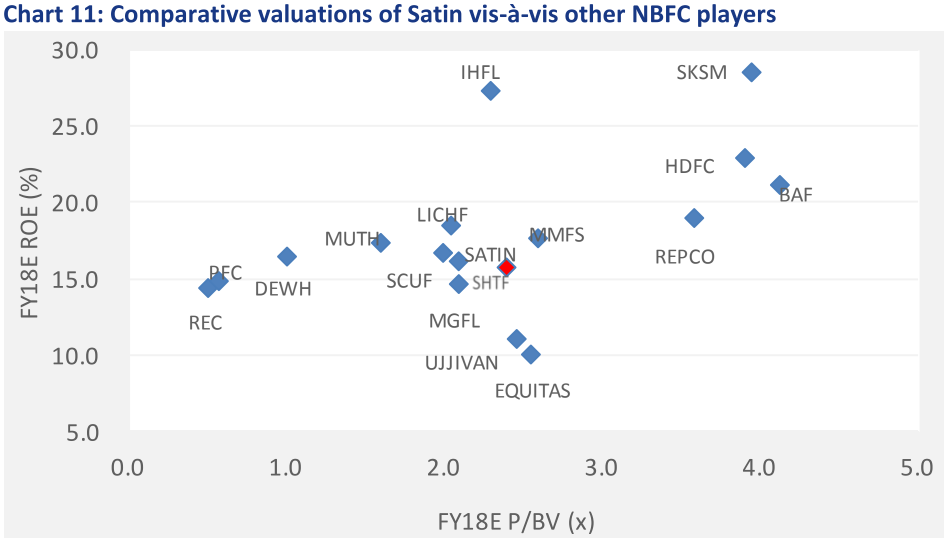
On a trailing FY16 basis, Satin is trading at a >40% discount to SKSM. We believe this discount will gradually narrow provided Satin continues to grow to a much higher pace with improved NIMs and RoAs.

Table 10: Satin's valuation compared to MFI

	Satin	SKSM			Equitas			Ujjivan		
	FY16	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
BPS (INR)	101	109	145	193	50	66	74	119	149	168
Diluted EPS (INR)	20	24	36	48	6	6	8	20	19	20
RoA (%)	2.2	5.1	4.9	4.7	3.0	2.3	2.2	3.7	3.0	2.2
RoE (%)	22.1	24.9	28.4	28.6	13.3	10.6	11.1	18.3	15.0	12.4
Diluted P/E (x)	24.8	32.7	21.7	16.1	28.8	31.9	22.9	20.5	21.9	20.9
Price/ BV (x)	4.9	7.2	5.4	4.0	3.6	2.7	2.4	3.5	2.8	2.5

Source: Edelweiss research, Bloomberg

Chart 11: Comparative valuations of Satin vis-à-vis other NBFC players



Source: Bloomberg, Edelweiss research

We believe that Satin is an attractive opportunity in India's burgeoning MFI space, which besides scaling up AUMs, also endeavours to bring stability in its franchise and operating metrics and deliver consistent earnings growth. This will lead to the stock's further rerating.

Key Risks

Susceptibility to unsecured microfinance loan book

Microfinance customers typically belong to the economically weaker sections with limited sources of income, savings and credit records. Ergo, the potential loss is higher in case of credit default compared to asset-backed financing customers. Further, there can be no assurance that joint liability arrangements will ensure repayment by other members of the group in the event of default by any one of them.

Incremental competition from MFI players as well as small finance banks

Micro finance credit demand is met by various entities including MFIs viz., SHGs, co-operative societies, local area banks, NGOs etc. Though we expect NBFC-MFI to gain market share over SHGs and other entities given the former's wide presence and deeper customer reach, competition from SHGs cannot be ruled out completely. Further, emergence of small finance banks, which will essentially serve the same segment as MFIs, is a risk. Moreover, they will be in a position to provide full suite of basic banking services heightening competition for MFIs.

Over leveraging of customers

Micro finance has emerged as one of the fastest growing segments clocking 33% AUM CAGR over FY12-16 to INR532bn (albeit on a lower base). With rising presence of MFIs, customers are now being approached by several players, leading to competition and resulting in over-leveraging of customers. However, RBI has imposed regulatory checks in terms of overall indebtedness limit and number of lenders a borrower can get a loan from. Moreover, credit bureaus provides the lender adequate information on a customer's overall indebtedness and repayment history.

Disruption in funding sources can strain liquidity and financial condition

If Satin is unable to obtain adequate financing or financing on satisfactory terms, its ability to grow or support business and respond to business challenges could be limited. Its ability to raise funds on acceptable terms and at competitive rates hinges on various factors including credit rating, regulatory environment & policy initiatives in India, investors' and/or lenders' perception and current & future results of operations and financial condition.

Business subject to statutory approvals

As Satin caters to customer segment at lower end of the income spectrum (poor households), it is vulnerable to political risk, similar to that witnessed in Andhra Pradesh in 2010. Moreover, it is likely to remain under active RBI purview. Any adverse measures could derail the micro-finance growth story. Further, any forfeiture of licence or levy of fines and penalties may impact operations and financial performance of the business.

Company Description

Amongst top 5 larger MFI players with North India focus

Satin was incorporated in 1990 with the primary objective of providing individual and small business loans. Subsequently, in 2008, in order to diversify its book, the company ventured into the MFI vertical and also expanded its presence by increasing branches via grographical expansion. By 2013, Satin was amongst the top 10 players within the MFI space and its ranking jumped to fifth position by FY16, clearly reflecting market share gains.

The company has a strong branch expansion strategy, which not only involves indepth area surveys and competition assessment, but also analysing demographic and income profiles of customers residing in those geographies. This is probably one of the reasons why the company did not enter Andhra Pradesh (‘AP’), thereby emerging unscathed during the AP crisis; in fact, the company’s portfolio grew by ~36% in FY11.

Financial services other than pure lending

Having established its credentials within the MFI space, Satin could now leverage on its branch prensence, provide more financial services to the bottom of the pyramid and grab opportunities available to lend to upper-end of MFI borrowers. The company, in 2015, began offering other products such as MSME loans and product financing—solar lamps. Product financing for solar lamps has commenced in UP, Bihar and Haryana. The product already has gained traction with ~200,000 borrowers and a loan book of INR113mn as at FY16.

Table 11: Satin’s product offerings

	MFI loans	Product financing - Solar lamps	MSME
Start Date	May 2008	Oct 2015	April 2016
Ticket size (INR)	15,000 - 50,000	< 4,000	100,000 - 1,000,000
Average ticket size (INR)	24,000	< 4,000	700,000
Tenure	12 - 24 months	upto 12 months	24 - 60 months
Interest range (%)	22 - 26	22 - 23	23
No. of states present		16	

Source: Company

Apart from providing lending services, Satin’s erstwhile associate company Taraasha Services (now acquired by Satin) acts as business correspondent for 2 private banks (RBL Bank and Yes Bank) and 2 NBFCs (Reliance Capital and IFMR). These services are rendered through 6 states; pretty much the states in which the company has limited MFI operations. This enables Satin capture MFI market share even in geographies in which it is not directly present.

Satin—Mapping the journey

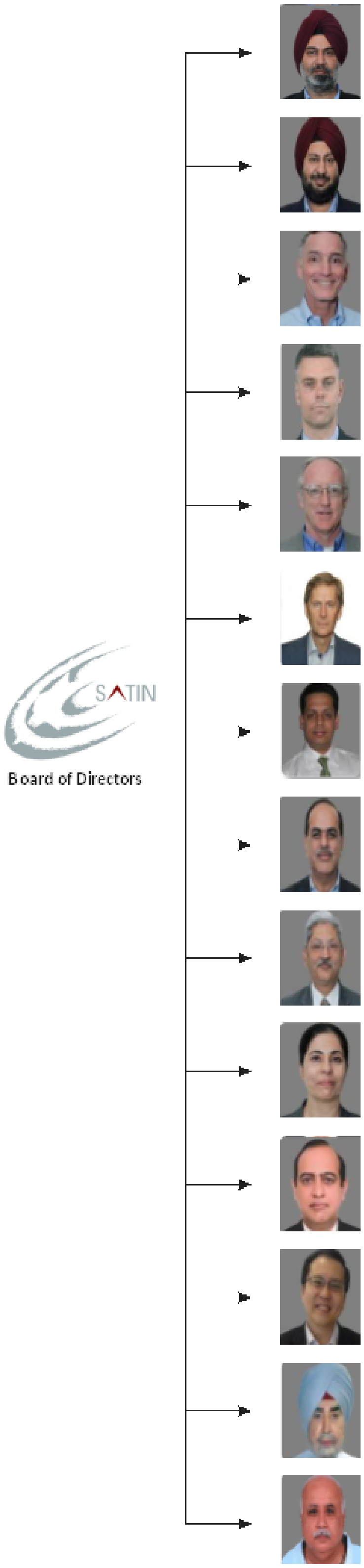
Fig. 3: Evolution of Satin

2015	'Listing on NSE, BSE and CSE; Received top MFI grading of MFI 1
2013	'Reaches 5 lakh clients and INR5bn portfolio; Converts to NBFC-MFI in Nov 2013; Rating upgraded to 'MFI 2+' by CARE (second highest on an eight point scale); Complete and profitable exit to PE investor
2010	'Reaches 1 lakh clients and INR1bn portfolio; One of the first MFI to do a multi-originator securitization; Raised funding from 2 funds - first MFI to raise capital post Andhra Pradesh MFI crisis
2008	First PE Investment;
1998	Register as NBFC with RBI
1996	IPO and listing on Delhi, Jaipur and Ludhiana stock exchanges
1990	Company incorporation

Source: Company

Management profile

Fig. 4: Strong management pedigree



H P Singh, Chairman, MD & Promoter
Greater than 25 years of experience in MFI;
Experience in the field of accounts, project financing, MFI, and company law
Holds fellow degree of ICAI, Participated in Harvard Business School's Accion program and leadership program at Wharton Business School

Satvinder Singh, Director
Has extensive consumer marketing and finance experience; Developed new methods of credit appraisal and marketing

Davis Golding, Director
Over 30 years experience in international finance, banking, and mergers and acquisitions
Holds a B.A. in Business Administration from Duke University, Durham, North Carolina

Kasper Svarrer, Director
Over 15 years of experience with MajInvest Equity, World Bank, etc
Holds an MSc in Forestry and Executive MBA from Henley Business School, UK

Richard B. Butler, Director
Served for 30 years at various international financial service entities
A graduate in Development Economics & Middle Eastern History from Georgetown University & a post graduate studies in Agriculture Economics at the University of Minnesota

Arthur Sletteberg, Director
MD at Norwegian Microfinance Initiative (NMI) AS
Earlier worked as Executive Vice President FerdAS-Norway's largest family office

Suramya Gupta, Director
Director in Asian PE Investments business and heads the India business for SBI Holdings
Has previously worked with Merrill Lynch, Stern Stewart and ICICI
Holds mechanical engineering from Delhi College of Engineering, MBA in Finance and Strategy from IIM Lucknow.

Rakesh Sachdeva, Director
Actively involved in evaluating the company's macro issues
Is a Fellow of the Institute of Chartered Accountants of India

Sundeep Kumar Mehta, Director
Over 14 years of experience; Served at Escorts, Panacea Biotech, Bata India, Eicher, etc
PGDM and a Science graduate

Sangeeta Khorana, Director
Over 15 years of experience in civil services with Indian Government
Doctorate from University of St. Gallen in & Masters' from University of Berne, Switzerland
Published several international journals and books

Sanjay Bhatia, Director
Over 28 years of experience in providing consultancy services on Income Tax, Corporate Tax and Corporate law matters to various leading organizations
Over 28 years of experience; a Fellow Chartered Accountant

Colin Goh, Director
MBA with specialised training in Economics & Finance from Curtin University of Technology
Strategic Business Advisor to M/S Project Innovations Pte

S. S. Chawla, Director
Served in the Lok Sabha Secretariat for 32 years most recently as Deputy Secretary
Has been associated with Satin since March 2003

Anil Kumar Kalra, Director
Over 30 years of experience in Banking & Financial Services
Holds an MBA in Finance from Delhi University

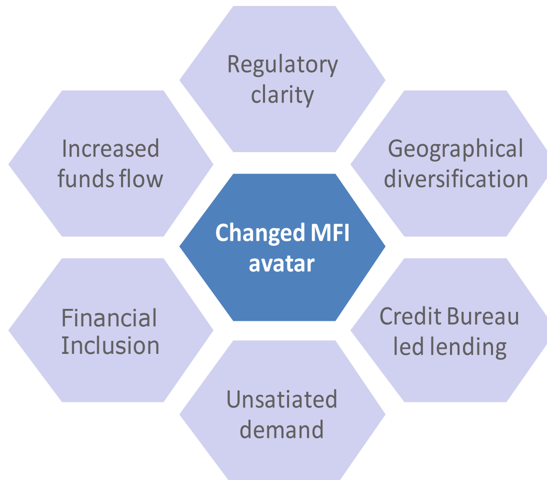
Source: Company

Industry Overview

The industry post crisis: Resurgence on back of regulatory clarity

Post AP crisis, the MFI industry has come a long way in gaining earnings stability and respect not only from investors and capital markets, but also from regulator RBI.

Fig.5: MF industry—The new avatar



Source: Edelweiss research

The changed form: Regulatory clarity, lenders' confidence and mapping new geographies

The following have infused the domestic MFI with optimism:

- **Regulatory clarity:** The grant of a banking licence to Bandhan Micro Finance and soft finance bank (SFB) licence to 8 MFIs speaks volumes about the importance placed on the role of the industry in promoting financial inclusion. Stability emerged when RBI announced a series of measures in 2011 starting with creation of a new category of NBFCs i.e., NBFC-MFI.

  Starting April 2014, the central bank relieved the industry further by abolishing the interest rate cap of 26%. It is now a function of MFI's borrowing cost with a 10% margin cap or 2.75x the average base rate of top 5 banks, whichever is lower. Further, RBI recently revised upwards the limit related to total indebtedness of a borrower, eligible rural & semi-urban household annual incomes and loan amounts, reflecting Mint Street's comfort.

Table 12: RBI guidelines for NBFC-MFI

Criteria	Guidelines
NBFC-MFI qualification	85% of total assets to be in qualifying assets Atleast 50% plus loans for income generation activities
Qualifying assets	
Borrower's family income	Rural: <= INR120,000 per annum Non-Rural: <= INR160,000 per annum
Ticket size	First cycle: <= INR60,000 Subsequent cycle: <= INR100,000
Total indebtedness	<= INR100,000
Tenure	>= 24 months for loans above INR15,000
Collateral/Security Deposit	None
Repayment cycle	Weekly, fortnightly or monthly
Interest rate	-Margin cap - 10% over cost of borrowing -Avg base rate of top 5 commercial banks x 2.75 Lower of A & B
Processing fees	<= 1% of loan amount
Penalty	No penalty for delayed payment
Insurance premium	Actual cost of insurance can be recovered from borrower and spouse Administrative costs can be recovered as per IRDA
Security deposit	No security deposit / margin to be taken

Table 13: RBI's comfort reflected in relaxation of lending parameters for MFI

	Earlier	Revised
Annual income	Rural - INR60,000 Urban or semi-urbanINR1,20,000	Rural - INR1,00,000 Urban or semi-urbanINR1,60,000
Total indebtedness	INR50,000	INR1,00,000 (Education and medical expenses will be excluded while arriving at the total indebtedness of a borrower)
Loan amount	First cycle - INR35,000 Subsequent cycle - INR50,000	First cycle - INR60,000 Subsequent cycle - INR1,00,000
Classification	70% of total loans of the NBFC-MFI for income generation 30% can be for other purposes such as housing repairs, education, medical and other emergencies	50% of total loans of the NBFC-MFI for income generation 50% can be for other purposes such as housing repairs, education, medical and other emergencies

Table 14: RBI guidelines w.r.t. asset quality

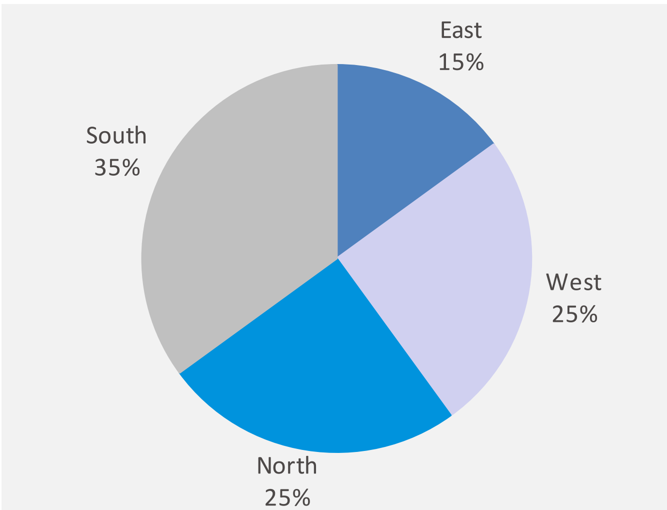
Asset quality		RBI	SKS
Asset Classification	Standard	0-90 days	0-60 days
	Sub-Standard	91-180 days	61-180 days
	Loss	>180 days	>180 days
Provisions	Standard	1% of overall portfolio reduced by NPA provisions	0.3%-1% depending on NPA or as per RBI guidelines, whichever is higher
	Sub-Standard	50% of instalments overdue	50% of outstanding principal
	Loss	100% of instalments overdue	100% of outstanding principal/write-off

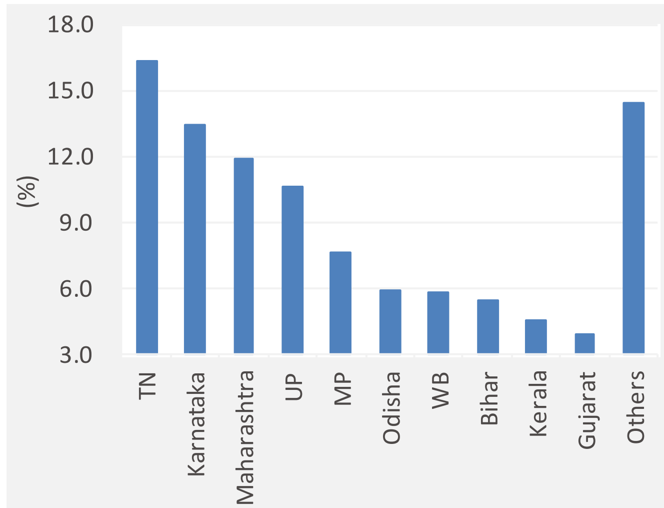
Source: RBI, Company

- **Resumption of funding:** Flows have improved on both debt and equity fronts. Post RBI intervention in 2011, bank funding started flowing in for the sector and continues to be the primary source of funding. Riding the strength of emerging stability, equity fund flows have also been robust, leading to most players being well capitalised to capture the next leg of growth. The most shining examples are the stellar listing and performance of Equitas and Ujjivan IPOs.

- **Mapping new geographies:** Before the AP crisis, much of the MFI portfolio was concentrated in South India. But, post this, players' business strategy has been to keep political risks at the lowest by expanding operations to various geographies. In a bid to achieve diversification, states in the North and West viz., Bihar, Uttar Pradesh, Rajasthan, Uttrakhand and Gujarat, have grown significantly.

Chart 12: Well distributed amongst 4 geographies; state-level concentration well balanced





Source: Company, MFIN Micrometer

- **Credit bureaus a huge positive:** As per MFIN, the 2 national bureaus on MFs have more than 70mn client records in their database and most of the lending is only being done post a bureau check. Other than dramatically improving the credit quality, this has also solved issues of multiple borrowing and over-leveraging by borrowers. Further, creation of credit bureaus has instilled credit discipline amongst borrowers as a bad credit score restricts lending to them, which was not the case earlier.

- **Unsatiated demand:** CRISIL expects non-AP MFI industry loan book to scale up from INR532bn as at FY16 to INR1.03tn by FY18E, 40% AUM CAGR over FY16-18E. Major triggers for sustenance of this AUM growth are:
  - Diversification to newer geographies.
  - Low interest rates, which will boost demand.
  - Cheaper and sustainable borrowing source funnel availble to MFI players—banks, MUDRA, capital markets, etc.

  All this has helped MFI gain market share compared to banks.

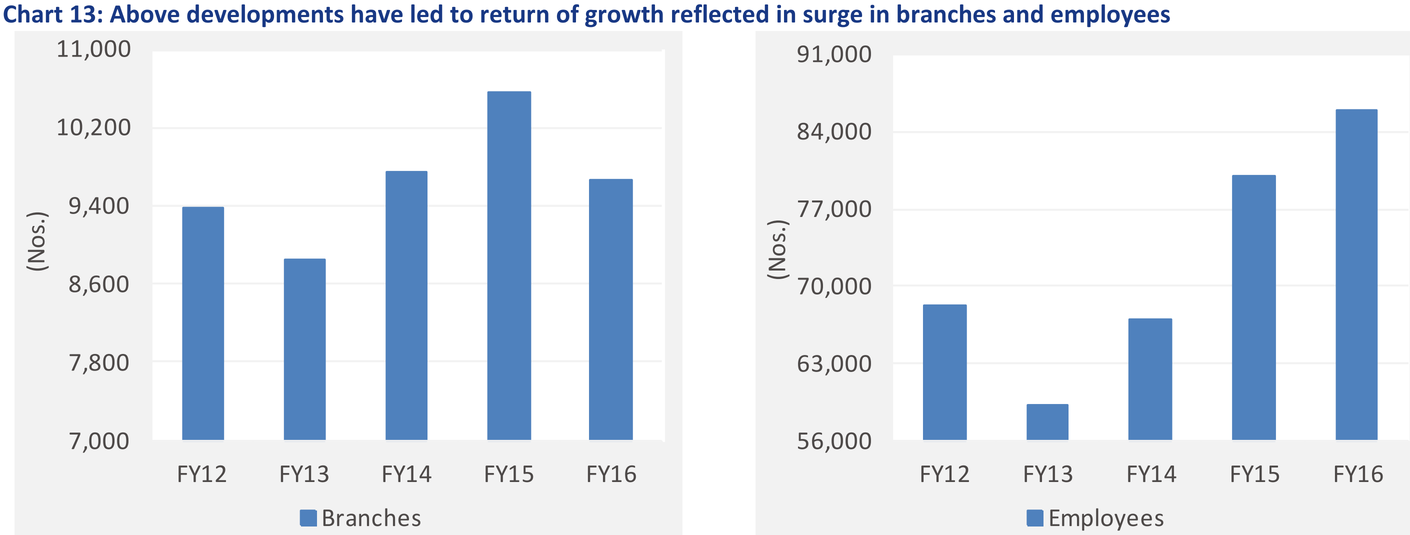
Benefits of the above 6 factors already reflecting well in industry numbers:

Outreach: The number of clients has jumped >20% over the past 3 years (after excluding clients served by Bandhan MFI).

Growth: Disbursements over 3 year period catapuled ~40% anhored by increase in number of disbursements (up 24% YoY) as well as 16% rise in disbursement per account to INR17,827. Hence, the industry's outstanding loan book over FY13-16 catapulted >45% to INR532bn as at FY16.

Asset quality: While growth has been heartening, asset quality too has been good. Portfolio at Risk (PAR) numbers have consistently moved down across maturity buckets and stand at pristine levels of 33ps (PAR 30 days) with PAR 180 days at just 11bps as on March 2016.

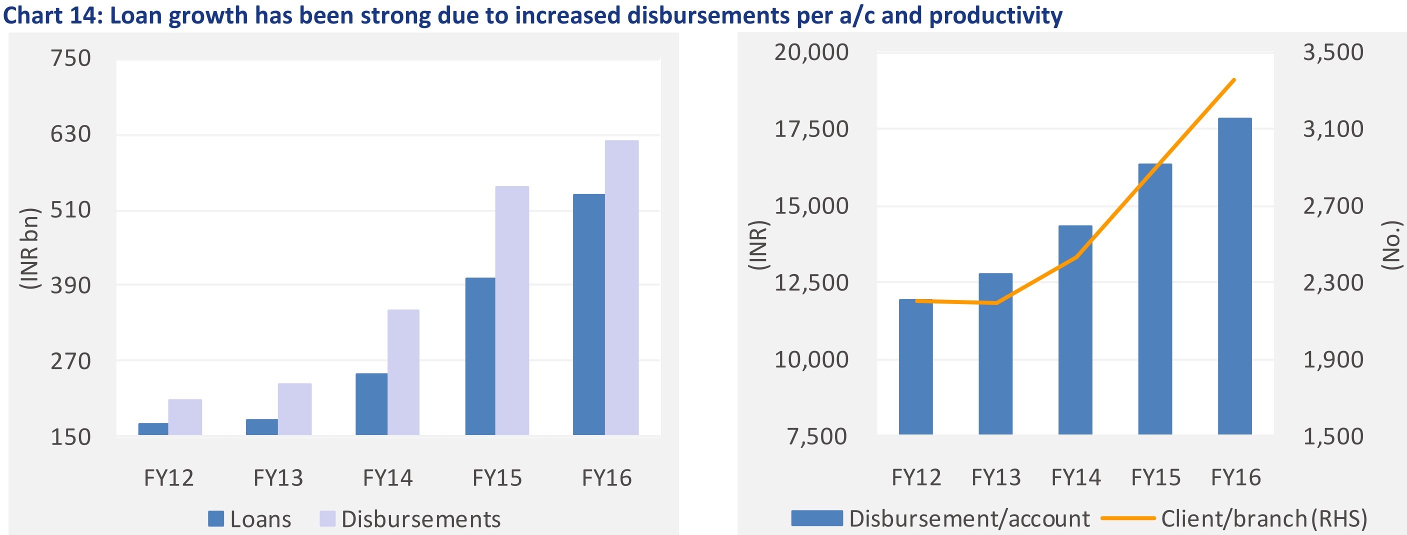
Chart 13: Above developments have led to return of growth reflected in surge in branches and employees



Source: MFIN

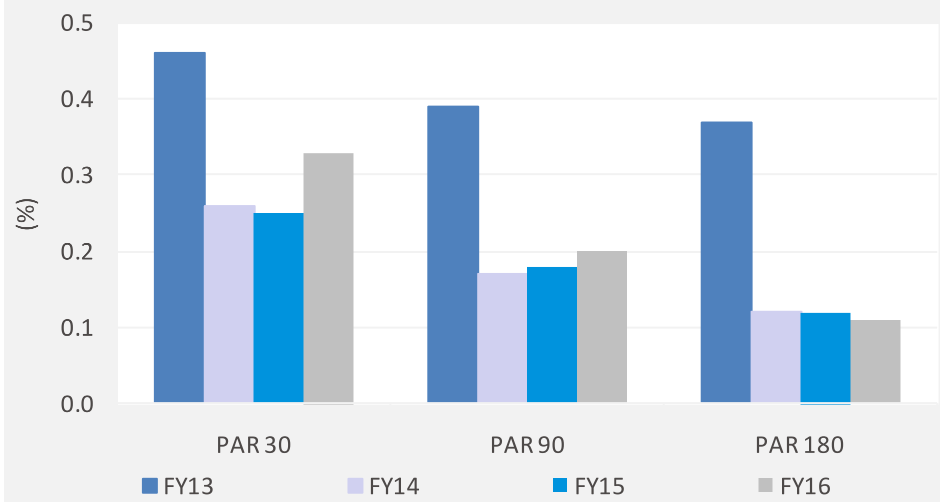
Note: Reduction in branches and employees is owing to non inclusion of Bandhan's data by MFIN. Bandhan's branches as at FY15 were at 2,022 and number of employees were at 13,231

Chart 14: Loan growth has been strong due to increased disbursements per a/c and productivity



Source: MFIN

Chart 15: Improving credit quality and other income streams have fuelled spurt



Source: MFIN

Financial Statements

Income statement (INR mn)

Year to March	FY13	FY14	FY15	FY16
Interest income	841	1,695	2,929	5,049
Interest charges	543	1,061	1,775	2,899
Net interest income	298	634	1,154	2,150
Fee & other income	102	221	313	536
Net revenues	400	855	1,467	2,686
Operating expense	324	530	903	1,599
- Employee exp	159	235	392	884
- Depreciation /amortisation	6	7	20	29
- Other opex	159	288	491	686
Preprovision profit	76	325	564	1,087
Provisions	23	91	97	208
PBT	53	234	467	880
Taxes	14	78	148	296
PAT (excl. extraordinaries)	39	156	319	584
Extraordinaries	-	-	2	5
Reported PAT	39	156	317	579
Preference Dividend	-	1	9	6
PAT (post Preference dividend)	39	155	308	573
Number of shares (mn)	22.7	22.7	25.4	32.0
Basic EPS (INR)	2.2	6.8	12.2	20.3
Diluted EPS (INR)	2.1	6.7	11.9	20.0

Growth ratios (%)

Year to March	FY13	FY14	FY15	FY16
NII growth	NA	112.8	82.0	86.3
Net revenues growth	NA	113.8	71.6	83.1
Opex growth	NA	63.3	70.3	77.1
PPP growth	NA	330.4	73.6	92.7
Provisions growth	NA	304.2	6.7	114.4
PAT growth	NA	297.4	98.7	85.9

Operating ratios (%)

Year to March	FY13	FY14	FY15	FY16
Yield on advances	NA	20.7	18.3	18.7
Cost of funds	NA	14.2	14.0	13.2
Spread	NA	6.6	4.3	5.4
Net interest margins	NA	7.8	7.2	7.9
Cost-income	79.6	61.2	60.2	58.4
Tax rate	26.4	33.3	31.7	33.7

Balance sheet (INR mn)

As on 31st March	FY13	FY14	FY15	FY16
Share capital	227	287	314	315
Reserves and surplus	1,010	1,157	1,681	2,925
Shareholders' fund	1,237	1,444	1,995	3,240
Long term borrowings	5,814	8,913	15,977	26,036
Short term borrowings	84	173	324	1,447
Total borrowings	5,898	9,086	16,301	27,483
Long term Liabilities & prov.	3	3	14	29
Deferred tax liability (net)	(7)	(25)	(53)	(87)
Sources of funds	**7,131**	**10,509**	**18,256**	**30,665**
Net block	42	53	55	119
Capital work in progress	40	66	84	72
Intangible assets	1	2	6	22
Total fixed assets	83	120	144	213
Non current investments	7	1	6	6
Cash and cash equivalents	2,053	2,152	3,487	7,098
Loans & advances	4,541	7,849	14,645	22,748
Other Assets	644	676	1,102	1,246
Current Assets (ex cash)	118	335	671	1,636
Other current liab. & ST prov.	315	624	1,798	2,282
Total current liab. & provisions	315	624	1,798	2,282
Net current assets (ex cash)	(197)	(289)	(1,127)	(646)
Uses of funds	**7,131**	**10,509**	**18,256**	**30,665**
Book value per share (INR)	54.5	61.0	76.2	101.4
Disbursements	6,264	12,292	23,658	36,061
Portfolio (Incl. Assigned)	5,800	10,561	21,407	32,708
Assignment	1,259	2,712	6,762	9,960
CAR (%)	23.4	15.3	15.7	16.8
Gross NPA (%)	0.2	0.0	0.0	0.2
Net NPA (%)	0.1	0.0	0.0	0.1

RoE decomposition (%)

Year to March	FY13	FY14	FY15	FY16
Net interest income/Average AUN	6.6	7.8	7.2	7.9
Other Income/Average AUM	2.3	2.7	2.0	2.0
Net revenues/Average AUM	8.9	10.5	9.2	9.9
Operating expense/Average AUM	7.2	6.5	5.6	5.9
Provisions/Average AUM	0.5	1.1	0.6	0.8
Taxes/Average AUM	0.3	1.0	0.9	1.1
Total costs/Average AUM	8.0	8.5	7.2	7.8
ROA	0.9	1.9	2.0	2.2
Equity/Average AUM	22.6	16.4	10.8	9.7
ROAE	3.8	11.6	18.4	22.1

Valuation metrics

Year to March	FY13	FY14	FY15	FY16
Diluted EPS (INR)	2.1	6.7	11.9	20.0
EPS growth (%)	*NA*	*214.6*	*78.9*	*67.4*
Book value per share (INR)	54.5	61.0	76.2	101.4
Diluted P/E (x)	233.7	74.3	41.5	24.8
Price/ BV (x)	9.1	8.1	6.5	4.9

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Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bajaj Finserv, Bank of Baroda, DCB Bank, Dewan Housing Finance, Federal Bank, HDFC, HDFC Bank, ICICI Bank, IDFC, Indiabulls Housing Finance, IndusInd Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Max India, Multi Commodity Exchange of India, Manappuram General Finance, Magma Fincorp, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, Repco Home Finance, State Bank of India, Shriram City Union Finance, Shriram Transport Finance, South Indian Bank, SKS Microfinance, Union Bank Of India, Yes Bank

Recent Research

Date	Company	Title	Price (INR)	Recos
11-Jul-16	**IndusInd Bank**	En-route to deliver Phase III targets; *Result Update*	1,124	Buy
11-Jul-16	**South Indian Bank**	Incremental stress lower; retail focus sustains; *Result Update*	23	Buy
01-Jul-16	**ICICI Bank**	Retail rhapsody; corporate de-risking on the mend; *Visit Note*	241	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

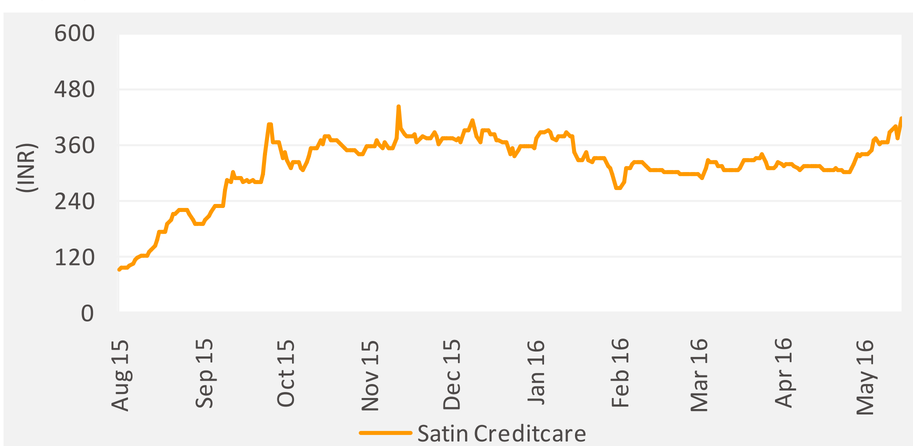
	Buy	Hold	Reduce	Total
Rating Distribution* * - stocks under review	158	59	12	229

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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